HB

28

SENATE COMMITTEE REPORT

DATE: 5/18/03

FURTHER: Finance

DATE TURNED IN TO OFFICE: 5-19-03

Resources Committee considered CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 28(FIN)

HB 28 OIL & GAS ROYALTY MODIFICATION

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

and recommends:

Senate Bill:
[ ] same title
[ ] new title

House Bill:
[ ] same title
[ ] technical title
[ ] new: SCR #_____

[ ] be **replaced** with _____ **CS** _____ (_____)

[ ] adopt **previous** _____ **CS** _____ (_____)

[ ] attached amendment(s)

[ ] adopt Letter of Intent by _____ Committee

[ ] further referral to _____ Committee

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#
DNR	5/3/03	✓		2

[ ] **APPROPRIATION - no fiscal note**

SIGNATURES AND RECOMMENDATIONS:	DO PASS	DO NOT PASS	NO REC	AMEND
	✓			
	✓			
	✓			
CHAIR:	✓			

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: CSSSHB 28(FIN)
(H) Publish Date: 5/17/03

Revision Date/Time (Note if correction): 5-8-03
Dept. Affected: Natural Resources
Title: Oil & Gas Royalty Modification
BRU: Resource Development
Component: Oil and Gas Development
Sponsor: Kohring, Rokeberg
Requester: House Finance
Component No. 439

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual	150.0	150.0	150.0	150.0	150.0	150.0
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	**150.0**	**150.0**	**150.0**	**150.0**	**150.0**	**150.0**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
1108 Statutory Designated Prog. Receipt	150.0	150.0	150.0	150.0	150.0	150.0
TOTAL	**150.0**	**150.0**	**150.0**	**150.0**	**150.0**	**150.0**

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

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

Fiscal Note for CS SS HB 28(RES):

HB 28 would amend AS 38.05.180(j) which addresses oil and gas royalty modifications. The $150,000 per year would pay for the services of an independent contractor to assist the DNR Commissioner in evaluating the applicant's financial and technical data prior to making a determination on royalty modification. Under paragraph (6)(A), "V" version, page 5, lines 14-26, this amount would be reimbursed to the state by the applicant.

Prepared by: Mark D. Myers
Phone 269-8800
Division: Oil and Gas
Date/Time 5/8/2003
Approved by: Tom Irwin, Commissioner
Date 5/8/2003
Agency: Natural Resources

(Revised 9/2002 OMB)

ALASKA STATE LEGISLATURE

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REPRESENTATIVE VIC KOHRING
DISTRICT 14

SPONSOR STATEMENT

SSHB 28

House Bill 28 will take a royalty adjustment system that is 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. 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.

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REPRESENTATIVE VIC KOHRING
DISTRICT 14

SECTIONAL ANALYSIS
CSSSHB 28 (FIN)

ADDENDUM to Legal Services' May 9 analysis

Paragraph (5) -- assignability of royalty modification:

- at page 4, lines 13 – 18: replaces the term **modification** with the word **reduction** and adds a provision that the commissioner may not unreasonably withhold the written approval required by the section.

Other page/line number changes noted on May 9 analysis

LEGAL SERVICES

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

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MEMORANDUM May 9, 2003

SUBJECT: CSSSHB 28 (RES) -- sectional analysis
(Work Order No. 23-LS0177\V)

TO: Representative Vic Kohring

FROM: Jack Chenoweth
Assistant Revisor of Statutes

Per staff's further request, set out below is an overview by bill section of CSSSHB 28 (RES), 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 substantially amend 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, together with particular additional changes sought by the House Special Oil and Gas Committee. 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 11 - 12, 15 - 17, and 18 - 19: with respect to 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 20 - 23: 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 24 - page 4, line 2: 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 3 - 12: 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;

see addendum

Paragraph (5) -- assignability of royalty modification:

-- at page 4, lines 13 - ~~19.~~ 18 ~~eliminates~~ modifies the requirement of existing paragraph (5) to change 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 ~~20~~ 19 - page 5, line ~~12~~ 8: 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, line ~~13~~ 9 - page 6, line ~~8~~ 5: revises the set of circumstances under which the commissioner may require evaluation by an independent contractor, and establishes terms and conditions that apply when the commissioner chooses to require a lessee or

lessees to pay for the services of an independent contractor; the circumstances differ as between royalty modifications for encouraging new production and royalty modifications to prolong economic life or to reestablish production; in each instance, the payment requirement is limited to $150,000 and the commissioner is to determine the scope of the work to be performed by the contractor;

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

-- at page 6, beginning at line ~~9~~ 6: 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 ~~17~~ 14 - ~~20~~ 17: 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, line ~~21~~ 18 through ~~page 8,~~ line ~~2~~ 30: 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 ~~8~~ page 7 line 1 thru Pg 8 line 6, lines ~~3-19~~ 4-6: although renumbered, no change is made in this paragraph;

Existing paragraph (12) -- final action:

-- at page 8, beginning at line ~~10~~ 7: 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 9, lines 1 and 2: no substantive change is made in this paragraph.[1]

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[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 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.

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 paragraph[2], there is in the State Procurement Code an exemption for contracts with experts retained by the commissioner of natural 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
03-506.med

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

> (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); . . . .

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DOCUMENT(S)
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UNOCAL

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.

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.

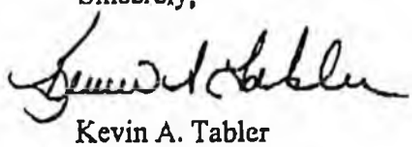
In another case, a property transferred to Unocal years ago, involved a Purchase and Sales Agreement and a Bill of Sale. No operational, financial or production data was ever received by Unocal. Additionally, it is not uncommon for geological and geophysical data licenses to be non-transferable. Unless 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 Statue, 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 inconsistant 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) says 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 unecessary 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 CSHB 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.

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)(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)

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 committments have been made. Prior approval does not work in this situation. A negative response to a request for assignment could jeopardies 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 unecessary 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