

HB

57

STATE OF ALASKA

REPRESENTATIVE
MIKE CHENAULT

Official Business

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



HOUSE OF REPRESENTATIVES

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

SPONSOR STATEMENT HOUSE BILL 57

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

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

Dear Ms. Parker

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

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

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

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

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

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

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

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

Sincerely,



Jim Calvin
Partner

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

Benefits and Costs of HB 57 Based on Escalating Contract Value

FY	State Leases	Royalty Share	Contract Value	Royalty Value	Difference	Economic Costs	Economic Benefits			
						Royalty Foregone	Royalty Paid	Payroll Impacts	Industrial Property Taxes	Total Economic Output
Thousand cubic feet per year			\$/Mcf	\$/Mcf	\$/Mcf					
2003	25,885,747	3,453,159	1.50	2.37	0.87	3,004,248	5,179,738	50,000,000	2,400,000	333,000,000
2004	25,885,747	3,453,159	1.54	2.43	0.89	3,080,305	5,310,871	51,500,000	2,400,000	341,430,380
2005	25,885,747	3,453,159	1.63	2.57	0.94	3,257,771	5,616,847	53,045,000	2,400,000	361,101,266
2006	25,885,747	3,453,159	1.71	2.70	0.99	3,422,561	5,900,967	54,636,350	2,400,000	379,367,089
2007	25,885,747	3,453,159	1.80	2.84	1.04	3,600,027	6,206,943	56,275,441	2,400,000	399,037,975
2008	25,885,747	3,453,159	1.89	2.98	1.09	3,777,493	6,512,919	57,963,704	2,400,000	418,708,861
2009	25,885,747	3,453,159	1.97	3.12	1.15	3,954,959	6,818,896	59,702,615	2,400,000	438,379,747
						24,097,365	41,547,181	383,123,109	16,800,000	2,671,025,316

The table is structured to foster comparison with the Division of Oil and Gas fiscal note, Table 2.³ For simplicity, baseline contract value and economic impacts shown for 2003 reflect actual figures from the McDowell Group report "The Economic Impacts of Agrium Kenai Nitrogen Operations in Alaska, 2001." No attempt was made to adjust these baseline figures to reflect any changes that may have occurred between 2001 and 2003.

Projections for future years are based on the following additional assumptions:

- Agrium operates at 100 percent capacity, which was the case in 2001, the year for which economic impacts were calculated.
- The average "Contract Value" at which Agrium purchases gas is assumed to escalate at the same rate Division of Oil and Gas projects for "Royalty Value".⁴ The effect of using the actual 2001 contract value as the nominal contract value for 2003, together with annual increases proportional to those of the royalty value is to reduce the "Royalty Foregone" under HB 57 from \$36 million (per the original fiscal note) to \$24 million.
- "Royalties Paid" equal the "Royalty Share" times the "Contract Value."
- Increases in payroll impacts are 3 percent per year, based on Agrium's anticipated cost of labor.
- "Total Economic Output" is the sum of gross sales value of Agrium production and the indirect and induced effects of company spending. The ratio of these components is roughly 2 to 1. Payroll and industrial property taxes shown represent part of Agrium's total economic output. Economic output is an inherently broad and somewhat imprecise measure. For simplicity, in this analysis it is assumed to increase in proportion to raw materials cost (contract value).
- Amounts shown are in nominal (not discounted) dollars

³ Minor differences in calculated values between the two tables are the result of rounding.

⁴ Agrium believes this is a reasonable expectation.



Kenai Chamber of Commerce
402 Overland
Kenai, Alaska 99611
(907) 283-7989
(907) 283-7183 (Fax)

RESOLUTION 2003-01

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

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

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

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

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

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

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

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

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

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

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



Kenai Chamber of Commerce
402 Overland
Kenai, Alaska 99611

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

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

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

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

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

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

Cherie L. Brewer

Cherie L. Brewer
Chamber Board President

Suggested by: City Council

CITY OF KENAI

RESOLUTION 2003-08

A RESOLUTION OF THE COUNCIL OF THE CITY OF KENAI, ALASKA, SUPPORTING HB57, "AN ACT AMENDING THE MANNER OF DETERMINING THE ROYALTY RECEIVED BY THE STATE ON GAS PRODUCTION AS IT RELATES TO THE MANUFACTURE OF CERTAIN VALUE ADDED PRODUCTS."

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

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

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

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

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

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

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

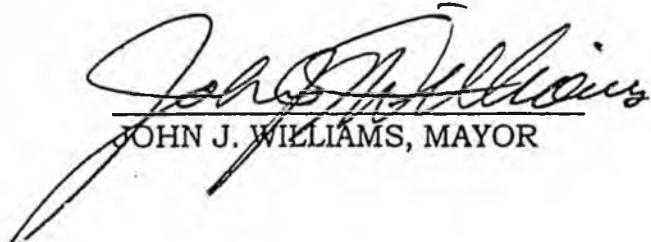
NOW, THEREFORE, BE IT RESOLVED BY THE COUNCIL OF THE CITY OF KENAI, ALASKA, the following:

Section 1: The Kenai City Council urges the 23rd Alaska State Legislature to enact HB 57, "An Act Amending the Manner of Determining the Royalty Received by the State on Gas Production as it Relates to the Manufacture of Certain Value Added Products."

Section 2: Copies of this resolution shall be sent to all members of the 23rd Alaska State Legislature.

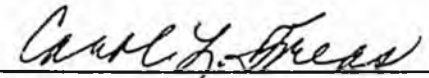
Section 3: This resolution takes effect immediately upon its enactment.

PASSED BY THE COUNCIL OF THE CITY OF KENAI, ALASKA, this 19th day of February, 2003.



JOHN J. WILLIAMS, MAYOR

ATTEST:



Carol L. Freas, City Clerk

Introduced by: Mayor, Superman
Date: 02/18/03
Action: Adopted
Vote: 8 Yes, 0 No, 1 Absent

**KENAI PENINSULA BOROUGH
RESOLUTION 2003-024**

**A RESOLUTION SUPPORTING THE PASSAGE OF HOUSE BILL 57 AND SENATE
BILL 50 AMENDING THE MANNER OF DETERMINING THE ROYALTY
RECEIVED BY THE STATE ON GAS PRODUCTION AS IT RELATES TO THE
MANUFACTURE OF CERTAIN VALUE-ADDED PRODUCTS**

- WHEREAS,** Agrium Kenai Nitrogen Operations is exceptional for its combination of high pay levels, amount and concentration of expenditures in the Kenai Peninsula Borough and Alaska; and
- WHEREAS,** Agrium Kenai Nitrogen Operations is one of the few industries adding value to Alaska's natural resources by using Cook Inlet natural gas to create anhydrous ammonia and two forms of urea; and
- WHEREAS,** Agrium Kenai Nitrogen Operations purchases natural gas from producers in Cook Inlet; and
- WHEREAS,** Agrium Kenai Nitrogen Operations markets its products around the world competing against major world competition which is primarily based upon the monetization of trapped gas resources; and
- WHEREAS,** Agrium Kenai Nitrogen Operations is the Kenai Peninsula's third largest private employer and accounts for an additional 700 jobs in Alaska and the Kenai Peninsula Borough; and
- WHEREAS,** Agrium Kenai Nitrogen Operations expenditures in Alaska are spread to over 250 businesses statewide with 118 companies located within the Kenai Peninsula Borough; and
- WHEREAS,** House Bill 57 and Senate Bill 50 have been introduced which will provide for the State of Alaska to enter into agreements with non-affiliated natural gas producers to accept as the price for the State's royalty share the price established in an arm's length contract negotiated between the natural gas producer and Agrium Kenai Nitrogen Operations;

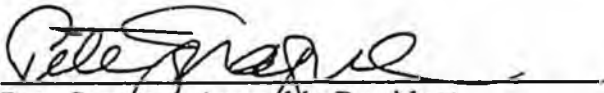
NOW, THEREFORE, BE IT RESOLVED BY THE ASSEMBLY OF THE KENAI PENINSULA BOROUGH:

SECTION 1: That the Kenai Peninsula Borough Assembly urges the 23rd Alaska State Legislature to enact House Bill 57 and Senate Bill 50, Acts amending the manner of determining the royalty received by the state on gas production as it relates to the manufacture of certain value added products.

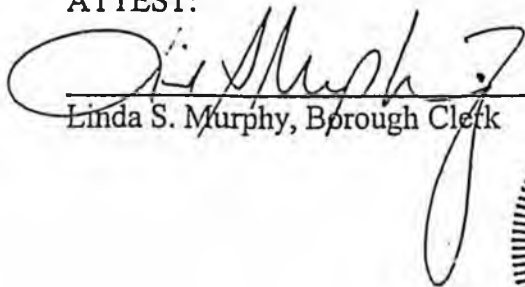
SECTION 2: That copies of this resolution shall be sent to Senator Tom Wagoner, Senator Alan Austerman, Representative Mike Chenault, Representative Paul Seaton, Representative Kelly Wolf and Governor Frank Murkowski.

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

ADOPTED BY THE ASSEMBLY OF THE KENAI PENINSULA BOROUGH THIS 18TH DAY OF FEBRUARY 2003.


Pete Sprague, Assembly President

ATTEST:


Linda S. Murphy, Borough Clerk



THE
FOLLOWING
DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES

kenai

nitrogen operations

Impact on Local Economy

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

Caring for the Kenai

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

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

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



Partners in the Community

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

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

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

Agrium

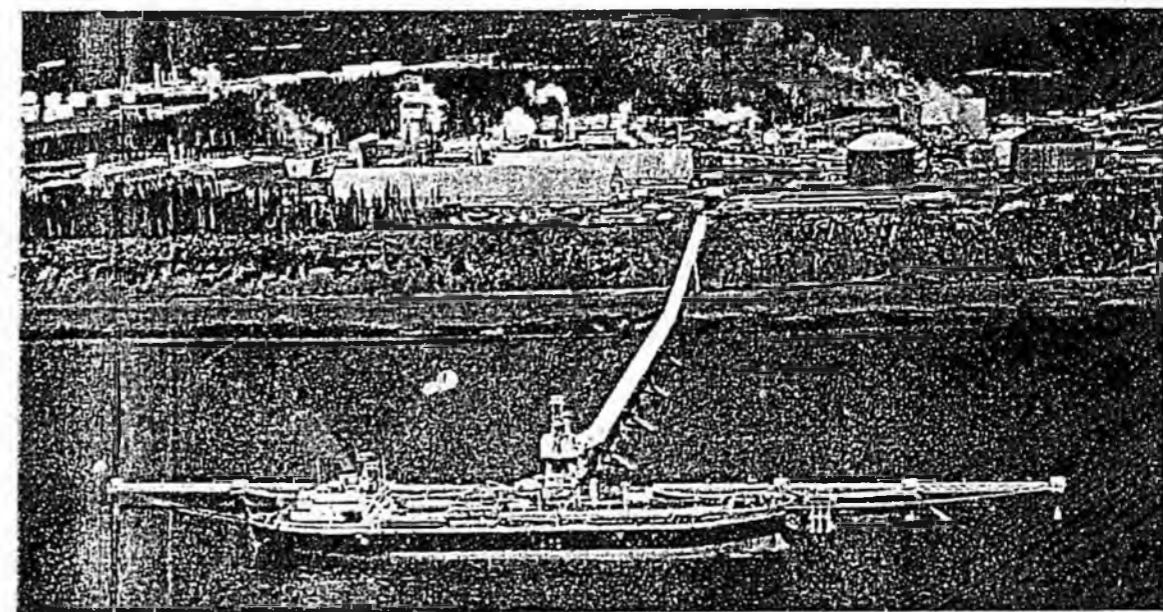
kenai

nitrogen operations

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

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

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



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

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

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

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

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

Agrium

Kenai Nitrogen Operations

P.O. Box 575,
Mile 21, Spur Highway
Kenai, Alaska
99611

Phone: (907) 776-8121

Fax: (907) 776-5579

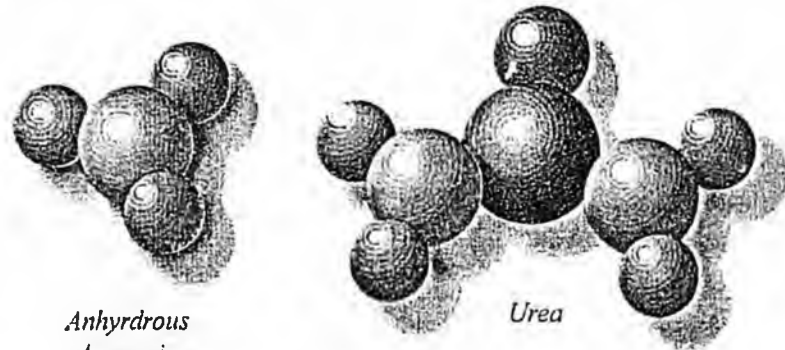
<http://www.agrium.com>

PUBLISHED 1201
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Nourishing a Growing World

Fertilizer Products

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



Anhydrous Ammonia

Urea

- Hydrogen
- Nitrogen
- Carbon
- Oxygen

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

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

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

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

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

Environmental Stewardship

We are continually working to reduce the environmental impact of our operations. Complying with state and federal environmental regulations is just a beginning. Environmental considerations are a part of all our business decisions.

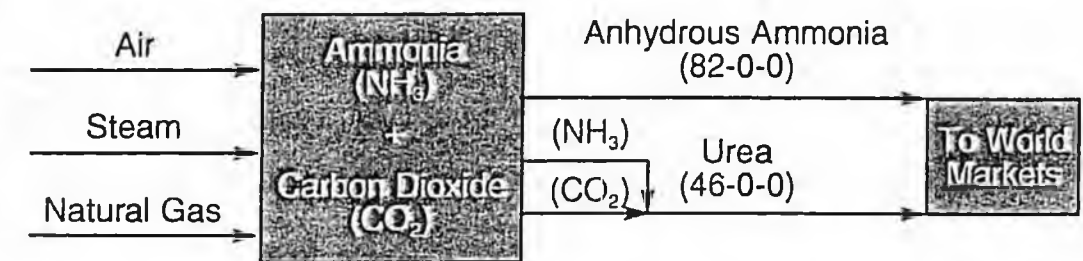
Our environmental protection begins with the safety of our employees. Everyone benefits from having a safe workplace, which comes from careful attention to safe operating procedures, emergency preparedness and preventative maintenance. These practices reduce the potential for plant upsets which could impact the environment.

Since 1996 we have reduced hazardous waste generation at the plant by 99 percent. We accomplished this by replacing a process solution that produced a hazardous byproduct with one that generates no waste, and by replacing solvent and caustic dip tanks with part washers that use hot water and soap.

We have an aggressive pollution prevention plan, and continually look for opportunities to reduce waste volume and toxicity. Our waste minimization efforts have received praise from the Alaska Department of Environmental Conservation and have been recognized by Alaska's Green Star Program.

We continually implement efficiency improvements to reduce atmospheric emissions and burn less fossil fuel. In spring, 2001, the start-up of an electric cogeneration facility eliminated more than 500 tons (455 tonnes) per year of nitrogen oxide emissions.

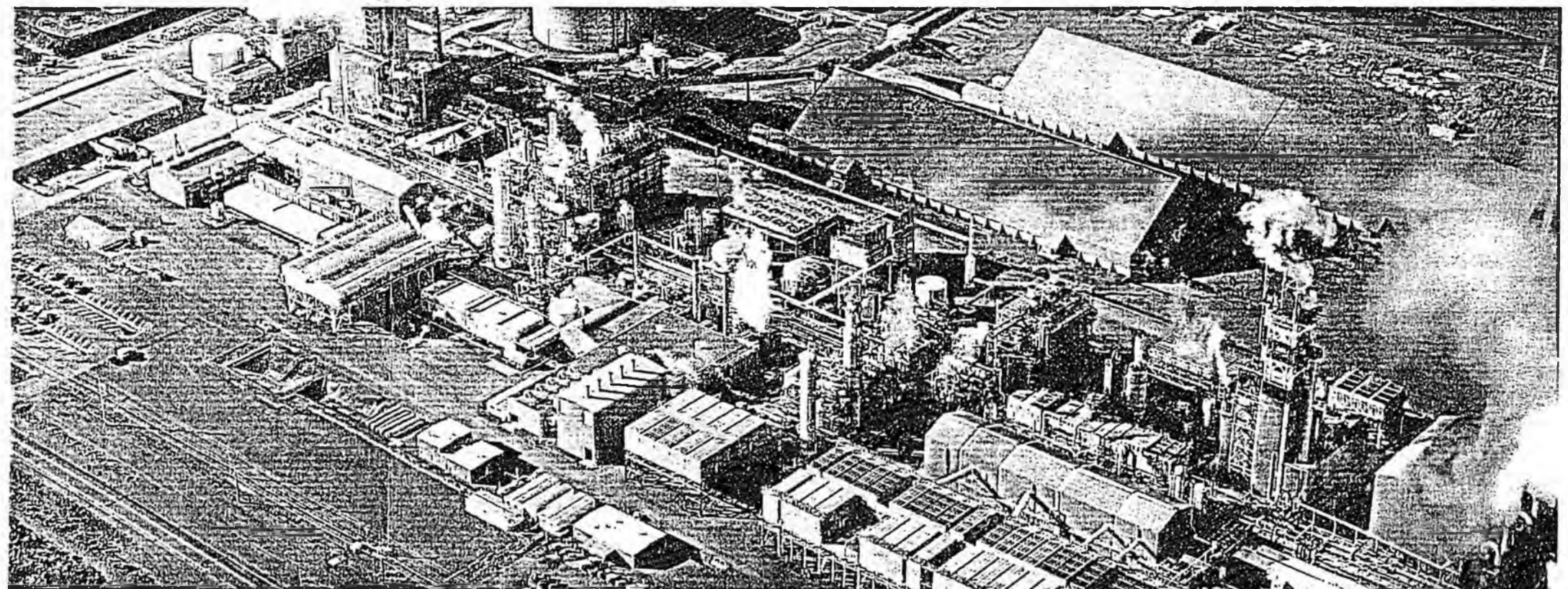
Raw Materials and Products



Best Management Practices

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

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



FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB 57
 () Publish Date: _____

Revision Date/Time (Note if correction): 2/11/2003 Dept. Affected: Natural Resources
 Title Royalty Gas Contracts BRU Oil and Gas Development
 Component Oil and Gas Development
 Sponsor Chenault
 Requester House Oil and Gas Component No. 439

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()		**See Revenue Impact Analysis Below**		
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FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

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

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

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. HB 57

ANALYSIS CONTINUATION

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

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

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

	Gas Production from State Leases (Thousand Cubic Feet per Year)	State Royalty Share	State Royalty Percent (%)	Contract			Royalty Foregone (\$ per Year)	Discount/Compound Factor 0.08	Discounted Royalty Foregone (\$ per Year)
				Value	Royalty Value	Diff			
2000	26,337,176	3,431,229	13.03%	\$1.20	\$1.70	\$0.50	\$ 1,715,814	121.2%	\$ 2,079,597
2001	27,004,457	3,573,255	13.23%	1.38	2.20	0.81	2,907,105	112.2%	3,262,844
2002	24,315,609	3,353,117	13.77%	1.47	2.55	1.08	3,621,743	103.9%	3,763,826
Average				\$1.35			\$8,244,462		\$9,106,267

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

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

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

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. HB 57

ANALYSIS CONTINUATION

**Table 3. Impact of HB 57 on State Royalty Revenue: Changing Supply
FY 2003 - 2009**

Unocal Commitments Under Existing Gas Supply Contract								
FY	Total (1000 Cubic Feet per Year)	State Leases	Non-State	State Royalty Share	Contract	Royalty	Diff	Royalty
					Value	Value		Foregone
					(\$ per Mcf)			(\$ per Year)
2003	53,500,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.37	\$1.17	4,045,820
2004	51,900,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.43	\$1.23	4,230,642
2005	53,500,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.57	\$1.37	4,713,683
2006	38,600,000	19,300,000	19,300,000	2,574,620	\$1.20	\$2.70	\$1.50	3,874,594
2007	21,199,999	10,600,000	10,600,000	1,414,040	\$1.20	\$2.84	\$1.64	2,325,817
2008	14,000,000	7,000,000	7,000,000	933,800	\$1.20	\$2.98	\$1.78	1,666,540
2009	9,100,000	4,550,000	4,550,000	606,970	\$1.20	\$3.12	\$1.92	1,168,156
Royalty Losses Under Existing Gas Supply Contracts =								\$22,025,252

New Gas Produced from Other 3rd-Party Producers								
FY	Total (1000 Cubic Feet per Year)	State Leases	Non-State	State Royalty Share	Contract	Royalty	Diff	Royalty
					Value	Value		Foregone
					(\$ per Mcf)			(\$ per Year)
2003	1,728,506	1,728,506	-	230,583	\$2.00	\$2.37	\$0.37	\$ 85,691
2004	1,728,506	1,728,506	-	230,583	\$2.00	\$2.43	\$0.43	98,033
2005	1,728,506	1,728,506	-	230,583	\$2.00	\$2.57	\$0.57	130,287
2006	14,100,000	9,447,000	4,653,000	1,260,230	\$2.00	\$2.70	\$0.70	888,360
2007	31,500,001	21,105,001	10,395,000	2,815,407	\$2.00	\$2.84	\$0.84	2,378,463
2008	38,700,000	25,929,000	12,771,000	3,458,929	\$2.00	\$2.98	\$0.98	3,405,960
2009	43,600,000	29,212,000	14,388,000	3,896,881	\$2.00	\$3.12	\$1.12	4,382,316
Royalty Losses Under New gas Supply 3rd-Party Contracts =								\$11,369,110
Total Royalty Losses from Existing & Potential 3rd-Party Contracts (Nominal) =								\$33,394,362
Total Royalty Losses (Discounted) =								\$25,481,582

Assumptions

1. Annual gas consumption at the fertilizer plant is equal to about 52 billion cubic feet per year (Bcf), based on historic rates of gas usage over the past five years.
2. State leases account for approximately half (initially about 25.9 Bcf per year) of the total gas usage at the plant; the remaining one-half is from federal and private leases.
3. The state royalty share of gas dispositions to the plant is 13.34 percent.
4. The contract value used in transactions between Unocal and Agrium is \$1.20 per thousand cubic feet (Mcf) of gas; \$1.35 per Mcf is used for sensitivity analysis (below) based on the average of the contract price observed over the past three years, due to high ammonia spot prices.
5. Royalty value is indexed to the Alaska Department of Revenue prevailing value for Cook Inlet Gas (DOR PV). The Division of Oil and Gas forecasts DOR PV to increase from about \$2.50 per Mcf today, to \$3.12 per Mcf in FY 2009, based on the historic, long-term trend observed over the period 1995-02.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. HB 57

ANALYSIS CONTINUATION

Assumptions (Continued)

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

Sensitivity Analysis

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

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

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

Revision Date/Time (Note if correction): 2/11/2003 Dept. Affected: Natural Resources
Title: Royalty Gas Contracts BRU: Oil and Gas Development
Component: Oil and Gas Development
Sponsor: Chenault
Requester: House Oil and Gas Component No. 439

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES ()		**See Revenue Impact Analysis Below**				
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FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

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

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

FISCAL NOTE #1

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(O&G)

ANALYSIS CONTINUATION

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

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

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

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

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

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

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

FISCAL NOTE #1

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(O&G)

ANALYSIS CONTINUATION

**Table 3. Impact of HB 57 on State Royalty Revenue: Changing Supply
FY 2003 - 2009**

Unocal Commitments Under Existing Gas Supply Contract								
FY	Total (1000 Cubic Feet per Year)	State Leases	Non-State	State Royalty Share	Contract	Royalty	Diff	Royalty
					Value	Value		Foregone
					(\$ per Mcf)		(\$ per Year)	
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2005	53,500,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.57	\$1.37	4,713,683
2006	38,600,000	19,300,000	19,300,000	2,574,620	\$1.20	\$2.70	\$1.50	3,874,594
2007	21,199,999	10,600,000	10,600,000	1,414,040	\$1.20	\$2.84	\$1.64	2,325,817
2008	14,000,000	7,000,000	7,000,000	933,800	\$1.20	\$2.98	\$1.78	1,666,540
2009	9,100,000	4,550,000	4,550,000	606,970	\$1.20	\$3.12	\$1.92	1,168,156

Royalty Losses Under Existing Gas Supply Contracts = **\$22,025,252**

New Gas Produced from Other 3rd-Party Producers								
FY	Total (1000 Cubic Feet per Year)	State Leases	Non-State	State Royalty Share	Contract	Royalty	Diff	Royalty
					Value	Value		Foregone
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2005	1,728,506	1,728,506	-	230,583	\$2.00	\$2.57	\$0.57	130,287
2006	14,100,000	9,447,000	4,653,000	1,260,230	\$2.00	\$2.70	\$0.70	888,360
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2009	43,600,000	29,212,000	14,388,000	3,896,881	\$2.00	\$3.12	\$1.12	4,382,316

Royalty Losses Under New gas Supply 3rd-Party Contracts = **\$11,369,110**

Total Royalty Losses from Existing & Potential 3rd-Party Contracts (Nominal) = **\$33,394,362**

Total Royalty Losses (Discounted) = **\$25,481,582**

Assumptions

1. Annual gas consumption at the fertilizer plant is equal to about 52 billion cubic feet per year (Bcf), based on historic rates of gas usage over the past five years.
2. State leases account for approximately half (initially about 25.9 Bcf per year) of the total gas usage at the plant; the remaining one-half is from federal and private leases.
3. The state royalty share of gas dispositions to the plant is 13.34 percent.
4. The contract value used in transactions between Unocal and Agrium is \$1.20 per thousand cubic feet (Mcf) of gas; \$1.35 per Mcf is used for sensitivity analysis (below) based on the average of the contract price observed over the past three years, due to high ammonia spot prices.
5. Royalty value is indexed to the Alaska Department of Revenue prevailing value for Cook Inlet Gas (DOR PV). The Division of Oil and Gas forecasts DOR PV to increase from about \$2.50 per Mcf today, to \$3.12 per Mcf in FY 2009, based on the historic, long-term trend observed over the period 1995-02.

ANALYSIS CONTINUATION

Assumptions (Continued)

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

Sensitivity Analysis

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

WORK DRAFT

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23-LS0303V
Chenoweth
2/25/03

CS FOR HOUSE BILL NO. 57()

F.Y.I.

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): REPRESENTATIVES CHENAULT, Whitaker

Clean copy
before Resources
Tomm.

A BILL

FOR AN ACT ENTITLED

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

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

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

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

13 (1) but only if

14 (A) for a contract between the lessee and a gas or electric

WORK DRAFT

WORK DRAFT

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

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

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

(A) the contract price is unreasonably low;

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

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

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

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

WORK DRAFT

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23-LS0303V

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

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

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

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

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