

SCOMM

133:1

ALASKA STATE LEGISLATURE

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REPRESENTATIVE VIC KOHRING DISTRICT 14

SPONSOR STATEMENT

SSHB 28

House Bill 28 will take a royalty adjustment system that has not been used and put in its place an understandable and usable adjustment method for fields that might otherwise prove to be uneconomic. It will provide a usable system for reduction of royalties belonging to Alaska so that the State can encourage production of oil and gas fields that might be marginal or not economically feasible were it not for such reductions.

As has been pointed out so many times, in this global market, Alaska needs to remain competitive in order to encourage development of its oil and gas resources. Development of these resources will provide a broader economic base, more employment for Alaskans and a safer, more stable environment for all concerned.

The 19th Alaska Legislature amended AS 38.05.180(j) and put in place, the current system. Unfortunately, the calculation contained in the current law is arguably unintelligible to many. The implementation of the current statute is too limiting in the flexibility allowed to the Commissioner to craft a deal acceptable to individuals and in the best interest of Alaska. Additionally, the process review put forth in the 1995 legislation is too burdensome and costly for the private sector and thus discourages people from making application. The end result is that oil is left in the ground that could be extracted and adding to the State's economic base.

Although the idea behind HB 28 is not new, it sets forth an understandable modification formula; protecting the public's interest in such proceedings and maintaining the public's ability to comment on the preliminary findings and determination made by the Commissioner. This legislation further maintains the involvement of the Legislature through the Legislative Budget and Audit Committee, a committee that holds meetings year round. HB 28 is consistent with the Governor's goal of increasing oil and gas production and increasing Alaska's resource revenue.

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MEMORANDUM

February 14, 2003

SUBJECT: Draft SSHB 28 -- sectional analysis
(Work Order No. 23-LS0177\D)

TO: Representative Vic Kohring

FROM: Jack Chenoweth
Assistant Revisor of Statutes

Per Ben Grenn's request, set out below is an overview by bill section of draft SSHB 28, a measure relating to adjustments to royalty reserved to the state to encourage otherwise uneconomic production of oil and gas. The bill, as introduced, would replace the text of current AS 38.05.180(j). That subsection was last amended for other than stylistic reasons by ch. 85, SLA 1995 (SCS CSHB 207 (Finance) am S of the 1995 regular session). Proposed in this bill is replacement of much, but not all, of the current text of subsection (j) with the text of a House-passed predecessor version of the 1995 Act, CSHB 207 (Finance) am. The bill also makes conforming changes in three related subsections of AS 38.05.180.

Bill section 1. The provisions set out a series of changes to subsection (j). The principal substantive changes are as follows:

Paragraph (1) -- circumstances allowing for royalty modification:

-- at page 1, lines 6 and 7: explicit authority to change royalty by "an increase or decrease" is here deleted, retaining only the more generic reference to "modification";

-- at page 1, line 13 - page 2, line 3: the condition on modification that tied to authorization or reauthorization by law in a preceding 10 year period is removed as is the July 1, 2015, cutoff date authorizing royalty modifications;

-- at page 2, lines 12 - 14, 17 - 19, and 20 - 21: with respect to an oil or gas field or pool or portion of an oil or gas field or pool, additional conditions, all relating to a determination on the part of the commissioner of natural resources of economic "feasibility", are added for circumstances involving requests for royalty reductions involving new production, or for those sought "to prolong the economic life" of a field or pool or portion of either when decreasing oil or gas prices influence future production, or for those sought to reestablish production of shut-in oil or gas production;

Paragraph (2) -- showing required; applicable standard:

-- at page 2, lines 22 - 25: no substantive change is made in this paragraph; the insertion and deletion restores the choice of term first set out in the 1995 House-passed version;

Paragraph (3) -- conditions to be attached to requested royalty modification:

-- at page 2, line 26 - page 4, line 4: explicit authority to change royalty by "an increase or decrease or other modification" is added; specific detailed requirements relating to descriptions accompanying findings that support a royalty modification and detailed terms and conditions applicable to a modification, distinguishing in their terms as between modification of royalty to support new production versus modification relating to prolonging the life of a field or pool or modification to reestablish production of shut-in oil or gas, are replaced by a more generic, universally applicable, single standard ("*sliding scale royalty or other mechanism that shall be based on a change in the price of oil or gas and may also be based on other relevant factors . . .*"); the standard described is not new but its invariable application to *all* royalty modification-related change requests apparently would be;

Paragraph (4) -- limits on royalty modification:

-- at page 4, lines 5 - 14: modifies the application of the terms of the existing condition of paragraph (4) to have it apply only in the event of a royalty "reduction"; limits on the amount of the royalty that may be determined for new production versus modification relating to prolonging the life of a field or pool, or modification to reestablish production of shut-in oil or gas set out in current law are retained;

Paragraph (5) -- assignability of royalty modification:

-- at page 4, lines 15 - 21: eliminates the requirement of existing paragraph (5) that a royalty modification must be accompanied by a provision allowing the royalty modification to be assigned only with consent of the commissioner of natural resources;

Existing paragraph (6) -- procedures applicable to supporting data:

-- at page 4, line 22 - page 5, line 14: revises the text on public disclosure of information submitted to support an applicant's request for a reduction of royalty;

Existing paragraph (7) -- hiring and use of consultants:

-- at page 5, lines 15 - 23: revises the set of circumstances under which the commissioner may require evaluation by an independent contractor to limit it to instances of requested royalty reductions,

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

-- at page 5, beginning at line 24: amends the set of circumstances under which the commissioner must make and publish preliminary findings to limit it to instances of requested royalty reductions, and substitutes a common, more simplified public notice and comment process for all applications;

Existing paragraph (9) -- disclosure of the effects of royalty reduction:

-- at page 7, lines 1 - 4: eliminates the requirement of existing paragraph (9) obligating the commissioner of natural resources to include in the findings "the reasonably foreseeable effects of the proposed royalty modification on the state's revenue";

Existing paragraph (10) -- opportunity for and procedures applicable to Legislative Budget and Audit Committee review of preliminary findings and determination:

-- at page 7, lines 5 - 17: reinserts a deadline for the commissioner's appearance before the Legislative Budget and Audit Committee and eliminates explicit authority for the commissioner to appear before the committee in an executive session insofar as discussion may involve disclosure to the committee of confidential financial and technical data that support the commissioner's preliminary findings and determination;

Existing paragraph (11) -- transmittal of preliminary determination to legislature:

-- at page 7, lines 18 - 24: although renumbered, no change is made in this paragraph;

Existing paragraph (12) -- final action:

-- at page 7, beginning at line 25: eliminates the requirement that the governor approve the final findings and determination that are prepared by the commissioner; makes other word changes consistent with amendments set out earlier in the bill;

Existing paragraph (13) -- certain related provisions made inapplicable to limit the commissioner's authority to modify royalty under subsection (j):

-- at page 8, lines 19 and 20: no change is made in this paragraph.¹

¹ The provisions referenced in the text of this paragraph provide as follows:

Sec. 38.05.134. Conversion to lease. If the licensee requests and the commissioner determines that the work commitment obligation set out in an oil

and gas exploration license issued under AS 38.05.132 has been met, the commissioner shall convert to one or more oil and gas leases all or part, as the licensee may indicate, of the area described in the exploration license that remains after the relinquishments, removals, or deletions required by AS 38.05.132(d)(2). A lease issued under this section

(3) must be conditioned upon a royalty in amount or value of not less than 12.5 percent of production, except that the lessee who, proceeding under AS 38.05.131 - 38.05.134, under a lease issued in the Cook Inlet sedimentary basin who is the first to file with the commissioner a nonconfidential sworn statement claiming to be the first to have drilled a well discovering oil or gas in a previously undiscovered oil or gas pool and who is certified by the commissioner within one year of completion of that discovery well to have drilled a well in that pool that is capable of producing in paying quantities shall pay a royalty of five percent on all production of oil or gas from that pool attributable to that lease for a period of 10 years following the date of discovery of that pool, and thereafter the royalty payable on all production of oil or gas from the pool attributable to that lease shall be determined and payable as specified in the lease; the payment of the five percent royalty under this paragraph is authorized only to a holder of a lease who meets the requirements of AS 38.05.180(f)(4);

[AS 38.05.180. *Oil and gas leasing.*] (f) Except as provided by AS 38.05.131 - 38.05.134 and 38.05.177, the commissioner may issue oil and gas leases on state land to the highest responsible qualified bidder as follows:

(1) the commissioner shall issue an oil and gas lease to the successful bidder determined by competitive bidding under regulations adopted by the commissioner; bidding may be by sealed bid or according to any other bidding procedure the commissioner determines is in the best interests of the state;

(2) whenever, under any of the leasing methods listed in this subsection, a royalty share is reserved to the state, it shall be delivered in pipeline quality and free of all lease or unit expenses, including but not limited to separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation off the lease or unit area;

(3) following a pre-sale analysis, the commissioner may choose at least one of the following leasing methods:
of not less than 12.5 percent in amount or value of the production removed or sold from the lease;

(A) a cash bonus bid with a fixed royalty share reserved to the state;

(B) a cash bonus bid with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease and a fixed share of the net profit derived from the lease of not less than 30 percent reserved to the state;

(C) a fixed cash bonus with a royalty share reserved to the state as the bid variable but no less than 12.5 percent in amount or value of the production removed or sold from the lease;

(D) a fixed cash bonus with the share of the net profit derived from the lease reserved to the state as the bid variable;

(E) a fixed cash bonus with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease with the share of the net profit derived from the lease reserved to the state as the bid variable;

(F) a cash bonus bid with a fixed royalty share reserved to the state based on a sliding scale according to the volume of production or other factor but in no event less than 12.5 percent in amount or value of the production removed or sold from the lease;

(G) a fixed cash bonus with a royalty share reserved to the state based on a sliding scale according to the volume of production or other factor as the bid variable but not less than 12.5 percent in amount or value of the production removed or sold from the lease;

(4) notwithstanding a requirement in the leasing method chosen of a minimum fixed royalty share, on and after March 3, 1997, the lessee under a lease issued in the Cook Inlet sedimentary basin who is the first to file with the commissioner a nonconfidential sworn statement claiming to be the first to have drilled a well discovering oil or gas in a previously undiscovered oil or gas pool and who is certified by the commissioner within one year of completion of that discovery well to have drilled a well in that pool that is capable of producing in paying quantities shall pay a royalty of five percent on all production of oil or gas from that pool attributable to that lease for a period of 10 years following the date of discovery of that pool, and thereafter the royalty payable on all production of oil or gas from the pool attributable to that lease shall be determined and payable as specified in the lease; for purposes of this paragraph, the reduced royalty authorized by this paragraph is subject to the following:

(A) only one reduction of royalty authorized by this paragraph may be allowed on each lease that qualifies for reduction of royalty under this paragraph;

(B) if, under this paragraph, application is made for a royalty reduction for a lease that was entered into before March 3, 1997, the commissioner may approve the application only if, on that date, the lease was a nonproducing lease that was not committed to a unit approved by the commissioner under (m) of this section, that is not part of a unit

Bill sections 2 - 4. These provisions make conforming amendments to subsections (p), (s), and (t) of AS 38.05.180, substituting "reduce royalty" for "decrease royalty" in places indicated.

Bill section 5. Under the referenced paragraph², there is in the State Procurement Code an exemption for contracts with experts retained by the commissioner of natural

under (p) or (q) of this section, and that has not been made part of a unit under AS 31.05;

(C) if application for a royalty reduction is made under this paragraph for a lease on which a discovery royalty was claimed or may be claimed under the discovery royalty provisions of former AS 38.05.180(a) in effect before May 6, 1969, the commissioner shall disallow the application under this paragraph unless the applicant waives the right to claim the right to a reduced royalty under the discovery royalty provisions of former AS 38.05.180(a) in effect before May 6, 1969; and

(D) the commissioner shall adopt regulations setting out the standards, criteria, and definitions of terms that apply to implement the filing of applications for, and the review and certification of, discovery oil and gas royalty certifications under this paragraph;

(5) notwithstanding and in lieu of a requirement in the leasing method chosen of a minimum fixed royalty share, or the royalty provision of a lease, for leases unitized as described in (p) of this section, leases subject to an agreement described in (s) or (t) of this section, or interests unitized under AS 31.05, the lessee of all or part of an oil or gas field identified in this section that has been granted approval of a written plan submitted to the Alaska Oil and Gas Conservation Commission under AS 31.05.030(i) shall, subject to (dd) of this section, pay a royalty of five percent on the first 25,000,000 barrels of oil and the first 35,000,000,000 cubic feet of gas produced for sale from that field that occurs in the 10 years following the date on which the production for sale commences; the fields eligible for royalty reduction under this paragraph, all of which are located within the Cook Inlet sedimentary basin, were discovered before January 1, 1988, and have been undeveloped or shut in from at least January 1, 1988, through December 31, 1997, are

- (A) Falls Creek;
- (B) Nicolai Creek;
- (C) North Fork;
- (D) Point Starichkof;
- (E) Redoubt Shoal; and
- (F) West Foreland.

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

resources to help evaluate the request for a royalty modification. One of the changes made in the bill shifts the contracting obligation from the department to the applicant. Repeal of the paragraph would eliminate the Procurement Code exemption for the retention of experts.

Bill section 6 gives the measure an immediate effective date.

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(b) This chapter (i.e. the State Procurement Code) applies to every expenditure of state money by the state, acting through an agency, under a contract, except that this chapter does not apply to

. . . .

(33) contracts between the Department of Natural Resources and contractors qualified to evaluate hydrocarbon development, production, transportation, and economics, to assist the commissioner of natural resources in evaluating applications for oil and gas royalty increases or decreases or other oil and gas royalty adjustments, and evaluating the related financial and technical data, entered into under AS 38.05.180(j);

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: SS HB 28
() Publish Date: _____

Revision Date/Time (Note if correction): 2/19/2003 Dept. Affected: Natural Resources
Title Oil & Gas Royalty Modification BRU Oil and Gas Development
Component Oil and Gas Development
Sponsor Kohring, Rokeberg
Requester House Oil and Gas Component No. 439

Expenditures/Revenues (Thousands of Dollars)

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

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

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

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

Estimate of any current year (FY2003) cost: 0.0

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

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

****HB 28 would provide a number of amendments to AS 38.05.180(j) which addresses oil and gas royalty modifications. The amendment adding the language "portion of field or pool" could result in a negative fiscal impact to the state.**

Under the current statutes, the Commissioner may modify royalties to allow for production from an oil or gas field or pool. At any given point of development or production, all oil and gas fields or pools contain a portion that is uneconomic in spite of the overall field or pool profitability. HB 28 expands AS 38.05.180(j) from "an oil or gas field or pool" to "a portion of a field or pool." Granting royalty relief for a portion of a pool creates an incentive for lessees to reallocate oil and gas to the portion of a pool benefiting from the reduced royalty rate. It also increases the workload and oversight responsibilities

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Division Oil and Gas Date/Time 2/19/2003
Approved by: Tom Irwin, Commissioner Date 2/19/2003
Agency Natural Resources

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. SS HB 28

ANALYSIS CONTINUATION

for the Division, which would then be required to assure proper allocation to the various parts of a single pool. In addition to problems of hydrocarbon allocation, there would be problems associated with cost allocation when assessing the request for royalty relief. Moreover, HB 28 opens the door to every oil or gas reservoir in the state being eligible for a royalty reduction. While it is not possible to accurately predict what the fiscal impact of this language could be to the state's royalty revenues, it will be a negative impact.