

SB

50

SENATE COMMITTEE REPORT First Committee of Referral

DATE: 1/31/03

FURTHER: Finance

Date of 5-Day Notice: _____
(in accordance with Uniform Rule 23)

DATE TURNED
IN TO OFFICE: 4-17-03

Resources Committee considered SENATE BILL NO. 50

SB 50 ROYALTY GAS CONTRACTS

"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."

and recommends:

be replaced with _____ CS SB 50 (RES)

adopt previous _____ CS _____ (_____)

attached amendment(s)

adopt Letter of Intent by _____ Committee

further referral to _____ Committee

Senate Bill:

same title
 new title

House Bill:

same title
 technical title
 new: SCR # _____

NEW FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#
DNR	4/17/03	<input checked="" type="checkbox"/>		

PREVIOUS FISCAL NOTE(S):

Department	Date	Fiscal	Zero	FN#

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	Do PASS	Do NOT PASS	No REC	AMEND
<i>Geoff Deekin</i>	<input checked="" type="checkbox"/>			
<i>Ben Glavin</i>	<input checked="" type="checkbox"/>			
<i>Thomas A. Wagoner</i>	<input checked="" type="checkbox"/>			
<i>John P. ...</i>	<input checked="" type="checkbox"/>			
<i>...</i>			<input checked="" type="checkbox"/>	
<i>...</i>			<input checked="" type="checkbox"/>	
CHAIR: <i>Scott ...</i>			<input checked="" type="checkbox"/>	

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 2 CORRECTED
Bill Version: CSHB 57(FIN)
(H) Publish Date: 4/7/03

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

Expenditures/Revenues (Thousands of Dollars)

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

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

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES (GF 1004)	*(98.0)	*(130.3)	*(938.8)	*(2,438.9)	*(3,476.4)	*(4,462.7)
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FUND SOURCE (Thousands of Dollars)

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

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

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

ANALYSIS CONTINUATION

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

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

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

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

Assumptions

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

FISCAL NOTE #2 corrected

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(FIN)

ANALYSIS CONTINUATION

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

Sensitivity Analysis

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

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: DRAFT
Bill Version: CSSB50(RES) wk draft
() Publish Date: _____

Revision Date/Time (Note if correction): 3/26/2003 Dept. Affected: Natural Resources
Title: Royalty Gas Contracts BRU: Resource Development
Component: Oil and Gas Development
Sponsor: Wagoner
Requester: Senate Resources Component No. 439

Expenditures/Revenues (Thousands of Dollars)

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

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
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Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES (GF 1004)	(98.0)	(130.3)	(938.8)	(2,438.9)	(3,476.4)	(4,462.7)
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FUND SOURCE (Thousands of Dollars)

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)

** Fiscal Note prepared for Senate Resources Committee Work Draft

This bill amends AS 38.05.180(aa) requiring DNR to enter into agreements with lessees to use the price for gas established in contract(s) entered into on or after the effective date between the lessee and a manufacturer of agricultural chemicals as the value of the state's royalty share. SB 50 will result in a loss of state revenues. Should lessees supplying gas to only one agricultural manufacturer apply under AS 38.05.180(aa), the state could lose an estimated \$11.5 million in cumulative royalties over the period FY 2004-09; an average of about \$1.9 million per year (see Table 1, below).

Prepared by: Mark D. Myers Phone 269-8800
Division: Oil and Gas Date/Time 3/26/2003
Approved by: Tom Irwin, Commissioner Date 3/26/2003
Agency: Natural Resources

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSSB 50(RES) wk dr

ANALYSIS CONTINUATION

Table 1. Impact of SB 50 on State Royalty Revenue: FY 2003 - 2009

New Gas Produced from Other 3rd-Party Producers - State Lands								
FY	Total	State Leases	Non-State	State Royalty Share	Contract	Royalty	Diff	Royalty Foregone
					Value	Value		
(1000 Cubic Feet per Year)				(\$ per Mcf)			(\$ per Year)	
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Assumptions

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

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSSB 50(RES) wk dr

ANALYSIS CONTINUATION

5. The average state royalty share for gas dispositions to the plant is 13.34 percent.
6. Royalty value is indexed to the Alaska Department of Revenue prevailing value for Cook Inlet Gas (DOR PV). The Division of Oil and Gas forecasts DOR PV to increase from about \$2.50 per Mcf today, to \$3.12 per Mcf in FY 2009, based on the historic trend observed during 1995-02.
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Alaska State Legislature

Senate Resources Committee

Senator Scott Ogan, Chair

Senator Fred Dyson
Senator Kim Elton
Senator Georgianna Lincoln
Senator Ralph Seekins
Senator Ben Stevens
Senator Tom Wagoner



State Capitol, Room 103
Juneau, AK. 99801-1182
Phone: (907) 465-4907
Fax: (907) 465-3265

Memorandum

DATE: April 10, 2003

TO: All Resources Committee Members

FROM: Senator Scott Ogan
Chairman, Senate Resources Committee

RE: SB 50

Attached is a copy of the work draft CS for SB 50 Royalty Gas Contracts. This version matches HB 57 which is currently in the House Rules Committee. A copy of the revised fiscal note for the house bill is also included. Once the CS for SB 50 is adopted, I will be able to get a revised fiscal note for the senate version.

If you have any questions, please contact my committee aide, Linda Hay at extension 4907.

Senator Scott Ogan



SENATOR SCOTT OGAN Alaska State Legislature

Senate District H Lazy Mountain * Butte * Chugiak * Peters Creek

Knik-Goose Bay * Big Lake * Houston * Willow * Talkeetna * Trapper Creek

State Capitol, Room 103, Juneau Alaska 99801 * (907) 465-3878 * 1 (800) 862-3878 * Fax (907) 465-3265

Senator_Scott_Ogan@legis.state.ak.us

Http://www.akrepublicans.org/ogan

FACSIMILE TRANSMITTAL SHEET

TO: Jack Chenoweth

FROM: Linda Hay

COMPANY:

DATE: 4-17-03

FAX NUMBER:

TOTAL NO. OF PAGES INCLUDING COVER: 1

PHONE NUMBER:

RE:

URGENT FOR REVIEW PLEASE COMMENT PLEASE REPLY PLEASE RECYCLE

NOTES/COMMENTS:

please prepare a final on
CSSB 50 (Res) 23-LS0429\Q as
amended by 23-LS04~~28~~29\Q.1

Passed out of Senate Resources
yesterday.

Thomas Jack

*Motion
to adopt
by UIC
Dyson 4/16/03*

23-LS0429\Q.1
Chenoweth
4/15/03

AMENDMENT

OFFERED IN THE SENATE

BY SENATOR WAGONER

TO: CSSB 50(), Draft Version "Q"

- 1 Page 2, line 23, following "acceptance of":
- 2 Delete "the use of the contract price"
- 3 Insert "an amount that is different than the amount due under the lease [THE
- 4 USE OF THE CONTRACT PRICE]"
- 5
- 6 Page 2, line 31, following "commissioner":
- 7 Delete "shall"
- 8 Insert "may"
- 9
- 10 Page 3, line 4, following "agreement":
- 11 Insert "if it is in the best interest of the state"
- 12
- 13 Page 3, line 17:
- 14 Delete "and"
- 15 Insert "or"
- 16
- 17 Page 3, line 19, following "state":
- 18 Delete ";
- 19 Insert ".
- 20
- 21 Page 3, lines 20 - 22:
- 22 Delete all material.

*allows
discretion
in royalty
relief
granted*

*adopted
amend adopted*

23-LS0429\Q
Chenoweth
4/14/03

CS FOR SENATE BILL NO. 50()

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): SENATOR WAGONER

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(bb) is amended to read:

5 (bb) In (aa) and (ee) of this section,

6 (1) "gas or electric utility" includes an electric cooperative organized
7 under AS 10.25, a municipal utility, and a gas or electric utility regulated under
8 AS 42.05; provided that, if the contract gas is transmitted to consumers through a
9 pipeline and the gas utility either owns the pipeline or is related in ownership to the
10 owner of the pipeline, then the gas utility qualifies as a "gas or electric utility" within
11 the meaning of this paragraph only if it is bound or agrees to be bound by the
12 covenants set out in AS 38.35.120;

13 (2) "price for the gas established in the contract" includes tax
14 reimbursement amounts, deliverability and other charges, and other forms of

1 consideration paid by the gas or electric utility or by the manufacturer of
2 agricultural chemicals, as appropriate, under the contract;

3 (3) "state's royalty share of gas production"

4 (A) includes payments on federal leases made to the state under
5 30 U.S.C. 191;

6 (B) does not include the state's royalty share of gas production
7 from land patented to the state under

8 (i) P.L. 84-830, 70 Stat. 709 (Alaska Mental Health
9 Enabling Act);

10 (ii) 38 Stat. 1214 (Act of March 4, 1915); or

11 (iii) 43 U.S.C. 1635 in settlement of the claims of the
12 state under 38 Stat. 1214.

13 * Sec. 2. AS 38.05.180(bb) is amended by adding a new paragraph to read:

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

18 * Sec. 3. AS 38.05.180(cc) is amended to read:

19 (cc) The provisions of (aa) and (ee) of this section do not prohibit the
20 commissioner from accepting any payment on a federal lease tendered by the federal
21 agency responsible for determination and transmittal of the payment to the state under
22 30 U.S.C. 191 or otherwise due the state as the state's royalty share of gas production
23 irrespective of the state's acceptance of the use of the contract price for purposes of
24 determining royalty share on gas production under that subsection.

25 * Sec. 4. AS 38.05.180 is amended by adding a new subsection to read:

26 (ee) For a contract that is entered into on or after the effective date of this Act,
27 within 90 days after the written request of a lessee of a lease issued under this section
28 or of a lessee of federal land from which the state is entitled under applicable federal
29 law to receive a share of the royalty on gas production, in order to establish the value
30 of the state's royalty share of gas production sold by the lessee under the contract, the
31 commissioner shall enter into an agreement with the lessee to use or accept as a price

1 for the gas an amount that is not less than the price established in the contract between
2 the lessee and a manufacturer of agricultural chemicals, not to exceed the amount that
3 would otherwise be due under the lease. The commissioner may enter into the
4 agreement

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

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

17 (A) the contract price is unreasonably low; and ^{OR}

18 (B) the prospective reduction in royalty receipts would not be
19 balanced by employment opportunities or other tangible benefits to the state;
20 and ^{OR}

21 (3) the commissioner determines that use of the agreement setting the
22 price is in the best interest of the state.

23 * Sec. 5. The uncodified law of the State of Alaska is amended by adding a new section to
24 read:

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

AMENDMENT

OFFERED IN THE SENATE

BY SENATOR WAGONER

TO: CSSB 50(), Draft Version "Q"

1 Page 2, line 23, following "acceptance of":

2 Delete "the use of the contract price"

3 Insert "an amount that is different than the amount due under the lease [THE

4 USE OF THE CONTRACT PRICE]"

5

6 Page 2, line 31, following "commissioner":

7 Delete "shall"

8 Insert "may"

9

10 Page 3, line 4, following "agreement":

11 Insert "if it is in the best interest of the state"

12

13 Page 3, line 17:

14 Delete "and"

15 Insert "or"

16

17 Page 3, line 19, following "state":

18 Delete ";

19 Insert "."

20

21 Page 3, lines 20 - 22:

22 Delete all material.

adopted

23-LS0429V
Chenoweth
4/7/03

CS FOR SENATE BILL NO. 50()
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): SENATOR WAGONER

A BILL
FOR AN ACT ENTITLED

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

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

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

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

14 (1) but only if

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(A) for a contract between the lessee and a gas or electric 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) for a contract entered into for a circumstance described in (1)(A) of this subsection

- (i) the contract price is unreasonably low;
- (ii) [(B)] the prospective reduction in royalty receipts would not be balanced by increased benefits to in-state gas and electric consumers;
- (iii) [(C)] the lessee and the utility are related in management, ownership, or other aspect; and
- (iv) [(D)] the contract price is not in the best interest of

all 4 must be present for a utility

Agrium

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the state;

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

(i) the contract price is unreasonably low;

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

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

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

*mne
rest of the
manufacturer*

* 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(bb) 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.

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

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

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 2 CORRECTED
 Bill Version: CSHB 57(FIN)
 (H) Publish Date: 4/7/03

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

Expenditures/Revenues (Thousands of Dollars)

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

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

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES (GF 1004)	*(98.0)	*(130.3)	*(938.8)	*(2,438.9)	*(3,476.4)	*(4,462.7)
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FUND SOURCE (Thousands of Dollars)

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

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

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

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

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

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

Total Royalty Losses (Discounted) = (7,619,642)

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

Assumptions

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

ANALYSIS CONTINUATION

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

Sensitivity Analysis

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

23-LS0429\H
Chenoweth
3/25/03

CS FOR SENATE BILL NO. 50()
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): SENATOR WAGONER

A BILL
FOR AN ACT ENTITLED

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

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

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

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

14 (1) but only if

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

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

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

23 (A) the contract price is unreasonably low;

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

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

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

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

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aspect; and

(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(bb) 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.

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

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

moved by Sen Wagner
objected by Sen Stevers for discussion —

AMENDMENT #1

Page 3 after line 11 insert (C) in granting an application under this section, the commissioner may use or accept an amount in excess of the price for the gas established in the contract but less than would otherwise be due under the lease when it is in the best interest of the state.

if there is an upside
the state shares in it —

LEGAL SERVICES

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

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

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

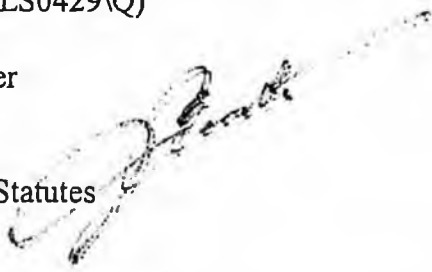
MEMORANDUM

April 14, 2003

SUBJECT: Draft CSSB 50 () -- notes to accompany the draft
(Work Order No. 23-LS0429\Q)

TO: Senator Tom Wagoner

FROM: Jack Chenoweth
Assistant Revisor of Statutes



This is a redraft of the above-captioned measure based on guidance provided in the copy of an April 11 e-mail from Department of Natural Resources officials.

The changes requested result in substantially dissimilar treatment of the existing royalty value determination for gas used for a gas or electrical utility (unchanged, with the gas price being set as the contract price) and the proposed handling of royalty determination for gas used for manufacturer of agricultural chemicals (floating between a "floor" and a "ceiling"). Because of that difference, I've opted to reformat the text. AS 38.05.180(aa), substantially amended in earlier versions of SB 50, is here left unchanged and does not appear in the text of the measure. The substantive changes now are set out in a new subsection, identified as (ee) [bill section 4], limited to the determination of royalty on gas production committed to use by a manufacturer of agricultural chemicals. The amendments set out in bill sections 1 - 3 are necessary conforming changes.

In subsection (ee), the key provision appears near the end of the introductory sentence: "an agreement . . . to use or accept as a price for the gas an amount that *is not less than* the price established in the contract between the lessee and [the] manufacturer not to exceed. . . ." That should serve to set the floor on the price, but allow the commissioner the discretion to use a price at the floor, at the amount calculated (to serve as the "ceiling"), or at some intervening amount. All of the conditions and factors that would bear on the commissioner's deliberations as set out in the immediately preceding "I" version are carried forward together with the addition--actually, a revision--of the statement that the authorization to use a price falling below the ceiling must meet the state's best interests.

As revised, I am of the view that subsection (ee) provides the commissioner little real guidance as to whether or not to enter into the agreement and, if so, at what price between the "ceiling" and the "floor" the price should be set. The commissioner is to consider the various factors that are set out, but is it altogether clear that the commissioner's eventual decision is to be based on some application of these factors?

JBC:med
03-395.med

Enclosure



ALASKA STATE LEGISLATURE

SENATOR THOMAS H. WAGONER
CHAIR, SENATE COMMUNITY AND REGIONAL AFFAIRS COMMITTEE
VICE-CHAIR, SENATE RESOURCES COMMITTEE

Sponsor Statement **SB 50 – Royalty Gas Contracts**

Senate Bill 50 amends existing statutory language that establishes the manner of determining the royalty received by the state on gas production.

The amendments extend the ability to enter into agreements to the lessee **and a manufacturer**. A manufacturer is then defined as an entity, other than a gas or electric utility, engaged in a value-added product that uses state royalty natural gas.

The intent of this bill is to allow certainty to manufacturing entities regarding the costs of their royalty gas share so they have the ability to better predict their costs of operation and thus, be competitive in the world market.

In turn, that assures their continued presence in the State of Alaska and the continued benefits of employment opportunities for residents. It also assures continued use of the State's royalty gas share.

SS SB 50 S(RES) 2-27 mj



ALASKA STATE LEGISLATURE

SENATOR THOMAS H. WAGONER
CHAIR, SENATE COMMUNITY AND REGIONAL AFFAIRS COMMITTEE
VICE-CHAIR, SENATE RESOURCES COMMITTEE

SB 50 SENATE RESOURCES

(4-11-03: mj)

CS work draft I

4/7/03

Changes from Work Draft \I and Work Draft \H

Page 1. No changes

Page 2: Lines 23 is the beginning of the changes.

“H” version references to the (aa) contracts essentially merged the exceptions for both the utility contracts and manufacturing contracts (page 2 lines 21 through page 3 line 2).

“I” version clearly sets out the provisions in separate sections for:

- (aa) contracts for utilities – in (2) (A) (begins on page 2 line 23); and
- (aa) contracts for a manufacturer of agricultural chemicals – in (2)(B) (begins on page 3, line 2)

There was previous committee discussion of changing “and” to “or” in old cs on page 3 line 1.

The new CS accomplishes that for the new language regarding manufacturer of agricultural chemicals, as was requested.

Page 3 – Sec. 2: Sec 3, and Sec. 4: no changes



ALASKA STATE LEGISLATURE

SENATOR THOMAS H. WAGONER

CHAIR, SENATE COMMUNITY AND REGIONAL AFFAIRS COMMITTEE

VICE-CHAIR, SENATE RESOURCES COMMITTEE

SB 50 – CSH Explain

March 26, 2003

PAGE 1: LINES 10-12

SB 50 new language insert was

“or between the lessee and a manufacturer, as appropriate”

CS expanded to be specific to

- Contract to use or accept a price for gas
- on or after the effective date of the act
- a manufacturer of agricultural chemicals

PAGE 2: LINES 10-11

CS inserts new phrase “of agricultural chemicals” to further define the manufacturer

PAGE 2: LINES 30-31

CS inserts new phrase “of agricultural chemicals” to further define the manufacturer

PAGE 3: LINE 7 (SEC. 2)

CS inserts new phrase “of agricultural chemicals” to further define the manufacturer

PAGE 3: LINES 8-12 (SEC. 3)

CS definition expanded to reflect “manufacturer of agricultural chemicals” as more specific definition for manufacturer.

PAGE 3: LINES 13-18 (SEC. 4)

CS adds new section to restrict application of this new provision to contracts entered into on or after the effective date of this act.

SB 50 – Draft CS S(RES) 3-26-03 mj



ALASKA STATE LEGISLATURE

SENATOR THOMAS H. WAGONER
CHAIR, SENATE COMMUNITY AND REGIONAL AFFAIRS COMMITTEE
VICE-CHAIR, SENATE RESOURCES COMMITTEE

Sectional Analysis **SB 50 – Royalty Gas Contracts**

Section 1. Amends AS 38.05.180(aa) to add a new entity, a lessee and a manufacturer, who would be able to establish an agreement with the State for royalty gas share prices.

Amends subsection (aa)(1), which lists restrictions imposed for such price agreements, by revising the existing section to reflect it as a subsection (A) specific only to a contract between the lessee and a gas or electric utility,

Amends subsection (aa)(1) by inserting a new subsection (B) that lists the specific restrictions for the new entity, a lessee and a manufacturer.

Amends subsection (aa)(2)(B), which sets out exemptions from the provisions of subsection (aa)(1), by inserting language regarding circumstances for the new entity, referencing new sections (B)(1) and inserting language specifying an exemption for employment or tangible benefits.

Amends subsection (aa)(2)(C) by including manufacturer, as appropriate.

Section 2. Amends AS 38.05.180(bb)(2) by including manufacturer, as appropriate.

Section 3. Amends AS 38.05.180(bb) by inserting new paragraph (4) which is the definition of a “manufacturer”.



ALASKA STATE LEGISLATURE

SENATOR THOMAS H. WAGONER

CHAIR, SENATE COMMUNITY AND REGIONAL AFFAIRS COMMITTEE

VICE-CHAIR, SENATE RESOURCES COMMITTEE

DATE: February 27, 2003

TO: Senator Scott Ogan, Chair
Senate Resources Committee

FROM: Senator Tom Wagoner 

RE: Committee Hearing – SB 50

I would appreciate your hearing Senate Bill 50 in the Resources Committee at your earliest convenience.

I am attaching a Sponsor Statement, a Sectional Analysis, and other information pertaining to the bill.

Also, this bill is a companion to HB 57. That bill was revised in the House Oil and Gas Committee to better define “manufacturing”. I have requested a draft, blank committee substitute for SB 50 that reflects those revisions and will provide it to you when it is completed.

Thank you for your time and consideration.

PREPARED REMARKS OF
MICHAEL L. NUGENT
BEFORE VARIOUS LEGISLATIVE COMMITTEES
MARCH, 2003

Mr. Chairman, members of the committee, thank you for the opportunity to testify before you this afternoon. My name is Mike Nugent and I am the General Manager of Agrium's Kenai Nitrogen Operations based in Kenai, Alaska. With me today is Lisa Parker, Government & Community Relations Advisor for Agrium U.S. and Eric McDowell from the McDowell Group. I am here today to speak in favor of the bill before you – SB 50.

As I view this legislation, it is just one piece of the pie¹, which could provide producers in Cook Inlet with stability, and Agrium with certainty of what the costs are to manufacturer the products we sell. The major raw material we use to manufacture our products is natural gas.

Agrium's Kenai Nitrogen Operations is one of Alaska's few major value added manufacturing operations. The Kenai plant is the second largest producer of nitrogen products in the United States, with the largest facility being in Louisiana. From Kenai, we manufacture 6% of the total nitrogen products in North America.

¹ The whole pie consists of having long-term, reliable, reasonably priced gas.

While we are located in Kenai, the majority of our product is exported to Pacific Rim countries, including Korea, Taiwan, Mexico, Thailand, and Australia, to name a few. In total we exported product to fifteen different countries and in 2001 the gross sale value of our product was \$210 million (this is total sales). Kenai has been able to be competitive in world markets

- ✓ because of its location – close to Pacific Rim Markets,
- ✓ because there is a skilled workforce, and
- ✓ because there is a stable government.

Countries that compete with Kenai to sell fertilizer products – Russia, Indonesia, Saudi Arabia, and Venezuela – do not have these same attributes, particularly a stable government. However, what they do have are extremely low natural gas prices, which puts Kenai at a disadvantage in marketing our product. This disadvantage is in part due to current provisions in state contracts, which require the State of Alaska to receive the highest prevailing price for the State's royalty gas.

The bill before you, SB 50, could help in that it would allow the commissioner to accept, as the price being paid to the state for its gas, the price that has been negotiated between Agrium and the producer.

Over the past few weeks there has been some questions with respect to the fiscal impact of this bill. With respect to the fiscal implications I would like to offer the following comments:

1. The Department of Natural Resources has supplied you with a fiscal note. It does not consider the other economic impacts; such as wages, purchases of goods and services, taxes, and new developments, to the State of Alaska, it only considers the impact of natural gas value.
2. This analysis is based on forecasts and these forecasts involve several variables such as volume, price, ownership, etc. all of which are very difficult to accurately predict. This analysis also assumes we are operating at full capacity or in other words, consuming maximum volumes of natural gas.
3. As opposed to forecasting the future, the reality of today is, Agrium's Kenai operation is currently curtailed due to the inability of suppliers to deliver adequate natural gas supplies. Our plant is operating on average at 75% capacity so there is currently a real revenue reduction to the state, Agrium, and the local economies; regardless of which price forecast is used.
4. Unless we are able to find a producer who can provide us with a large quantity of natural gas, at a competitive price, and in the very near future, this curtailment will last for several years or could even result in our shutdown. We have had repeated discussions with the current and future producers in Cook Inlet and one of the primary areas of concern is the additional royalty the producer is currently subject to. To quote one of the producers in a letter sent recently to the City of Kenai

“ As a producer looking to market our natural gas, there is great hesitation to enter into a gas sales agreement with a purchaser

such as Agrium because it adds yet another layer of risk to the producer. A producer selling gas to Agrium runs the risk, in fact the probability, that several years after selling its gas to Agrium, the State will assert a claim that royalty needs to be paid on a value higher than the arms length negotiated contract price. This additional royalty, plus interest accrued at a higher-than-market rate would have to be born by the producer and/or by the purchaser. It is for this reason that Aurora Power and its natural gas marketing affiliate strongly endorse HB57 and the concept that royalty should be paid on the basis of arms length negotiated contract price."

5. As noted above, the development of new natural gas reserves is more difficult because of the risk of unknown state royalty gas values.
6. The risk is associated with the value or price being set by others in a process we have not participated in.
7. If we are not successful in developing additional competitive gas reserves, we will not survive as a business. As a result the revenues to the State from royalty gas sales and the added value our business brings to the local economies will be zero.
8. Natural gas will have a different value to different consumers. One price does and will not fit all.
9. The overall economic benefits that different natural gas consumers bring to the local economies will be different. So don't just focus on the value of the gas, look at the whole economic picture.

Prepared Remarks of Michael L. Nugent
Congressional Committees
March, 2003
Page 5 of 5

Eric McDowell from The McDowell Group is here to answer any questions you might have with respect to the economic benefits as well as the economic impacts this facility has in Alaska. In the study the McDowell Group undertook last year they concluded "By Alaskan economic standards, the Agrium operation is exceptional for its combination of high pay levels, amount and concentration of expenditures in the local area, and the degree of value added manufacturing that occurs in Alaska prior to export. The result is a high multiplier impact."

Mr. Chairman and members of the committee, again, thank you for the opportunity to speak before you. We would be happy to answer any questions.

North Peninsula Chamber of Commerce

P.O. Box 8053 • Nikiski, Alaska 99635

NIKISKI IS ON THE MOVE...



April 9, 2003

RESOLUTION 2003-001

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

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

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

WHEREAS, this industry, 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 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 a manufacturer of value added products; and

North Peninsula Chamber of Commerce
Resolution 2003-001

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

SECTION 1: That the North Peninsula Chamber of Commerce urges the 23rd Alaska State Legislature to enact HB 57 and SB-50, "An Act Amending The Manner Of Determining The Royalty Received By The State On Gas Production As It Relates To The Manufacture Of Certain Value Added Products."

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

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

ADOPTED BY THE BOARD OF DIRECTORS OF THE NORTH PENINSULA CHAMBER OF COMMERCE MARCH 2003.

Signed:

Fred A. Miller
President



Kenai Chamber of Commerce
402 Overland
Kenai, Alaska 99611

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

RESOLUTION 2003-01

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

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

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

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

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

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

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

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

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

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

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



Kenai Chamber of Commerce
402 Overland
Kenai, Alaska 99611

(907) 283-7989
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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.

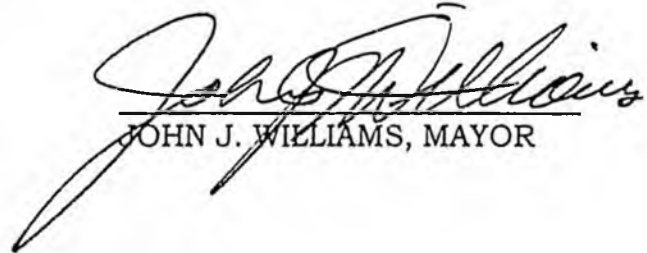
NOW, THEREFORE, BE IT RESOLVED BY THE COUNCIL OF THE CITY OF KENAI, ALASKA, the following:

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.

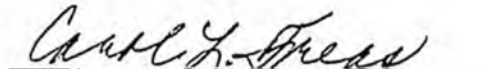
Section 3: This resolution takes effect immediately upon its enactment.

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:	
Vote:	

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.

MAR 21 2003

SOLDOTNA CHAMBER OF COMMERCE

RESOLUTION 2003-02

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

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

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

WHEREAS, this industry, 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; and

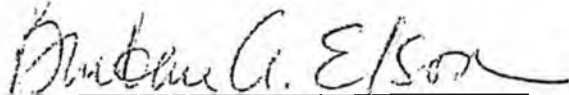
NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF DIRECTORS OF THE SOLDOTNA CHAMBER OF COMMERCE:

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

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

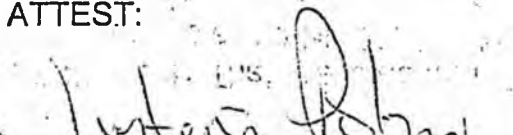
SECTION 3: That this resolution takes effect immediately upon its enactment.

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



Barbara Elson, President

ATTEST:



Justin Polzin, Executive Director

CITY OF SOLDOTNA
RESOLUTION 2003-17
(Requested by Council Member McLane)

A RESOLUTION SUPPORTING HOUSE BILL 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

WHEREAS, the manufacturing of value added resources in the State of Alaska serves 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 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 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,

NOW, THEREFORE, BE IT RESOLVED BY THE CITY COUNCIL OF THE CITY OF SOLDOTNA, ALASKA:


Section 1. The Soldotna 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 shall take effect immediately upon adoption.

ADOPTED this 26th day of February, 2003.

ATTEST


Patricia C. Burdick, CMC, City Clerk


David R. Carey, Mayor

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

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

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

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

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

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

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

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

Agrium

Kenai Nitrogen Operations

February, 2003



Summary of

Alaskan Direct Economic Impacts

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

- McDowell Group, October 2002

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

- ✓ \$95 million in purchases of goods and services from 250 Alaskan businesses
- ✓ \$24.6 million in direct payroll; including benefits, expenditures exceed \$35 million
- ✓ \$2.5 million in taxes and lease payments
- ✓ \$140,000 in charitable donations to 37 non-profit organizations and groups

Summary of

Alaskan Indirect Economic Benefits

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

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

Did You Know?

- ✓ Agrium is the Kenai Peninsula's third largest private employer with an average employment of 292 people
- ✓ Agrium accounts for an additional 700 jobs in Alaska and the Kenai Peninsula Borough
- ✓ Agrium direct expenditures on the Kenai amounted to \$90.5 million in 2001 on goods and services provided by 118 Kenai Peninsula companies
- ✓ Agrium donations to local school and youth activities accounted for 53% of the company's charitable donations
- ✓ Agrium's Kenai Nitrogen Operations is the second largest nitrogen production complex in the U.S.A.
- ✓ Agrium's Kenai Nitrogen Operations accounts for about 6 percent of North America's nitrogen production
- ✓ In 2001, Agrium's Kenai Nitrogen Operations exported 1.5 million tons of ammonia and urea to 14 countries valued at \$190 million
- ✓ Agrium's Kenai Nitrogen Operations is one of Alaska's few value added industries