

SCOMM

104:10

Revision Date: February 13, 1998 Correction

Title: Develop Stranded Gas Resources

Dept. Affected:

Revenue

BRU:

Administration and Support

Component:

Commissioner's Office

Sponsor: Rules

Requestor: Governor

COMPONENT SERIAL NO.

123

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04
PERSONAL SERVICES	81.6	82.7	84.0	85.3	86.6	87.9
TRAVEL	30.0	30.0	30.0	30.0	30.0	30.0
CONTRACTUAL	375.0					
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS	5.0	5.0	5.0	5.0	5.0	5.0
TOTAL OPERATING	491.6	117.7	119.0	120.3	121.6	122.9

CAPITAL EXPENDITURES						
----------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
------------------------	--	--	--	--	--	--

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	*** 191.6	117.7	119.0	120.3	121.6	122.9
1001 CBRF						
1048 University of AK receipts						
Other	300.0					
TOTAL	491.6	117.7	119.0	120.3	121.6	122.9

Estimate of any current year cost \$

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

*** The legislation as currently drafted allows for the \$300,000 in contractual costs to be recovered from future applicants. This bill could be modified to provide that all costs would be borne by an applicant.

See Attached

Prepared by:

Mary Marshburn, Roger Marks

Division:

Office of the Commissioner

Approved by Commissioner:

Wilson L. Condon

Agency:

Revenue

Phone: 343-9242

Date: February 13, 1998

Date: February 13, 1998

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AMENDMENT

OFFERED IN THE HOUSE

TO: CSHB 393(O&G), Draft Version ~~"K"~~ "L"

1 Page 2, line 19, following "tankers":

2 Insert "although experimental research is being conducted on other
3 alternative technologies such as gas to liquids, this technology is not yet
4 commercially viable; if this research results in a commercially viable technology,
5 and, after economic analysis by the state of the application of this technology, it is
6 shown that local or state tax or regulatory changes are necessary to commercialize
7 an Alaska project using this technology, then this technology may be considered in
8 regard to this legislation."

AMENDMENT ^H#13 ADOPTED

3/24/98

OFFERED IN THE HOUSE

BY REPRESENTATIVE BUNDE

TO: CSHB 393(0&G), Draft version "B"

- 1 Refers to Page 18, Line 26 of the CS
- 2 Amendment #1, page 4, line 12 – Following "public disclosure or"
- 3 Insert "public disclosure"
- 4 Refers to Page 18, Line 30 of the CS
- 5 Amendment #1, page 4, line 17 – Following "information"
- 6 Delete "and"
- 7 Insert "or"

AMENDMENT #1*MOVED BY COMMITTEE ON 3/24/98***OFFERED IN THE HOUSE****TO: CSHB 393(O&G), Draft Version "B"**

- 1 **Page 4, line 12:**
- 2 **Delete "enter into"**
- 3 **Insert "develop"**

- 4 **Page 4, line 14:**
- 5 **Delete "is an"**
- 6 **Insert "will result in contracts that are an"**

- 7 **Page 4, line 16:**
- 8 **Delete "enter into"**
- 9 **Insert "develop"**

- 10 **Page 4, line 18:**
- 11 **Delete "is"**
- 12 **Insert "will result in contracts that are"**

- 13 **Page 5, line 1, following "state":**
- 14 **Insert "developed"**

- 15 **Page 5, line 4:**
- 16 **Delete "entered into"**
- 17 **Insert "developed"**

- 18 **Page 5, line 7, following "contract":**
- 19 **Insert "developed"**

1 Page 5, line 14:

2 Delete "negotiated"

3 Insert "developed"

4 Page 5, line 17:

5 Delete "negotiated"

6 Insert "developed"

7 Page 5, line 18:

8 Delete "commissioner of revenue"

9 Insert "governor"

10 Page 5, line 19:

11 Delete "as provided in this Act"

12 Page 5, line 21, following "contract":

13 Insert "developed under this Act"

14 Page 5, line 22:

15 Delete "under this Act"

16 Page 6, line 14:

17 Delete "enter into a"

18 Insert "negotiate terms for inclusion in a proposed"

19 Page 7, line 18, following "for":

20 Insert "development of"

21 Page 8, line 8:

22 Delete "plan"

23 Insert "detailed description of options"

- 1 Page 8, line 10:
- 2 Delete "plan"
- 3 Insert "detailed description of options"
- 4 Page 10, line 20:
- 5 Delete "enters into a contract"
- 6 Insert "submits a contract to the governor"
- 7 Page 10, line 24:
- 8 Delete "under AS 43.82.020"
- 9 Page 10, line 29:
- 10 Delete "; or"
- 11 Insert "; and"
- 12 Page 13, line 22:
- 13 Delete "entered into"
- 14 Insert "developed"
- 15 Page 16, line 14:
- 16 Delete "(a) A contract"
- 17 Insert "The term of a contract developed"
- 18 Page 16, line 15:
- 19 Delete "entered into for a term"
- 20 Insert "for"
- 21 Page 16, lines 19 - 23:
- 22 Delete all material.
- 23 Page 16, line 27:
- 24 Delete "or a contract under AS 43.82.020"

1 Page 16, following line 31:

2 Insert a new subsection to read:

3 "(b) A contract developed under this chapter may provide for the assignment
4 to or withdrawal of a qualified sponsor or member of a qualified sponsor group."

5 Renumber the following subsections accordingly.

6 Page 17, line 1:

7 Delete "or contract"

8 Page 17, line 15:

9 Delete "condition of"

10 Insert "term in"

11 Page 18, line 26, following "disclosure":

12 Insert "or is not in the long-term fiscal interests of the state"

Public Disclosure

13 Page 18, line 29:

14 Delete "and"

15 Insert ","

16 Page 18, line 30, following "information":

17 Insert ", ~~and~~ to protect the long-term fiscal interests of the state"

OR

18 Page 20, lines 21 - 23:

19 Delete all material.

20 Insert "submit the contract to the governor."

21 Page 21, lines 4 - 8:

22 Delete all material.

23 Insert "previously submitted a proposed contract to the governor, the"

- 1 Page 21, line 9:
 - 2 Delete "existing"
 - 3 Insert "currently proposed"
- 4 Page 21, line 10, following "the":
 - 5 Insert "previously"
- 6 Page 22, line 27:
 - 7 Delete ", under"
- 8 Page 22, lines 28 - 29:
 - 9 Delete all material.
 - 10 Insert "submit the contract to the governor."
- 11 Page 22, line 31:
 - 12 Delete all material.
 - 13 Insert "section"
- 14 Page 23, lines 2 - 3:
 - 15 Delete "The commissioner may not execute a contract developed under this chapter
 - 16 and a"
 - 17 Insert "The governor may transmit a contract developed under this chapter to the
 - 18 legislature together with a request for authorization to execute the contract. A"
- 19 Page 23, line 5:
 - 20 Delete "commissioner"
 - 21 Insert "governor"
- 22 Page 23, lines 15 - 16:
 - 23 Delete all material.
 - 24 Insert "commissioner shall include terms in a contract developed under AS 43.82.020
 - 25 that provide for administrative termination of a party's rights, under the procedures and

1 conditions of this section, if the party has"

2 Page 24, lines 6 - 7:

3 Delete "entered into"

4 Insert "developed"

5 Page 24, line 11:

6 Delete "executes"

7 Insert "develops"

8 Page 24, line 15:

9 Delete "require as a condition of"

10 Insert "include a term in"

11 Page 24, line 22:

12 Delete "each of the affected municipalities"

13 Insert "a municipality"

14 Page 25, line 27:

15 Delete "entered into"

16 Insert "developed"

17 Page 25, line 29, following "contract":

18 Insert "developed"

19 Page 26, line 2, following "contract":

20 Insert "developed"

21 Page 26, line 7, following "state":

22 Insert "developed"

23 Page 26, line 11, following "contract":

- 1 Insert "developed"
- 2 Page 26, line 17:
- 3 Delete "for which it is"
- 4 Insert "that the commissioner of revenue"
- 5 Page 26, lines 18 - 20:
- 6 Delete all material.
- 7 Insert "expects will be restricted from imposing a tax, or a portion of a tax, as a result
- 8 of implementation of a contract developed under this chapter"
- 9 Page 26, line 26:
- 10 Delete "area to"
- 11 Insert "distance within"
- 12 Page 26, lines 26 - 27:
- 13 Delete "party to a contract under AS 43.82.020 is"
- 14 Insert "person may be"
- 15 Page 27, line 11:
- 16 Delete "uneconomic or uncompetitive to develop"
- 17 Insert "not being marketed due to prevailing cost or price conditions"
- 18 Page 27, line 12, following "determined":
- 19 Insert "by an economic analysis"
- 20 Delete ";
- 21 Insert "."
- 22 Page 27, lines 13 - 15:
- 23 Delete all material.
- 24 Page 27, line 23:

1 Delete "with the commissioner of revenue under AS 43.82.020"

2 Insert "approved by the legislature as a result of submission of a proposed contract
3 developed under AS 43.82"

4 Page 27, lines 30 - 31:

5 Delete "with the commissioner of revenue under AS 43.82.020"

6 Insert "approved by the legislature as a result of submission of a proposed contract
7 developed under AS 43.82"

8 Page 28, lines 7 - 8:

9 Delete "under AS 43.82.020 with the commissioner"

10 Insert "approved by the legislature as a result of submission of a proposed contract
11 developed under AS 43.82"

12 Page 28, lines 15 - 16:

13 Delete "with the commissioner under AS 43.82.020"

14 Insert "approved by the legislature as a result of submission of a proposed contract
15 developed under AS 43.82"

LEGAL SERVICES

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

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

130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

MEMORANDUM

March 23, 1998

SUBJECT: Alaska Stranded Gas Act (HB 393 H)
TO: Representative Joe Ryan
FROM: Richard A. Glover 
Legislative Counsel

Enclosed are the amendments you requested. I have made a small change to amendment B.17, as I think it reflects your actual intent, rather than what is stated in the \F and \H versions. AS 43.82.410 will read as follows, with the changes emphasized:

Sec. 43.82.410. Notice and comment regarding the contract. The commissioner shall

(3) offer to appear before each house of the legislature in executive work session to provide a review of the commissioner's preliminary findings and determination, the proposed contract, and the supporting financial, technical, and market data; if ~~a~~ [EACH] house of the legislature accepts the commissioner's offer, **that** [EACH] house shall give notice of that house's meeting to the public; if the financial, technical, and market data that is to be provided must be kept confidential under AS 43.82.310, the commissioner may not release the confidential information during a public portion of a committee meeting;

I trust this change meets with your approval. If I may be of further assistance, please advise.

RAG:pl:jr
98-060.plm

Enclosure

AMENDMENT

#3

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

- H 3* *Ad. Fed*
- 1 Page 2, lines 8 - 11:
 - 2 Delete all material.
 - 3 Renumber the following paragraphs accordingly.
 - 4 Page 2, lines 23 - 28:
 - 5 Delete all material.
 - 6 Insert "tankers;"
 - 7 Page 3, lines 7 - 15:
 - 8 Delete all material. *with Drawn*
 - 9 Renumber the following paragraphs accordingly.
- H 4*

Failed

AMENDMENT

#5

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

- 1 Page 10, line 26, following "AS 43.82.210;":
- 2 Insert "however, the terms concerning payments in lieu of taxes must also include
- 3 payment of interest at the rate specified in AS 45.45.010(a) for suspended taxes;"

AMENDMENT

#6 WITHDRAWN

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

1 Page 10, line 28:

2 Delete "(A)"

3 Page 10, lines 29 - 30:

4 Delete "~~or~~ AND

5 (B) royalty value"

6 Insert "however, the terms modifying the state's right to royalty in value or in kind
7 must include payment of interest at the rate specified in AS 45.45.010(a) for delayed or
8 suspended payments"

AMENDMENT

#7 AD-PRO

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

1 Page 13, line 10, following "royalty":

2 Insert "on gas"

3 Page 13, following line 31:

4 Insert a new subsection to read:

5 "(d) Nothing in this chapter permits modification of the state's rights that
6 relate to timing, notice, and rights to receive oil royalty in kind or in value under oil
7 and gas leases or unit agreements."

AMENDMENT # 3 *AD. PTD*

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

1 Page 13, lines 20 - 23:

2 Delete all material and insert:

3 "(4) the modification does not impair the ability of the state to meet
4 the demand in this state for gas during the term of the contract ~~entered into~~ *DEVELOPED* under
5 AS 43.82.020."

See page 13

1 to promote administrative certainty and efficiency.

2 (c) Except as provided in (b) of this section, the commissioner's discretion
3 under this section in developing proposed terms for a contract under AS 43.82.020 is
4 not limited to consideration of the economic rent of the approved qualified project.

5 **Sec. 43.82.220. Contract terms relating to royalty.** (a) Notwithstanding any
6 contrary provisions of AS 38, the commissioner of natural resources, with the
7 concurrence of the commissioner of revenue and the affected parties holding a state
8 lease or unit agreement, may develop proposed terms for inclusion in a contract under
9 AS 43.82.020 that modify the timing and notice provisions of the applicable oil and
10 gas leases and unit agreements pertaining to the state's rights to receive its royalty in
11 kind or in value, if

12 (1) the viability of the approved qualified project depends on long-term
13 gas purchase and sale agreements;

14 (2) certainty over time regarding the quantity of royalty gas that the
15 state may be taking in kind is needed to secure the long-term purchase and sale
16 agreements;

17 (3) the specified period of the state's commitment to take its royalty
18 share in value or in kind does not exceed the term of the purchase and sale
19 agreements; and

20 (4) the modification does not impair the ability of the approved
21 qualified project ^{For The State} to meet the reasonably foreseeable demand in this state for gas within
22 economic proximity of the project during the term of the contract ^{Developed} ~~entered into~~ under
23 AS 43.82.020.

24 (b) Notwithstanding any contrary provisions of AS 38, the commissioner of
25 natural resources, with the concurrence of the commissioner of revenue and the
26 affected parties holding a state lease or unit agreement, may develop proposed terms
27 for inclusion in a contract under AS 43.82.020 that establish a valuation method for
28 the state's royalty share of the gas production from an approved qualified project.

29 (c) The commissioner of revenue shall include any proposed terms relating to
30 royalty developed in accordance with this section in the proposed contract under
31 AS 43.82.400.

AMENDMENT #9 FAILED

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

- 1 Page 13, line 24:
- 2 Delete "Notwithstanding any contrary"
- 3 Insert "Subject to the"

AMENDMENT

#10 FAILED

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

1 Page 16, following line 1:

2 Insert a new section to read:

3 "Sec. 43.82.235. Contract term relating to a project labor agreement. The
4 commissioner shall include in a proposed contract submitted to the legislature for
5 approval under AS 43.82.200 a term that requires the qualified sponsor or qualified
6 sponsor group and contractors of the qualified sponsor or qualified sponsor group to
7 develop and enter into a project labor agreement with appropriate collective
8 bargaining organizations for the project."

AMENDMENT #11

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

1 Page 19, line 5, following "Law,":

2 Insert "to the legislature,"

3 Page 19, line 10, following "Law,":

4 Insert "the legislature,"

AMENDMENT #11

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

- 1 Page 19, line 15:
- 2 Delete "may be disclosed"
- 3 Insert "shall be disclosed on request"

AMENDMENT

#12 Fails

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

- 1 Page 21, line 26:
- 2 Delete "the Legislative Budget and Audit Committee"
- 3 Insert "each house of the legislature in executive work session"
- 4 Page 21, line 27:
- 5 Delete "the committee"
- 6 Page 21, line 29:
- 7 Delete "the Legislative Budget and Audit Committee"
- 8 Insert "a house of the legislature"
- 9 Page 21, line 30:
- 10 Delete "the committee"
- 11 Insert "that house of the legislature"
- 12 Delete "the committee's"
- 13 Insert "that house's"
- 14 Page 21, lines 30 - 31:
- 15 Delete "and all members of the legislature"
- 16 Page 22, lines 9 - 10:
- 17 Delete "Legislative Budget and Audit Committee under AS 43.82.410(3)"
- 18 Insert "legislature"

A M E N D M E N T

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

1 Page 1, lines 3 -6:

2 Delete all material.

3 Insert "develop stranded gas resources in the state; relating to the effect of"

4 Page 3, line 15:

5 Delete "and royalties"

6 Page 5, line 6:

7 Delete "and royalty"

8 Page 5, following line 28:

9 Insert a new subsection to read:

10 "(d) The legislature intends that contracts entered into under this Act are not to
11 impair, delay, or restrict the income to the Alaska permanent fund established under art. XI,
12 sec. 15, Constitution of the State of Alaska."

13 Page 6, line 4:

14 Delete "and royalty"

15 Page 6, lines 13 - 14:

16 Delete "and for royalty adjustments"

17 Page 6, line 16:

18 Delete "(1)"

A M E N D M E N T

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

- 1 Page 11, lines 18 - 23:
- 2 Delete all material and insert:
- 3 "(1) Alaska net income tax under AS 43.20;"
- 4 Renumber the following paragraphs accordingly.
- 5 Page 11, lines 29 - 30:
- 6 Delete all material.

- 1 Page 6, line 19:
- 2 Delete "; and"
- 3 Insert "."
- 4 Page 6, line 20:
- 5 Delete all material.
- 6 Page 10, lines 27 - 30:
- 7 Delete all material.
- 8 Renumber the following paragraphs accordingly.
- 9 Page 13, lines 5 - 31:
- 10 Delete all material.

AMENDMENT

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

1 Page 1, line 3, following "resources in":

2 Insert "certain areas of"

3 Page 1, line 6, following "resources in":

4 Insert "certain areas of"

5 Page 6, line 25, following "gas":

6 Insert "from a well or wells located in the state north of 66 degrees, 30 minutes north

7 latitude."

A M E N D M E N T

OFFERED IN THE HOUSE

BY REPRESENTATIVE RYAN

TO: CSHB 393(O&G), Draft Version "B"

1 Page 13, following line 31:

2 Insert a new section to read:

3 "Sec. 43.82.225. Contract terms relating to waste heat. The commissioner
4 of revenue shall include in a contract under AS 43.82.020 a term requiring the
5 qualified sponsor or qualified sponsor group and contractors of the qualified sponsor
6 or qualified sponsor group to provide to the state at no cost all waste heat generated
7 by the qualified project. Nothing in this section requires a term of a contract under
8 AS 43.82.020 to require a qualified sponsor, qualified sponsor group, or contractors
9 of the qualified sponsor or qualified sponsor group to build facilities for the collection
10 or delivery of waste heat to a particular location or facility. In this section, "waste
11 heat" means energy that is the surplus of, or the by-product of, an industrial process."

ALASKA STATE LEGISLATURE

House of Representatives

COMMITTEE ASSIGNMENTS:

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SPECIAL COMMITTEE ON OIL & GAS, MEMBER
JUDICIARY COMMITTEE, MEMBER
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HESS BUDGET SUBCOMMITTEE, MEMBER



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Representative Norman Rokeberg

MEMORANDUM

TO: Rep. Mark Hodgins, Chair, House Special Committee on
Oil & Gas
Rep. Scott Ogan
Rep. Joe Ryan
Rep. Con Bunde
Rep. Tom Brice
Rep. Allen Kemplen

FROM: Rep. Norman Rokeberg *Norman Rokeberg/jp*

DATE: March 18, 1998

RE: Amendment to HB 393

Attached are the following for your consideration:

1. Memorandum from Legal Services regarding "periodic payments in lieu of taxes"; and
2. Proposed amendment to the B version of HB 393

Attachments

LEGAL SERVICES

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

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

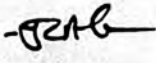
130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

MEMORANDUM

March 16, 1998

SUBJECT: Alaska Stranded Gas Act (HB 393/Work Order 20-GH2006B.1)

TO: Representative Norman Rokeberg
Attn: Janet

FROM: Richard A. Glover 
Legislative Counsel

Enclosed is the amendment you requested. You also asked if the periodic payments described in AS 43.82.500 could be a lump sum payment bargained for in lieu of taxes. The bill consistently calls for "periodic payments in lieu of taxes." However, as long as the contract terms are consistent with the other requirements of the statute, there is no requirement for any specified number of payments, other than the plain meaning of the word "periodic," meaning more than one. A single payment is likely not permitted, but there is no requirement that the payments extend over any specified time.

If I may be of further assistance, please advise.

RAG:jdr
98-164.jdr

Enclosure

03-13-2004 5:54 PM

1 administratively terminate a contract after the party has committed full project funding
2 except as provided in (e) of this section.

3 (d) A party to a contract who is affected by the commissioner's action to
4 terminate under (a) of this section may file an appeal with the superior court under the
5 Alaska Rules of Appellate Procedure.

6 (e) The commissioner may provide terms and conditions in a contract entered
7 into under AS 43.82.020 upon which a party's rights under the contract may be
8 administratively terminated after the party commits full project funding.

9 **Article 6. Municipal Participation.**

10 **Sec. 43.82.500. Obligation to share payments with municipalities.** If the
11 commissioner executes a contract under AS 43.82.020 that includes terms that exempt
12 a party to the contract, and the property, gas, products, and activities associated with
13 the approved qualified project that is subject to the contract, from a municipal tax or
14 assessment in accordance with AS 29.45.810 or AS 29.46.010(b), or AS 43.82.200 and
15 43.82.210, the commissioner shall require as a condition of the contract that the party
16 pay a portion of the periodic payments due under the contract to the ^{Revenue} affected
17 municipality.

18 *new section - see amendment lines 3-9*
19 **Sec. 43.82.510. Municipal advisory group.** (a) If the commissioner approves
20 an application and proposed project plan under AS 43.82.140 and decides to develop ^{Revenue}
21 a contract under AS 43.82.020 and 43.82.200, the commissioner shall notify each
22 affected municipality *and economically affected municipality.*

23 (b) The mayor of each of the ~~affected~~ municipalities notified by the
24 commissioner under (a) of this section may appoint one representative to a municipal
25 advisory group in relation to the application.

26 (c) Each municipal advisory group serves until a final action is taken on the
27 application for which the group was appointed.

28 (d) Each municipal advisory group shall elect a chair.

29 **Sec. 43.82.520. Duties of the commissioner of revenue in relation to**
30 **municipal participation.** (a) The commissioner shall meet with each municipal
31 advisory group periodically to report on the development of the contract provisions that
affect the municipalities.

(b) In developing a contract under AS 43.82.200 - 43.82.270, the commissioner shall ensure that each ^{revenue} ~~affected municipality~~ ^{AND economically affected municipality} receives a fair and reasonable share of the payments provided under AS 43.82.210 in accordance with the following principles:

(1) the share of the payments to ^{revenue affected} ~~municipalities~~ ^{given priority} should be ~~determined~~ ^{over payments to economically affected municipalities} with due regard to the anticipated size of the tax base that the contract would exempt from municipal taxation ^{by revenue affected municipalities}

(2) the share of the payments to municipalities should be determined with due regard to the anticipated economic and social burdens that would be imposed on the municipality by construction and operation of the project;

(3) the respective shares of the total payments to the state and to municipalities should be fixed in a manner to ensure that their respective interests are aligned;

(4) to the extent practicable, the periodic amounts paid to each of the ~~affected~~ municipalities should be stable and predictable; and

(5) to the extent practicable, the provisions for sharing payments with municipalities should be consistent with the principles established in AS 43.82.210(b).

(c) In establishing the municipal shares under (b) of this section, the commissioner shall consult with the pertinent municipal advisory group.

Article 7. Miscellaneous Provisions.

Sec. 43.82.600. Governing law. If a provision of this chapter conflicts with another provision of state or municipal law, the provision of this chapter governs.

Sec. 43.82.610. Regulations. The commissioner of revenue, the commissioner of natural resources, and the commissioner of labor may adopt regulations to carry out their respective duties under this chapter.

Sec. 43.82.620. Procedures for collection of amounts due; security. (a) The commissioner may adopt procedures for the collection of amounts due the state under a contract entered into under AS 43.82.020, including the collection of interest and penalties.

(b) The commissioner may require a party to a contract under AS 43.82.020 to provide security sufficient to guarantee amounts due under the contract.

Sec. 43.82.630. Reports and audits. The commissioner may require periodic

reports from and may at reasonable intervals conduct audits and inspect the books of a party that has entered into a contract under AS 43.82.020 to ensure compliance with the provisions of this chapter and the regulations adopted under this chapter and of the terms of the contract.

Sec. 43.82.640. Annual report of the commissioner of labor. On an annual basis, the commissioner of labor shall prepare and present to the legislature a comprehensive report on each party to a contract with the state under AS 43.82.020, and its contractors, regarding the state residency of the employees working in this state on the approved qualified project that is subject to the contract. The commissioner of labor shall use state databases, including data from the quarterly reports by a party to the contract under AS 43.82.020 and its contractors for unemployment insurance purposes, to determine state residency of employees regarding compliance with AS 43.82.230.

Article 8. General Provisions.

Sec. 43.82.900. Definitions. In this chapter, unless the context requires otherwise,

(1) "affected municipality" means an economically affected municipality or a revenue affected municipality ~~a municipality for which it is reliably expected by the commissioner that, after the commencement of activities under AS 43.82.200, a contract entered into under AS 43.82.020 will, under AS 43.82.210, affect taxes that otherwise would be imposed by that municipality;~~

(2) "commencement of commercial operations" means the start of regular deliveries of marketable products from an approved qualified project;

(3) "cubic foot of gas" means the quantity of gas contained in a volume of one cubic foot at a standard temperature of 60 degrees Fahrenheit and a standard absolute pressure of 14.65 pounds per square inch;

(4) "economic proximity" means the area to which a party to a contract under AS 43.82.020 is willing to design, construct, and operate a gas line to provide service to a local consumer;

(5) "economic rent" means the estimated total gross revenue less estimated total costs for a qualified project over the term of a contract under AS 43.82.020, measured in undiscounted nominal dollars; for purposes of this

1 paragraph, "total costs" do not include a rate of return on capital, financing costs, or
2 any payments to governments;

3 *new (6) re "economically affected municipality" see amendment B.1 p 2, lines 15-22*
4 7 (6) "full project funding" means full approval by a party to a contract

5 under AS 43.82.020 for the expenditure of the capital necessary for construction and
6 operation of the approved qualified project that is subject to the contract;

7 (7) "gas" has the meaning given in AS 43.55.900;

8 (8) "group" means two or more persons;

9 (9) "lease or property" has the meaning given in AS 43.55.900;

10 (10) "periodic payment" means payment made in lieu of one or more

11 other taxes under a contract under AS 43.82.020;

12 *new subsection (12) re: "revenue affected municipality" see amendment B.1, p 3, lines 1-5*
13 (11) "stranded gas" means gas that is uneconomic or uncompetitive to

14 develop as determined by the commissioner for a particular project;

15 14 (12) "uneconomic or uncompetitive" means gas that is not being
16 marketed due to prevailing cost or price conditions as determined by an economic
17 analysis by the commissioner.

18 Sec. 43.82.990. Short title. This chapter may be cited as the Alaska Stranded
19 Gas Development Act.

20 * Sec. 4. AS 29.10.200 is amended by adding new paragraphs to read:

21 (54) AS 29.45.810 (exemption from municipal taxation);

22 (55) AS 29.46.010(b) (exemption from municipal assessment).

23 * Sec. 5. AS 29.45 is amended by adding a new section to read:

24 Sec. 29.45.810. Exemption from municipal taxation. (a) A party to a
25 contract with the commissioner of revenue under AS 43.82.020, and the property, gas,
26 products, and activities associated with the approved qualified project that is subject
27 to the contract, are exempt, as specified in the contract, from all taxes identified in the
28 contract that would be levied and collected by a municipality under state law as a
29 consequence of the participation by the party in the approved qualified project.

30 (b) This section applies to home rule and general law municipalities.

31 * Sec. 6. AS 29.46.010 is amended by adding a new subsection to read:

(b) Notwithstanding (a) of this section, a party to a contract with the
commissioner of revenue under AS 43.82.020 is exempt, as specified in the contract,

AMENDMENT

OFFERED IN THE HOUSE

BY REPRESENTATIVE ROKEBERG

TO: CSHB 393(O&G), Draft Version "B"

1 Page 24, line 16, following "to the":

2 Insert "revenue"

3 Page 24, following line 17:

4 Insert a new section to read:

5 "Sec. 43.82.505. Payments to economically affected municipalities. If the
6 commissioner executes a contract under AS 43.82.020 that will produce one or more
7 economically affected municipalities, the commissioner shall include a term in the
8 contract that provides for periodic payments to the economically affected
9 municipalities under the principles in AS 43.82.520."

10 Page 24, line 20, following "each":

11 Insert "revenue"

12 Page 24, line 21, following "municipality":

13 Insert "and economically affected municipality"

14 Page 24, line 22:

15 Delete "affected"

16 Page 25, line 2:

17 Following "each":

18 Insert "revenue"

19 Following "municipality":

20 Insert "and economically affected municipality"

1 Page 25, line 4:

2 Following "to":

3 Insert "revenue affected"

4 Delete "determined"

5 Insert "given priority over payments to economically affected municipalities"

6 Page 25, line 6, following "taxation":

7 Insert "by revenue affected municipalities"

8 Page 25, line 14:

9 Delete "affected"

10 Page 26, line 17, following "means":

11 Delete all material.

12 Insert "an economically affected municipality or a revenue affected municipality."

13 Page 26, lines 18 - 20:

14 Delete all material.

15 Page 27, following line 2:

16 Insert a new paragraph to read:

17 "(6) "economically affected municipality" means a municipality the
18 commissioner of revenue determines will be reasonably required to provide additional
19 public services under the terms proposed in an application approved under
20 AS 43.82.140(a); the commissioner may consider historical data from construction of
21 the Trans Alaska Pipeline System, and information submitted by a municipality in
22 making the determination;"

23 Renumber the following paragraphs accordingly.

24 Page 27, following line 10:

25 Insert a new paragraph to read:

1 "(12) "revenue affected municipality" means a municipality for which
2 it is reliably expected by the commissioner of revenue that, after the commencement
3 of activities under AS 43.82.200, a contract entered into under AS 43.82.020 will
4 affect taxes, under AS 43.82.210, that otherwise would be imposed by that
5 municipality;"

6 Renumber the following paragraphs accordingly.

LEGAL SERVICES

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MEMORANDUM

March 11, 1998

SUBJECT: Gas projects (CSHB 393(O&G))

TO: Representative Mark Hodgins, Chair
House Special Committee on Oil and Gas

FROM: Tamara Brandt Cook
Director *TBC*

Here is a draft committee substitute you requested of a bill originally introduced by the governor. I have some comments.

(1) The bill as introduced does not seem to comply with Art. IX, sec. 1 of the state constitution which states:

The power of taxation shall never be surrendered. This power shall not be suspended or contracted away, except as provided in this article.

Under AS 43.82.210 in the bill, a contract will contain terms that substitute periodic payments in lieu of taxes. These contract terms will, I suppose, be expected to prevent the state from later changing the law and imposing those taxes as a result of the federal and state prohibitions on the impairment of contracts. (Art. I, sec. 15, Constitution of the State of Alaska) The problem is that this is exactly the kind of contract that is prohibited under Art. IX, sec. 1. While the state may certainly provide for a tax exemption, I do not think it is possible for the state to give up its power to repeal the exemption and impose the tax in the future. Any contract that has that effect will probably be void as against public policy.

(2) AS 43.82.230(a) requires the commissioner of revenue to include in a contract a term requiring contracting with and employment of state residents, "within the constraints of law..." As a practical matter, there is little chance that such a term could ever be included. (*Hicklin v. Orbeck*, 565 P.2d 159 (Alaska 1977), rev'd on other grounds, 437 U.S. 518 (1978)) To the extent that the change made in this CS to the definition of "Alaska resident" adds a durational residency requirement of one year or longer, it is likely to be constitutionally invalid.

(3) The requirement added in AS 43.82.435 of this CS that the authority to enter into a contract be authorized by the legislature may violate the separation of powers doctrine. While the legislature may enact standards for the exercise of an executive power, it may generally not reserve the power to approve or authorize a particular action. For example,

Representative Mark Hodgins

March 11, 1998

Page 2

former AS 37.05.280, requiring legislative approval of certain leases of state office space, was held to violate the principle of separation of powers. (Marine View Chapter Juneau Tenants Association v. Alaska State Housing Authority, Superior Court, First Judicial District, 1JU-80-1037 Civ., Nov. 3, 1981) Currently the Procurement Code contains a similar lease approval requirement in AS 36.30.080, but at the time of the Code rewrite, a representative of the Attorney General's office testified that the provision was invalid. Likewise, the executive branch has, for many years, taken the position that the requirement for legislative approval of royalty oil contracts is unconstitutional (See Governor's transmittal letter for SB 164 dated April 22, 1995, Senate Journal, pages 1190-1191) Note, however, that while the executive branch has consistently, and, in my view, correctly, asserted that legislative approval provisions are unconstitutional, it has often conformed to them to accommodate the legislative desire for oversight.

(4) AS 43.82.400 uses the term "public revenue." I don't know what that means.

(5) The definition of "uneconomic or uncompetitive" added in paragraph 12 of AS 43.-82.900 in this CS is not useful. That phrase is not used in the bill at all except in the paragraph (11) of the same section. Taken together the net result of both the definitions is to define "stranded gas" as follows: (11) "stranded gas" means gas that is not being marketed due to prevailing cost or price conditions as determined by an economic analysis by the commissioner. Is that a good definition for your purpose? If so, I suggest you substitute it for paragraphs (11) and (12).

(6) In AS 43.82.510 added by this CS it is presumed that more than one municipality will be affected and so several members will be appointed to the group. What if only one municipality is affected?

(7) In AS 43.82.200(2)(A) and (B) are mutually exclusive. Does this make sense?

(8) AS 43.82.300 is unclear to me. Upon approval of an application, a commissioner can request certain information, but, if the information is not provided, the commissioner is prohibited from continuing to review the application. Hasn't the application already been approved? What, then, is left to review?

TBC:lmb
98-035.lmb

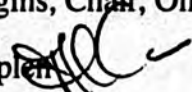
Enclosure

ALASKA STATE LEGISLATURE



REPRESENTATIVE ALLEN KEMPLER

MEMO

DATE: 2/26/98
TO: Representative Mark Hodgins, Chair, Oil and Gas Committee
FROM: Representative Allen Kempler 
SUBJECT: HB 393 - Alaska Stranded Gas Development Act

After reviewing the above piece of legislation, I have a few questions for the Administration.

1. Page 2, Lines 20 through 23 - How did the Department come to this conclusion? Have they conducted any analysis of future gas demand? There is at least one industrial project, over by Tyonek, that is projected to consume the same volume as the Fort Richardson base. If access to long-term, low-cost natural gas supplies were made available through a spur line to Enstar's distribution system, would the private sector respond with sufficient value-added development projects to register an impact on TAGS? This would also have an influence on how we take our economic rent share in value or in royalty.

ACTION: Is it possible for us to hear from the economic development industry (i.e. ARDOR) on this one?

2. Page 3, "economic rent" is used quite extensively in the proposed legislation. The definition of this term appears to leave a great deal of latitude to creative accountants. It may be appropriate for the Committee to establish some parameters for this concept.

ACTION: 1) Could we ask the Department for additional clarification?
2) Include clarifying language in the bill.

3. Page 3, Lines 28 through 31 - the notion of joint sharing in profitability seems a very reasonable proposition. However, it may be prudent for the state to examine what our experience has been with this approach. Have there been any profits reported? How much has the state received from these arrangements? Are there any lessons to be learned?

ACTION 1) A report from the Departments (Natural Resources and Revenue) updating the Committee on how existing profit sharing arrangements with industry have worked.

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4. Page 4, "reducing uncertainty" is another concept used fairly frequently in the proposed legislation. While I can certainly understand the industry's desire to lock in as many variables as possible, it seems there needs to be some additional discussion in this area. The state has a fiduciary responsibility to ensure that the risks of a dynamic and ever changing marketplace are properly accounted for in any long-term contractual arrangement. What happens when one or more of the sponsor group participants changes ownership through merger, hostile takeover, etc. and the new investors demand a renegotiation of the contract? This has potential for significant downside to the state because of the back-end loading aspect of the fiscal regime. Just when it appears that state and local governments are getting their fair share of the profits, along comes a new player saying the marketplace has changed and the state has to renegotiate or else.

Some people have asserted that the State's recent experience with the Northstar lease renegotiations are an indication that original contractual commitments may not be honored or considered binding by lessees. It is my understanding that BP acquired leases through assignment and then refused to honor net profit bid agreements, which would have deferred payments to the future and given the state a significant share of future profits. BP has been able to demand new terms as a condition of development, despite prior commitments. If this is true, is there reason to believe these proposed contracts will endure?

It appears to me that this type of situation merits serious consideration by the committee. Contracts that run for 30 years require us to be very careful about the arrangements. I would submit the proposition that the above situation is an argument for the state taking an equity share of the natural gas pipeline project. This would ensure that the state is always at the table as a true partner in the development and on-going operation of the pipeline.

The industry would not want the state government taking a direct hand in the project. However, it would be possible for the state to maintain a stakeholder role by having the Permanent Fund enter the project as an investor. I am prepared to present a more detailed discussion of this approach if need be.

ACTION: 1) I suggest the committee ask the Permanent Fund people to make a presentation regarding this notion. ?

2) Include language requiring sponsor group to identify a viable approach to having the state become an equity investor. ?

5. Page 6, Line 17 - It is my understanding that at least 30 trillion cubic feet of natural gas exists on the North Slope. Why are we establishing a floor of only 500 billion cubic feet over 20 years?

ACTION: 1) Adjust this figure upward to reflect a more aggressive production schedule for North Slope natural gas.

6. Page 6, Line 21 - "proximity of the project" is a phrase needing further definition. We must ensure that the communities of Fairbanks and those in south-central Alaska are able to be served by this gas.

ACTION: 1) Insert definition of "proximity of the project" into appropriate section.

7. Page 7, "proposed project plan" should include additional requirements to address issues raised by various concerned parties.

ACTION: 1) Insert a new sub-section asking that an applicant include a proposal for mitigating the project's impacts on adjacent communities such as increased demand for public services.

2) Insert a new sub-section asking for a proposal describing how the state could minimize the uncertainty of realizing its backend loaded profits.

3) Insert a new sub-section asking that an applicant include recommendations for how to handle on-going operation of the gas pipeline.

8. Page 8, "diligent development" is undefined. Line 31 on page 9 sets out a date for just the application deadline of June 30, 2004. Testimony by Mr. Findley of ARCO indicated a timeline of contract signed by 2002. Testimony by Mr. Lewis of Yukon Pacific indicated that even this timeline was insufficiently aggressive.

ACTION: 1) Insert a definition of "diligent development" and change the date on line 31 of page 9 to June 30, 2002.

9. Page 12, lines 9 through 14 - the distribution of economic rent between the sponsor group participants, the state and municipalities under a range of economic circumstances merits further analysis.

ACTION: 1) Insert a new sub-section asking that an applicant to present an analysis of how an equitable distribution of economic rent could occur under a range of economic circumstances for sponsor group, state and municipalities.

10. Page 13, lines 2-4 - the state share of royalty gas may shift over time as the state economy continues to develop. Economic prosperity within the state may require increasing amounts of royalty gas over the lifetime of the 30 year contract.

ACTION: 1) Insert a sub-section stating that it is the preference of the state to create a process of periodic review with language clarifying under what conditions royalty share can be adjusted.

11. Page 15, lines 14 through 17 - Alaska hire is very important. Developing the knowledge infrastructure for training Alaskans is a critical component of comprehensive development of a skilled labor force.

ACTION: 1) Insert language on line 17 "and who has successfully graduated from an accredited Alaskan training organization."

12. Page 21, Line 29 - Before the Commissioner executes the contract he should bring it before the entire Legislature for approval.

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page 4

ACTION: 1) Insert language on line 31 "the commissioner shall present the proposed contract to the Alaska State Legislature for ratification and approval."

13. Page 12, line 24 - Economic incentives have proven to be the best guarantor of effective private sector action to achieve public policy goals. It is suggested that Alaska hire goals would be strengthened by creating an incentive based system.

ACTION: 1) Insert new sub-section "(d) the commissioner shall develop a credit against periodic payment in lieu of taxes. Said credit shall be for every \$1.00 given to an accredited Alaskan training organization providing skill development in oil and gas support services, \$1.10 shall be credited against the periodic payment in lieu of taxes account."

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(c) Competitive bidding in a sale, exchange or other disposition described in (a) of this section may not be waived by the commissioner of natural resources under AS 38.05.183 unless prior written notice of proposed waiver is given to the board.

(d) *[Repealed, § 5 ch 112 SLA 1980.]* (§ 2 ch 9 SSSLA 1974; am § 5 ch 112 SLA 1980; am § 43 ch 21 SLA 1991)

Effect of amendments. — The 1991 amendment, effective June 11, 1991, in subsection (a), substituted "a bill approving" for "a resolution approving" in the second sentence and made punctuation changes.

NOTES TO DECISIONS

Stated in *McKinnon v. Alpetco Co.*, 633 P.2d 281 (Alaska 1981).

Sec. 38.06.055. Legislative approval. (a) In addition to the recommendation by the board required under AS 38.06.050, the commissioner of natural resources may not enter into a sale, exchange, or other disposition of oil or gas or of the rights or waiver of the rights to receive future production of royalty oil or gas under AS 38.05.183 without the prior approval of the legislature. The legislature may approve a sale, exchange, or other disposition of oil or gas or of the rights or of a waiver of the rights to receive future production of royalty oil or gas only by enacting legislation.

(b) The provisions of (a) of this section do not apply to

(1) the sale, exchange, or other disposition of oil or gas for one year or less if the sale, exchange, or other disposition is entered into to relieve storage or market conditions;

(2) contracts for the sale of state-owned royalty gas or oil that specify the sale and delivery of not more than

(A) 400 barrels of crude oil per day;

(B) 460 barrels of natural gas liquids per day; and

(C) 2,400 Mcf of natural gas per day.

(c) A sale, exchange, or other disposition of oil or gas under (b)(1) of this section may not be continued after the end of one year or renewed with the same party without the prior approval of the legislature under (a) of this section. This subsection does not apply to a sequential competitively bid sale of oil or gas made with the same party under (b)(1) of this section. (§ 2 ch 9 SSSLA 1974; am § 2 ch 146 SLA 1977; am § 1 ch 131 SLA 1978; am § 6 ch 112 SLA 1980; am § 2 ch 64 SLA 1985)

Effect of amendments. — The 1985 amendment in subsection (c) in the first sentence deleted "made" following "oil or gas" and "to provide relief for market or storage conditions" following "same party" and added the last sentence.

Opinions of attorney general. — The legislature may not conditionally approve a contract since such conditional acceptance is in law a rejection of the offer and the contract would have to be returned for renegotiation. February 23, 1977, Op. Att'y Gen.

NOTES TO DECISIONS

Quoted in *McKinnon v. Alpetco Co.*, 633 P.2d 281 (Alaska 1981).

Sec. 38.06.060. Confidentiality. Notwithstanding AS 09.25.110 — 09.25.120, the board may provide by regulation for the confidentiality of those documents and records in its possession or control which contain confidential business or marketing information the protection of which is essential to the person who has submitted them to the board or in the judgment of the board is essential to the best interest of the state. Such confidentiality, however, shall not preclude the proper review by the legislature. (§ 2 ch 9 SSSLA 1974)

Opinions of attorney general. — The chairman of the Alaska Royalty Oil and Gas Development Advisory Board may accurately represent to various private companies that documents they provide to the

Comments to the Oil & Gas Committee

Good Morning, ^{Chairman} Representative Hodgins ^{& members of the Committee.}. Thank you for inviting us to testify here today. I'd like to give a brief overview of the position of the "pipeline" communities - which are the Fairbanks North Star Borough, the City of Valdez, and the North Slope Borough.

Last April the mayors of the pipeline communities got together and formed a non-profit called Trans-Alaska Gasline Now. The group was formed for three reasons. First, to encourage all parties to make every effort, as soon as possible, to make the North Slope gas available for those ready to proceed with the building of the gasline. The second reason is to help expedite the building of the gasline so that our communities can benefit from natural gas. And the third reason and perhaps the most important, is to give our communities along the pipeline corridor a stronger voice in issues related to a gasline through a united effort.

We've heard from a number of sources, that there will have to be a "tax holiday" of municipal property taxes in order for the project to be economically viable. In response, we have agreed to exempt property taxes for a period of five years. In exchange for this exemption, we propose that the municipalities involved would take an equity position proportionate to the dollar value of the exempted taxes. Though our financial ownership interest in the project would be small, it would produce a revenue stream which would dwarf, over time, the amount of taxes exempted at the "front

end" of the project. This approach creates a government/business partnership that, from our view, is in the public interest.

We are willing to listen to other proposals as well. We understand that soon there will be framework legislation for the gasline project, since no sponsor has been named. However, there are a number of issues that collectively we feel very strongly about. Any legislation must allow affected local governments a role in the development and approval of contracts for any payments in lieu of taxes. We cautiously agree to a limited tax exemption,

but we will not find it acceptable for any agency to negotiate on our behalf.

that our communities have been misinformed and that we fully participate in contract negotiations. We suggest

It is unfortunate, but our communities are still feeling the negative impacts of the TAPS agreement. We would prefer that history not repeat itself.

Another issue surrounding projects such as these is confidentiality. WE run up against that barrier every year with the valuation of the oil pipeline. We would like to find a legal way to be included in discussions that affect our communities. We realize there have been endless discussions about Alaska Hire and it's legal limitations. We would hope that any legislation would make provisions for the sponsor of the gasline to have conversations about hiring needs and specific job skills. We would hate for our residents to not have access to good paying jobs because of a lack of training, when advance planning and communication could prevent that from happening.

In short, we are enthusiastic supporters of the gasline. We are willing to be flexible in order to make the project economically viable. We have concerns about framework legislation being too broad to offer us any

protection, but we are also willing to work with any interested party. Thank you for your time.

advance and with as much certainty as the Constitution of the State of Alaska allows; 1
and 2

(3) maximize the benefit to the people of the state of the development 3
of the state's stranded gas. 4

**Sec. 43.82.020. Contracts for payments in lieu of other taxes and for 5
royalty adjustments.** The commissioner may, under this chapter, enter into a contract 6
with a qualified sponsor or qualified sponsor group providing for (1) periodic payment 7
in lieu of one or more taxes that otherwise would be imposed by the state [OR A 8
MUNICIPALITY] upon the qualified sponsor or members of the qualified sponsor group as 9
a consequence of the sponsor's or group's participation in an approved qualified 10
project under this chapter; and (2) certain adjustments regarding royalty under 11
AS 43.82.220. 12

Article 2. Qualification and Application Procedures. 13

Sec. 43.82.100. Qualified project. Based on information available to the 14
commissioner, the commissioner may determine that a proposal for new investment is 15
a qualified project under this chapter only if the project 16

(1) would produce at least 500 billion cubic feet of stranded gas within 17
20 years from the commencement of commercial operations; and 18

(2) **[IS CAPABLE, SUBJECT TO APPLICABLE COMMERCIAL
REGULATION AND TECHNICAL AND ECONOMIC CONSIDERATIONS, OF MAKING]
would make gas available in sufficient quantities to meet reasonably foreseeable [DEMAND IN THIS
STATE FOR GAS] present and future needs of communities within proximity to the project at a
price equal to the wellhead value plus the allocated transportation costs to the pipeline connection. 19**

Sec. 43.82.110. Qualified sponsor or qualified sponsor group. The 22
commissioner may determine that a person or group is a qualified sponsor or qualified 23
sponsor group if the person or a member of the group 24

(1) intends to own an equity interest in a qualified project or commit 25
gas that it owns to a qualified project; and 26

(2) meets one or more of the following criteria: 27

(A) owns a working interest in at least 10 percent of the 28
stranded gas proposed to be developed by a qualified project; 29

(B) has the right to purchase at least 10 percent of the stranded 30
gas proposed to be developed by a qualified project; 31

Sec. 43.82.180. Withdrawal of applications. Subject to the terms of a 1 reimbursement agreement under AS 43.82.240 or other agreement with the Department 2 of Revenue, the Department of Natural Resources, the commissioner of revenue, or the 3 commissioner of natural resources affecting the withdrawal of an application, a 4 qualified sponsor or qualified sponsor group may withdraw an application submitted 5 under AS 43.82.120 at any time before the date that the commissioner of revenue 6 enters into a contract under AS 43.82.430 without further obligation under this chapter. 7

Article 3. Contract Development. 8

Sec. 43.82.200. Contract development. If the commissioner of revenue 9 approves an application and proposed project plan under AS 43.82.140, the 10 commissioner may develop a contract under AS 43.82.020 that may include 11

(1) terms concerning periodic payment in lieu of one or more taxes as 12 provided in AS 43.82.210; 13

(2) terms developed under AS 43.82.220 relating to 14

(A) timing and notice of the state's right to take royalty in kind 15 or in value; or 16

(B) royalty value; 17

(3) terms regarding Alaska hire and Alaska contracting under 18 AS 43.82.230; 19

[(4) TERMS REGARDING PERIOD PAYMENT TO, OR AN EQUITY OR 21 OTHER INTEREST IN A PROJECT FOR, MUNICIPALITIES UNDER AS 43.82.500;]

(4) terms regarding arbitration or alternative dispute resolution 22 procedures; 23

(5) terms and conditions for administrative termination of a contract 24 under AS 43.82.440; and 25

(6) other terms or conditions that are 26

(A) necessary to further the purposes of this chapter; or 27

(B) in the best interests of the state. 28

Sec. 43.82.210. Contract terms relating to payment in lieu of one or more state 29 taxes. (a) If the commissioner of revenue approves an application and proposed 30 project plan under AS 43.82.140, the commissioner may develop proposed terms, for 31

inclusion in a contract under AS 43.82.020, for periodic payment in lieu of one or 1
 more of the following taxes that otherwise would be imposed by the state [OR A 2
MUNICIPALITY] upon the qualified sponsor or a member of the qualified sponsor group 3
 as a consequence of participating in an approved qualified project: 4

(1) oil and gas production taxes and oil surcharges under AS 43.55; 5

(2) oil and gas exploration, production, and pipeline transportation 6
 property taxes under AS 43.56; 7

(3) oil and gas conservation tax under AS 43.57; 8

(4) Alaska net income tax under AS 43.20; 9

[(5) **MUNICIPAL SALES AND USE TAX UNDER AS 29.45.650 -29.45.680 OR 10**
29.45.700 - 29.45.710;] 11

[(6) **MUNICIPAL PROPERTY TAX UNDER AS 29.45.010 - 29.45.250 OR 12**
29.45.550 - 29.45.600;] 13

[(7) **MUNICIPAL SPECIAL ASSESSMENTS UNDER AS 29.46;**] 14

(5) a comparable tax or levy imposed by the state [OR A **MUNICIPALITY]** 15
 after the effective date of this bill section; 16

(6) other state taxes [OR **MUNICIPAL TAXES**] or categories of state taxes
 identified by 17
 the commissioner. 18

(b) If the commissioner chooses to develop proposed terms under (a) of this 19
 section, the commissioner shall, if practicable and consistent with the long-term fiscal 20
 interests of the state, develop the terms in a manner that attempts to balance the 21
 following principles: 22

(1) the terms should, in conjunction with other factors such as cost 23
 reduction of the project, cost overrun risk reduction of the project, and increased fiscal 24
 certainty and successful marketing, improve the competitiveness of the approved 25
 qualified project in relation to other development efforts aimed at supplying the same 26
 market; 27

(2) the terms should accommodate the interests of the state, [**THE AFFECTED 28**
MUNICIPALITIES,] and the project sponsors under a wide range of economic conditions, 29
 potential project structures, and marketing arrangements; 30

(3) the state's [**AND AFFECTED MUNICIPALITIES' COMBINED**] share of the 31

approved qualified project's economic rent under the contract should be relatively 1
 progressive; that is, the state's [AND AFFECTED MUNICIPALITIES' COMBINED] annual
 share of 2

the approved qualified project's economic rent generally should not increase when 3
 there are decreases in project profitability, or decrease when there are increases in 4
 project profitability; 5

(4) the state's [AND AFFECTED MUNICIPALITIES COMBINED] share of the 6
 approved qualified project's economic rent under the contract should be relatively 7
 lower in the earlier years than in the later years of the approved qualified project; 8

(5) the terms should allow the project sponsors to retain a share of the 9
 approved qualified project's economic rent that is sufficient to compensate the sponsors 10
 for risks under a range of economic circumstances; 11

(6) the terms should provide the state [AND AFFECTED MUNICIPALITIES]
 with 12
 a significant share of the approved qualified project's economic rent, when discounted 13
 to present value, under favorable price and cost conditions; 14

(7) the method for calculating the periodic payment in lieu of certain 15
 taxes under the contract should be clear and unambiguous; and 16

(8) while cost calculations for the approved qualified project under the 17
 contract should be based on amounts that closely approximate actual costs, agreed- 18
 upon formulas reflecting reasonable economic assumptions should be used if possible 19
 to promote administrative certainty and efficiency. 20

(c) Except as provided in (b) of this section, the commissioner's discretion 21
 under this section in developing proposed terms for a contract under AS 43.82.020 is 22
 not limited to consideration of the approved qualified project's economic rent. 23

Sec. 43.82.215. Contract terms relating to deferment of municipal taxes and assessments.

(a) If the commissioner of revenue approves an application and proposed project plan under AS 43.82.140, the commissioner may develop proposed terms for inclusion in a contract under AS 43.82.020 for deferment of municipal property taxes under AS 29.45.10 - 29.45.250 or 29.45.550 - 29.45.600 that otherwise would be imposed by a municipality upon the qualified sponsor or a member of the qualified sponsor group as a consequence of participating in an approved qualified project.

(b) Any deferments of municipal property taxes are subject to the following limitations which must be set out in the agreement

(1) the deferment may not exceed five years from the date the taxes were due and payable on any portion of the project.

(2) all deferred taxes must be repaid with interest calculated (at the Consumer Price Index calculated as of January 1 of each tax year) in equal annual installments during the first five years after the period of deferment.

(3) property taxes may not be deferred on facilities which are subject to taxes under AS 29.45.010 - 29.45.250 or 29.45.550 - 29.45.600 on the effective date of a contract under this chapter.

(4) property taxes may be deferred on only (1) property required for construction and operation of a Trans-Alaska natural gas pipeline; and (2) facilities that are constructed during the initial deferment period.

Sec. 43.82.218. Issuance of municipal bonds. Municipalities whose taxes have been deferred may issue bonds up to the amount necessary to accommodate expenditures required to be made by the municipality as a result of the impact of the project. The payment of principle and interest on such bonds shall be guaranteed by the State of Alaska in the event that the project sponsors fail to pay the full amount of the deferred taxes.

Sec. 43.82.220. Contract terms relating to royalty. (a) Notwithstanding any 24 contrary provisions of AS 38, the commissioner of natural resources, with the 25 concurrence of the commissioner of revenue and the affected parties holding a state 26 lease or unit agreement, may develop proposed terms, for inclusion in a contract under 27 AS 43.82.020, that modify the timing and notice provisions of the applicable oil and 28 gas leases and unit agreements pertaining to the state's rights to receive its royalty in 29 kind or in value, if 30

(1) the viability of the approved qualified project depends upon long- 31

**[ARTICLE 6. PAYMENT TO MUNICIPALITIES; EQUITY OR 1
OTHER PARTICIPATION BY MUNICIPALITIES. 2**

**SEC. 43.82.500. PAYMENT TO MUNICIPALITIES; EQUITY OR OTHER
PARTICIPATION BY 3
MUNICIPALITIES. (A) IF THE COMMISSIONER EXECUTES A CONTRACT UNDER AS
43.82.020 THAT 4
INCLUDES TERMS THAT EXEMPT A PARTY TO THE CONTRACT, AND THE
PROPERTY, GAS, PRODUCTS, AND 5
ACTIVITIES ASSOCIATED WITH THE APPROVED QUALIFIED PROJECT THAT IS
SUBJECT TO THE CONTRACT, 6
FROM A MUNICIPAL TAX IN ACCORDANCE WITH AS 29.45.810, AS 29.46.010(B), 7
AS 43.82.200, AND 43.82.210, THE COMMISSIONER SHALL REQUIRE, AS A CONDITION
OF THE 8
CONTRACT, THAT THE PARTY INSTEAD MAKE PERIODIC PAYMENT TO THE
AFFECTED MUNICIPALITY IN 9
A FAIR AND REASONABLE AMOUNT AS DETERMINED BY THE COMMISSIONER
UNDER (B) OF THIS 10
SECTION. 11**

**(B) AFTER CONSULTATION WITH THE AFFECTED MUNICIPALITY, THE
COMMISSIONER SHALL 12
DETERMINE THE AMOUNT OF PAYMENT DUE UNDER (A) OF THIS SECTION. IN
MAKING THE 13
DETERMINATION REQUIRED BY THIS SUBSECTION, THE COMMISSIONER SHALL 14
(1) ESTIMATE THE TOTAL OPERATING AND CAPITAL COSTS OF
ADDITIONAL SERVICES 15
AND CONSTRUCTION THAT WOULD BE PROVIDED AND PAID FOR BY THAT
MUNICIPALITY DURING THE 16
TERM OF THE CONTRACT UNDER AS 43.82.020 AS A RESULT OF THE
CONSTRUCTION AND OPERATION 17
IN THE MUNICIPALITY OF THE APPROVED QUALIFIED PROJECT THAT IS SUBJECT
TO THE CONTRACT; AND 18**

(2) AMORTIZE THE TOTAL COSTS ESTIMATED UNDER (1) OF THIS SECTION OVER THE 19 TERM OF THE CONTRACT OR A PORTION OF THE TERM OF THE CONTRACT. 20 (C) IN LIEU OF PAYMENTS UNDER (A) OF THIS SECTION, THE COMMISSIONER, WITH THE 21 CONCURRENCE OF THE MUNICIPALITY, MAY INCLUDE A TERM IN A CONTRACT UNDER AS 43.82.020 22 THAT PROVIDES THE MUNICIPALITY WITH AN EQUITY OR OTHER INTEREST IN THE APPROVED QUALIFIED 23 PROJECT THAT IS SUBJECT TO THE CONTRACT.] 24

Article 7. Miscellaneous Provisions. 25

Sec. 43.82.600. Governing law. If a provision of this chapter conflicts with 26 another provision of state or municipal law, the provision of this chapter governs. 27

Sec. 43.82.610. Regulations. The commissioner of revenue, the commissioner 28 of natural resources, and the commissioner of labor may adopt regulations to carry out 29 their respective duties under this chapter. 30

Sec. 43.82.620. Procedures for collection of amounts due; security. (a) 31

CITY OF VALDEZ, ALASKA

RESOLUTION NO 98-22

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF VALDEZ, ALASKA, PROVIDING COMMENTS TO HOUSE BILL 393 AND SENATE BILL 288, TITLED ALASKA STRANDED GAS DEVELOPMENT ACT

WHEREAS, House Bill 393 and Senate Bill 288 have been introduced by the Governor relating to contracts with the State establishing payments in lieu of other taxes by a qualified sponsor for projects to develop stranded gas in the State; and

WHEREAS, House Bill 393 and Senate Bill 288 change the traditional method of taxing gas property in Alaska by precluding those local governments where the gasline and liquefaction facilities would be located, from taxing that property on a traditional advalorem basis; and

WHEREAS, the Valdez City Council has had the opportunity to review House Bill 393 and Senate Bill 288 and held a work session with representatives from the State of Alaska Department of Revenue on March 1, 1998.

NOW, THEREFORE, BE IT RESOLVED that the City of Valdez makes the following comments regarding House Bill 393 and Senate Bill 288:

1. We applaud the State's efforts to encourage the building of a natural gas pipeline from Alaska's North Slope to Valdez which will provide tremendous long term benefits to all Alaskans.
2. A Gas to Liquids (GTL) project would have very different impacts on Valdez than a gasline and should be addressed separately. Therefore, reference to GTL should be removed from this bill.
3. There must be appropriate language to provide for the hiring of Alaska residents during both the construction and operational years.
4. Communities along the pipeline route will need impact funds to address the immediate impact on each community.
5. Job training should be provided in the communities within the proximity of the project.

6. There should be definitions for "affected community" and "communities within proximity of the project" in the bill which would be those communities who have been precluded from collecting traditional taxes on the gasoline as a result of this legislation.

7. The affected communities should be allowed participation in the negotiations between the State and the qualified sponsor group regarding those terms that would directly impact the affected community. Any such agreement must be ratified by the affected communities.

8. The confidentiality provision should extend to representatives of the affected communities so long as the representatives sign the confidentiality agreement referenced in the legislation.

9. If the payments to the affected communities are to be derived from a total dollar amount paid to the State, the allocation methodology between affected communities and the State should be set forth in the legislation, regulation or a contract between the State and affected communities.

10. Payments to the municipality could consist of the following:

(a) During the years of construction, up to five (5) years, the property taxes would be deferred.

(b) The taxes deferred in the first five years of construction would be paid over the first five years of operation as additional payments.

(c) Revenue stability to the affected community through a maximum mill rate to be assessed by the affected communities could be established now and be inflation proofed.

(d) The valuation/methodology of the gas project should be established by statute.

(e) Depending upon the maximum mill rate established, there should be a profit sharing agreement with the affected communities similar to the financial revenue sharing arrangement between the State and contract sponsors.

11. Existing provisions of the bill ensuring that gas would be made available to communities within proximity of the project should be retained.

12. Revenue payments to the affected communities should be in a first priority position before revenues are disbursed to the State.

PASSED AND APPROVED BY THE CITY COUNCIL OF THE CITY OF VALDEZ, ALASKA this 2nd day of March, 1998.

CITY OF VALDEZ, ALASKA

Dave C. Cobb, Mayor

ATTEST:

Sheri L. Caples, CMC, City Clerk

RESOLUTION NO. 98-18

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF VALDEZ, ALASKA, SUPPORTING THE FIVE (5) YEAR TAX EXEMPTION PROPOSED BY THE MAYORS OF THE FAIRBANKS NORTH STAR BOROUGH, NORTH SLOPE BOROUGH, CITIES OF FAIRBANKS, NORTH POLE AND VALDEZ FOR THE CONSTRUCTION OF THE TRANS-ALASKA GAS PIPELINE

WHEREAS, plans for a Trans-Alaska gas pipeline have been discussed and debated for many years in Alaska; and

WHEREAS, owners of the Trans-Alaska Gas Pipeline project are pursuing the construction of a natural gas pipeline; and

WHEREAS, the municipalities of Fairbanks North Star Borough, North Slope Borough, Cities of Fairbanks, North Pole and Valdez have recognized the importance of the construction of a natural gas pipeline; and

WHEREAS, the Mayors from these municipalities have agreed to offer up to a five (5) year tax exemption to the owners of the Trans-Alaska Gas Pipeline; and

WHEREAS, in exchange for this exemption, the Mayors propose that the municipalities involved would take an ownership position proportionate to the dollar value of the exempted taxes for the proposed five (5) year period; and

WHEREAS, the State of Alaska and other interested parties supporting the construction of a Trans-Alaska gas pipeline have stated that to be economically viable, a "tax holiday" would need to take place during construction as there would be little or no cash flow during that phase; and

WHEREAS, gas line take-offs would be expected so that each of these municipalities would have natural gas distributed to its citizens and businesses; and

WHEREAS, the Mayors of the affected municipalities find this a reasonable position and in the best interest of those communities involved by providing a less expensive form of energy to their citizens and will provide considerably cleaner emissions produced through combustion which will significantly affect air quality; and

WHEREAS, the State of Alaska is on record as stating that a tax exemption of some sort is necessary to move a gas line project to reality and would have to offer similar concessions for that part of the pipeline not located in an organized municipality; and

WHEREAS, through a small financial ownership interest by the municipalities in the pipeline, the revenue stream produced for at least the next fifty (50) years would diminish the amount of taxes exempted at the "front end" of the project; and

WHEREAS, this is a very positive approach to solving one of few remaining obstacles to construction of the gas line and creates a government/business partnership that is in the interest of the public and demonstrates flexibility from municipalities that show them to be part of a solution rather than part of a problem.

NOW, THEREFORE, BE IT RESOLVED that the City Council of the City of Valdez, Alaska, strongly supports the plan put forth by the Mayors of those municipalities involved and requests the Legislature and the Governor to support the plan by providing the same tax incentives in the unorganized areas of the State that would be affected.

PASSED AND APPROVED this 17th day of February, 1998.

David C. Cobb
David C. Cobb, Mayor

ATTEST:

Sheri L. Caples, City Clerk
Sheri L. Caples, CMC, City Clerk



By:

Hank Bartos
Mayor Hank Hove
Dan LaSota
Cole Sonafrank
Mike Young
Karen Parr

Introduced: 01/22/98
Amended: 01/22/98
Adopted: 01/22/98

RESOLUTION NO. 98 - 007

**A RESOLUTION SUPPORTING THE FIVE (5) YEAR TAX EXEMPTION PROPOSED
BY THE MAYORS OF THE FAIRBANKS NORTH STAR BOROUGH, NORTH SLOPE
BOROUGH, CITIES OF FAIRBANKS, NORTH POLE AND VALDEZ FOR THE
CONSTRUCTION OF THE TRANS-ALASKA GAS PIPELINE**

WHEREAS, plans for a Trans-Alaska gas pipeline have been discussed and debated for many years in Alaska; and

WHEREAS, owners of the Trans-Alaska Gas Pipeline project are pursuing the construction of a natural gas pipeline; and

WHEREAS, the municipalities of Fairbanks North Star Borough, North Slope Borough, City of Fairbanks, North Pole, and Valdez have recognized the importance of the construction of a natural gas pipeline; and

WHEREAS, the Mayors from these municipalities have agreed to offer up to a five (5) year tax exemption to the owners of the Trans-Alaska Gas Pipeline; and

WHEREAS, in exchange for this exemption, the Mayors propose that the municipalities involved would take an ownership position proportionate to the dollar value of the exempted taxes for the proposed five (5) year period; and

WHEREAS, the state of Alaska and other interested parties supporting the construction of a trans-alaska gas pipeline have stated that to be economically viable, a "tax holiday" would need to take place during construction as there would be little or no cash flow during that phase; and

WHEREAS, gasoline take-offs would be expected so that each of these municipalities would have natural gas distributed to its citizens and businesses; and

WHEREAS, the Mayors of the affected municipalities find this a reasonable position and in the best interest of those communities involved by providing a less expensive form of energy to their citizens and will provide considerably cleaner emissions produced through combustion which will significantly affect air quality; and

WHEREAS, the State of Alaska is on record as stating that a tax exemption of some sort is necessary to move a gas line project to reality and would have to offer similar concessions for that part of the pipeline not located in an organized municipality; and

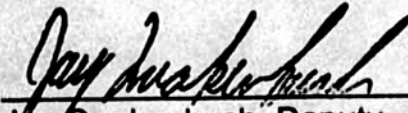
WHEREAS, through a small financial ownership interest by the municipalities in the pipeline, the revenue stream produced for at least the next fifty (50) years would diminish the amount of taxes exempted at the "front end" of the project; and

WHEREAS, this is a very positive approach to solving one of few remaining obstacles to construction of the gasoline and creates a government/business partnership that is in the interest of the public and demonstrates flexibility from municipalities that show them to be part of a solution rather than part of a problem.

NOW, THEREFORE, BE IT RESOLVED that the Fairbanks North Star Borough Assembly and Mayor Hank Hove strongly support the plan put forth by the Mayors of those municipalities involved and requests the Legislature and the Governor to support the plan by providing the same tax incentives in the unorganized areas of the state that would be affected.

BE IT FURTHER RESOLVED that copies of this resolution shall be sent to all members of the Interior Delegation and to the Honorable Tony Knowles, Governor, State of Alaska.

PASSED AND APPROVED THIS 22ND DAY OF JANUARY, 1998.



Jay Quakenbush, Deputy
Presiding Officer

ATTEST:



Mona Lisa Drexler, CMC/AAE
Municipal Borough Clerk

Ayes: Young, Sonafrank, Solie, Parr, Prax, LaSota, Webb, Quakenbush
Noes: McBride

1

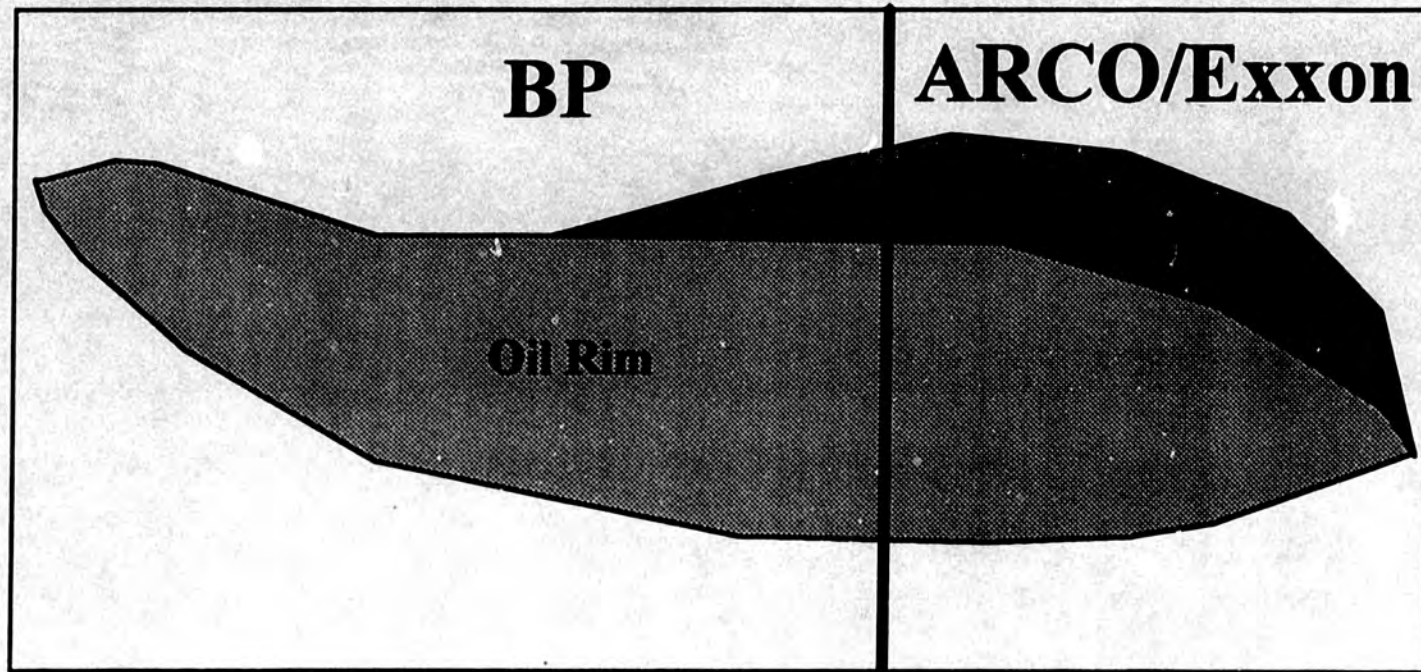
**REPORT TO HOUSE SPECIAL COMMITTEE
ON OIL AND GAS**

***THE EFFECT OF CONTRACTUAL ARRANGEMENTS AT
PRUDHOE BAY ON THE RELATIVE INCENTIVES TO HAVE
A GAS SALE***

STATE OF ALASKA DEPARTMENT OF REVENUE

MARCH 18, 1997

The Prudhoe Bay Reservoir



PA Ownership

Oil Rim

- BP	50%
- Arco/Exxon	44%

Gas Cap

- BP	13%
- Arco/Exxon	85%

Gas Distribution among PAs

Oil Rim	30% of gas
Gas Cap	70% of gas

Gas Distribution among Companies

BP	24% of gas
Arco/Exxon	74% of gas

PBUOA / IRA

Phases of Field Life

- Phase 1
- Phase 2
- Phase 3

Product Allocation / Cost Allocation

- Black Oil
- Condensate
- Natural gas liquids
- Sale gas

PHASE 1 - PRE MAJOR GAS SALE

Product Allocation

Oil - all to oil rim

Condensate - all to gas cap

- Est. gas cap gas going through separation facilities

- Est. amt. of condensate contained in the gas cap gas

NGLs - relative volumes of gas going through the CGF

Cost Allocation

90% Oil - all except minor amounts below

10% Condensate - p/bbl allocation

NGLs - proportional to capital expenditures for NGL/EOR
project

PHASE 2 - MAJOR GAS SALE

Product Allocation

Oil - no change

Condensate - no change

NGLs - switch from GOR to remaining hydrocarbon gas reserves method

Sale Gas - remaining hydrocarbon gas reserves

Cost Allocation

Oil - no change

Condensate - p/bbl allocation reduced

NGLs - no change

Sale Gas - no change (all to oil rim)

PHASE 3 - FIELD BECOMES GAS ORIENTED

Product Allocation

Oil - no change

Condensate - no change

NGLs - no change

Sale Gas - no change

Cost Allocation

Oil - remaining hydrocarbon gas reserves

Condensate - no change

NGLs - no change

Sale Gas - remaining hydrocarbon gas reserves

What Happens in a Major Gas Sale

- 1) Oil rim and gas cap sell gas
- 2) Operating costs shift from oil rim to gas cap
- 3) Oil rim receives more NGLs
- 4) Oil recovery is reduced

Scenarios

No Gas Sale

Gas Sale

Low ^{50¢ + 100¢} gas price / Low operating cost

Low gas price / High operating cost

High gas price / Low operating cost

High gas price / High operating cost

Compute difference

What does a Major Gas Sale Look Like?

6 year ramp-up beginning in 2005

Peak at 2010 with 1.68 bcf/d to market (14 mmta)

1.95 bcf/d to conditioning plant

1.90 bcf/d to pipeline

Spiked with light ends to increase BTUs

25 year life

No additional upstream capital costs

No additional upstream operating costs

11

**ELEMENTS OF CHANGE IN NPV
COMPARED TO NO SALE
(\$mm)**

SCENARIO

	Low Price/ Low O&M		High Price/ Low O&M	
	A/E	BP	A/E	BP
Lost Oil	(255)	(290)	(255)	(290)
O&M Shift	(78)	69	(78)	69
NGL Sales	(153)	41	(153)	41
Gas Sales	<u>892</u>	<u>292</u>	<u>1788</u>	<u>585</u>
Total	406	112	1303	405

SCENARIO

	Low Price/ High O&M		High Price/ High O&M	
	A/E	BP	A/E	BP
Lost Oil	(255)	(290)	(255)	(290)
O&M Shift	(477)	423	(477)	423
NGL Sales	(154)	42	(154)	42
Gas Sales	<u>892</u>	<u>292</u>	<u>1788</u>	<u>585</u>
Total	5	467	901	760

ELEMENTS OF CHANGE IN NPV
COMPARED TO NO SALE
OIL PRICE/VOLUME SENSITIVITIES
(\$mm)

SCENARIO

	Low Oil Volume/ Low Oil Price		Low Oil Volume/ High Oil Price	
	<u>A/E</u>	<u>BP</u>	<u>A/E</u>	<u>BP</u>
Lost Oil	(164)	(203)	(297)	(338)
O&M Shift	(502)	445	(109)	97
NGL Sales	(106)	24	(164)	31
Gas Sales	<u>1341</u>	<u>439</u>	<u>1341</u>	<u>439</u>
Total	569	706	770	230

SCENARIO

	High Oil Volume/ Low Oil Price		High Oil Volume/ High Oil Price	
	<u>A/E</u>	<u>BP</u>	<u>A/E</u>	<u>BP</u>
Lost Oil	(212)	(242)	(334)	(382)
O&M Shift	(681)	604	(120)	106
NGL Sales	(123)	48	(195)	76
Gas Sales	<u>1341</u>	<u>439</u>	<u>1341</u>	<u>439</u>
Total	325	848	691	240

Some Differential Incentives?

- BP's incentive for high operating cost?
- Arco/Exxon's incentive for higher wellhead price?
- Arco/Exxon's incentive for less than a major gas sale?



**YUKON
PACIFIC
CORPORATION**
TRANS-ALASKA GAS SYSTEM

JEFF B. LOWENFELS
PRESIDENT AND CHIEF EXECUTIVE OFFICER

March 13, 1997

Representative Ramona Barnes
House of Representative
STATE OF ALASKA
State Capitol, Room 403
Juneau, AK 99801-1182

Dear Representative Barnes:

I think you will find the enclosed testimony very interesting.

By way of background, this testimony was to have been given before the Oil and Gas Conservation Commission last year—before the Attorney General's office emasculated the OGCC and the hearings therefore concluded.

The 'blacked out' portions contain information the producers did not want to become public.

You might wish to speak to Commissioner David Johnston regarding his thoughts on the impact of Prudhoe Bay Unitization in delaying a gas sale.

Very truly yours,


Jeff Lowenfels



SOUTHERN
METHODIST
UNIVERSITY

James L. Smith

Cary M. Maguire Professor of Oil and Gas Management

February 24, 1997

David W. Johnston, Chairman
Alaska Oil and Gas Conservation Commission
3001 Porcupine Drive
Anchorage, AK 99501-3192

Dear Chairman Johnston:

Enclosed you will find two copies of my report, which was prepared in accordance with the instructions provided in your letter of January 10, 1997. Rather than taking the time and expense that would have been required to rewrite or edit the report to remove material that pertains to the subpoenaed documents, I have elected to simply black out all such sections or passages that appeared within my original draft.

The opinions and conclusions that are presented in this version are based on my general knowledge of the theory and practice of unitization agreements, as well as specific information pertaining to the Prudhoe Bay Unit that I have acquired from various public sources, including transcripts of the Commission's hearings on the question of compulsory unitization. I think the censored version is still quite readable and informative, and it does not compromise the confidentiality of any protected documents. I hope that you find the report to be useful.

I will be sending under separate cover a final invoice that brings my account up to date. It was a pleasure to assist you in this matter. If you have any questions, please do not hesitate to call me. Thank you.

Sincerely,

James L. Smith

encl.

Edwin L. Cox School of Business
PO Box 750333 Dallas TX 75275-0333
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E-mail: jsmith@mail.cox.smu.edu

TEACHING SPECIALTIES

Energy Economics and Policy (graduate and undergraduate levels).

Managerial Economics (MBA level).

Microeconomic Theory (graduate and undergraduate levels).

Economic Statistics and Econometrics (graduate and undergraduate levels).

REFEREED PUBLICATIONS

"Taxation and Investment in Russian Oil," *Journal of Energy Finance and Development* (forthcoming).

"Optimal Reservation Prices in Auctions," *Economic Journal*, with Dan Levin (vol 106, no. 438, 1996).

"Ranking Auctions with Risk Averse Bidders," *Journal of Economic Theory*, with Dan Levin (vol. 68, no. 2, 1996).

"On the Cost of Lost Production from Russian Oil Fields," *The Energy Journal* (vol. 16, no. 2, 1995).

"Equilibrium in Auctions with Entry," *American Economic Review*, with Dan Levin (June 1994).

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"Comment on 'Some Evidence on the Winner's Curse,'" *American Economic Review*, with Dan Levin (March 1991).

"Option Valuation of Claims on Real Assets: The Case of Offshore Petroleum Leases," *Quarterly Journal of Economics*, with J. Paddock and D. Siegel (August 1988).

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- "Equilibrium Patterns of Competition in OCS Lease Sales," *Econ. Inquiry*, (April 1982).
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- "Non-Aggressive Bidding Behavior and the Winner's Curse," *Econ. Inquiry* (July 1981).
- "Probabilistic Methods for Estimating Undiscovered Petroleum Resources," *Advances in the Economics of Energy and Natural Resources*, with F. O'Carroll (1980).
- "A Probabilistic Model of Oil Discovery," *The Review of Economics and Statistics* (November 1980).
- "Oil Supply Forecasting: A Disaggregated Process Approach," *Bell Journal of Economics*, with P. Eckbo and H. Jacoby (Spring 1978).
- "The Quality of Economic Writing in Four Newsmagazines," *Journal of Business Communication* (Spring 1973).

TECHNICAL REPORTS AND PUBLICATIONS

- "Calculating Investment Potential in South America," *World Oil*, (June 1995).
- "Russian Oil Update: The Private Investment Climate," *Russian Oil & Gas Guide*, vol. 4, no. 1, Pennwell Publishing Co., Tulsa, Oklahoma (January 1995).
- "Restoring Russian Oil Production: The Economic Viability and Potential of Damaged Fields," a report submitted to the U.S. Department of Energy under contract no. DE-AP0193IN00620.A000 (May 31, 1994).
- "Executive Summary," *Proceedings of the Second Annual Russian Oil Conference: "The Russian Petroleum Industry, Foreign Investment Opportunities,"* sponsored by the Royal Institute of International Affairs, London (February 11-12, 1993).
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- "Houston and the UH System: Partners for the Future," a report submitted to the Chancellor's Office, University of Houston System (January 1988).

- "Oil Import Tax: Pros & Cons," *The Professional Geologist*, American Institute of Professional Geologists, (October-December 1987).
- "International Petroleum Taxation: Reasons for Instability," in *Proceedings of the North American Meetings of the International Association of Energy Economists*, Calgary, July 5, 1987.
- "The Gasoline Marketing Industry in Texas," a report to the Texas Mid-Continent Oil & Gas Association (March 1985).
- "An Analysis of the Impact of Federal Tax and Leasing Policies on the Economic Prospects for Oilfield Development in Hostile Offshore Environments," a report to the U.S. Congressional Office of Technology Assessment under contract no. 433-5620.0 (September 1984).
- "Petroleum Reservoir Simulation Models: A New Tool for Economic Analysis of Public Energy Policies," in *Proceedings of the Fifteenth Annual Modeling and Simulation Conference*, published by the Instrument Society of America (April 19-20, 1984).
- "Does Profit-Share Leasing for Outer Continental Shelf Leases Need Finer Tuning?," *Oil and Gas Journal*, with D. Siegel (May 7, 1984).
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- "Option Valuation and Contingent Claims Analysis,"** ARCO Evaluation Forum, Denver, May 7, 1991.
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- "The Effects of Taxes and Price Regulation on the Supply of Offshore Gas,"** Special Conference on Energy Taxation, Center for Economic Policy Research, Stanford University, November 1984 (with H. Jacoby).
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- "Regional Modelling of Oil Discovery and Production,"** United Nations Conference on the Economics of Exploration and Development of Energy Resources, New York, September 1983 (with J. Paddock).
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- "Equilibrium Patterns of Competition for Offshore Petroleum Leases," Annual Meetings of the Western Economic Association, San Diego, June 1980.**
- "Comment on New Theories of Exploration for Energy Resources," Energy Exploration Conference sponsored by New York University, New York, May 1979.**
- "Bidding Behavior for Offshore Petroleum Leases: Some Empirical Evidence," Joint National Meetings of ORSA/TIMS, New Orleans, May 1979.**
- "Competitive Bidding Behavior and the Winner's Curse," Joint National Meetings of ORSA/TIMS, Los Angeles, November 1978.**
- "Forecasting Petroleum Discovery, Development, and Production," North American Meetings of the Econometric Society, Chicago, August 1978 (with P. Eckbo).**

This bill would authorize the executive branch to negotiate a contract with sponsors of proposed projects to develop stranded gas in Alaska. The payments required by the contract would replace some or all of the state and local taxes that would otherwise pertain to major economic activity engendered by the project.

A negotiated contract would make it possible to tailor the fiscal arrangements to meet the needs of the proposed project while, at the same time, ensuring the public benefits from the project. A set of arrangements providing for contractual payments in lieu of taxes is likely to provide fiscal terms that potential investors will believe are likely to remain permanently in place over the life of the project.

Given the extended time frame to develop and market the large volumes of stranded gas, revenues expected as a result of the bill are outside the time horizon of this fiscal note.

The fiscal note breakdown is as follows:

Personal Services: \$81,600.00

Salary and benefits to fund one DOR person devoted to the gas project.

Travel: \$30,000.00

The state must continue to inform Alaska communities of and involve them in discussion of contract and project issues. Some of the issues that affect them are community impacts induced by project development, payments to municipalities in lieu of taxes, availability of gas to communities and Alaska hire and contracting. In addition, the state will propose and advocate changes to the federal tax structure to improve project economics and evaluate federal regulatory changes to allow for regulatory certainty. This line item will fund travel within Alaska, to consultants and to Washington, D. C. for these purposes.

Contractual: \$375,000.00

\$75,000.00 to fund a socioeconomic study on the impacts induced on the local communities by project development. This study is a necessary step in constructing the foundation for discussion with municipalities and negotiations with project sponsors about payments to municipalities in lieu of taxes for the costs of and impacts from additional services and construction resulting from project development.

\$300,000 to fund contractual services and advice from experts in fiscal, regulatory, contract negotiation, legal, and financial areas. These technical and evaluative services would be necessary to the tax and regulatory work planned for the federal level; they would be required to assist the state in substantive and complex contract development and negotiation, potentially with multiple sponsors. The state does not have all of this expertise in-house. \$75,000 of these costs will be incurred in preparation for the application process regardless of whether there are applicants.

As per the proposed bill, contract applications may be made until June 30, 2004. Expenditures for contractual services, therefore, may be necessary any time between July 1, 1998 and June 30, 2004. Because there is no way of knowing now specifically when expenditures would be required, it may be beneficial to treat this \$300,000 as a continuing appropriation

The proposed legislation allows reimbursement of the state by the applicant for the expenses of an independent contractor used to assist in the evaluation of an application.

Miscellaneous: \$5000.00

To fund supplies, LNG conference participation, purchase of technical reports, etc.

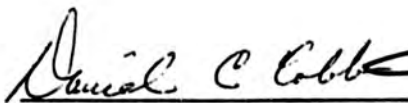
PROPOSED AMENDMENTS TO HB 393 BY PIPELINE MAYORS

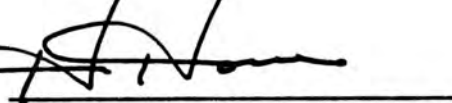
1. The Commissioner has the power to defer municipal taxes - not exempt pipeline owners from them.
2. The taxes may be deferred for a maximum of 5 years from the first year in which the taxes could have been collected.
3. The agreement must provide that any deferred taxes be repaid with interest (at the long bond rate calculated as of January 1) during the first five years after the period of deferment.
4. Municipalities that defer taxes must be able to issue bonds up to the amount necessary to accommodate expenditures required to be made by the municipality as a result of the impact of the project. The bonds must be guaranteed by the State of Alaska.
5. No deferrals of property taxes may be permitted for facilities which are presently subject to the ad valorem property tax.
6. The deferral of taxes may only apply to (1) projects that require construction of a Trans-Alaska natural gas pipeline; and (2) facilities in existence during the initial exemption period.
7. Communities in proximity to the pipeline must have guaranteed access to gas at a price equal to the wellhead value plus the allocated transportation costs to the pipeline connection.

MAYOR DAVID C. COBB

MAYOR HANK HOVE

MAYOR BENJAMIN NAGEAK


City of Valdez


Fairbanks North Star Borough


North Slope Borough

w/mmc/avchlis

Prepared Testimony of James L. Smith

Introduction

My name is James L. Smith and I reside at 10537 Beinhorn Road, Houston, Texas. The Alaska Oil and Gas Commission has asked me to provide this testimony, which represents my independent judgment and professional opinion regarding certain economic aspects of unitized operations at the Prudhoe Oil Pool.

I am trained as an economist and I specialize in the field of energy economics. I received the B.S. degree (1972) in Economics from the University of Illinois, and the M.A. (1976) and Ph.D. (1977) degrees in Economics from Harvard University. I currently serve on the faculty at the Business School of Southern Methodist University in Dallas, where I hold the Cary M. Maguire Chair in Oil and Gas Management. The views I express here are my own and do not necessarily reflect the views of Southern Methodist University. Previously, I have served on the faculty at the University of Illinois (Champaign-Urbana), the University of Houston, and the University of Maryland (College Park). Most of my teaching, writing, and research deals with the subject of energy economics. In addition to my academic duties, I have served as a consultant to various oil and gas companies and government agencies. I have also served from time to time as an expert witness in regulatory and legal proceedings that involve energy matters, including the Alaska North Slope Gas Royalty case. My resume is included as Attachment 1 to this testimony.

The Scope of My Testimony

The Commission has asked me to comment on the Oil Rim-Gas Cap structure of the Prudhoe Bay Unit and its likely impact on field development, resource recovery, and waste. In addition, I have been asked to consider whether it would be appropriate to seek more complete

integration of interests in the Pruhoe Oil Pool via compulsory unitization proceedings or other means. I have also been asked to evaluate and comment on pertinent elements of the working interest owners' testimony and contentions in this regard.

My report is organized around nine specific questions which the Commission has raised. I will attempt to address each question separately and in turn, but I recognize that several of the questions are closely related and therefore discussion of certain key issues may spill over into several parts of my testimony. The series of nine questions and my responses follow.

(1) *Explain the concepts and purposes of unitization and unit as they apply to oil and gas properties or reservoirs.*

The purpose of unitization is to eliminate incentives for wasteful and competitive practices in the development of a single pool by multiple owners. This goal is achieved by treating the pool as if it were a single asset in which each owner holds an individual interest.

Once this unitized structure has been created, the owners then share a common interest in finding and implementing the development program that maximizes the value of their jointly-held asset. This is the principal objective of unitized operations. All owners gain from actions that increase the value of the pool. All owners lose from actions that diminish the value of the pool. None profits at the expense of another. The permanent alignment of interests created by unitization produces incentives for each owner to enter into durable and robust commitments to pursue the common good.

The economics literature is quite clear regarding the objectives of unitized operations. Professor Stephen McDonald, in his classic exposition on the subject, summarizes the nature of unitization and unit operations as follows:

In sum, unitization converts a multiplicity of interests in a common reservoir to a single interest for purposes of extractive operations, and at the same time fixes the shares of participants in common net benefits. What then profits the unit as a whole profits each participant proportionately.¹

In terms of specific benefits, Professor McDonald lists four main advantages that can be expected to follow from unitized operations:² First, unitization tends to lead to the voluntary adoption of the optimum rate of production. Second, unitization allows the affected operators to adjust the rate of production so as to search continuously for maximum present value as events unfold and prices and costs change. Third, unitization leads to a more rational calculation regarding the disposition of gas produced with oil. And fourth, unitization makes possible a more rational use of cap gas in an oil reservoir. Each of these four separate objectives of unitized operations appears relevant, perhaps critical, to achieving efficient management of the Prudhoe Oil Pool.

(2) *Does the existence of separate participating areas for the Oil Rim and Gas Cap with different equity participations, or do other features of the existing contractual and property arrangements, mean that the Prudhoe Oil Pool is not unitized, or is not completely or not perfectly unitized?*

A pool is completely unitized when all commercial substances (e.g., oil and gas) contained within it are combined to form a single asset, as described above. The contractual arrangements that govern the Prudhoe Oil Pool have not achieved this. Instead, they have divided the reservoir substances into what are effectively two assets: the Oil Rim asset and the Gas Cap asset.

¹ Stephen L. McDonald, *Petroleum Conservation in the United States*, The Johns Hopkins Press, 1971, page 201.

² Stephen L. McDonald, *The Leasing of Federal Lands for Fossil Fuels Production*, Resources for the Future, 1979, pages 135-136.

Because development and production of one asset significantly impacts recovery of the other, potential conflicts can arise among the owners, despite the appearance of integrated operations. Because certain working interest owners hold a larger share of the Gas Cap asset than of the Oil Rim asset (and vice versa), the interests of individual owners in alternative field development projects and investments are misaligned. There is no natural consensus on a common course of action in developing the field. For example, plans to promote oil recovery at the expense of gas would affect separate owners differently, depending on their relative holdings of the two assets. Lacking a natural consensus on a common course of development and extraction, the owners have to rely on trading, bargaining, and compromise to forge a plan of action that is jointly acceptable. The ultimate impact of this compromise on field operations would depend on the relative bargaining strengths of the various parties and the scope of the disagreements they have to resolve.

Unitization of an oil field is distinct from a simple pooling of interests. The fact that certain interests have been pooled to create the Oil Rim and Gas Cap participating areas does not mean that the field has been unitized and does not ensure that the objectives of unitized operations will be achieved. This fundamental distinction is sometimes overlooked, even within the industry, as Burke and Starcher have noted:

The terms *pooling* and *unitization* are sometimes used interchangeably. However, unitization is normally more than a mere accumulation of acreage to create a drilling unit. Generally, unitization combines the economic interests in a reservoir to permit the joint exploration, development and operation in a more efficient manner.³

³ Frank M. Burke, Jr., and Mark L. Starcher, *Oil and Gas Taxation in Nontechnical Language*, PennWell Publishing Co., 1993, page 72.

Because of the coexistence of Oil Rim and Gas Cap participating areas, the natural alignment of interests that is produced by unitizing all reservoir substances into a single asset does not exist within the Prudhoe Oil Pool. In that sense, the Pool has not been completely unitized.

(3) *To what degree do the existing property and contractual arrangements for the Prudhoe Oil Pool fulfill the purposes of unitization?*

Although there is no objective scale upon which this question can be answered, I think it is fair to say that the existing contractual arrangements fall far short of achieving the purposes of unitization. Later in this testimony, I will cite specific conflicts between Oil Rim and Gas Cap interests that have jeopardized the optimum recovery of oil, raised questions concerning the rational disposition of gas, and demonstrated the lack of resilience of field development plans to changes in operating conditions. These are the very problem areas that unitization is specifically intended to avoid.

Given the existing contractual arrangements that have created dual assets under joint management (Gas Cap and Oil Rim), it is doubtful that the full benefits of unitization can be achieved. The dual participating-area structure of the Prudhoe Oil Pool would be expected to not jeopardize efficient management of the field only if at least one of the following three special requirements were met: (1) no physical communication or interaction between the reservoir substances contained within the Oil Rim and Gas Cap; (2) matching equity shares in the Oil Rim and Gas Cap held by each individual owner of the field, or (3) effective and costless bargaining procedures in place to resolve disputes and achieve compromise on issues where individual interests are not aligned. None of these conditions is met in the case of the Prudhoe Oil Pool. Consider each factor in turn.

(1) **Physical Communication.** If the reservoir substances were not in physical communication, then there would be less need to worry about the effect of the dual-participating area structure in the first place. Actions that benefit the Oil Rim could proceed without adverse consequences for the Gas Cap, and vice versa. However, the situation within the Prudhoe Oil Pool appears to be the opposite. From the outset, the owners have recognized that reservoir pressure provided by the Gas Cap would assist in the production of oil. I believe that the extent of physical interaction between Oil Rim and Gas Cap remains a significant issue as alternative depletion projects and development plans are being debated today. For example, BP's witness before the Commission reports that initiation of a major gas sale around the year 2005 would be expected to reduce ultimate recovery of oil reserves by 400 million barrels.⁴ Thus, depending on the strength of the next factor (i.e., differences in the extent of each owner's relative holdings in the Gas Cap versus Oil Rim), the potential exists for significant conflict regarding the management and ultimate disposition of the two jointly-held assets.

(2) **Disparate Holdings.** If each owner's equity interest in the Gas Cap matched that same owner's equity interest in the Oil Rim, potential conflicts that stem from the dual participating-area structure would be much diminished. This is because each owner would then give as much weight to Oil Rim values as to Gas Cap values. Any plan that would enhance the value of the Gas Cap by, say, \$2 billion at the expense of reducing the value of the Oil Rim by \$3 billion would be rejected by each and every owner. Major conflicts would be less likely if each owner's participation in the Oil Rim was the same as that owner's interest in the Gas Cap.

⁴ See the testimony of Mr. Stevens at page 853.

In fact, the differences between Oil Rim and Gas Cap holdings of each owner are quite significant, and therefore potentially divisive. BP holds roughly 51% of the Oil Rim, but only 14% of the Gas Cap. Arco and Exxon each hold roughly 22% of the Oil rim, but 43% of the Gas Cap. The smaller owners hold roughly 5% of the Oil Rim and 1% of the Gas Cap.⁵ These disparities are large enough to create substantial economic conflicts among the owners regarding how the two assets should be jointly managed.

(3) Conflict Resolution. The ultimate impact of conflicts that stem from the dual participating-area structure depends on the owners' ability to bargain, compromise, and set aside individual interests for the good of the entire unit. If conflicts can be quickly resolved in accordance with the greatest good, at reasonably low cost, and without delaying field development activities, then the conflicts that occasionally arise between Oil Rim and Gas Cap owners would be of little concern to the Commission. However, past experience shows that the process of resolving disputes among these owners is expensive, time-consuming, and disruptive to the planning and execution of field development activities. I will elaborate later on the potential for unresolved Gas Cap-Oil Rim conflicts to impair efficient operation and development of the Prudhoe Oil Pool.

It may be helpful to review the parties' own concerns about the extent to which the dual participating-area structure would engender conflict and impede development. There is no doubt that this was initially a concern to Arco and Exxon. [REDACTED]

[REDACTED].⁶ I believe that the Arco and

⁵ The percentages may not add up to 100% due to rounding.

⁶ [REDACTED]

Exxon traders still acknowledge having been concerned back then about the potential for Oil Rim-Gas Cap conflicts--even before any such disputes had arisen.⁷ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Despite repeated efforts to consolidate the Oil Rim and Gas Cap interests, however, the parties failed in their negotiations to form a single participating-area. In lieu of that, and to avoid subsequent conflicts between Oil Rim and Gas Cap interests, the traders carefully crafted provisions of the Prudhoe Bay Unit Operating Agreement (PBUOA) in a manner that was intended to achieve a balance of interests and to commit all parties to what appeared to be an effective plan of development. Close attention was paid to the matter of how costs and production would be allocated between the two participating areas and the responsibilities of each participating area in meeting Unit plans and objectives. There were also special provisions included in the agreement to maintain balance between the interests of the two participating areas as the field proceeded through different stages of development, and provisions to restore balance if development scenarios deviated from expectations.

This approach appears to have worked reasonably well for several years during the first phase of field development. However, by the mid-1980s the system of trades designed to balance

⁷ See, for example, [REDACTED] and Mr. Harrison's AOGCC testimony at page 951.

[REDACTED]

[REDACTED]

the competing interests and produce consensus on major development issues appears to have broken down. Serious disputes arose between Oil Rim and Gas Cap interests and these conflicts threatened to impair Unit operations.¹⁰ Only through a series of protracted legal proceedings and private negotiations, leading in some cases to revisions of the PBUOA, were the owners able to resolve these disputes and move on to implement planned development activities.¹¹

The [REDACTED] distinction between "company economics" versus "unit economics" that ran through these disputes confirms the extent to which the dual participating-area structure has failed to fulfill the basic purpose of unitized development.¹² Within a properly functioning unit, the distinction between company-based and unit-based economics would be transparent and innocuous. By looking at the unit, each owner would see an image of himself. The same tradeoffs, opportunities, and costs facing one would be shared by all. This is not how things appear to work within the Prudhoe Oil Pool.

Although the original PBUOA may have achieved a certain *balance* among interests of the competing owners (at least as those interests were perceived at the time), it did not *align* their interests. This is a key distinction that has not been emphasized much in the testimony of previous witnesses before this Commission. Any balance that is effected through a series of fixed trades among owners is precarious since the value of the constituent trades will very likely change with the passage of time as prices, costs, and reservoir performance evolve. Once certain trades grow less favorable, the owners who are adversely affected will experience individual incentives

¹⁰ The basic disputes centered on the allocation of costs and produced substances between the Oil Rim and Gas Cap participating areas [REDACTED]

¹¹ The resolution of disputed issues has taken place in a piecemeal fashion, with a series of individual agreements being reached (or imposed) on separate issues as they have arisen. Consider, for example, the San Diego FGSO arbitration, the GHX Agreement, the Issues Resolution Agreement, and Conservation Order No. 360.

¹² See, for example, [REDACTED] and the AOGCC testimony of Mr. Meggs at page 785.

to reinterpret or renegotiate the burdensome contract provisions, perhaps even to the extent of withholding performance.

Unitization is intended to mitigate such problems not by balancing the interests of all owners at a certain point in time, but by aligning their interests permanently. By effectively consolidating all interests into one asset which is jointly owned, (i.e., one participating area), the interests of all owners tend to remain aligned in support of a common plan--that which maximizes the value of the unit--even as market conditions, investment timing, and field development opportunities evolve.

To summarize my thoughts on this issue, the existing contractual arrangements that treat the Oil Rim and Gas Cap as separate assets are likely to engender conflicts that are difficult to resolve and which have the potential to impair development and operation of the field. This situation is not consistent with the purposes of unitized operations.

(4) *How significant would be the costs, uncertainty, "malincentives," and other problems that working interest owners claim would result from compulsory unitization proceedings?*

I believe that the costs of a compulsory unitization procedure would be significant. I am in general agreement with other witnesses who have described the inherent difficulty of combining the two participating areas into a single equity structure. We know that the owners have already attempted to achieve a single equity structure on several occasions, and failed at each juncture. I believe that the owners' efforts in this direction have been in earnest, and that their repeated failure reflects, at least partially, the difficulty of their task.

I do not necessarily agree, however, that the Commission should conclude from these prior failures that the task of compulsory unitization must be viewed as prohibitively difficult. Nor do I agree that the process of compulsory unitization would be chaotic or unfair. The

principal difficulty that the Commission would face in a compulsory unitization proceeding would be to arrive at appropriate estimates of the net economic values of the Gas Cap and Oil Rim assets. There are three major uncertainties associated with that estimation: (1) future netback values of the oil and gas resources at wellhead; (2) timing of a major gas sale; and (3) expected volumes of oil and gas to be sold from the field. Compulsory unitization would require probabilistic judgments to be made, either explicitly or implicitly, regarding each of these factors, and for the associated development scenarios to be weighted accordingly in arriving at the expected net economic value of future sales from each participating area.

Although difficult, these uncertainties are not unlike what the owners must deal with anyway. Evaluation of alternative development plans requires certain assumptions or judgments to be made regarding these three factors whether equities are organized into one or two participating areas. In other words, I do not believe that the owners or the Commission would have to start from scratch in pondering these factors. Further, part of the cost and effort that would be required of the owners and of the Commission in preparing for a compulsory unitization proceeding would probably be incurred anyway somewhere along the line in the normal course of reservoir study, development planning, performance review, and regulatory oversight that is required for diligent and proper management of the Prudhoe Oil Pool.

The most notable cost of a compulsory unitization proceeding, and one that would constitute a large burden borne by the owners, is the cost of uncertainty--each owner having to accept an outcome that would have an unpredictable impact on the value of their holdings. The risk of an adverse outcome is a true economic cost that the owners cannot afford to ignore. I believe that the owners' reluctance to put their whole equity at risk in any single proceeding has played a dominant role in the failure of the previous voluntary efforts to achieve a single

participating area. Rather than putting the whole pie up for grabs at once, the owners prefer to continue working within a framework that deals with a series of somewhat smaller and more compartmentalized issues. That approach requires negotiations over each slice of the pie as it is placed on the table, and it may seem less risky for the owners than compulsory unitization. Any one who feels shortchanged at one stage can hope to make it up at the next. And by continuing with voluntary efforts to resolve their conflicts, the owners are able to retain control of the process, including veto power over any outcomes that they strongly oppose. This further reduces the risk they face.

Although the fear of losing equity to others would be a burden placed on each owner in the process of compulsory unitization, the Commission would not directly bear any part of that burden or share in the cost of uncertainty. That does not necessarily mean, however, that the Commission should ignore the burden of risk in deciding how to proceed. I believe that a key issue in deciding whether to move to compulsory unitization is the question of how much weight (if any) to place on the owners' discomfort with the risk that such a proceeding would entail. If the Commission's responsibility encompasses a role in assisting owners to minimize costs (including the cost of bearing commercial risk), then more emphasis should be placed on this aspect. If the Commission's responsibility is limited to protecting the State of Alaska's interest in the field as a whole, then more weight should be placed on the question of whether compulsory unitization would increase the size of the pie and reduce economic waste--letting the chips fall where they may.

Several witnesses have described the process of compulsory unitization as almost certainly being chaotic, inherently unfair, and virtually impossible to complete. I disagree. The process of compulsory unitization of the Prudhoe Oil Pool would benefit significantly from the fact that the

resource has already been fairly divided into two assets. The remaining task that would be the subject of compulsory unitization proceedings would be to consolidate these two participating areas, not to revisit or revise the basis on which initial equity allocations were determined.

The only deliberations that should play any role in the proceedings would be focused on the single question of what is the economic value of the Gas Cap asset *relative* to that of the Oil Rim asset. That ratio is a single number, one parameter. I call that parameter the "e-factor" for "equity." I have already commented on the difficulty in arriving at that number, and I am not discounting those remarks here. What I am saying is that the proceedings could be narrowly focused and specifically organized around this one question: what is an appropriate value for the e-factor?

Other witnesses have emphasized the extent to which the owners have relied on trades that were made when the Unit was formed, as reflected in provisions of the PBUOA. They also suggest that it would be unfair (and perhaps violate the owners' correlative rights) to abandon or circumvent those provisions now. I agree. But I do not see that issue as being one of the dangers of a compulsory unitization proceeding. In arriving at an appropriate value for the e-factor, I would imagine that the provisions of the PBUOA would be taken into account exactly as the owners have agreed to them. Each owner of the Gas Cap holds a determinate share of that asset and certain responsibilities as a Gas Cap owner for financing shared unit operations. Likewise for the Oil Rim. In determining the net economic value of the Gas Cap asset under any particular development scenario, the net present value of Gas Cap revenues less costs would be estimated, in accordance with all relevant provisions of the PBUOA. As I understand that agreement, it translates the various trades between Gas Cap and Oil Rim owners into specific formulae and rules for allocating produced substances and costs. I do not see anything unfair or in violation of

the owners correlative rights in applying those rules to estimate the net value of the Gas Cap asset or the Oil Rim asset.

Once an appropriate value for the e-factor has been determined, the process of compulsory unitization would be straightforward. Each owner's share in the consolidated participating area would consist of the weighted average of that owner's existing equity shares in the Gas Cap and Oil Rim, respectively. The e-factor would be the appropriate weighting factor for this calculation and it would be applied uniformly to all owners.

Since calculation of the e-factor would incorporate and conform with all agreements that have been mutually agreed by the owners, it would then embody the various trades upon which the existing agreement rests and it would circumvent none of the deals upon which the various owners have been relying. For that reason, I do not see the process of consolidating the two participating areas into a single equity as being unfair to the interests of any owner, or in violation of correlative rights

(5) *Are there significant development or operational decisions still to occur in the future that could be adversely affected by features of the existing contractual and property arrangements for the Prudhoe Oil Pool?*

There are several major issues remaining where the Gas Cap and Oil Rim interests might conflict. I would start by recalling Mr. John Morgan's testimony to the effect that 50% of the production from the Prudhoe Oil Pool that BP deems possible by the year 2005 depends on investments that have yet to be made.¹³ The owners' mutual agreement to fund those investments

¹³ See the AOGCC testimony of Mr. Morgan at page 797.

will therefore play a significant role in the remaining life of the field, as it is currently expected to play out.

Additionally, we should consider the ability of the owners to respond to various unexpected developments that might affect future operations. What would be the impact on production incentives and development planning at Prudhoe Bay if world oil prices were to double within the next few years. For example, suppose that civil unrest within Saudi Arabia and elsewhere in the Mideast permanently slows oil production from those areas. What types of enhanced oil recovery at Prudhoe Bay would make sense under that higher-price scenario, and what portions of the field would be involved in heightened efforts to enhance oil recovery? What types of risk would be associated with relatively high-cost enhanced oil recovery facilities? And is it possible that some of those risks might fall disproportionately on owners of the Gas Cap while the rewards would be concentrated on owners of the Oil Rim?

Rising oil prices usually carry gas prices in the same direction. Therefore, we might pursue further the scenario of high oil prices sketched above. Suppose that due to the rising price trend, the Prudhoe Bay gas reserve becomes "commercial" at roughly the same time that oil prices are rapidly appreciating. By "commercial" I mean that the gas could be transported to market leaving a positive, but small, netback value at the wellhead. Should the gas then be sold, or should it be used for enhanced oil recovery? Would all of the owners agree on this type of issue? According to all previous testimony presented to this Commission, the decision to proceed with a major gas sale is a "no-brainer" on which all sides would obviously agree. If the netback value per mcf were large enough, that might be true. But I have strong doubts. If the netback value were relatively small, especially when compared to the value of 400 million barrels of oil

production which the major gas sale would be expected to displace, then I see the potential for serious disputes to emerge between the Oil Rim and Gas Cap interests.

Exxon's position, as I understand it, is that no such dispute would matter. The owners are already committed by contract to support a major gas sale of 2 TCF per day. The contract is apparently interpreted by Exxon to mean that it and Arco could unilaterally proceed to sell their gas. I find this testimony to be less than convincing. Speaking of plans to unilaterally undertake any type of depletion policy, over the protest of other owners, is far removed from the ideal of unitized operations undertaken to promote the common good. Moreover, I am surprised if it is Exxon's position that a major gas sale of 2 TCF per day has already been determined to promote the common good and therefore must proceed against whatever opposition BP would mount. Prior to knowing the netback value of gas at the wellhead, it would be impossible to know whether its sale does in fact promote the common good. Of course, the eventual netback value has not yet been determined, and that is why the owners have testified that uncertainty in gas values has stymied voluntary efforts to consolidate the two participating areas.

Nonetheless, if for the sake of argument we temporarily accept Exxon's claim that it has already been determined that it would be in the interest of the Unit for the gas to be sold, there is still a problem: how can we be sure that BP would also agree to produce and sell its gas? If it is appropriate Unit policy for Exxon's gas to be produced and sold, would it not also be appropriate Unit policy for BP's gas to be produced and sold? Whereas Exxon's unilateral action to sell its gas might solve all of Exxon's problem, it may solve only one-half or one-third of the Unit's problem. Thus, I see management concurrence in the size and timing of a major gas sale as a possible source of future Gas Cap-Oil Rim conflicts.

Another type of potential conflict between the Gas Cap and Oil Rim interests, and one of major importance, could arise as the field approaches the end of its productive life. Eventually, it will come time for the owners to reach a decision to terminate production and abandon the field. At that point, would the Gas Cap interests gain by prolonging oil production past the economic limit of the oil reserve if the payoff to them was that continued operations would keep alive the option for an eventual major gas sale? Would the incentive for them to do so be reinforced by the differential allocation of produced liquids (gas condensate and NGL) to the Gas Cap owners? I am not sure of the answers, but I think these questions should be addressed.¹⁴

(6) *Has the two participating-area structure resulted in benefits for developing the Prudhoe Oil Pool that would not have occurred otherwise?*

The principal benefit of the two participating-area structure is that it helped to facilitate the negotiations that ultimately lead to formation of the Prudhoe Bay Unit. If it is presumed that voluntary negotiations would have failed without the two participating areas, and that development of the field would not have proceeded, then we must count the creation of the dual participating-area structure as an enormous benefit to all parties concerned. However, if it is presumed that the State of Alaska would or could have used its powers to intervene and "revive" the failed negotiations in some manner, as seems likely, then the strategic importance of the two participating areas is diminished.

The owners have testified that the structure of competing interests which stems from their Gas Cap-Oil Rim rivalry has also been of significant value in stimulating greater scrutiny of development decisions and promoting more extensive research and better understanding of

¹⁴ [REDACTED]

development opportunities than would otherwise have occurred. What I do not understand about this argument is why, if extra effort and scrutiny are beneficial to the unit in cases where the owners are in conflict, such effort and scrutiny would not also be provided or undertaken in instances where the interests of the owners are more closely aligned. Whether interests are aligned or in contention, all owners share the incentive to research and debate matters that are vital to the value of their investment.

Further, I would expect the exchange of ideas and information among multiple owners to actually work better and carry greater weight in units where the interests and goals of respective owners are aligned--as in a single participating area. At least in that case there would be less incentive for any owner to shade or distort information to reflect favorably on projects that might enhance that owner's individual position at the expense of others. If owners have competing incentives within the unit, I would expect each owner to discount to some degree the information, analyses, and interpretations that are provided by the others.

(7) *To what degree would changes in the contractual and property arrangements for the Prudhoe Oil Pool such as combining the two participating areas reduce or eliminate the incentives for competitive, as distinguished from cooperative, behavior on the part of the working interest owners or otherwise reduce or eliminate disputes among them?*

While certain technical differences and commercial conflicts might remain, I believe that representatives of all the major owners agree that consolidation of the two participating areas into a single equity structure, *once achieved*, would go very far towards eliminating the conflicts that have accompanied development of the Prudhoe Oil Pool.

Of course, not all potential conflicts can be avoided no matter how the Unit is structured. If there are multiple owners who face significantly different costs of capital or who realize

different netbacks on produced oil, conflicts may emerge in taking one course of action over another. Such conflicts are based on circumstances that originate outside the Unit.

Unfortunately, there is no way to structure the Unit to anticipate the ebb and flow of those external differences or to neutralize them. This contrasts with the type of conflicts that stem from the existence of dual participating areas, which are not inherent in the nature of unitized operations, and which could be eliminated by consolidation of equity within a single participating area.

It is my opinion that few, if any, of the conflicts that have divided the owners of the Prudhoe Oil Pool stem from external circumstances. The cost-sharing disputes that caused the parties to adopt the so-called GHX-1 agreement did not arise because Exxon faced a higher cost of capital than Arco. BP did not initiate the Energy Conservation Task Force to save fuel gas in 1984 because it had a contract to sell petrol in Europe that Arco could not duplicate. The recent standoff on MI-NGL did not arise because Arco pays more federal income tax than BP. The fundamental conflict that drives all of these disputes is the fact that the owners have varying stakes in oil versus gas-related projects. Consolidating the two participating areas would go a long way towards resolving the disputes that have impaired development of the field.

[REDACTED]

(8) *Are there alternatives to compulsory unitization that could be employed to reduce or eliminate incentives for competitive behavior on the part of the working interest owners or otherwise reduce or eliminate disputes among them?*

I am not aware of any other approach, besides consolidating the holdings into a single participating area, that would ensure that the interests of the respective owners are in alignment and remain so as events unfold over the remaining life of the field. I have already commented on the limitations of attempting to balance the interests of multiple owners at one point in time in order to win agreement on a particular issue. The problem with this approach is that it is not robust--the balance is likely to be lost as circumstances and opportunities change. The environment is not static, and even with a binding and well-executed contract in hand, disputes may arise among owners whose interests fall out of alignment. At that point, each owner will find reasons to interpret the provisions of the contract in favor of its own position and to resist interpretations that threaten its interests.

Several witnesses have discussed the "case-by-case" approach to resolving Unit conflicts, which is an alternative to compulsory unitization that the Commission must consider. Rather than aligning the owners' interests once and for all via unitization, the case-by-case approach would rely on the Commission's oversight to deal with any future disputes if and when they arise. The idea would not be to eliminate future conflicts, but to get the Commission's help in resolving them.

There are some risks associated with the case-by-case approach. If intervention by the Commission in field operations is not something that the owners generally welcome, certain disputes and conflicts may simmer beneath the surface for an indefinite period of time before any owner would come forward. If the underlying issues are time-sensitive, with physical or economic waste hanging in the balance, such delay could be an important drawback.

In addition, the positions and analyses that respective owners might put to the Commission during such proceedings would be subject to the problem of malincentives. If the issues in dispute are not purely technical in nature, but based on conflicting equity interests within the pool, some owner may have an incentive to shade its presentation toward the outcome that is most favorable to its vested interest. In adjudicating these disputes, the Commission would very likely have to consider, at least implicitly, many of the same factors that would enter into a compulsory unitization proceeding.

Another danger in waiting for disputes to emerge is that the delay in responding to some potential problem could jeopardize major opportunities to enhance recovery. Consider the prospect of a major gas sale, for example. Any sale of gas from Alaska will require a major investment in transportation infrastructure, whether the gas is to be moved by pipeline or tanker. That investment will depend, in part, on the willingness of outside financiers to provide funds. If

a major conflict between the Gas Cap and Oil Rim owners regarding the size or timing of gas sales remains unresolved at that stage, the resulting project uncertainty would probably impact the financing, and perhaps preclude the project from going forward. There are lots of major gas projects on the drawing boards of producers all over the globe, each poised to proceed under the right market conditions. Anything that delays the ability of Alaskan producers to seize a window of commercial opportunity for a major gas sale also diminishes the likelihood that a major gas sale will ever occur. Other things being equal, there is a clear advantage in having put the affairs of the Unit in good working order well in advance, not at the last minute.

(9) *Has the two participating-area structure or other features of the contractual and property arrangements for the Prudhoe Oil Pool resulted in any delay of or failure to pursue any development project or impaired any operation?*

[REDACTED]

19 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]⁶

Conflicts stemming from the two participating-area structure have also impaired the implementation of major field development initiatives. Apart from the MI-NGL dispute, about

20 [REDACTED]
21 [REDACTED]
22 [REDACTED]
23 [REDACTED]
24 [REDACTED]
25 [REDACTED]
26 [REDACTED]

which the Commission has heard from others,

[REDACTED]

[REDACTED]

[REDACTED]

28 [REDACTED]
29 [REDACTED]

[REDACTED]

Weighing the Arguments Against Compulsory Unitization

Many of the witnesses who have already appeared before the Commission have offered a wide range of reasons why a compulsory unitization proceeding should not be initiated. I will close my remarks by commenting on some of the most prominent reasons given, and in the process attempt to summarize some of my own views.

Reason #1: *"The Unit is not broken; there is no problem, and therefore no need to fix it."*

Proponents of this view claim that the interests of the owners are already integrated to the extent possible, and that the conflicts that do emerge from time to time stem from external differences between the owners, not from the two participating-area structure of the Prudhoe Oil Pool. 1

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disagree. The two participating-area structure appears to generate major conflicts among owners that put the intended benefits of unitization in jeopardy.

Reason #2: *"The Unit may be broken; but the Commission should not attempt to fix it via compulsory unitization because that cure may be worse than the disease."* I have mixed feelings about this argument. The "cure" admittedly involves putting each owner's equity interest at some risk, and this represents a heavy burden--large enough to have prevented the owners from voluntarily consolidating the two participating areas into one. If this burden is a matter that properly falls under the Commission's purview, then it would have to be weighed very carefully against the benefits of achieving a greater alignment of interests among the owners. However, I do not agree that the "cure" is bad for the other reasons often given: I do not think that the process of compulsory unitization would be chaotic, unmanageable, or inherently unfair or in violation of the correlative rights of the owners.

Reason #3: *"Compulsory unitization should not be imposed by the State because it would not be a panacea for all that ails the Unit."* In my opinion, this argument is a red herring that deflects attention from the issues at hand. It is akin to arguing that we should not vaccinate children against disease because that would not solve the problem of world hunger. Most of the major conflicts that have been associated with Unit developments do stem from the two participating-area structure, and these problems would be resolved if the dual equities were consolidated. If other problems would remain unresolved, then the owners and the Commission might want to consider additional measures to further enhance operations within the Unit.

Reason #4: *"Compulsory unitization would be viewed by many as the State reneging on an agreement and would therefore establish a damaging precedent that could discourage future investment from coming to Alaska."* On legal grounds I cannot say whether initiating a

compulsory unitization procedure at this stage in the life of the field would constitute reneging on a contract. I do believe that the Commission operates under a charter that requires it continuously to guard the State's oil and gas resources against preventable waste. In that sense, any owner who enters into an agreement with the State to operate subject to the Commission's authority must know that its operations will be constrained by and subject to such considerations at all times. Moreover, from an economic perspective, I believe that consolidation of the separate equities into a single participating area can be accomplished without destroying any of the agreements, trades, or deals upon which the owners have been relying.

Reason #5: *"Compulsory unitization should not be imposed because the Commission has no statutory or legal authority to do so."* I have no knowledge or opinion regarding the validity of this claim or the weight that should be attached to it.

Reason #6: *"Compulsory unitization should not be attempted because the problem of malincentives would undermine the process and interfere with field operations."* The malincentives that threaten to interfere with operations at the Prudhoe Oil Pool stem from the dual participating-area structure, not from the attempts to consolidate the separate equities.

Whether or not compulsory unitization is pursued, the same malincentives will exist. It is misleading to argue that by circumventing the process of compulsory unitization we can also circumvent the effects of whatever malincentives are thought to exist within the Unit. Proponents of the "case-by-case" approach to conflict resolution apparently believe that the malincentives of the owners would be less damaging if played out over a long series of disputes than if confronted once and for all during the process of consolidating the two participating areas. My own view is that malincentives that are allowed to linger and persist beneath the surface would probably be

more damaging in the long run, and less predictable, than the rather obvious preference of each owner to emerge from compulsory unitization with the largest possible equity share.

I want to thank the Commission for allowing me to present these views. This completes my prepared testimony.

ATTACHMENT I

Curriculum Vita of Dr. James L. Smith

CURRICULUM VITA

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EDUCATION

B.S. [1972] Dept. of Economics, University of Illinois.

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PROFESSIONAL EXPERIENCE

Cary M. Maguire Chair of Oil and Gas Management, Edwin L. Cox School of Business,
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Professor, Dept. of Economics, University of Houston, 1989-95.

Board of Directors, International Assoc. for Energy Econ., Houston Chapter, 1989-93.

Director, Bureau of Business and Economic Research, and Professor of Economics,
University of Maryland, 1991.

Director, Center for Public Policy, University of Houston, 1987-90.

Associate Professor, Department of Economics, University of Houston, 1983-89.

Associate Professor, Department of Economics, University of Illinois, Champaign-Urbana,
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Research Affiliate, Energy Laboratory, Massachusetts Institute of Technology, 1981-83.

Research Collaborator, Dept. of Applied Mathematics, Brookhaven Natl. Lab., 1980-81.

Visiting Scientist, Center for Energy Policy Research, Massachusetts Institute of
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Visiting Research Associate, Norwegian School of Economics and Business
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Assistant Professor, Dept. of Economics, Univ. of Illinois, Champaign-Urbana, 1977-81.

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