ALASKA LEGISLATURE

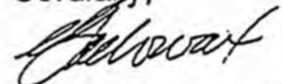
968

HOUSE and SENATE FINANCE COMMITTEE FILES, 1993-1994

Finally, as to the allocation of any royalty revenues which may be foregone as a result of the application of those proposed legislation, 74.5% would be allocated to the General Fund, 25% to the Permanent Fund, and 0.5% to the School Fund.

Please feel free to call if you have any additional questions.

Cordially,



Glenn A. Olds
Commissioner

GAO/sf

cc: House Resource Committee members
Representative Mark Hanley

Back-up

CHUGACH ELECTRIC
ASSOCIATION, INC.

January 25, 1993

Representative Bill Williams
Alaska State Legislature
Capitol Room 128
State Capitol
Juneau, AK 99801-1182

Dear Representative Williams:

Chugach is seeking to introduce legislation that will help resolve a royalty dispute that we are involved in with the Department of Natural Resources (DNR) concerning the valuation of federal royalties for natural gas that Chugach purchased at the Beluga River field. Chugach thought that this issue had been resolved in 1986 when legislation (AS 38.05.180(aa)) was passed. That legislation provides legislative guidance to DNR in valuing royalties for gas and electric utilities. Unfortunately, the current DNR administration has chosen to interpret the statute verbatim and is now disregarding the legislative intent that was behind the law. In so doing, the current DNR administration has flip-flopped the agency's position and is now apparently in disagreement with the intent behind the legislation that it fully supported in 1986.

If DNR prevails in its pursuit of increasing federal royalties for Beluga gas for prior years (1984-1992), electric rate-payers from Homer to Fairbanks will be asked to pay more than $21 million dollars in additional royalties. At issue today are the federal royalties for the years 1984-87 totaling $12.4 million. However, if DNR applies the same logic to future years (1988-1992), Chugach rate-payers would be liable for an additional $9 million. Chugach, which is a member-owned cooperative, will have no choice but to pass these additional costs on to our ratepayers (roughly two-thirds of the states population) through some type of rate surcharge. Unfortunately, today's customers would be forced to pay additional royalty payments for inexpensive natural gas that they may not have been here to use. This is not reasonable, and Chugach firmly believes that by making royalty demands that they know will simply be passed on to the consumers that the agency is actually trying to impose a tax on the Alaska public without any notice to them, and without the legislature's involvement.

5601 Minnesota Drive • P.O. Box 196300 • Anchorage, Alaska 99519-6300
Phone 907-562-7494 • FAX 907-562-0027

Homer Electric Association, Inc.

CORPORATE OFFICE
3977 Lake Street
Homer, Alaska 99603-7680
Phone (907) 235-8167
FAX (907) 235-3313

[illegible] Service Center
[illegible] Airport Way
Pouch 5280
Kenai, Alaska 99611-5280
Phone (907) 283-5831
FAX (907) 283-7122

February 18, 1993

William K. Williams, Chairman
House Resources Committee
Alaska State House of Representatives
PO Box V
Juneau, AK 99811

Dear Chairman Williams:

RE: HB 116, STATE SHARE OF FEDERAL GAS ROYALTIES

Homer Electric Association serves over 18,000 consumers on the Kenai Peninsula. Most of the power that was previously used and the power that is currently used is supplied by gas-fired turbines.

HB 116 will stop the Department of Natural Resources' attempt to collect its gas royalties on gas previously used and would eliminate future collection attempts via repricing gas and assessments of royalties. This will guarantee that HEA consumers will not be unfairly assessed for gas royalties in the future.

On behalf of HEA, I ask that your committee favorably report HB 116.

Sincerely,

HOMER ELECTRIC ASSOCIATION, INC.

N L Story / L B

N. L. Story
General Manager

NLS\HRC.ltr/lwb
cc: Representative Mark Hanley
Representative Gail Phillips
Representative Mike Navarre
Representative Ron Larson
Representative Parnell
Representative Joe Green
Dave Highers, CEA
Dave Hutchens, ARECA
HEA Board of Directors
NLS-rf H/K

Matanuska Electric
Association, Inc.

P.O. Box 2929
Palmer, Alaska 99645
Telephone: (907) 745-3231
Fax: (907) 745-9328

February 18, 1993

The Honorable William K. Williams
House of Representatives
State Capital Building
Juneau, Alaska 99801-1182

Dear Representative Williams:

Thank you for the opportunity to testify on behalf of House Bill 50 and 51 last week. The interties are important to continuing the quality of electric service to over 70 percent of this state's citizens.

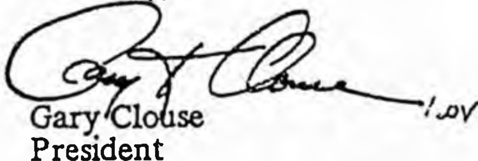
Likewise, we are writing today to support House Bill 116 to resolve a retroactive gas royalty issue for those citizens as well. We understand this Bill will come before the House Labor and Commerce Committee this week.

The Department of Natural Resources has been seeking to retroactively assess several million dollars in added royalties to the Cook Inlet field natural gas consumers. As you know, the electric utilities are big users of this natural gas. These added charges will create a tremendous burden on our electric customers. Our nonprofit status and the state rate making rules require us to pass along these wholesale power costs directly to our customers.

Some large loads, like the State of Alaska, school districts, local governments, and businesses will see large increases in their electric costs should the DNR procedure be allowed to stand. For example, the electric costs to the state would be increased several hundred thousands of dollars. On behalf of our customers, we ask your support of the amendments to the Alaska statue proposed in House Bill 116. The passage of this Bill will keep us from making large changes in the cost of electricity sold several years ago to citizens, government agencies, and businesses within the state.

Thank you for your continued support on these vital issues of legislation. Please share this letter with the members of the House Labor and Commerce Committee, as we are unable to testify in Juneau this week.

Sincerely,



Gary Clouse
President

sv
101.930218.390
cc: Members of the House Labor and Commerce Committee
David Highers, CEA
Norm Story, HEA
David Hutchens, ARECA

GOLDEN VALLEY ELECTRIC ASSOCIATION INC. Box 71249, Fairbanks, Alaska 99707-1249, Phone 907 452-1151

February 23, 1993

Mr. Dave Highers
General Manager
Chugach Electric Association
P.O. Box 196300
Anchorage, Alaska 99519-6300

SUBJECT: Royalties for Natural Gas

Dear Dave:

At their meeting on February 22, 1993, the Board of Directors of Golden Valley adopted the following resolution:

> WHEREAS, House Bill 116 has been introduced to amend AS 38.05.180 (An Act directing the commissioner of natural resources to accept, under certain circumstances, the contract price agreed to between a lessee of federal land and a gas or electric utility as the value of the federal government's royalty share from natural gas production when royalty is payable to the state under applicable federal law; and providing for an effective date.); and
>
> WHEREAS, Golden Valley Electric Association supports this legislation;
>
> THEREFORE, BE IT RESOLVED, that the Board of Directors of Golden Valley Electric Association, Inc. encourages the Fairbanks/Interior legislators to support House Bill 116.

We will contact the Interior legislators regarding this resolution.

Best regards,

Robert Hansen

Robert Hansen
Acting General Manager

WALTER J. HICKEL, GOVERNOR

DEPT. OF NATURAL RESOURCES

P.O. BOX 107034
ANCHORAGE, ALASKA 99510-7034
PHONE: (907) 762-2553

DIVISION OF OIL AND GAS

October 8, 1992

Post-It™ brand fax transmittal memo 7671	# of pages ▸ 2
To Anne McCool	From Jim Eason
Co. Peggy Elvin	Co.
Dept.	Phone #
Fax #	Fax #

Mike Carey, Editor
Anchorage Daily News
P.O. Box 149001
Anchorage, AK. 99514

Dear Mr. Carey:

I would appreciate the opportunity to respond to a recent series of advertisements in the Anchorage Daily News pertaining to Chugach Electric's potential payment of additional royalties on gas produced from federal oil and gas leases. I think it is important to clarify the Department of Natural Resources' position regarding the collection of royalty revenues and, at the same time, eliminate any misconceptions created by the Chugach advertisements.

It is the duty of the Department of Natural Resources to collect gas royalties due all Alaskans - not just for those living in Anchorage. The benefits of the State's royalties, whether those royalties come from state leases or from the state's share of federal lease revenues, belong equally to all citizens of the State. It is for that reason that, under state law, revenues collected by the department are deposited in the Permanent Fund, the General Fund and the School Fund.

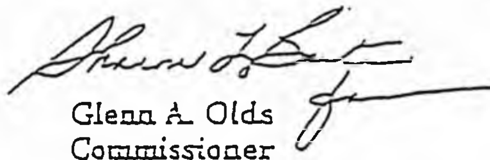
Alaska receives 90 percent of the royalties paid to the federal government by lessees of federal leases within the state. It is the department's belief that the lessees from whom Chugach purchased its gas underpaid their federal royalties during the period of 1984 to 1987. Under the applicable federal statutes and regulations, royalties are to be paid on the "value of production." Chugach, under its gas contract with the lessees, agreed to reimburse the lessees for any additional royalty the lessees owe. This fact in itself suggests that both Chugach and the lessees were aware of their potential exposure to additional royalty payments. Although Chugach believes that the gas it purchased should be valued according to the contract price it paid the lessee, this is not the law. The contract price sets a minimum value according to the statutes and regulations.

Where the contract price is not a fair value, federal law and regulation provide that a reasonable value will be determined by looking to the median price paid by other purchasers of gas in the same market area. In other words, the fact that the lessees and

spent as part of a public process and review. Thank you for sharing your views and concerns.

I realize that this will not be a popular decision with southcentral and interior power users and that it will place an additional burden on Chugach Electric.. In the past, Chugach and the State have been able to successfully resolve their differences concerning Beluga River gas royalties. I hope that spirit of cooperation can be continued.

Sincerely,



Glenn A. Olds
Commissioner

STATE OF ALASKA

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

400 WILLOUGHBY AVENUE
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400
FACSIMILE: (907) 586-2754

July 9, 1992

David L. Highers, General Manager
Chugach Electric Assn., Inc.
5601 Minnesota Drive
P.O. Box 196300
Anchorage, Alaska 99519-6300

Dear Mr. Highers:

Thank you for your letters of May 27 and June 15, 1992 to the Governor and me expressing concern regarding the impact of the State of Alaska's (State) decision to seek additional royalties derived from federal oil and gas leases located in the Beluga River gas field. Governor Hickel asked me to prepare a detailed response to your letter. I have discussed the issue with the Governor, and have given the matter a great deal of thought.

Your letter of May 27, 1992 asked that the Department of Natural Resources (DNR) withdraw an appeal filed with the federal government seeking to recover royalties due the State. These royalties are from federal leases located in the Beluga River gas field and indirectly affect Chugach Electric Association, Inc. (Chugach). The withdrawal of this appeal would not be in the best interest of the State. Essentially, the DNR believes that the federal government has ignored its own statutes and regulations to deprive the State of over $5,198,883 in lost royalties and $5,236,002 in interest.

Under the Minerals Leasing Act and the Alaska Statehood Act, the State is entitled to ninety percent of all royalties received from federal oil and gas leases in Alaska. The federal government, however, initially determines the amount of royalties due, collects the monies, and then forwards the State's share to the State. Under the applicable statutes and regulations, royalties are to be paid on the "value of production." Although Chugach believes that the production is valued according to the contract price received by a lessee on the sale of gas, this is not the law. The contract price sets a <u>minimum</u> value according to the statutes and regulations. Where the contract price is not a fair value, a reasonable value will be determined by looking to the median price paid by other purchasers of gas

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CORRECTION

THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

576(2/77)

WALTER J. HICKEL, GOVERNOR

DEPT. OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

P.O. BOX 107034
ANCHORAGE, ALASKA 99510-7034
PHONE: (907) 762-2553

October 8, 1992

Post-It™ brand fax transmittal memo 7671 | # of pages ▸ 2
To Anne McCool | From
Co.
Dept.
Fax # | Phone # | Fax #

Mike Carey, Editor
Anchorage Daily News
P.O. Box 149001
Anchorage, AK. 99514

Dear Mr. Carey:

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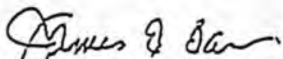
Where the contract price is not a fair value, federal law and regulation provide that a reasonable value will be determined by looking to the median price paid by other purchasers of gas in the same market area. In other words, the fact that the lessees and

Chugach elected to enter into long term contracts at a low price should not deprive the royalty owners--in this case, all Alaskans--of their right to receive a fair royalty.

Contrary to Chugach's claims, Enstar Natural Gas Company and Municipal Light and Power are not involved in this royalty dispute, and will not "be in line for an additional royalty surcharge." Nor is the department asking Chugach to pay royalties which are up to 17 times higher than the Beluga royalties reported by the lessees. The department is asking the federal government to follow its own precedents, law and regulations to ensure that the state receives its fair share of their royalties.

While Chugach would urge us to turn a blind eye to the federal government's under collection of royalties in order to benefit Chugach's customers, we simply cannot. Under state law, our obligation is to ensure the collection of all oil and gas revenues for the benefit of those in Barrow and Ketchikan, as well as in Anchorage. Any subsequent decision to subsidize one area's utility costs relative to others is the responsibility of the legislature.

Sincerely,



James E. Eason
Director
Alaska Division of Oil and Gas

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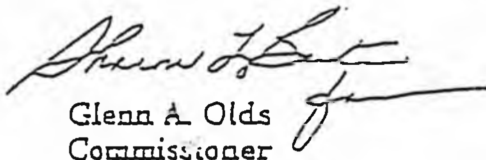

Glenn A. Olds
Commissioner

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

WALTER J. HICKEL, GOVERNOR

400 WILLOUGHBY AVENUE
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in the same market area. In other words, just because the lessees elected to enter into long term contracts at a low price should not deprive the federal government and the State of its right to receive a fair royalty for its gas. The Beluga River lessees elected to sell their gas to Chugach for $.21 per Mcf while the median price in the area was higher. Chugach is mistaken in the assumption that $2.26 per Mcf is the highest price paid. The highest price paid during the time frame studied in the majority price analysis is over $3.57 per Mcf. In addition, month by month, most median values claimed by the State are well below the alleged $2.26 per Mcf as stated in your letter.

In 1985, the federal government considered this same issue involving other federal oil and gas leases in the Kenai Feld where gas was being sold at a low price pursuant to a long term contract. The federal government determined that the contract price was not a fair value for royalty purposes and required that royalty be paid on the median price. The State received substantial additional royalties as a result of that audit.

Ignoring its own precedent, statutes, and regulations, the federal government has arbitrarily determined that the contract price constitutes a reasonable value for Beluga River gas. The state appealed this determination. The DNR has supplied supporting information for its royalty valuation position and the federal government is currently reviewing the appeal.

The State's position should be no surprise to the lessees and Chugach. The State's position is the same position it took in 1985 in the Kenai gas matter. Moreover, both Chugach and the lessees were aware at the time that they entered into their contract that the "reasonable value" could be different than the contract price since their contract contains a "pass through" provision to deal with this eventuality.

It is my obligation to ensure that the State receives fair value for its mineral interests. The State believes that the federal government has not used a "fair value" upon which to base the royalty payments for these federal leases. If I were to have the State withdraw its decision to seek fair royalty valuation through the legal appeal process when it held this belief in good faith, I would be neglecting my duties.

Although I share your concern that southcentral Alaskans may have to pay higher electric rates in the short term if the State prevails, the benefits of the State's royalties belong equally to all citizens of the state. I cannot favor one group over another. The legislature and the administration share the responsibility to determine how the revenues from the State's mineral resources are allocated and

HB

116

SFIN FILE

SENATE FINANCE COMMITTEE REPORT

DATE: 3/18/93

FURTHER:

DATE TURNED INTO OFFICE: 3-22-93

FINANCE Committee considered CS FOR HOUSE BILL NO. 116(FIN)(title am)

STATE SHARE OF FEDERAL GAS ROYALTIES

and recommends:

[ ] replace with ______ CS ______________________(FINANCE)
or [ ] adopt previous ______ CS ______________________(________)
[ ] attaches amendment(s)

[ ] same title
[ ] new title
[ ] technical title change (HB only)

[ ] adopts ______________________ Letter of Intent
[ ] further referral to the ______________________

[✓] do pass
[ ] do not pass
[ ] no recommendation
[ ] individual recommendations

NEW FISCAL NOTES

Department	Date	Zero	Fiscal

PREVIOUS FISCAL NOTES

Department	Date	Zero	Fiscal
DNR	3-10-93	-0-	

[ ] Appropriation No Fiscal Note

DO PASS: Tim Kelly

[signatures]

1. [signature] do pass
Co-Chair: Signature/Recommendation

OTHER RECOMMENDATIONS:

[signature] No Rec
[signature] No Rec
[signature, struck through] No Rec

2. [signature] - No Rec
Co-Chair: Signature/Recommendation

FISCAL NOTE

STATE OF ALASKA
1993 LEGISLATIVE SESSION

BILL NO. CSHB116 (FIN)

Revision Date: 10-Mar-93
Title: "State Share of Federal Gas Royalities"
Sponsor: Representative Hanley
Requestor: House Finance

Department Affected: Natural Resources
BRU: Resource Development
Components: Oil & Gas Development
Component Serial No. 439

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 94	FY 95	FY 96	FY 97	FY 98	FY 99
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						
REVENUE fund source:						

FUNDING: (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year (FY93) impact: $ See attached page

ANALYSIS: (Attach a separate page if necessary)

SEE ATTACHED PAGE

Prepared by: Jim Eason, Director — Phone: 762-2547
Division: Oil & Gas — Date: 10-Mar-93
Approved by Commissioner: Glenn A. Olds for [signature] — Date: 10-Mar-93
Agency: Department of Natural Resources

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE
For further distribution information call the Governor's Legislative Office

(REV 11/92) (1fnform.xls/DNR)

REPLACES RESOURCES F.N. 1 2/25/93

The retroactive application provisions of the bill make it difficult to evaluate the fiscal impact of the bill. It is not known, at this time, if any refunds, except for the one described below, will be due the federal lessees because of the proposed retroactive change in state policy. An audit of past federal/state royalty collection policies beginning in 1959, which will require a considerable amount of time and resources, would have to be completed in order to determine the full fiscal impact of this bill.

What is known today is that if the bill becomes law, the state will be barred from advocating for higher royalty values for gas production from federal leases in the Beluga River field for past production periods. The state believes that as of April 15, 1992, approximately $10.4 million is owed for the audit period between October 1, 1984 through June 30, 1987. Because interest continues to accrue on the past due principle, the amount of the claim continues to grow.

As to the allocation of any royalty revenues which may be foregone as a result of the application of this proposed legislation, for leases issued on or before December 1, 1979, 74.5% would be allocated to the General Fund, 25% to the Permanent Fund, and 0.5% to the Public School Trust Fund. In the event of leases issued after December 1, 1979, 49.5% would be allocated to the General Fund, 50% to the Permanent Fund, and 0.5% to the Public School Trust Fund.

At this point in time, the amount owed is based on a claim by the state. However, the state's position in support of the area pricing theory or median value pricing theory, and the amount sought may or may not be sustained by a court with jurisdiction for this issue.

Section-by-Section Analysis of CSHB 116(Finance)

Section 1. In 1986, the legislature directed the Department of Natural Resources ("DNR") to use, except in certain circumstances, the contract price of natural gas sold by a lessee to a gas or electric utility as the value of the state's royalty share of production from that lessee. AS 38.05.180(aa). Cook Inlet lessees sell natural gas to these utilities, and have historically paid royalties based upon that contract price. In March, 1985, DNR demanded that its lessees begin paying additional gas royalties, on the theory that the contract price did not represent the gas' "value." Had DNR prevailed, the liability for those additional royalties would have fallen on the utilities. That's because the utilities, as part of their contracts with the lessees, agreed to pay any additional royalty assessment made by the state.

Ultimately, of course, that would have meant that any additional royalties would be paid by the utility's customers.

The possibility of additional royalty demands therefore created considerable uncertainty and threatened to impose substantial burdens on consumers. These burdens, the legislature believed, outweighed any revenues the state might recieve from a higher valuation of these royalties. Even DNR, which supported the 1986 legislation, concluded that "it is appropriate to accept a contract price as the royalty value for arms-length sales to regulated utilities...because Alaska consumers would be the direct beneficiaries of the certainty of the price provided by such a contract...," but felt that legislation was necessary to permit it to use the utility contract price.

The 1986 law was intended to remove these uncertainties and potential burdens by establishing (except in limited circumstances) the utility contract price as the "value" of the state's royalty share. The law, however, applied only to ***state*** leases. The state also receives 90% of natural gas royalties paid under ***federal*** leases, and the 1986 law neglected to resolve the problem with respect to the state's share of federal royalties. As a result, DNR currently feels obligated to encourage the federal government to reject the utility contract price as the "value" of federal royalty gas, even though the agency is compelled (absent special circumstances) to accept that price for state lease purposes.

Since substantial quantities of gas are sold to utilities from federal leases, this has created precisely the uncertainty and potential consumer liability that the 1986 law was intended to prevent. And because DNR is making this claim with respect to old royalties--those paid from 1984-87--a ruling in its favor would mean that today's consumers, stretching from Homer to Fairbanks, would

have to pay an electric rate surcharge for power that was used 6-9 years ago by other consumers.

Section 1 of HB 116 closes the unintended loophole in current law by extending the reach of the 1986 legislation to the state's share of federal royalty gas. The inserted words "*or a lessee of federal land from which the state is entitled under applicable federal law to receive a share of the royalty on gas production*" extend the section's protections to federal lessees. The inserted words "or accept" reflect the fact that the federal government will ultimately set the royalty "value" for its leases; DNR, however, would be required (under the standards of the section) to "accept" the federal government's use of the utility contract as the measure of "value," if the federal government itself proposed to use that value.

In fact, the Department of Interior's Minerals Management Service ("MMS"), in two recent audit decisions, decided to use arms-length utility contract prices as the value of Beluga River Field gas for the period 1984-87. DNR is attempting to appeal those rulings, claiming a higher "value" exists. Under Section 1 of the bill, and upon the lessee's application, DNR would be required (except in the circumstances articulated in existing §180(aa)) to withdraw those appeals and "accept" MMS' decision.

The House Finance Committee narrowed the reach of both the 1986 law, and this legislation, by requiring, at p. 2, lines 6-12, that, in order to have the state accept the contract price, the utility must be in the business of providing gas or electric power to the general public (either directly, or through wholesale contracts to other utilities). This amendment insured that the benefits of the legislation will only be extended to public consumers, as was the legislature's original intent in 1986. The Finance Committee amendment also limited the legislation to utilities that were not "affiliated" with a major purchaser. This aspect of the amendment was intended to preclude collusive attempts to take advantage of this legislation.

Section 2. AS 38.05.180(aa) requires the use of the utility contract price as the value of "the state's royalty share of gas production," a term defined in existing §180(bb)(3). In order to extend that valuation rule to the state's share of federal royalties, it is necessary to amend that definition to include "payments on federal leases under 30 U.S.C. 191." 30 U.S.C. §191 is the federal statute under which 90% of federal gas royalties are distributed to the state.

Section 3. This section was inserted by the Finance Committee. A question arose whether the bill, as originally drafted, might preclude the state from accepting its share of federal royalties if the federal government, without any encouragement from the state, decided to reject the contract price and assess additional royalties on its own initiative. Although under current federal rules this result is considered unlikely, this section clarifies that if federal policy

changes, and any additional royalties are assessed despite the state's acceptance of the contract price, the state may receive and retain any resultant revenues.

Section 4. Section 5 of the 1986 law (Ch. 55, SLA 1986) made it clear that, as to state leases, DNR was only required to use ***new*** utility contracts as the royalty "value." This was done for three reasons: (1) DNR, in its March, 1985 announcement, proposed to reject utility contracts as the royalty value only prospectively--beginning April 15, 1985; (2) DNR, during the 1986 session, had already settled with all its lessees under the then-existing utility contracts, pending passage of the law; and (3) even though the law applied prospectively only, DNR assured the legislature that it would use enactment of the law as statutory justification for completing its settlements under existing utility contracts.

In other words, the "valuation" issue with respect to then-existing utility contracts had already been taken care of amicably, and there was no need to reopen those matters.

None of those considerations exist with respect to the valuation of federal royalties. DNR is currently attempting to compel MMS to retroactively reject utility contract prices as far back as 1984. It has engaged in no settlement discussions that might amicably dispose of prior-year valuation issues. And, it has taken the position that, unless AS 38.05.180(aa) is amended to require use of the utility contract price for prior year federal royalties, it must continue to urge rejection of that price for those years.

As a result, Section 4 of CSHB 116 (Finance) applies the rules of AS 38.05.180(aa) (as amended by Sections 1 and 2 of this bill) to gas production from federal leases that occured prior to the effective date of this legislation. The wording used in Section 4 is identical to amended §180(aa) and (bb), except that

(1) the word "prospective" is deleted from subsection (b)(2). That's because this section is concerned not with prospective reductions in royalty due to accepting new contract prices, but rather with acceptance of the contract price for prior production from federal leases; and

(2) the definition of "state's royalty share of gas production" references only the federal revenue sharing provision of 30 U.S.C. §191, rather than also referencing revenues from state leases, because this special section is concerned solely with prior production from ***federal*** leases.

Section 4 has a very limited reach. It does not affect prior production from state leases at all--the introductory language of the section makes this clear by stating that it applies solely to leases "entered into under applicable federal law." Moreover, all significant federal royalty disputes involving Cook Inlet gas have

already settled, and this legislation will not have any effect on binding settlement agreements. As a practical matter, the effect of Section 4 will be confined to federal royalty gas from the Beluga River Field that is sold to Chugach Electric Assn., Inc. for Railbelt power generation.

Section 5. Under AS 01.10.090, "no statute is retrospective unless expressly declared therein." Because Section 3 is intended to define what the state must accept (under certain conditions) as its share of ***past*** federal royalty production, an explicit retroactivity clause is necessary.

Section 5 should create no legal problems. Governmental policies towards defining royalty "value" have changed over the years, without any serious argument that the changes constitute unilateral amendments to pre-existing leases. Moreover, here the use of the utility contract price is at the lessee's option.

Section 6. This section gives the legislation an immediate effective date.

Representative Mark Hanley

Alaska State Legislature

Memorandum

To: Senator Drue Pearce

From: Representative Mark Hanley

Re: Request to schedule CS HB 116 (FIN) (TITLE AM) "An act amending the manner of determining the royalty received by the state on gas production, and directing the commissioner of natural resources to accept, under certain circumstances, the contract price agreed to between a lessee of federal government's royalty share from natural gas production on federal land from which the state is entitled under applicable federal law to receive a share of the royalty on gas production; and providing for an effective date."

This memo is to respectfully request that the above mentioned legislation be scheduled for a hearing in the Senate Finance Committee at your earliest possible convenience.

CS HB 116 (FIN) (Title Am) is necessary because the Department of Natural Resources is pressuring the federal government to retroactively increase the value of the gas is sold to a level above the price agreed to in long term contracts signed by the utilities. The higher price would immediately be passed along to consumers in the form of higher utility rates.

This bill will require the Department of Natural Resources to use the same standards for valuation of natural gas from federal lands as it currently uses on gas from state lands. Under existing law, the Department uses the contract price of natural gas sold to a gas or electric utility as the value for figuring the state's royalty on production from **state** leases. This bill would require the Department to also use the contract price when determining the value of gas sold to utilities from **federal** leases.

Interim: 3111 C St., Suite 410 Anchorage, AK 99503; (907) 561-2033 Session: State Capitol, Juneau, AK 99801-1182; (907) 465 4939

Alaska State House of Representatives
Eighteenth Legislature
****

RCS# 152 03-17-93
Item 4 10:43:22

CSHB 116(FIN)--RECONSIDERATION

Second Reading
Title Amendment No. 1

Yeas:	36	Barnes, Brice, Brown, Bunde, Davies, B.Davis, G.Davis, Finkelstein, Foster, Green, Grussendorf, Hanley, Hoffman, Hudson, James, Kott, Larson, Mackie, MacLean, Martin, Menard, Moses, Mulder, Navarre, Nicholia, Nordlund, Olberg, Parnell, Phillips, Porter, Sanders, Therriault, Toohey, Ulmer, Williams, Willis
Nays:	1	Vezey
Excused:	1	Davidson
Absent:	2	Carney, Sitton

STATE OF ALASKA

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

400 WILLOUGHBY AVENUE
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400
FACSIMILE: (907) 586-2754

July 9, 1992

David L. Highers, General Manager
Chugach Electric Assn., Inc.
5601 Minnesota Drive
P.O. Box 196300
Anchorage, Alaska 99519-6300

Dear Mr. Highers:

Thank you for your letters of May 27 and June 15, 1992 to the Governor and me expressing concern regarding the impact of the State of Alaska's (State) decision to seek additional royalties derived from federal oil and gas leases located in the Beluga River gas field. Governor Hickel asked me to prepare a detailed response to your letter. I have discussed the issue with the Governor, and have given the matter a great deal of thought.

Your letter of May 27, 1992 asked that the Department of Natural Resources (DNR) withdraw an appeal filed with the federal government seeking to recover royalties due the State. These royalties are from federal leases located in the Beluga River gas field and indirectly affect Chugach Electric Association, Inc. (Chugach). The withdrawal of this appeal would not be in the best interest of the State. Essentially, the DNR believes that the federal government has ignored its own statutes and regulations to deprive the State of over $5,198,883 in lost royalties and $5,236,002 in interest.

Under the Minerals Leasing Act and the Alaska Statehood Act, the State is entitled to ninety percent of all royalties received from federal oil and gas leases in Alaska. The federal government, however, initially determines the amount of royalties due, collects the monies, and then forwards the State's share to the State. Under the applicable statutes and regulations, royalties are to be paid on the "value of production." Although Chugach believes that the production is valued according to the contract price received by a lessee on the sale of gas, this is not the law. The contract price sets a <u>minimum</u> value according to the statutes and regulations. Where the contract price is not a fair value, a reasonable value will be determined by looking to the median price paid by other purchasers of gas

in the same market area. In other words, just because the lessees elected to enter into long term contracts at a low price should not deprive the federal government and the State of its right to receive a fair royalty for its gas. The Beluga River lessees elected to sell their gas to Chugach for $.21 per Mcf while the median price in the area was higher. Chugach is mistaken in the assumption that $2.26 per Mcf is the highest price paid. The highest price paid during the time frame studied in the majority price analysis is over $3.57 per Mcf. In addition, month by month, most median values claimed by the State are well below the alleged $2.26 per Mcf as stated in your letter.

In 1985, the federal government considered this same issue involving other federal oil and gas leases in the Kenai field where gas was being sold at a low price pursuant to a long term contract. The federal government determined that the contract price was not a fair value for royalty purposes and required that royalty be paid on the median price. The State received substantial additional royalties as a result of that audit.

Ignoring its own precedent, statutes, and regulations, the federal government has arbitrarily determined that the contract price constitutes a reasonable value for Beluga River gas. The state appealed this determination. The DNR has supplied supporting information for its royalty valuation position and the federal government is currently reviewing the appeal.

The State's position should be no surprise to the lessees and Chugach. The State's position is the same position it took in 1985 in the Kenai gas matter. Moreover, both Chugach and the lessees were aware at the time that they entered into their contract that the "reasonable value" could be different than the contract price since their contract contains a "pass through" provision to deal with this eventuality.

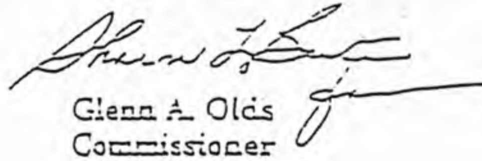
It is my obligation to ensure that the State receives fair value for its mineral interests. The State believes that the federal government has not used a "fair value" upon which to base the royalty payments for these federal leases. If I were to have the State withdraw its decision to seek fair royalty valuation through the legal appeal process when it held this belief in good faith, I would be neglecting my duties.

Although I share your concern that southcentral Alaskans may have to pay higher electric rates in the short term if the State prevails, the benefits of the State's royalties belong equally to all citizens of the state. I cannot favor one group over another. The legislature and the administration share the responsibility to determine how the revenues from the State's mineral resources are allocated and

spent as part of a public process and review. Thank you for sharing your views and concerns.

I realize that this will not be a popular decision with southcentral and interior power users and that it will place an additional burden on Chugach Electric.. In the past, Chugach and the State have been able to successfully resolve their differences concerning Beluga River gas royalties. I hope that spirit of cooperation can be continued.

Sincerely,



Glenn A. Olds
Commissioner

WALTER J. HICKEL
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

July 16, 1992

David L. Highers, General Manager
Chugach Electric Assn., Inc.
5601 Minnesota Drive
P.O. Box 196300
Anchorage, Alaska 99519-6300

Dear Mr. Highers:

Thank you for your letter dated May 27, 1992 requesting my help and intervention on behalf of Chugach. Assuring a reliable and affordable power supply for interior and south central Alaska benefits all of us in the short term and in the long term. I have asked Commissioner Olds to prepare a detailed response to your letter and to continue to work with Chugach to better understand it's concerns and hopefully resolve our differences.

Administration of oil and gas leases and valuation of gas royalties is a complicated matter. There will always be a natural tension between the lessor and the lessee concerning the royalty value, but, if the two sides are willing, they should be able to reach an acceptable compromise. I hope that will be the case in this instance.

Sincerely,

Walter J. Hickel
Governor

WALTER J. HICKEL, GOVERNOR

DEPT. OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

P.O. BOX 107034
ANCHORAGE, ALASKA 99510-7034
PHONE: (907) 762-2553

Post-it™ brand fax transmittal memo 7671 | # of pages ▸
To Anne McCord | From Jim Eason
Co. [illegible] | Co.
Dept. | Phone #
Fax # | Fax #

October 8, 1992

Mike Carey, Editor
Anchorage Daily News
P.O. Box 149001
Anchorage, Ak. 99514

Dear Mr. Carey:

I would appreciate the opportunity to respond to a recent series of advertisements in the Anchorage Daily News pertaining to Chugach Electric's potential payment of additional royalties on gas produced from federal oil and gas leases. I think it is important to clarify the Department of Natural Resources' position regarding the collection of royalty revenues and, at the same time, eliminate any misconceptions created by the Chugach advertisements.

It is the duty of the Department of Natural Resources to collect gas royalties due all Alaskans - not just for those living in Anchorage. The benefits of the State's royalties, whether those royalties come from state leases or from the state's share of federal lease revenues, belong equally to all citizens of the State. It is for that reason that, under state law, revenues collected by the department are deposited in the Permanent Fund, the General Fund and the School Fund.

Alaska receives 90 percent of the royalties paid to the federal government by lessees of federal leases within the state. It is the department's belief that the lessees from whom Chugach purchased its gas underpaid their federal royalties during the period of 1984 to 1987. Under the applicable federal statutes and regulations, royalties are to be paid on the "value of production." Chugach, under its gas contract with the lessees, agreed to reimburse the lessees for any additional royalty the lessees owe. This fact in itself suggests that both Chugach and the lessees were aware of their potential exposure to additional royalty payments. Although Chugach believes that the gas it purchased should be valued according to the contract price it paid the lessee, this is not the law. The contract price sets a minimum value according to the statutes and regulations.

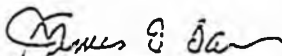
Where the contract price is not a fair value, federal law and regulation provide that a reasonable value will be determined by looking to the median price paid by other purchasers of gas in the same market area. In other words, the fact that the lessees and

Chugach elected to enter into long term contracts at a low price should not deprive the royalty owners--in this case, all Alaskans--of their right to receive a fair royalty.

Contrary to Chugach's claims, Enstar Natural Gas Company and Municipal Light and Power are not involved in this royalty dispute, and will not "be in line for an additional royalty surcharge." Nor is the department asking Chugach to pay royalties which are up to 17 times higher than the Beluga royalties reported by the lessees. The department is asking the federal government to follow its own precedents, law and regulations to ensure that the state receives its fair share of their royalties.

While Chugach would urge us to turn a blind eye to the federal government's under collection of royalties in order to benefit Chugach's customers, we simply cannot. Under state law, our obligation is to ensure the collection of all oil and gas revenues for the benefit of those in Barrow and Ketchikan, as well as in Anchorage. Any subsequent decision to subsidize one area's utility costs relative to others is the responsibility of the legislature.

Sincerely,



James E. Eason
Director
Alaska Division of Oil and Gas

Back-up

REGAL ALASKAN HOTEL
ANCHORAGE

March 1, 1993

Senator Drue Pearce
State Capitol, Room 508
Juneau, Alaska 99801-1182

Dear Senator Pearce,

I am writing to advise you of my support of HB 116 and SB 104. As a commercial user of Chugach Electric Association's product, I find it incredulous that a retroactive royalty is being pushed by the Department of Natural Resources. I would like to compare this philosophy to any business for a moment. Suppose I sold my customers a product at an agreed upon price, accepted payment for services, then came back to my customer 8 years later and said, "Oh, by the way, the price I charged you for my services 8 years ago wasn't fair value. I need more money". You know the kind of response I would get from any customer to this kind of scenario. Why should the Department of Natural Resources be able to change the agreement and retroactively burden customers who are trying to meet their obligations to a supplier? How is a business supposed to responsibly plan on meeting it's financial obligations if actual costs are unknown?

Please support HB 116 and SB 104 and resolve this ludicrous attempt to harass Chugach Electric Association and its customers into paying a surcharge we really don't owe. This has gone on far too long already. Thank you for taking this time to read my concerns on this issue.

Sincerely,

Max J. Lowe

Max J. Lowe, CHA
General Manager
Regal Alaskan Hotel

Correspondence

cc: David L. Highers

CHUGACH ELECTRIC
ASSOCIATION, INC.

January 25, 1993

Representative Bill Williams
Alaska State Legislature
Capitol Room 128
State Capitol
Juneau, AK 99801-1182

Dear Representative Williams:

Chugach is seeking to introduce legislation that will help resolve a royalty dispute that we are involved in with the Department of Natural Resources (DNR) concerning the valuation of federal royalties for natural gas that Chugach purchased at the Beluga River field. Chugach thought that this issue had been resolved in 1986 when legislation (AS 38.05.180(aa)) was passed. That legislation provides legislative guidance to DNR in valuing royalties for gas and electric utilities. Unfortunately, the current DNR administration has chosen to interpret the statute verbatim and is now disregarding the legislative intent that was behind the law. In so doing, the current DNR administration has flip-flopped the agency's position and is now apparently in disagreement with the intent behind the legislation that it fully supported in 1986.

If DNR prevails in its pursuit of increasing federal royalties for Beluga gas for prior years (1984-1992), electric rate-payers from Homer to Fairbanks will be asked to pay more than $21 million dollars in additional royalties. At issue today are the federal royalties for the years 1984-87 totaling $12.4 million. However, if DNR applies the same logic to future years (1988-1992), Chugach rate-payers would be liable for an additional $9 million. Chugach, which is a member-owned cooperative, will have no choice but to pass these additional costs on to our ratepayers (roughly two-thirds of the states population) through some type of rate surcharge. Unfortunately, today's customers would be forced to pay additional royalty payments for inexpensive natural gas that they may not have been here to use. This is not reasonable, and Chugach firmly believes that by making royalty demands that they know will simply be passed on to the consumers that the agency is actually trying to impose a tax on the Alaska public without any notice to them, and without the legislature's involvement.

5601 Minnesota Drive • P.O. Box 196300 • Anchorage, Alaska 99519-6300
Phone 907-563-7494 • FAX 907-562-0027

I have enclosed copies of the "white paper" that details the issue which we have prepared for you and your staff to review. The thin document contains the history of the issue, rate impacts to the railbelt for the 1984-87 time period, a draft bill that would resolve the problem and a section by section analysis of the bill. The thicker document is merely a compilation of the attachments to the white paper which provides back-up information on the issue.

We have already approached several legislators who have expressed an interest in this issue and we hope to have a bill sponsored in the very near future. I hope you can join us in supporting the legislation. Please feel free to contact Dan Bloomer, my Executive Staff Assistant, at 762-4595 if you need any additional information.

Sincerely,

David L. Highers
General Manager

Enclosures

STATE OF ALASKA

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

400 WILLOUGHBY AVENUE
JUNEAU, ALASKA 99801-1796
PHONE: (907) 465-2400
FACSIMILE: (907) 586-2754

February 23, 1993

The Honorable Bill Williams, Chairman
House Resources Committee
Alaska State Legislature
State Capitol Building, Room 128
Juneau, Alaska 99801-1182

Dear Representative Williams:

I am responding to your request for additional information concerning whether HB 116 is precedential in any nature and how any royalty revenues that might be foregone through implementation of that legislation would otherwise have been distributed.

The proposed legislation is precedential on at least two points. First, passage of this legislation would result in the requirement that the department accept contract prices for certain gas produced from federal leases regardless of whether or not those values represent the full royalty value to which the state would otherwise be entitled absent this legislation. Secondly, to the best of my knowledge, making the effective date of HB 116 retroactive to January 3, 1959 would also be precedential.

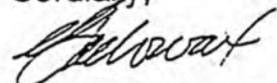
The 1986 amendments to AS 38.05.180 were similar to the proposed legislation in their effect on the royalty valuation for production from state-owned lands. However, the 1986 amendments differ in the timing of their applicability. Unlike the proposed amendments, the 1986 amendments were not retroactive. The contract price for the gas was not binding for royalty purposes until a new contract was negotiated, in this case after 1986. The 21 cents per MCF contract price in effect in 1986 was not accepted as the royalty value. Rather, a settlement value of 75 cents per MCF was used as the royalty value until 1989 when Chugach negotiated a new contract with the Beluga River field lessees.

)-J9LH

Finally, as to the allocation of any royalty revenues which may be foregone as a result of the application of those proposed legislation, 74.5% would be allocated to the General Fund, 25% to the Permanent Fund, and 0.5% to the School Fund.

Please feel free to call if you have any additional questions.

Cordially,



Glenn A. Olds for
Commissioner

GAO/sf

cc: House Resource Committee members
Representative Mark Hanley

Homer Electric Association, Inc.

CORPORATE OFFICE
3977 Lake Street
Homer, Alaska 99603-7680
Phone (907) 235-8167
FAX (907) 235-3313

[illegible] Service Center
[illegible] Airport Way
[illegible] 5280
[illegible] 996[illegible]-5280
Phone [illegible] 283-[illegible]
FAX [illegible] 283-7[illegible]

February 18, 1993

William K. Williams, Chairman
House Resources Committee
Alaska State House of Representatives
PO Box V
Juneau, AK 99811

Dear Chairman Williams:

RE: HB 116, STATE SHARE OF FEDERAL GAS ROYALTIES

Homer Electric Association serves over 18,000 consumers on the Kenai Peninsula. Most of the power that was previously used and the power that is currently used is supplied by gas-fired turbines.

HB 116 will stop the Department of Natural Resources' attempt to collect its gas royalties on gas previously used and would eliminate future collection attempts via repricing gas and assessments of royalties. This will guarantee that HEA consumers will not be unfairly assessed for gas royalties in the future.

On behalf of HEA, I ask that your committee favorably report HB 116.

Sincerely,

HOMER ELECTRIC ASSOCIATION, INC.

N L Story /LB

N. L. Story
General Manager

NLS\HRC.ltr/lwb
cc: Representative Mark Hanley
Representative Gail Phillips
Representative Mike Navarre
Representative Ron Larson
Representative Parnell
Representative Joe Green
Dave Highers, CEA
Dave Hutchens, ARECA
HEA Board of Directors
NLS-rf H/K

Matanuska Electric
Association, Inc.

P.O. Box 2929
Palmer, Alaska 99645
Telephone: (907) 745-3231
Fax: (907) 745-9328

February 18, 1993

The Honorable William K. Williams
House of Representatives
State Capital Building
Juneau, Alaska 99801-1182

Dear Representative Williams:

Thank you for the opportunity to testify on behalf of House Bill 50 and 51 last week. The interties are important to continuing the quality of electric service to over 70 percent of this state's citizens.

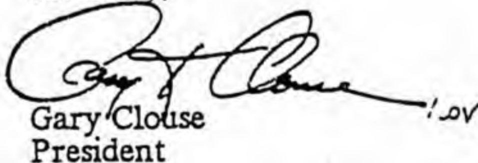
Likewise, we are writing today to support House Bill 116 to resolve a retroactive gas royalty issue for those citizens as well. We understand this Bill will come before the House Labor and Commerce Committee this week.

The Department of Natural Resources has been seeking to retroactively assess several million dollars in added royalties to the Cook Inlet field natural gas consumers. As you know, the electric utilities are big users of this natural gas. These added charges will create a tremendous burden on our electric customers. Our nonprofit status and the state rate making rules require us to pass along these wholesale power costs directly to our customers.

Some large loads, like the State of Alaska, school districts, local governments, and businesses will see large increases in their electric costs should the DNR procedure be allowed to stand. For example, the electric costs to the state would be increased several hundred thousands of dollars. On behalf of our customers, we ask your support of the amendments to the Alaska statue proposed in House Bill 116. The passage of this Bill will keep us from making large changes in the cost of electricity sold several years ago to citizens, government agencies, and businesses within the state.

Thank you for your continued support on these vital issues of legislation. Please share this letter with the members of the House Labor and Commerce Committee, as we are unable to testify in Juneau this week.

Sincerely,



Gary Clouse
President

sv
101.930218.390
cc: Members of the House Labor and Commerce Committee
David Highers, CEA
Norm Story, HEA
David Hutchens, ARECA

GOLDEN VALLEY ELECTRIC ASSOCIATION INC. Box 71249, Fairbanks, Alaska 99707-1249, Phone 907 452-1151

February 23, 1993

Mr. Dave Highers
General Manager
Chugach Electric Association
P.O. Box 196300
Anchorage, Alaska 99519-6300

SUBJECT: Royalties for Natural Gas

Dear Dave:

At their meeting on February 22, 1993, the Board of Directors of Golden Valley adopted the following resolution:

WHEREAS, House Bill 116 has been introduced to amend AS 38.05.180 (An Act directing the commissioner of natural resources to accept, under certain circumstances, the contract price agreed to between a lessee of federal land and a gas or electric utility as the value of the federal government's royalty share from natural gas production when royalty is payable to the state under applicable federal law; and providing for an effective date.); and

WHEREAS, Golden Valley Electric Association supports this legislation;

THEREFORE, BE IT RESOLVED, that the Board of Directors of Golden Valley Electric Association, Inc. encourages the Fairbanks/Interior legislators to support House Bill 116.

We will contact the Interior legislators regarding this resolution.

Best regards,

Robert Hansen

Robert Hansen
Acting General Manager

An Analysis of the Department of Natural Resources' Demand for Additional Beluga River Royalty Payments from Railbelt Utility Consumers

An Analysis of the Department of Natural Resources' Demand for Additional Beluga River Royalty Payments from Railbelt Utility Consumers

Prepared for Chugach Electric Assn., Inc

by

BIRCH, HORTON, BITTNER and CHEROT
Jon K. Tillinghast
Juneau, Alaska

January, 1993

I. Introduction

The Alaska Department of Natural Resources ("DNR") has asked the federal Minerals Management Service ("MMS") to retroactively assess additional royalties against natural gas production from federal leases in Cook Inlet's Beluga River Unit. [1]/ Chugach Electric Association, Inc. purchases gas from the Beluga River producers; would likely be liable for those royalties under its purchase agreements; and would necessarily pass any resultant costs on to its Railbelt consumers, probably through some form of rate surcharge. [2]/

For the period covered by DNR's demand--October, 1984 through June, 1987 (the "demand period")--the estimated amount of the potential royalty assessment, and hence the potential rate surcharge on Railbelt consumers, is $12.4 million. [3]/ An additional $9 million surcharge could result if DNR makes a similar demand for subsequent years. [4]/

This paper discusses the history of the Cook Inlet gas royalty controversy, as it applies to public utilities, as well as the impact of DNR's current demand on Railbelt consumers. The point here is that DNR's actions are irreconcilably inconsistent with longstanding state policy favoring the acceptance of the contract price as the "value" of royalty gas when that gas is purchased by a public utility at arm's-length.

That policy is engrained in AS 38.05.180(aa), a 1986 statute which generally requires DNR to accept the utilities' contract price for state royalty purposes. DNR vigorously supported that legislation. As DNR itself explained, the legislation was

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[1]/ The state would receive 90% of those federal royalties through the revenue-sharing provision of 30 U.S.C. §191.

[2]/ Any rate surcharge would need to be approved by the Alaska Public Utilities Commission.

[3]/ This figure includes the principal amount the retroactive royalties, as well as interest through December 31, 1992.

[4]/ Estimating the potential cost of retroactive royalty demands for subsequent years is difficult because of DNR's methodology for computing those royalties (*see* Section IV, *post*).

warranted because, in the case of sales to utilities, the long-term contract price actually r[illegible]ented the gas' "value"; accepting the contract price was in the public intere[illegible] a higher "value" assessment would both unduly harm Railbelt consumers and inject damaging uncertainty into utilities' fiscal planning.

In 1986, DNR advanced seven different reasons why Alaska was best served by accepting the contract price when gas was sold to public utilities, and this paper is subdivided into those same seven themes. Subsections III(A)-(G) look back to 1986, recounting DNR's words on each of these seven policies. Subsections IV(A)-(G) then apply each of those policies to DNR's current initiative.

The lesson of that exercise is obvious: public utilities, and indeed the legislature, thought they had settled the Cook Inlet royalty gas issue with the 1986 legislation. DNR, however, feels it has found a loophole in that law, allowing it to resurrect the dispute for federal Beluga gas royalties. In so doing the agency is both disavowing a position that has survived three successive administrations, and threatening to cause the same unpleasant impacts on the Alaska economy that it fought so hard, in 1986, to avoid.

All of which suggests the need for clarifying legislation to ensure that the 1986 law achieves its intended purposes. Leaving aside royalty "valuation" issues generally, the issue of valuing Cook Inlet royalty gas raises special concerns that, as DNR itself has long maintained, demand tailored treatment. This subset of Cook Inlet gas production represents a minute fraction of the state's royalty receipts; however, to Railbelt consumers, the financial impacts of royalty revaluation would impose a considerable burden on an already fragile regional economy.

II. The Nature of the Current Controversy

This is an unusual royalty dispute. Although nominally imposed on the Beluga River producers, DNR is well aware that these retroactive royalties, if assessed, will be paid by individual Alaskans. As a result, this is not so much a demand for more royalties, but rather an effort to impose a hidden tax--one levied without public or legislative involvement.

DNR's theory is that the "value" of Beluga gas is higher than the price at which royalties were originally paid, and that royalties are due on the higher amount. Chugach has purchased Beluga gas from the unit's three producers--ARCO Alaska, Inc.; Chevron U.S.A. Inc.; and Shell Oil Co.--under long-term sales contracts since 1965. During the demand period, gas was sold under those contracts at $.21/mcf, and royalties were paid on that amount. [5]/ DNR is asking MMS to retroactively value the Beluga River royalty gas that was sold to Chugach at over $2/mcf.

There is a good reason why Beluga actually sold for $.21/mcf during the demand period. The Beluga River field was discovered in 1962, but there was no available market for it. Unlike oil, natural gas can't easily be stored or transported, but requires a costly gathering and distribution system. No prospective purchaser would invest in such a system unless it is assured of a long-term supply of gas at what are then-reasonable prices. As a result, purchasers needing to construct such a system normally require long-term purchase contracts. [6]/

The need for such a contract was particularly acute at Beluga. Chugach proposed to build a generating facility at Beluga, and then transmit the electricity

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[5]/ "Mcf" means "thousand cubic feet."

[6]/ *See* Foster v. Atlantic Refining Co., 329 F2nd 485, 488 (5th Cir. 1964) ("The practicalities of the gas industry require that gas be sold under long-term contracts because the pipelines must have a committed source of supply sufficient to justify financing, construction, and operation.")

to Anchorage. The capital investment for that facility has been about $130 million, and the contract price ($.16\mcf originally, and increased to $.21\mcf in 1973) was an integral part of the financial prospects justifying that investment.

At all times, the long-term contracts between Chugach and the producers were negotiated at arm's length. Both won considerable value. Chugach received a long-term price that justified financing of power generation facilities. The producers won an otherwise non-existent market for their gas.

Railbelt Alaskans, of course, also benefitted considerably from that contract. As Chart I shows, during the period at issue here--the mid-1980's--Chugach, despite the higher cost of providing virtually any service in Alaska, was able to supply power to Railbelt Alaskans at less than the national average.

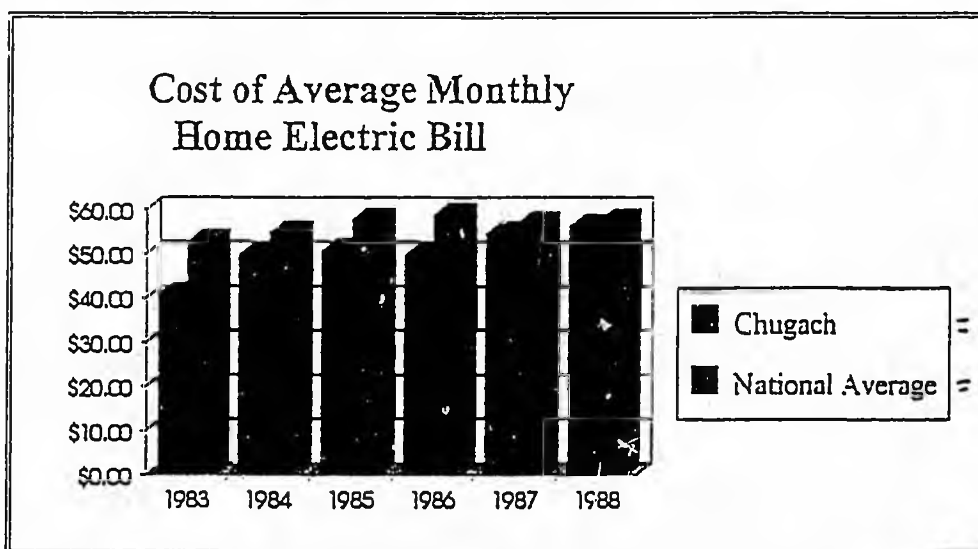

CHART 1: SOURCE: Chugach Electric retail rate history; Energy Information Administration--Typical Electric Bills

It is this contract, and the benefits that flowed from it, which DNR now wishes MMS to disregard, imposing royalties instead at about 10 times the price actually paid by Chugach to the producers.

To date, MMS has refused DNR's demand, because federal law generally fixes royalty payments at the sales contract price, particularly where--as here--the

contract was arm's length. DNR has, however, appealed MMS' position to a higher level within that agency.

III. Since 1986, DNR and the Legislature have pursued a consistent state policy of accepting the long-term sales price to public utilities as the "value" of royalty gas

As Chart 2 shows, Cook Inlet gas is sold for a variety of purposes, under a variety of very different contracts. The prices charged under those contracts are dependent on a range of factors, including: the existence (or nonexistence) of competing buyers; contract volume and term; when the contract was entered into; the purchaser (whether or not related to the seller); and the purpose and destination of the sale.

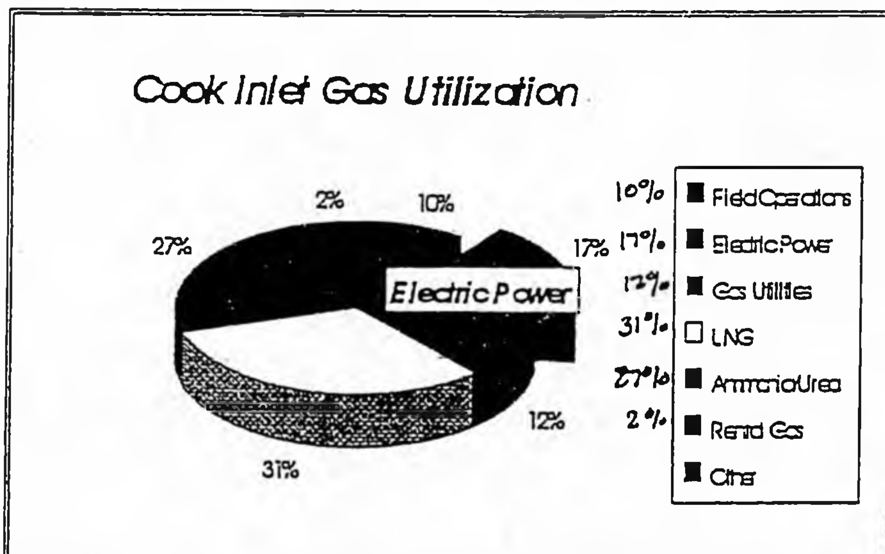

CHART 2. SOURCE: Ak. Dept. of Natural Resources, "Historical and Projected Oil and Gas Consumption," April, 1992.

The four major gas producing fields in the Inlet are North Cook Inlet, Beluga, McArthur River and Kenai. The principal historical producers and purchasers of those fields are displayed in Chart 3.

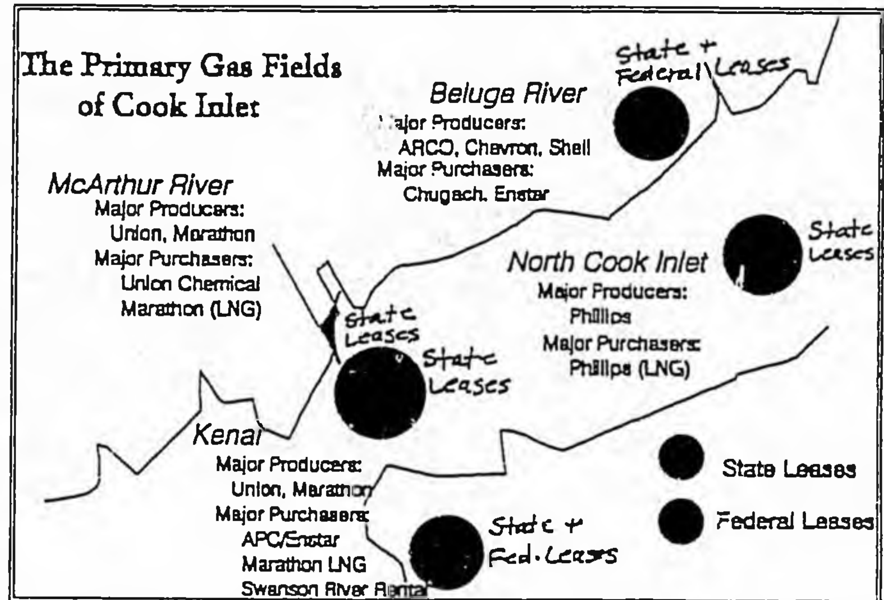

CHART 3

DNR or MMS, as the case may be, generally holds a 1/8th royalty on leases in these fields. Rather than take that royalty gas "in kind," DNR and MMS require the producers to pay them for 1/8th of total production from the field. And historically, producers have paid those royalties based upon the price that they received from buyers of that gas.

Beginning in the mid-1980's, MMS began revaluing Cook Inlet royalty payments, focusing on Union and Marathon's production from the Kenai field. And in 1984, the state entered into a valuation agreement for Phillips' LNG sales from the North Cook Inlet field.

Then, on March 18, 1985, DNR issued a "Notice to Lessee," announcing that, prospectively, it would no longer accept the long-term contract price for Cook Inlet gas production, including that from Beluga River. Attachment 1. DNR believed that it was required to assign a higher "value" to royalty production as a matter of law. "This is a lease enforcement action," DNR said, "and it is not optional." 7/

7/ Statement by Esther C. Wunnicke, Commissioner, DNR, to Anchorage Caucus, April 2, 1985 at 4. Attachment 2.

Later in 1985, the MMS and DNR settled much of the Kenai field controversy. Royalties due on Union's Kenai dispositions to its chemical plant, and to the Swanson River field under a rental agreement, were settled with both governments in November, 1985; and royalties due on Union and Marathon's contract with Alaska Pipeline Company were settled the next month. Also in 1985, Marathon settled with DNR on royalties due from Kenai LNG sales.

The dispute over royalties due on sales of Beluga River gas to Chugach Electric Assn., however, did not settle. Royalties had been paid on that gas at the contract price of $.21/mcf; the state, conversely, asked for prospective royalties of $2.05/mcf. In response, Chugach, and the Beluga producers, filed suit in state superior court. [8]/

DNR Commissioner Wunnicke conceded at the time that DNR's new position "is not a popular decision." Attachment 2 at 1. Although technically imposed on the Beluga producers, DNR's proposed new royalties would actually fall on Chugach because of a "pass through" clause in Chugach's purchase contracts. *See, e.g.*, Attachment 3. And those costs in turn would be passed to Chugach's consumers. At the time, Chugach estimated a $3 million/year rate increase from DNR's proposal. [9]/

The legislature's response to the agency was SB 309, introduced by Senators Vic Fischer, Kelly and Faiks. As originally drafted, the bill would require acceptance of the contract price for *all* long-term gas sales--not just those to utilities. Attachment 5. For that reason, DNR opposed it. [10]/

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[8]/ ARCO Alaska, Inc. *et al.* v. State of Alaska, 3AN-85-6218, 7617, 7633 (Consolidated) Civ., Ak. Superior Ct., Third Judicial Dst.

[9]/ Presentation of Chugach Electric Assn. to Senate Resources Committee, 1986 at 1. Attachment 4.

[10]/ Letter, Commissioner Wunnicke to Drue Pearce, April 28, 1986 (Attachment 6). The letter explains why DNR opposed original SB 309, but supported subsequent committee substitutes. The principal reason, according to Wunnicke, was that while it was "appropriate to accept a

The Senate Resources Committee, however, confined the legislation to royalties on gas sold to regulated utilities, and DNR enthusiastically embraced the bill. DNR had always wanted, according Wunnicke, to accept the contract price when utilities were involved; the problem, she said, was that it was "constrained even in that kind of settlement talk by the legislative directive that they obtain fair market value." 11/

Throughout legislative deliberations on SB 309, DNR continually stressed seven themes:

A. DNR believed that it was pennywise and pound foolish to extract a few extra royalty dollars at the price of burdening Southcentral's economy. Accepting the contract price as the royalty value for public utilities was good policy, DNR said, "because Alaska consumers would be the direct beneficiaries of any royalties lost to the state as a result of using solely the contract price to establish royalty value." 12/ The Attorney General agreed:

> SB 309 is intended to directly benefit Alaska consumers by providing additional price certainty for gas sold to consumers and for gas sold to generate electricity for consumers. The Alaska consumers would also be the beneficiaries of any royalties foregone by the state, because the lower royalties would result in lower electric and gas bills.

Letter, Atty. General Brown to Gov. Sheffield, May 28, 1986 at 2 (Attachment 8); *see also* Minutes, Senate Rules Committee, Feb. 27, 1986 at No. 155 (Attachment 9) ("Kay Brown says that the Department of Natural Resources policy has been to benefit consumers."); Minutes, House Finance Committee, May 10, 1986 at 051086 (Attachment 10) ("Ms. Brown said with the House Finance proposed

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contract price as the royalty value for arms-length sales to regulated utilities," the original bill did "not distinguish between consumer and industrial uses."

11/ Minutes, Senate Resources Committee, 2/10/86 at No. 353. Attachment 7.

12/ Attachment 6 at 1-2.

Committee Substitute, the state was giving up some contract rights in order to benefit consumers directly. She said the department feels that is proper because any of the royalties that are lost would go directly to benefit citizens in Alaska."); Letter, Wunnicke to Rep. John Sund, May 18, 1986 (Attachment 11) ("The department believes it is appropriate to accept a contract price as the royalty value for arms-length sales to regulated utilities...because Alaska consumers would be the direct beneficiary...").

As Commissioner Wunnicke summarized in a letter to Rep. Richard Shultz:

> The Department ***strongly supports*** the bill as it has come to the Committee. [The benefits of accepting the utilities' contract price] will affect up to 270,000 gas and electric customers in Alaska and in future years if gas production occurs elsewhere in the state, we can expect even broader benefits from use of the state's royalty gas.

April 22, 1986 (Attachment 12) at 1; emphasis added.

B. DNR concluded that accepting the utilities' contract price would yield the state full "value" for its royalty gas, and therefore accepting that price was in the "best interest" of the state. As we have seen, DNR explained its 1985 Notice to Lessee by arguing that it was legally compelled to seek full "value" for its royalty gas. However, in legislative debates on SB 309, the agency conceded that accepting the utilities' contract price would yield the state full "value," since any lost royalties would flow directly to Alaska consumers:

> Commissioner Wunnicke stated that since the beneficiaries of the legislation are in-state, nonprofit, or government owned utilities or cooperatives, the state would not lose its fair value for its resources.

Minutes, Senate Resources Committee, Feb. 19, 1986 at No. 180 (Attachment 13); *see also* Attachment 10 at 051086. For this reason, in the final legislation the legislature made the finding that:

> ...the best interest of the state will be served if the commissioner of natural resources is authorized to establish the in-value royalty for gas sold to a gas or electric utility by using the contract price between the lessee of the state and the utility, whether or not the gas lease establishes a different standard for the valuation...

Sec. 1, Ch. 55, SLA 1986. In its March 3, 1986 analysis of the legislation, DNR concurred with that finding. Attachment 14. And the Attorney General, in his review of the legislation, concluded that the legislation offended no constitutional mandate to receive "full fair market value" for the royalty gas. Attachment 8 at 2.

C. *DNR argued that utilities' sales contracts presented a unique situation requiring tailored royalty treatment.* Over the years, DNR has devoted considerable effort, and achieved considerable success, revaluing other royalties based upon the "value" concept. And DNR fought hard during the 1986 legislative session to retain the authority to pursue that general state policy--indeed, and as we have seen, DNR opposed original SB 309 because it would have required acceptance of the contract price for a broader range of royalty controversies.

The agency, however, strongly believed that an exception should be made for utilities' contracts, and that sound public policy warranted that distinction. In explaining her department's opposition to original SB 309, and its support for later substitutes, Commissioner Wunnicke explained:

> The [original] bill does not distinguish between consumer and industrial uses...The effect of the bill would be to require use of a contract price in virtually all cases.

> The department believes it is appropriate to accept a contract price as the royalty value for arms-length sales to regulated utilities...because Alaska consumers would be the direct beneficiaries of any royalties lost to the state...The department is not persuaded that industrial gas uses should receive the same exemption, since the likely effect would be to increase the profits of industrial concerns without a corresponding public benefit.

Attachment 6 at 1-2; *see also* Attachment 10 at 051086 (DNR "did not believe it was a good idea to forego the contract rights, or forego the intent [sic] of future income, for other types of sales."); Attachment 12 at 1.

The limited application of the bill, DNR stressed, did not make this "special interest" legislation:

> The Bill is not a "special interest" rewrite of the state's royalty valuation policy. The benefits that would accrue under the Bill would benefit more than three-quarters of the state's citizens.

Letter, Wunnicke to Sen. Sackett, March 3, 1986 at 4 (Attachment 22).

Apart from the logical distinction between royalty settlements that would benefit Alaskans dollar-for-dollar, and settlements that would not, the limitations of SB 309 minimized its fiscal impact. Indeed, DNR gave the legislation a "zero" fiscal note. *Id.*

D. DNR wanted to avoid the uncertainty caused by a rejection of the utilities' contract price. Even in its internal deliberative process leading to the 1985 Notice to Lessee, DNR acknowledged that, by refusing to accept the contract price for utilities' sales, the agency was injecting damaging uncertainty into utility planning:

> The fluctuation of royalty value independently of the contract price under which gas is sold injects uncertainty into the long-term planning by oil companies and utilities. This uncertainty (and higher

> royalty rates) may reduce incentives to invest capital in oil and gas and utility enterprises, or affect the timing or structuring of such enterprises.

Kay Brown to Wunnicke memo, Nov. 6, 1984 at 3. Attachment 15.

In its testimony on SB 309, Chugach stressed the uncertainty created by DNR's 1985 Notice to Lessee, which announced for the first time that the state would no longer base royalties on the contract price:

> Our commitment to build generation facilities at the Beluga gas field back in 1965 was able to occur only because we had signed long-term contracts ensuring the stability of the price for that Beluga River gas. In fact, had we been unsuccessful in obtaining long-term contracts ensuring stable fuel prices, we would have been unable to make that plant investment.

Testimony of Dr. Joyce N. Murphy, Senate Resources Committee, Feb. 10, 1986 at 4 (Attachment 16). As a result, Chugach stressed the need for a full and final legislative settlement of "the underlying royalty policy question." *Id.* at 6. ***"A lasting solution"*** is what Chugach sought. *Id.*; emphasis added.

DNR agreed. In fact, Commissioner Wunnicke warned the Senate Resources Committee that "***there is some urgency*** in passage of this bill as the utilities are already in negotiations for future long-term contracts." Attachment 13 at No. 103; emphasis added.

Thus, DNR frequently cited the price "certainty" resulting from accepting the contract price--both to utilities and their customers--as a principal reason for its support of the bill. Attachment 14 at 1 (SB 309 "will allow the state to provide certainty in royalty gas valuation for Alaska consumer uses..."); Attachment 11 at 1 ("Alaska consumers would be the direct beneficiaries of the certainty of price..."); Attachment 8 at 2 ("SB 309 is intended to directly benefit Alaska consumers by providing additional price certainty...").

And, the legislature itself thought the bill would provide that certainty. According to the Senate floor statement, SB 309 would "provid[e] long term price stability for southcentral and railbelt electric consumers." Attachment 20 at 1.

E. DNR wanted to avoid an adversarial relationship with the Railbelt's principal utility. As discussed earlier, Chugach sued the state in response to the 1985 Notice to Lessee. Chugach and DNR settled that dispute "in principle" at a royalty price of $.75/mcf--a number closer to the long-term contract price than the $2.05/mcf sought by DNR through its "value" methodology. Attachment 17. [13] However, that settlement was contingent on passage of SB 309. *Id.* The bill was needed to effectuate that settlement, DNR said (*id.*); and, as the Attorney General advised, the legislation "will eliminate the expenses and uncertainty of that litigation for the state, Chugach Electric Association, Inc., and consumers." Attachment 8 at 2.

F. DNR believed that AS 38.05.180(aa) created a legislative definition of value for royalty gas sold to utilities, even if the particular controversy was not within the scope of the statute. The significance of this position will become apparent when we explore DNR's recent about-face in the next section of this paper.

As finally enacted by SB 309, AS 38.05.180(aa) required acceptance of the utilities' contract price only when the purchase contract was "entered into on or after the effective date of this Act." Sec. 5, Ch. 55, SLA 1986. But the Chugach purchase contract which was the subject of the settlement described in (E), *ante*, pre-dated the statute. By a strict reading of its terms, then, SB 309 would not "authorize" the Chugach settlement.

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[13]/ *See also* Attachment 13 at No. 103; Minutes, House Rules Committee, May 11, 1986 at No. 128 (Attachment 18).

But DNR, as we know, said it would--and for good reason. Whether or not the particular controversy was within the scope of the new statute, said DNR, new AS 38.05.180(aa) provided a legislative definition of "value" for *all* gas royalty controversies involving long-term sales contracts to utilities. In response to a question from Senators Fahrenkamp and Sturgulewski as to how a prospective bill could help settle a dispute over a pre-existing contract, Commissioner Wunnicke explained:

> The commissioner stated that the agreement they have made [with Chugach] is in settlement of litigation and should not be seen as a difference in policy. She said it is DNR's responsibility to get fair market value. Efforts to reach agreement in the litigation have been constrained by this responsibility. ***If the legislation under discussion passes, she will interpret that as direction that a long-term contract entered into with a nonprofit electrical cooperative or municipal utility will be guidance for determining market value.***

Attachment 13 at No. 068; emphasis added.

G. DNR opposed the assessment of royalty delinquencies involving utility contracts retroactively. If DNR revalued royalties paid in previous years on the basis of a long-term utility contract, a troubling unfairness would result. The customers who consumed that royalty gas would have paid for the gas at the lower rate. But any rate surcharge imposed to compensate for a royalty revaluation would be paid for by today's consumers. Simply put, today's customers would be required to pay for other people's prior use of electricity.

DNR recognized that unfairness as early as its March 18, 1985 Notice to Lessees--the one announcing the agency's short-lived policy of disregarding the contract price. The effective date of that Notice was April 1, 1985, the agency explaining:

> ...[T]he state has elected to enforce this policy prospectively only in order to reduce conflicts and to avoid certain difficulties associated with retroactive adjustments of these royalties.

Attachment 1 at 1. DNR then postponed the effective date yet another two weeks, and explained why to the Anchorage Caucus:

> I decided not to seek retroactive royalty payments based on current market values. For both the retroactive and prospective periods, the gas sales contracts between the producers and the utilities provide that royalty adjustments will be passed through to Enstar and Chugach Electric. Prospective collection can be implemented in an orderly fashion. However, retroactive collection would create significant legal and financial risks for the state's utility companies, including Chugach--a consumer cooperative. In particular, it is uncertain how, and to what extent, retroactive royalty collections could be passed through to consumers.

Attachment 2 at 3.

H. Post-enactment events seemingly put the Cook Inlet gas issue to rest. With the enactment of SB 309, and subsequent Cook Inlet settlements, it seemed as though the disruption caused by DNR's 1985 Notice to Lessee had finally been laid to rest. On September 26, 1986, Chugach and the producers settled with DNR on the value of royalties from state leases at Beluga River. In 1989, Chugach and the Beluga producers entered into a new long-term contract, and on December 4, 1989, DNR Commissioner Gorsuch agreed to use that contract's price to determine royalty values. Attachment 19.

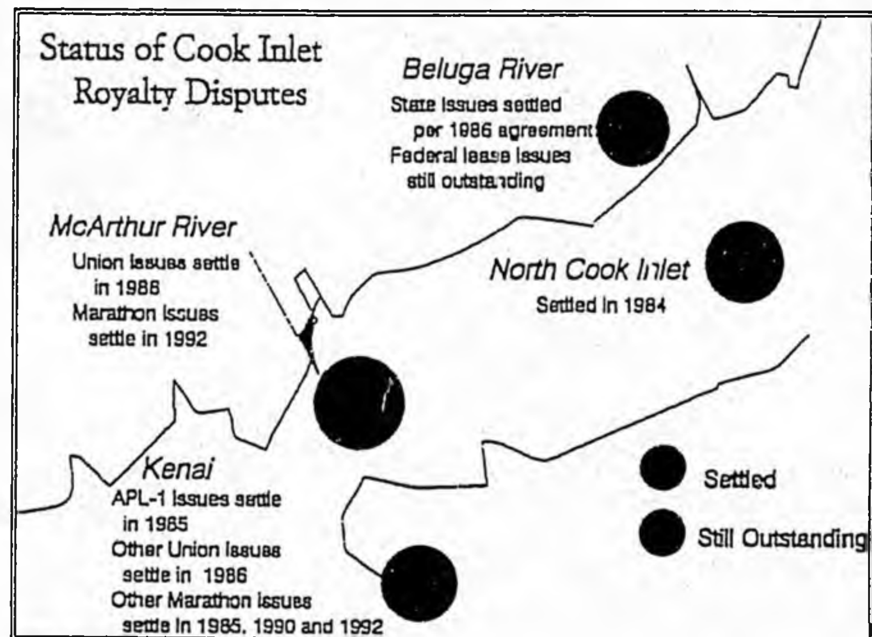

CHART 4

This, combined with settlements involving the other major Cook Inlet gas fields, laid the entire region's royalty disputes at rest, save for a routine federal audit of the royalties paid on MMS leases in the Beluga River Unit. *See* Chart 4. It is through this last vestige of a once-divisive controversy that DNR has now chosen to disown long-standing state policy on Cook Inlet gas sales to utilities, and pick a fight.

It is to that recent action that this paper now turns.

IV. DNR's current initiative against Chugach is contrary to every principal adopted by the agency in 1986.

From October, 1984 through June, 1987, the Beluga River producers (and hence Chugach and Railbelt consumers) paid royalties to the federal government on two federal Beluga River Unit leases according to the long-term contract price established in the Chugach contract--$.21/mcf. This was the same amount paid to the state--with its acquiescence--until the April 15, 1985 effective date of the Notice to Lessee. [14]/

This was also the amount called for by federal law. DNR concluded long ago that "[t]he federal lease forms are different from the state forms, and different standards and procedures apply." [15]/ Whatever state leases might require (absent AS 38.05.180(aa)), federal law generally accepted arm's-length long-term contract prices during the 1984-86 demand period. [16]/

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[14]/ After that date, and pursuant to the Chugach/DNR settlement of state lease royalties, DNR received $.75/mcf for Beluga River state leases.

[15]/ DNR, "Questions and Answers on Cook Inlet Royalty Gas," April 11, 1985 at 7. Attachment 21.

[16]/ A 1977 U.S. Geological Survey Notice to Lessee, NTL-5, generally required the federal government to accept the intrastate Chugach contract price, as long as it exceeded $.18/mcf. 42 *Fed. Reg.* 22610. While NTL-5 also contained a provision for increasing the royalty above the contract price when market conditions demanded, that Notice was modified by the federal "NTL-5 Act of 1987" for any production between 1982 and July 31, 1986. P.L. 100-234. Under that Act, "MMS could, and in most cases should, accept as royalty value contract prices which were dictated by the market and which would be lower than the highest price paid for a major portion of production." *Cong. Rec.* S18631, *daily ed.*, Dec. 21, 1987.

For production subsequent to July 31, 1986, MMS issued new regulations. In explaining those regulations, MMS stressed that, even for prior production, "it was the Department's intent to recognize contract price as the value for [intrastate sales under pre-1977 contracts]...MMS believes that it would be inequitable to rescind these provisions and possibly subject such sales to significantly increased royalty values." 51 *Fed. Reg.* 26760 (July 25, 1986). MMS' current regulations, effective March 1, 1988, straightforwardly provide that royalties shall be based on "the gross proceeds accruing to the lessee," as long as the contract proceeds were negotiated at arm's-length. 30 C.F.R. §206.152(b)(1)(i). *See* Mandell-Rice, *Federal Gas and Gas Products Valuation Regulations*, Paper No. 5, Royalty Valuation and Management, Rocky Mountain Mineral Law Foundation (1988).

In 1989, MMS began a routine audit of the producers' royalty payments. In late 1989, DNR informed MMS that it wished to participate in that audit, and in 1991 wrote MMS a lengthy letter demanding that the federal agency disregard the Chugach contract price, and retroactively assess over $10 million in additional royalties on the basis of a higher royalty "value." MMS rejected the state's demand, and the state, on March 11, 1992, appealed to a higher level within the agency. [17]/

> ***DNR's Royalty Theory, and Its Overreaching Use of that Theory***
>
> *DNR would recompute Beluga River royalties based on the so-called "median value analysis." Under this analysis, MMS would find "the highest price* ***paid*** *for a majority of like quality gas produced in the* ***field or area.****"* 42 Fed. Reg. 22611, May 4, 1977; *emphasis added. In other words, MMS would find that price at which, or below which, more than half of the gas in the "field or area" was sold. That would become the royalty "value."*
>
> *In its arguments to MMS, DNR would use all of Cook Inlet as the "field or area" from which to find this "value." Far more troubling are the "prices" that DNR would use. DNR would not use the prices actually "paid" at the time for other gas. Rather, it would use the settlement value for this other gas achieved through after-the-fact litigation. In other words, DNR, having forced other producers into settlements favorable to the agency, would then bootstrap those settlements by using them as the measure of Beluga River royalties.*

DNR's appeals are currently awaiting a preliminary determination by MMS as to whether the state may appeal an audit determination. MMS' regulations make no provision for third party appeals--the audit being a matter between MMS and the lessee. 30 C.F.R. §290.2. The initial question, then, is whether DNR is being officious.

The most troubling aspect of DNR's attempted appeals, however, is that they offend clear legislative direction given the agency in 1986--direction that DNR has

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[17]/ The March 11, 1992 Notice of Appeal was with reference to ARCO's royalty liability. Another appeal was filed with reference to Chevron's liability on July 2, 1992.

not only acknowledged, but heretofore supported. Let's examine DNR's current initiative against the seven policies that it and the legislature mutually endorsed in SB 309:

A. DNR's initiative would materially burden Railbelt consumers. DNR's demand of MMS--to ***retroactively*** increase three years' royalty ten-fold--would fall even harder on Railbelt consumers than its 1985 Notice to Lessees, which applied only prospectively.

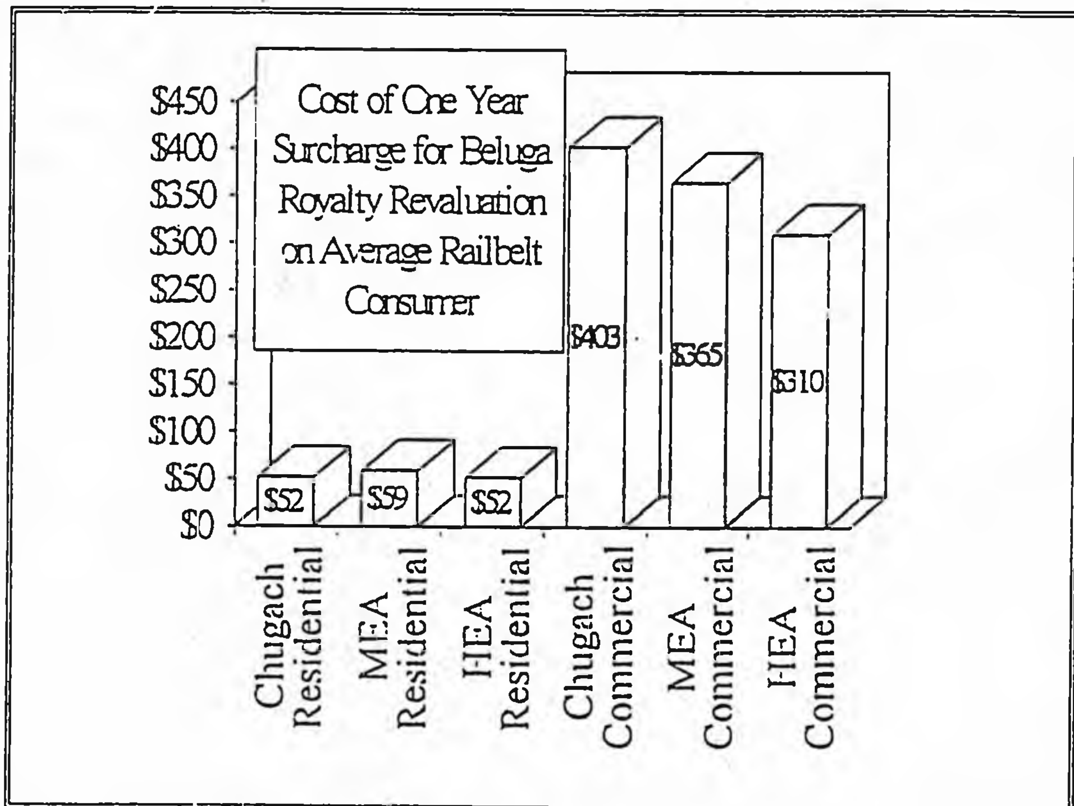

CHART 5

While it is difficult to predict precisely how the APUC would structure the surcharge necessary to allow Chugach to recover DNR's additional royalties, Chart 5 illustrates the impact on Railbelt consumers from a one-year surcharge on electric rates. Moreover, these are just averages. Chugach estimates that some of its largest commercial consumers, such as Carrs, Liquid Air, and the state and federal goverments, would pay a surcharge of ***over $40,000*** each.

Moreover, Chugach customers won't bear the burden alone. Chugach sells power wholesale to other electric utilities, and, as Chart 6 shows, those other

utilities will bear a material part of the $12.4 million surcharge occasioned by DNR's demand:

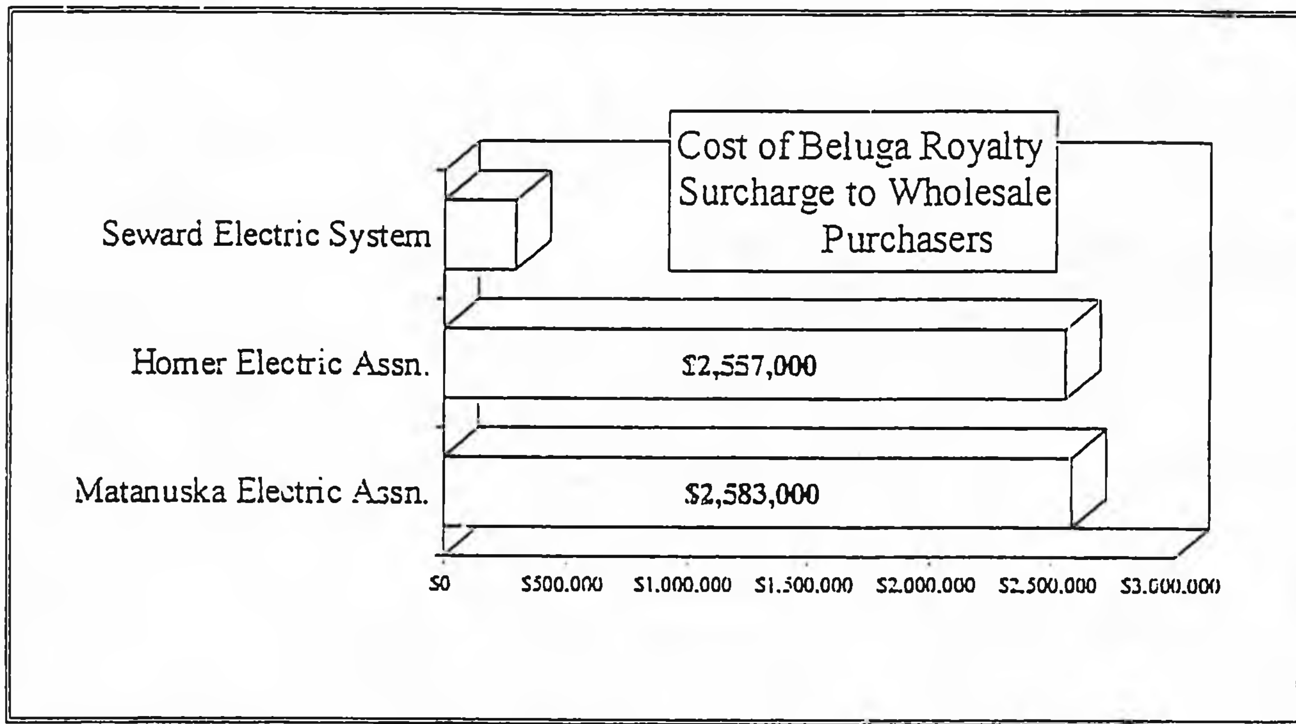

CHART 6

B. DNR has forgotten its findings that accepting the contract price in the case of sales to public utilities yields the state "full value" for its royalty gas, and therefore it is in the "best interest" of the state to accept that price. DNR has defended its demands upon MMS on the theory that it is legally obliged to seek full value for state resources--the same rationale that the agency once used to apologize for its 1985 Notice to Lessee. The agency, however, hasn't explained where that obligation comes from--after all, these are federal lands, and there is no statutory or constitutional provision forcing DNR to tell the federal government how to manage its property.

But jurisdictional issues aside, DNR has forgotten its words in 1986--that, because any "reduced" royalty occasioned by accepting the utilities' contract price for royalty purposes will be passed on directly to Alaska consumers, the state is

therefore receiving full "value" by accepting that contract price. For that reason. the legislature has already found that it is in the "best interest of the state" to accept the utility contract price [18]/--a finding in which, as we have seen, DNR enthusiastically concurred.

C. ***DNR forgets that gas sales to utilities require tailored treatment.*** Over the past years, DNR has been remarkably successful in winning retroactive oil royalty payments on the "value" theory. That policy existed back in 1986, and DNR recognized then that, as sound a policy as the "value" concept might generally be, it shouldn't apply to royalty gas sold to public utilities, which in turn is used to directly benefit Alaska consumers.

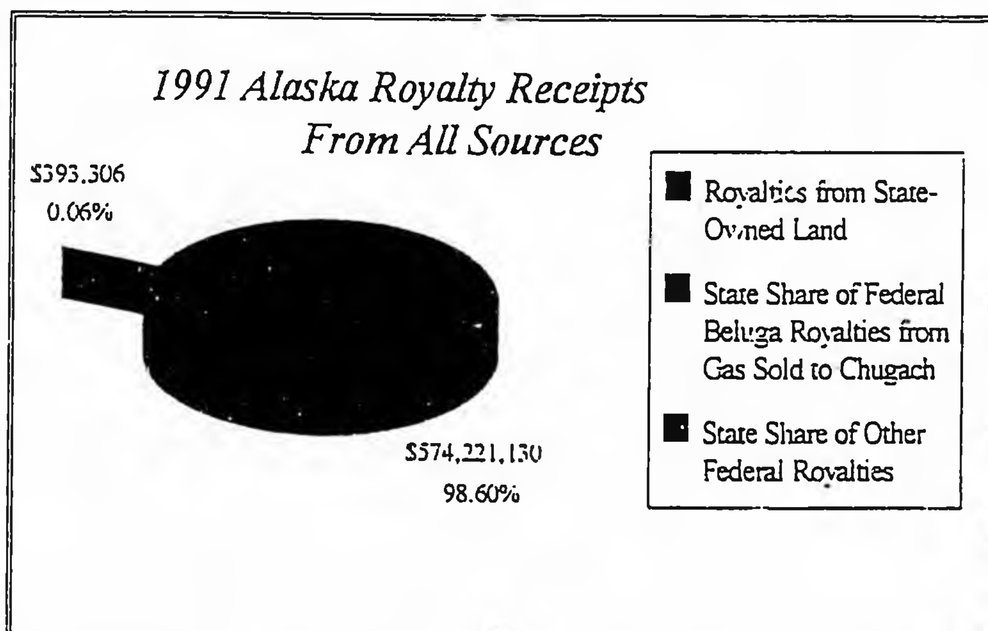

CHART 7 [19]/

Recall that DNR supported SB 309 in part because, by tailoring a policy to royalty gas sales to utilities, the fiscal impacts of that policy would be inconsequential. As Chart 7 shows, the state's take from federal Beluga River royalties on gas sold to Chugach is only a tiny slice of the state's royalty income. Requiring DNR to abide by existing legislative royalty gas

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[18]/ Sec. 1, Ch. 55, SLA 1986.
[19]/ SOURCE: State and Other Federal royalties: Ak. Dept. of Natural Resources, Royalty Management. Beluga Royalties: Beluga producers. The figures for the state's 90% share of federal royalties are based on MMS reports of producers' unaudited payments for 1991. The figures also include any interest and penalties: therefore, they are only an approximation of the state's actual 90% share for that year.

policy will have no impact outside that slice, because that policy is confined to *gas* sales to ***utilities***, and because all other consequential royalty gas controversies have already been settled. *See* Chart 4, *ante*.

But while the Beluga gas controversy is of little consequence to the state treasury, it is of considerable importance to both Chugach and Railbelt energy consumers. As Chart 8 shows, over three quarters of Chugach's power is generated from Beluga River gas. And, as Chart 9 shows, nearly half of the Railbelt's electric power comes from Chugach's generation of electricity from the Beluga River field.

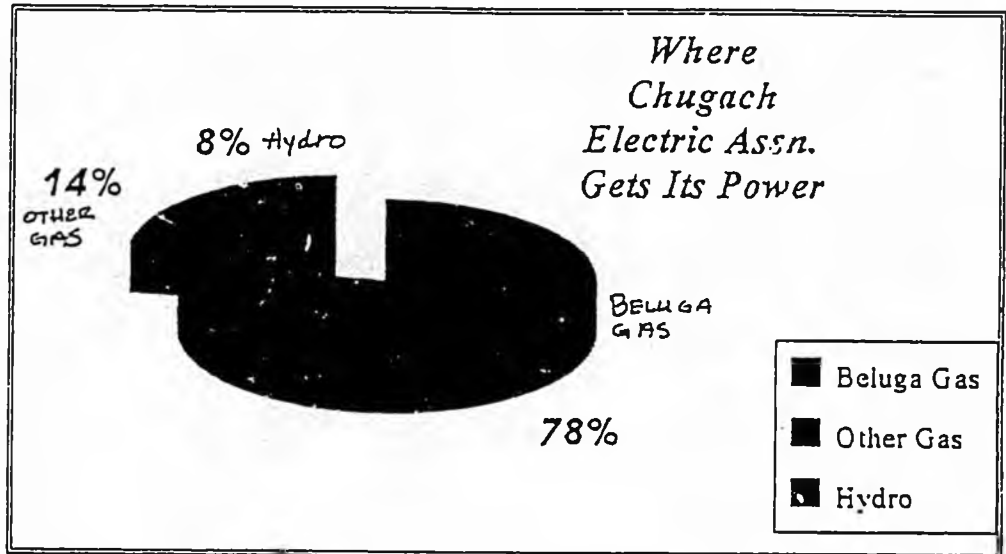

CHART 8

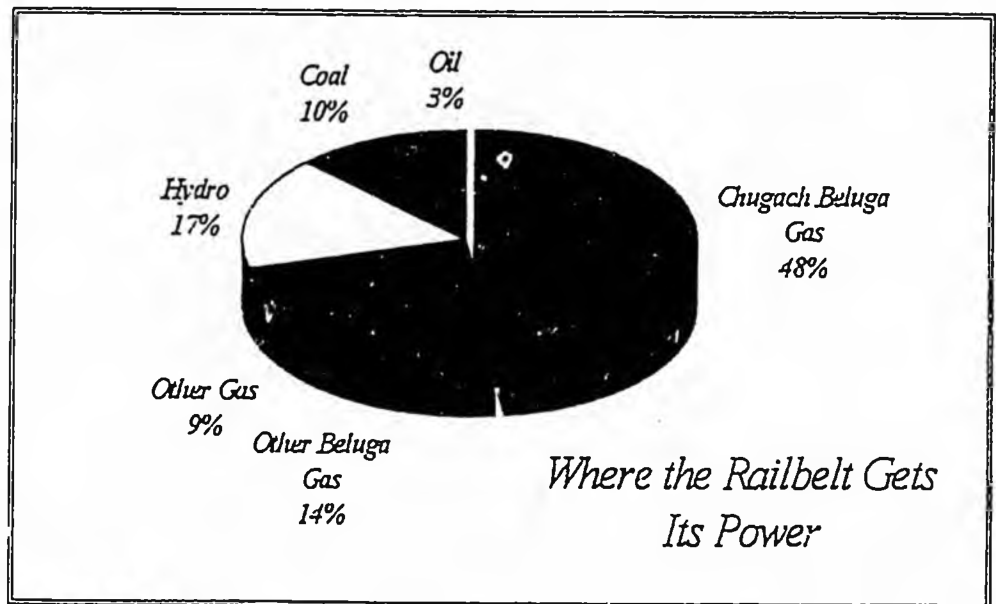

CHART 9

Little wonder

that DNR, and the legislature, have heretofore found the public interest in reasonably priced Beluga River power generation to outweigh any arguable impact on the state treasury. [20]/

D. DNR's actions are causing severe budgetary uncertainty to public utilities. DNR's $12.4 million claim is a considerable contingent liability for Chugach--one impairing both its budgetary planning and financial soundness. And should DNR eventually succeed, Chugach would then face continued uncertainty over how the APUC will structure any resultant rate surcharge.

But the problem is worse than that. Not only must Chugach face perhaps years of litigation over DNR's federal demands--litigation with an uncertain outcome--but it must also fear similar demands from DNR for ***subsequent*** years. Remember that DNR's current appeals cover only 1984-87. Chugach estimates that, if the same "value" demands are made for 1987-92, Chugach (and hence its customers) could owe ***an additional $9 million.*** While federal law for those subsequent years even more clearly favors acceptance of arms-length contract prices (*see* n. 16, *ante*), DNR refuses to assure the company that its demands will stop with 1987.

E. DNR is needlessly provoking litigation with Chugach. Given that:

(1) DNR is under no legal obligation to attempt to shape federal law;

(2) federal law generally favors acceptance of the contract price, and DNR is asking that an exception be made to that policy; and

(3) third parties aren't normally allowed to participate in MMS audit proceedings,

[20]/ The only adverse fiscal impact of adhering to existing state policy with respect to federal Beluga River royalties is the loss of the state's speculative claim to a higher "value" from that production. But as we have seen, DNR's position, under federal law, is doubtful.

it seems that DNR is going out of its way to provoke a costly lawsuit.

F. DNR's view–that the 1986 legislation does not prevent it from rejecting the contract price for federal royalties–ignores Commissioner Wunnicke's promise to the legislature that the new statute would govern all gas royalty disputes. DNR explains its recent conduct by pointing out that the 1986 legislation--AS 38.05.180(j)--applies only to state leases, and thus it remains compelled to seek out a higher "value" for federal leases. But recall what Commissioner Wunnicke told the legislature: if the bill passed, DNR would use the legislation as a legislative definition of "value" when royalty gas was sold to utilities at arm's length, ***even if the controversy was outside the scope of the statute itself.*** Section III(F), *ante*. That is why DNR believed that the 1986 legislation would authorize the agency to settle with Chugach on its then-existing long-term contract, even though that contract was outside the statute's reach. *Id.*

In sum, DNR has heretofore maintained ***both*** that: (1) it believes that, when savings through a long-term contract are passed on to Alaska utility consumers, any resultant "lower" price still yields the state full "value" (section III(B), *ante*); and (2) the legislature has defined "value" to equal the long-term contract price, whether or not the contract or lease at issue is within the scope of AS 38.05.180(aa).

G. DNR has forgotten its policy against retroactive assessments. Even in 1985, when DNR felt itself legally constrained to seek a higher "value" for all royalty gas, it refused to seek those assessments retroactively because of the hardship that it would cause to utilities. Here, DNR's retroactive demands are far more burdensome, since utilities, after 1986, have planned their affairs on the reasonable assumption that the royalty gas issue had settled, and that contract prices would henceforth be used for royalty valuation.

DNR, after all, had both settled the 1986 Chugach litigation on that basis, and had, in 1989, accepted Chugach's new long-term contract price for future state royalties. DNR's recent initiative was utterly unpredictable, and at irreconcilable odds with a policy firmly implanted in both legislative and administrative precedent.

V. The Need for Legislation

The statutory policy engrained in AS 38.05.180(aa) is a sound one. And as DNR itself has stressed, it is a policy that applies beyond the technical reach of the statute itself. The statute, as we have seen, was supposed to provide a "lasting solution" to the "underlying royalty policy question." Attachment 16 at 4, 6. The legislature itself stressed that the legislation would "provid[e] long term price stability for southcentral and railbelt electric consumers." Attachment 20 at 1.

As a result, additional legislation shouldn't be necessary to achieve that goal. DNR's protest--that it is involuntarily compelled to tell the federal government to make Beluga River a special case, and impose a higher royalty--is feigned.

But feigned or not, it is a reality nonetheless--both for Chugach and every Railbelt consumer. As a result, a technical amendment to AS 38.05.180(aa) is necessary--not to change the statute's meaning, but to remind the agency of its purpose, as once defined by DNR itself.

Attached to this paper are two appendices: (1) proposed legislation; and (2) a technical explanation of that legislation. By making minor changes to the statute, the legislature can assure itself that the 1986 law cannot be undermined either directly or indirectly, and the controversy that the legislature thought settled in 1986 can finally, seven years later, be laid to rest.

HB

117

HFIN

FILE

HOUSE COMMITTEE REPORT

(11)

Date Referred: March 1, 1993 — FURTHER REFERRALS:

Date of Committee Action: 3/12/93

The FINANCE Committee considered: HB 117

HOUSE BILL NO. 117 — NAME MANVIL H. OLSON BRIDGE (SCHROCK RD.)

"An Act naming the Manvil H. Olson Bridge."

RECOMMENDATIONS: [ ] the same title

be replaced with ______ [ ] a new title

[ ] have attached amendments(s)

[ ] do pass

[ ] do not pass

[✓] no recommendations

[ ] individual recommendations

[ ] additional referral to the ______ Committee

ADOPTS: ______ letter of Intent

ATTACHES NEW FISCAL NOTE(s): (Dept) — APPROVES PREVIOUS: (Dept/Date)

[ ] fiscal impact ______ — [ ] fiscal note(s) ______

[ ] zero fiscal note ______ — [✓] zero fiscal note(s) DOT 3/1/93

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	DNP	NR	AM
Larson	✓	McLean		X	
Hanley	X	Grussendorf		X	
Martin	X	Hoffman		X	
Parnell	X	Brown		✓	
Navarre	✓	Therriault		X	

CHAIRMAN'S SIGNATURE

STATE OF ALASKA
1993 LEGISLATIVE SESSION

FISCAL NOTE

N: 1
Bill Version: HB 117
(H) Publish Date: 3/1/93

Revision Date:
Title: Name Mavil H. Olson Bridge (Schrock Road)
Sponsor: Menard, Carney
Requestor:

Department Affected: DOT&PF
BRU: Central M&O
Component: Central M&O
Component Serial Number: 567

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY94	FY95	FY96	FY97	FY98	FY99
PERSONAL SERVICES	0	0	0	0	0	0
TRAVEL	0	0	0	0	0	0
CONTRACTUAL	0	0	0	0	0	0
SUPPLIES	0	0	0	0	0	0
EQUIPMENT	0	0	0	0	0	0
LAND & STRUCTURES	0	0	0	0	0	0
GRANTS, CLAIMS	0	0	0	0	0	0
MISCELLANEOUS	0	0	0	0	0	0
TOTAL OPERATING:	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE FUND SOURCE	0	0	0	0	0	0

FUNDING: (Thousands of Dollars)

FUNDING	FY94	FY95	FY96	FY97	FY98	FY99
1002 FEDERAL RECEIPTS	0	0	0	0	0	0
1003 GF MATCH	0	0	0	0	0	0
1004 GF	0	0	0	0	0	0
1005 GF/PROGRAM RECEIPTS	0	0	0	0	0	0
1006 GF/MHTIA	0	0	0	0	0	0
OTHER	0	0	0	0	0	0
TOTAL FUNDING:	0	0	0	0	0	0

POSITIONS

POSITIONS	FY94	FY95	FY96	FY97	FY98	FY99
FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

Estimate of current year (FY93) impact: $

ANALYSIS: (Attach a separate page if necessary)

The Little Su Bridge (#1030) on Schrock Road will be under construction during the Summer of 1993. Signs can be included with the project.

Prepared by: Margaret Holland
Phone: 266-1440

Division: Central Region, Regional Director's Office
Date: February 8, 1993

Approved by Commissioner:

Frank O'Turpin
Phone: 465-3900

Agency: Department of Transportation and Public Facilities
Date: February 8, 1993

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Back-up

HB117
Rep. Curt Menard
2/20/93

HOUSE BILL NO. 117
Representative Curt Menard

SPONSOR'S STATEMENT

I introduced HB117, naming bridge #1030, located at Schrock Rd. over the Little Su River, after Manvil Olson. Mr. Olson spent many years constructing bridges at this same area in order for people to gain access to the end of Schrock Rd.

When people in the Schrock area are giving others directions they always refer to this river crossing as, "the Manvil Olson bridge". Many of my constituents and others in the community have put together a petition requesting the bridge be named after Mr. Olson.

Enclosed is a brief history of Mr. Olson's accomplishments. After reading it, I'm sure you will agree with my constituents that it is only fitting that this new bridge be named after Manvil Olson. He has demonstrated and captures the true spirit of an Alaskan pioneer.

HISTORY

MANVIL H. OLSON

Manvil Olson was born January 19, 1908, in Bird Island, Minnesota. He was among the first civilian travelers on the Alcan Highway, moving to Alaska with his wife and daughter in 1947. The family first settled in Haines, where he operated a garage.

In 1949, the Olsons moved to Skagway, where he became a machinist on the White Pass and Yukon Railroad. The family moved to Anchorage in 1951, where Manvil became a machinist on the Alaska Railroad.

In 1953, he lived on a homestead near Wasilla, six miles off the end of the nearest road. He and his family developed the homestead over the next several years. He opened and operated a commercial dairy farm from 1959 until 1964. The farm still produces hay and beef. During the homesteading period, Mr. Olson also worked full time on the railroad and after leaving the railroad worked at the Fort Richardson Motor Pool. He continued to work on the homestead evenings and weekends. He also did custom machine and equipment work for his neighbors.

In 1978, he drew a tract of land in the Delta Barley Project. At the age of 70, he began developing the parcel with his sons, eventually clearing and planting 2,400 acres of land. The farm, known as Big G Ranch, which is now owned by the family is still in operation.

Mr. Olson was a strong advocate of agriculture development and its potential in Alaska. He founded one farm on the family homestead north of Wasilla, where he cleared the land. In order to develop the area and continue his operation, he built four vehicle bridges over the little Su River, using three different designs. At the time of his death he was involved in managing a purebred herd of Scottish Highland beef cattle in Wasilla.

Mr. Olson's drive for great projects did not end with statehood and he remained committed to agricultural development in Alaska all of his life.

Mr. Olson is survived by his wife of 48 years, Beulah Weedon Olson; his daughter, Karen Olson Lee of Anchorage; his sons, Harold and Arnold of Wasilla; and his four grandchildren.

MANVIL H. OLSON

Wasilla resident Manvil Harold Olson, 84, died July 13 at his Little Susitna River home.

Olson

A funeral will be held at 2 p.m. Friday at First Presbyterian Church of Wasilla, 1375 E. Bogard Road.

Mr. Olson was born Jan. 19, 1908, in Bird Island, Minn. He spent the first 18 years of his life on a farm in the Mille Lacs area of Minnesota. He left the farm after high school and moved to Chicago where he became a machinist and tool and dye maker. He was a member of the Machinists Union International.

Mr. Olson enlisted in the Navy during World War II, serving on a destroyer in the Pacific and Atlantic theaters. He married Beulah Weedon Nov. 13, 1944, in Virginia. He was among the first civilian travelers on the Alcan Highway, moving to Alaska with his wife and daughter in 1947. The family first settled in Haines, where he operated a garage.

In 1949, the Olsons moved to Skagway, where he became a machinist on the White Pass and Yukon Railroad. The family moved to Anchorage in 1951. Mr. Olson became a machinist on the Alaska Railroad.

In 1953, he lived on a homestead near Wasilla, six miles off the end of the nearest road. He and his family developed the homestead over the next several years. A commercial dairy farm was opened in 1959, and operated until 1964. The farm still produces hay and beef.

During the homesteading period, Mr. Olson also worked on the railroad and at the Fort Richardson Motor Pool. He did custom machine and equipment work for his neighbors.

In 1978, he drew a tract of land in the Delta Barley Project. At the age of 70, he began developing the parcel with his sons, eventually

clearing and planting 2,400 acres of land. The farm, known as Big G Ranch, was successfully completed and is still in operation.

According to his family, Mr. Olson was a strong advocate of agriculture development and its potential in Alaska. He founded one farm on the family homestead north of Wasilla and another at Delta. At the time of his death, he was involved in managing a purebred herd of Scottish Highland beef cattle in Wasilla.

Mr. Olson is survived by his wife of 48 years, Beulah Weedon Olson of the family farm; his daughter, Karen Olson Lee of Anchorage; his sons, Harold and Arnold of Wasilla; his grandchildren, Leighton and Conan Lee of Palmer and Anchorage, and John Olsen and Stanley Olson, both of Wasilla; his niece, Louise Augustsson of Anchorage; his nephew, Wayne Lofgren of Anchorage; his brother, Otto of Missouri; and his sisters, Vicki MacClean and Florence Haglund, both of Minnesota, and Lorraine Veith of Dallas.

Arrangements were by Kehl's Palmer Mortuary.

11/18/92

Page 1

We the Undersigned petitioners of Schrock Road and Surround area Request the appropriate naming of the New Bridge Be The Manvil Olson Bridge.

Name	Phone
Betty Jean Bosch	746-4007
Tim Reed	373-5457
Ray Reed	373-5457
Dennis R. Caswell	376-2335
Doug Washburn	376 6431
Edward A. Wooley	373-7506
[illegible] Burton	373-7506
LaRetta Caswell	376-2335
Carl Wilbur	376-5623
Marcella Wilbur	376-5623
Ed E. Wooley	373-0527
Kathy Wooley	373-0527
Wm. L. Pens	376-8635
[illegible] Schaber	373 5794
[illegible]	832-1587
Audrey J. Schaber	373-5794
[illegible]	373-2872
Bev Baldwin	376-2080
Glen Butts	Mes. = 376-0549
[illegible] Bush	376 4676
Mattie M. Bush	" "
Frank Bush	376 5772
J. Marguerite Colvin	
Roxanne Willard	373-6918
Tom [illegible]	376-2647
Richard Burk	
[illegible]	[illegible]

Angela Busn — N/A
Kenneth Jenks
Nancy Heller
Randy Randall
Peggy Snelling
[illegible] Drabb
Joel S. Smith
Shelia D. Smith
Rozannah Smith
Shelia P. Hess
James S Helminiak
Joselynn Helminiak
Ron Kunek
Mary [illegible]
Carol Bragg — 373-2991
Jim E. Bragg
[illegible] Fitzgibbon — 376-5837
William Smith
Joyce Fitzgibbon
Tammy L. Brown — 746-4007
Timothy S. Thompson — " "
Arnold Olson — 373-179[illegible]
Stanley Olson — 373-1[illegible]
Jason J. Brown
Dana L. Richards.
Harold J. Olson — 323-1092
Onavice Reich (Olson)
John Olsen
Beulah W. Olson — 376-5771
Craig Toomey — 376-1004
Mary A. Roberts — 746-2774

Name	Phone
[illegible] Sprague	746-1090
Jim Sprague	" " " "
Troy Weeks	376-1004
Andy Hunter	376-7608
[illegible]	[illegible]
[illegible] Tobin	376-6979
Carolyn Bush	376-5722
Randa Gawley	376-2647
Callie Willard	376-2647
Fritz Slater	376-5666
Troy [illegible]	376-7510
John A Antoni	376-5527
[illegible] Antoni	376-5527
Mary [illegible]	376-5527
Christina S Warren	373-0597
Michael J. Willhite	373-1795
Timothy W. Willhite	373-1795

Bridge No. 1030

LOCATION: on the little Susitna River off the end of the Schrock Rd.

I am requesting that the above bridge be Dedicated in memory of my father Manvil H. Olson, recently deceased July 13, 1992.

He has a long history in this area, one that predates statehood. He homesteaded north of the little Su 1/4 mile north off the end of the schrock Rd in 1953.

LEGAL
e18
18N R1W

Our original access to the homestead was where the present day North Shushana road is. He built a bridge there in 1954, actually just down stream, where the current Shushana bridge is, was our ford.

In 1955 the Federal Road Commission extended the schrock rd. three miles ~~down stream~~ west, to where it ends to this day

He worked on that road extension operating a dozer.

That same year he built a bridge over the little Su and a new road to the homestead from the end of Schrock Rd.

During the time from 1954 – 1958 he cleared land on the homestead and land for many other homesteaders within the area, a lot, of this was later rented and used for the dairy that was started in 1957. For the first year of the dairy operation milk was hauled in ten gallon cans to a dairy owned and operated by Pat Carney, another individual who embraced the true definition of the

homestead act, to farm.

The reason the milk was delivered to the Carney farm was that the milk truck would not cross the bridge, a gross weight question.

(late 57) → In 1958 he built a cantilever suspension bridge over the Little Su. This piece of artistic engineering the milk truck crossed.

In 1959 we had our 100 yr. flood and the bridge floated down stream like a big ship.

During this time, with water three feet deep in the river bottom flats, he rowed the milk to the south side in ten gallon cans and hauled them to the Carney farm.

When the water went down the Corps of Engineers put in a ferry; however, the milk truck would not cross this.

In the summer of 1959 he built a new bridge over the river, this time with a center pier. In 1960, or late 1959, the Corps of Engineers (or late 1959) built us a Bailey bridge.

My father was a major bridge builder in the years before statehood. He, to my knowledge built the only suspension bridge over the Little Su. The close proximity of the homestead, the incredible energy expended in the development of the area, the operation of a business, his committment to Alaska. He built four vehicle bridges over the Little Su of three different designs.

His drive for great projects did not end with statehood as he remained committed to agriculture and development in Alaska all of his life. This new bridge is a fitting memorial to my father. Thank you Harold Olson