

SCOMM

#46:19

Proposed amendment to HB 366

Delete lines 21 through 26, and replace with the following language:

* Sec. 2. AS 38.05.183(f) is amended to read:

(f) The commissioner may not enter into a contract for the sale of royalty oil unless the contract provides that

(1) any material amendment to the contract that appreciably reduces the consideration received by the state requires prior approval of the legislature;

(2) an assignment of unprocessed royalty oil may occur only under the following conditions:

(a) the assignee or assignor demonstrates to the satisfaction of the department and the Alaska Royalty Oil and Gas Development Advisory Board that the assignment of crude oil to be refined within Alaska will result in a significant increase in monetary benefits to Alaska's energy consumers; and

(b) the assignee or assignor demonstrates to the satisfaction of the department and the Alaska Royalty Oil and Gas Development Advisory Board that the Alaskan energy consumer receives the greatest proportion of monetary benefit from the assignment.

STATE OF ALASKA



POUCH V
JUNEAU, ALASKA 99811
(907) 465-4941

HOUSE SPECIAL COMMITTEE ON OIL AND GAS

CSHB 366

Sectional Analysis

CSHB 366 amends several aspects of Title 38 relating to the disposition of royalty oil and gas and the Alaska Royalty Oil and Gas Development Advisory Board. These changes are discussed in the sectional analysis below.

Section 1. This amendment requires the commissioner of the Department of Natural Resources to make a determination, prior to the export of royalty oil or gas, that such a sale is in the best interest of the state. This language eases statutory requirements regarding the foreign and domestic export of Alaskan crude oil and natural gas.

This section also repeals language requiring the commissioner to make a determination that such "royalty-in-kind oil or gas is surplus to the present and projected intrastate domestic and industrial needs (of the state)." This language, which was passed at the time of the 1974 oil shortage, presently influences the type of royalty sales that may be made despite the fact that 1.6 million barrels of oil is now produced on the North Slope daily. This language has further resulted in severe difficulties in allowing the department to conduct competitive bid sales.

Section 2. This section specifies that the assignment of unrefined royalty oil shall be premised on a significant increase of direct monetary benefits to energy consumers. This section further specifies that the total direct monetary benefit to these consumers shall outweigh the monetary benefits to the assignor and the assignee. Determination of monetary benefit will be made by either the assignee or the assignor, to the satisfaction of the department and the Alaska Royalty Oil and Gas Advisory Board.

Section 3. This section moves the Royalty Board from the Department of Commerce and Economic Development to the Department of Natural Resources. The Board was housed in DNR until 1980, at which time the Board lost its authority to advise the legislature and was also transferred to DCED. These actions ostensibly occurred because of the Board's history of rubber-stamping administration recommendations.

The Alaska Royalty Oil and Gas Development Advisory Board presently serves as a forum for holding public hearings on royalty issues, and the Board also makes formal recommendations on proposed royalty sales to the Department of Natural Resources. The Board does not have any paid staff, and members of the DNR's Division of Oil and Gas serve as Royalty Board staff while also attending to their other duties.

This transfer is supported by both the Department of Natural Resources and the Department of Commerce and Economic Development.

Proposed amendment to HB 366

Delete lines 21 through 26, and replace with the following language:

(g) An assignment or resale of royalty oil under AS 38.05 - 38.06 may occur under the following conditions:

(1) the assignee demonstrates to the department and the Alaska Royalty Oil and Gas Development Advisory Board that the assignment or resale of crude oil to be refined within Alaska will result in a significant increase in benefits to Alaska's energy consumers, and

(2) the assignee demonstrates to the department and the Alaska Royalty Oil and Gas Development Advisory Board that the Alaskan energy consumer receives the greatest proportion of benefit from the assignment or resale.

(g) An assignment or resale of royalty oil under AS 38.05 - 38.06 may occur under the following conditions:

1. the assignee demonstrates to the department and the royalty board that the assignment or resale of crude oil to be refined within Alaska will result in a significant increase in benefits to Alaska's energy consumers, and
2. the assignee demonstrates to the department and the royalty board that the Alaskan energy consumer receives the greatest proportion of benefit from the assignment or resale.

§ 38.05.035

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Repealed, § 20

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§ 38.05.035

PUBLIC LANDS

§ 38.05.035

(4) prescribe application procedures and practices for the sale, lease or other disposition of available land, resources, property, or interest in them;

(5) prescribe fees or service charges, with the consent of the commissioner, for any public service rendered;

(6) under the conditions and limitations imposed by law and the commissioner, issue deeds, leases or other conveyances disposing of available land, resources, property or any interests in them;

(7) have jurisdiction over state land, except that land acquired by the Alaska World War II Veterans Board and the Agricultural Loan Board or the departments or agencies succeeding to their respective functions through foreclosure or default; to this end the director possesses the powers and, with the approval of the commissioner, shall perform the duties necessary to protect the state's rights and interest in state land, including the taking of all necessary action to protect and enforce the state's contractual or other property rights;

(8) *[Repealed, § 20 ch 182 SLA 1978.]*

(9) maintain such records as the commissioner considers necessary, administer oaths, and do all things incidental to the authority imposed; the following records and files shall be kept confidential upon request of the person supplying the information:

(A) the name of the person nominating or applying for the sale, lease, or other disposal of land by competitive bidding;

(B) before the announced time of opening, the names of the bidders and the amounts of the bids;

(C) all geological, geophysical and engineering data supplied, whether or not concerned with the extraction or development of natural resources;

(D) except as provided in AS 38.05.036, cost data and financial information submitted in support of applications, bonds, leases and similar items;

(E) applications for rights-of-way or easements;

(F) requests for information or applications by public agencies for land which is being considered for use for a public purpose;

(10) account for the fees, licenses, taxes or other money received in the administration of this chapter including the sale or leasing of land, identify their source, and promptly transmit them to the proper fiscal department after crediting them to the proper fund; receipts from land application filing fees and charges for copies of maps and records shall be deposited immediately in the general fund of the state by the director;

(11) select and employ or obtain at reasonable compensation cadastral, appraisal, or other professional personnel the director considers necessary for the proper operation of the division;

(12) be the certifying agent of the state to select, accept and secure by whatever action is necessary in the name of the state, by deed, sale,

ferred to the commissioner" for "returned to the jurisdiction of the division of lands" and "Transportation and Public Facilities" for "Highways" and made a series of technical changes; and repealed former subsection (a), relating to the sale, lease, or other disposal of university land.

Legislative history reports. — For report on ch. 267, SLA 1976 (FCCS SCSHB 139), see 1976 Senate Journal, p. 1461.

Opinions of attorney general. — The interaction of AS 38.05.030(b), 38.05.035(a)(7) and (12), AS 35.05.040(1), and AS 35.20.010 was examined to deter-

mine (1) which agency of the state had authority to accept title to land transferred by the federal government and (2) which agency had authority to manage the land, which was conveyed for airport and other purposes. The division of lands is the proper agency for acceptance of title. The division of aviation in the (former) Department of Public Works possesses the authority to manage the granted land for airport and directly related purposes while the division of lands possesses the authority to manage the land for other public purposes. April 14, 1977, Op. Att'y Gen.

NOTES TO DECISIONS

Scope of subsection (a). — Subsection (a) of this section only covers disposals of land by the commissioner of natural resources. *State v. University of Alaska*, Sup. Ct. Op. No. 2303 (File No. 4579), 624 P.2d 807 (1981).

Creation of state park including university lands. — Since creation of a state park which included university lands was a disposal by the legislature, not by administrative action, subsection (a) of this section was inapplicable. *State v. University of Alaska*, Sup. Ct. Op. No. 2303 (File No. 4579), 624 P.2d 807 (1981).

By enacting AS 41.20.210 (now see AS 41.21.121), creating Chugach State Park, the legislature did not impliedly repeal subsection (a) of this section, which prevents disposal of university lands by the commissioner of natural resources without the approval of the Board of

Regents of the University of Alaska. AS 41.20.210 withdrew the particular university land involved from the operation of the management mechanism created by subsection (a) and AS 14.40.170(a)(4), which grants certain management powers to the Board of Regents. *State v. University of Alaska*, Sup. Ct. Op. No. 2303 (File No. 4579), 624 P.2d 807 (1981).

Construction of state lease provision reserving right to grant right-of-way. — Provision in a lease issued by the State of Alaska, Division of Lands, expressly reserving the right to grant an easement or right-of-way across the leased property was construed to include an interagency transfer of a right-of-way to the Department of Transportation and Public Facilities. *Wessells v. State, Dep't of Hwys.*, Sup. Ct. Op. No. 1402 (File No. 2834), 562 P.2d 1042 (1977).

Sec. 38.05.032. School land disposition procedures. [Repealed, § 20 ch 182 SLA 1978.]

Sec. 38.05.035. Powers and duties of the director. (a) The director shall

(1) have general charge and supervision of the division and may exercise the powers specifically delegated to the director; may employ and fix the compensation of assistants and employees necessary for the operations of the division; and is the certifying officer of the division, with the consent of the commissioner, and may approve vouchers for disbursements of money appropriated to the division;

(2) manage, inspect and control state land and improvements on it belonging to the state and under the jurisdiction of the division;

(3) execute laws, rules, regulations and orders adopted by the commissioner;

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State of Alaska
Department of Natural Resources
Supplemental Findings
Competitive Royalty Oil Sale
(Prudhoe Bay and Kuparuk River Units)

November 28, 1984

Supplemental Findings
Competitive Royalty Oil Sale
(Prudhoe Bay and Kuparuk River Units)

AS 38.05.183(d) states that oil and gas taken in-kind as the state's royalty share of production may not be sold or otherwise disposed of for export from the state until the Commissioner of Natural Resources determines that the royalty in-kind oil or gas is surplus to the present and projected intrastate domestic and industrial needs for oil and gas. I find that the 90,000 bpd scheduled for competitive sale on December 11, 1984 is surplus to present and projected intrastate domestic and industrial needs for oil.

AS 38.05.183 also requires the Commissioner to submit an annual report to the state legislature "showing the immediate and long-term domestic and industrial needs of the state for oil and gas and an analysis of how these needs are to be met." The Department of Natural Resources, Division of Oil & Gas (the Department) complies with that requirement by preparing a document, published each January, entitled Historical and Projected Oil and Gas Consumption (also called the Supply/Demand study). The January 1984 Supply/Demand study concluded, as it has in previous years, that in-state supplies of both oil and gas far exceeded the immediate and long-term domestic and industrial needs of the state for oil and gas.

Due to the absence of any new information concerning the immediate and long-term domestic and industrial needs of the state for oil and gas, the Department again concluded, both in the Preliminary Findings and Determination to Negotiate Backup Royalty Oil Contract(s) and Conduct a Competitive Royalty Oil Sale (July 12, 1984) and the Final Findings and Determination to Conduct a Competitive Royalty Oil Sale for In-Kind Oil from the Prudhoe Bay and Kuparuk River Units (October 10, 1984), that the 90,000 bpd of state royalty oil to be sold competitively on December 11, 1984 is surplus to in-state needs. Consequently, upon the publication of the Preliminary Finding and execution of contracts with backup purchasers, the state gave a six-month notice to the North Slope producers of its intent to take 90,000 bpd of royalty oil in-kind (as provided by procedures in the Prudhoe Bay and Kuparuk River Unit Agreements).

The Department's conclusion was and is based in part on the interpretation of AS 38.05.183 stated in each Supply/Demand study since 1982. In that year, the study first gave specific definitions to certain phrases in that statute. Since 1982, the first chapter of every Supply/Demand study has contained a list of possible definitions for some of the imprecise clauses of AS 38.05.183, such as "how these needs are to be met". The Supply/Demand study definition of that phrase specifies the Department's long-standing position that the state's present and projected intrastate domestic and industrial needs for oil and gas may be met from a variety of sources, including state royalty oil. See 1984 Supply/Demand study page 1.7.

The intent of the statute should not be regarded as complete state self-sufficiency in refined products from state royalty oil. Rather, the Department believes the legislature was aiming at ensuring adequate overall oil and gas supplies for the state. The 1984 Supply/Demand study states that, "Under reasonable assumptions about recoverable reserves and Alaskan consumption, the current inventory of both oil and gas is more than sufficient to meet the presently identifiable needs of Alaskans for the next 15 years." Presently, the Department of Revenue's most recent crude oil price forecasts remain conservative due to the continued surplus in world supplies. While unfavorable from a revenue standpoint, that surplus will likely translate into dampened crude oil prices for Alaska consumers and industrial users. Only if the cost of imported products were significantly above the cost of products which could be refined in Alaska (e.g. when oil is not available to local refiners at the market price), or if Alaska users were suffering from an absolute shortfall in petroleum products, would the Department not consider the royalty oil to be sold at the competitive sale as "surplus" to present and projected in-state needs. Neither of these was found to be the case.

The Department's view of the purpose of AS 38.05.183 stems first from the atmosphere of absolute shortage, particularly in motor fuels, which prevailed at the time the statute was written. The statute was adopted in 1974, when the worldwide oil crisis and the imposition of federal oil contract controls raised the spectre of product shortages in Alaska despite North Slope crude oil production. The Department's view stems second from the apparent paradox of continued imports into regions such as Southeast Alaska, where the landed cost of such imports from Puget Sound undercuts the cost of delivered refined products to Southeast from Railbelt refiners. Under the most constrained interpretation of the statute, the Department would be obliged to promote in-state refining with royalty oil for the sake of absolute self-sufficiency, even when this resulted in higher prices for Alaskans. Clearly, this was not the intent of the statute. Intrastate needs for oil and gas are presently being met from a variety of sources, including state royalty oil. As charged, the 1984 Supply/Demand study identifies those sources and discusses how in-state needs are to be met, given the total supply of hydrocarbons within the state. In terms of total present and projected demand vs. total present and projected supply, intrastate refined product needs can be met with ease by the unprecedented production of crude oil from the North Slope, which is available to any purchaser willing to meet the market clearing price for that oil. For these reasons, the Department determined in the 1984 Supply/Demand study that the state enjoys a surplus of hydrocarbons relative to present and foreseeable demand.

Even if AS 38.05.183(d) were interpreted to require all intrastate needs to be satisfied by royalty oil before export could occur, I would find that the competitive sale amounts are surplus to present and projected intrastate domestic and on industrial needs for two reasons. First, persons who have a demand for oil as a result of current in-state processing or supply activities are granted priority rights to purchase royalty oil at the competitive sale. Second, during the term of the competitive sale contracts, royalty oil will remain in-value and will be available for disposition in-state.

The Department has provided for satisfaction of demand for royalty oil on the part of in-state refiners and in-state suppliers by giving them priority rights to purchase oil at the competitive sale. A priority will be offered to bidders which have sold an average of at least 5,000 bpd of refined petroleum products to distributors or consumers within the State of Alaska during the twelve-month period beginning June 1, 1983 and ending May 31, 1984, and which possess the ability to process crude oil into refined petroleum products at a processing facility owned by the bidder. Priority status will enable the in-state supplier to meet the highest winning bid in each of the three categories of royalty oil to be competitively sold. That right extends to the number of lots remaining in each category after the first round award of lot(s) to the highest winning bidder(s) in each category and priority bidders who have been posted as apparent high bidders. Consequently, in the first round of awards, priority bidders enjoy the possibility of receiving oil at the lowest price posted in each category. In addition, in-state suppliers are reasonably assured of receiving the desired volume of oil in the second round of awards, provided they are willing to meet the competitively established price. 11 AAC 03.250(5) states that:

"present or projected intrastate domestic and industrial needs" means in-state domestic and industrial demand at a competitive market price for the royalty oil, gas, or gas liquids. "Competitive market price" includes, but is not limited to, a price established by competitive bid.

Thus, in-state refiners and suppliers will have the first right to royalty crude at a competitive market price so that their supply is assured.

At the present time the state leaves approximately 104,735 bpd of royalty oil in-value with the North Slope lessees. The lessees export this oil from Alaska and tender the reported netback sale proceeds to the state. During the first six months of the term of the competitive sale contracts, April 1985 to September 1985, approximately 26,013 bpd of royalty oil will remain in-value. During the following six months of the term, October 1985 to March 1986, approximately 41,013 bpd of royalty oil will remain in-value. These amounts will remain available for disposition in-state if the Department finds the disposition(s) to be in the State's best interest. (If a contract currently being negotiated with Golden Valley Electric Association is approved, future amounts available for disposition would be reduced by 5,000 bpd.)

Several parties have recently expressed an interest in purchasing royalty oil from the State. Our conclusion that the competitive sale amounts are surplus to present and projected needs was drawn with the knowledge that all in-state refiners do not have 100% of their projected capacity supplied by state royalty oil. For example, as mentioned in the Preliminary Finding, the Department has conducted negotiations for the sale of royalty oil to MAPCO Inc. to fuel a proposed refinery expansion. The successful outcome of those negotiations is not, however, regarded by the Department as prerequisite to the possible export of the state's royalty oil in the planned competitive sale. First, MAPCO representatives indicated to the Department that the proposed refinery expansion may not be built, throwing the question of MAPCO's projected needs into doubt. Second, if MAPCO had a projected demand for royalty oil at a competitive price, it could have availed itself of its


opportunity to purchase oil at the competitive sale, as a priority bidder. Since it is a current in-state refiner, MAPCO would have been entitled to all the priority rights discussed above. Third, by virtue of its proximity to the Trans Alaska Pipeline (TAPS), MAPCO has unique opportunities to supply its refinery with North Slope oil. MAPCO currently receives 35,000 bpd of royalty oil directly from the State. MAPCO also receives 5,000 bpd of royalty oil through its agreement with another state royalty oil purchaser - the Golden Valley Electric Association. In addition, about 60% of the oil run through the MAPCO refinery is, with a minor quality penalty, reinjected into TAPS to re-emerge as whole oil at Valdez. That oil, which is the property of MAPCO, may be exchanged for more oil from the North Slope and again withdrawn from TAPS at Fairbanks. One of the several advantages that MAPCO enjoys with its state royalty oil contract, relative to other in-state refiners, is this absence of any state control over the return oil. MAPCO could also purchase oil directly from the North Slope lessees to satisfy any demand not met through the purchase and exchange of royalty oil. Finally, MAPCO's location on TAPS allows it to enter into "in-transit stop" arrangements in which MAPCO "borrows" oil from other TAPS shippers. The borrowed oil is processed in MAPCO's refinery with the full amount returned to the original shipper at Valdez through a combination of return oil and quality bank payments. This in-transit stop arrangement remains feasible so long as MAPCO's current contract which does not expire until 2003, remains in effect. The Department believes that any failure by MAPCO to secure oil through these possible sources of supply indicates that MAPCO's demand may exist only so long as it believes the State is willing to supply it with oil at a price below competitive prices. As explained above, 11 AAC 03.250(5) provides that projected needs means in-state demand at a competitive price.

Since the Department made its most recent finding of ample in-state hydrocarbon supplies, published in the Final Finding of October 10, 1984, several Alaskan parties in addition to MAPCO have expressed interest in purchasing royalty oil. Chevron has requested further volumes of royalty oil to meet a possible increase in "throughput" at its 18,000 bpd Nikiski Refinery. Chevron owns and exports 12,000 bpd of North Slope production in addition to the 18,000 bpd of royalty oil which it processes at Nikiski. New parties also propose to create additional new refineries in Alaska. Because these proposals were not known to the Department at the time of the most recent determination of an in-state hydrocarbon surplus, the state has decided to reduce the one-year term of those lots offered in the Kuparuk River oil category (category A) to six months. This will enable the state to have an additional 15,000 bpd of royalty oil available in the fall of 1985 for those who offer to purchase state royalty oil at terms which lead the Department to find that the disposition(s) would be in the state's best interest.

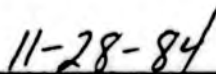
As stated, the impressive quantities of oil available within the state, which are the highest in the nation on a per-capita basis, diminish the likelihood of an actual "need" by these groups in the sense of supply availability. However, given the very recent nature of the new proposals received, the Department will further review their merits, as well as supply alternatives in addition to royalty oil. It has been the Division's experience that the term "need" is perceived differently by prospective in-state royalty oil

purchasers. Rather than the physical unavailability of oil due to world shortages or the unwillingness of North Slope producers to sell ANS crude at the market clearing price, prospective in-state royalty oil purchasers often view their feedstock needs in terms of the royalty oil price and terms they require for economic viability. While the Department recognizes that there are a host of oil-related economic activities which can be made viable should the state choose to undercut the market clearing price of Alaska North Slope oil for specific parties, this is not seen as the definition of "need" in AS 38.05.183, nor is it clearly in the State's best interest to do so.

Given the short-term nature of the proposed competitive sale, the consideration extended to in-state refiners and suppliers through the priority bidding system, the lack of demonstrated current need on the part of other potential in-state purchasers, and the amounts of oil remaining in-value available for disposition, I find pursuant to AS 38.05.183 that the royalty oil to be disposed of at the competitive sale is surplus to present and projected intrastate domestic and industrial needs.



Kay Brown, Director
Division of Oil & Gas
Department of Natural Resources



Date

1
2 IN THE HOUSE

BY THE HOUSE SPECIAL
COMMITTEE ON OIL AND GAS

3 HOUSE BILL NO.

4 IN THE LEGISLATURE OF THE STATE OF ALASKA

5 FOURTEENTH LEGISLATURE - FIRST SESSION

6 A BILL

7 For an Act entitled: "An Act relating to royalty oil and gas."

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

9 * Section 1. AS 38.05.183(d) is amended to read:

10 (d) Oil or gas taken in kind by the state as its royalty share
11 may not be sold or otherwise disposed of for export from the state
12 until the commissioner determines that the sale is in the best inter-
13 est of the state [ROYALTY-IN-KIND OIL OR GAS IS SURPLUS TO THE PRESENT
14 AND PROJECTED INTRASTATE DOMESTIC AND INDUSTRIAL NEEDS]. The commis-
15 sioner shall make public, in writing, the specific findings and rea-
16 sons on which the determination is based and shall, within 10 days of
17 the convening of a regular session of the legislature, submit a report
18 showing the immediate and long-range domestic and industrial needs of
19 the state for oil and gas and an analysis of how these needs are to be
20 met.

21 * Sec. 2. AS 38.05.183 is amended by adding a new subsection to read:

22 (g) An assignment or resale of royalty oil or gas purchased from
23 the state may not occur unless the commissioner determines that the
24 ^{resident Alaskan commercial} assignor or seller ~~is~~ the primary beneficiary of the assignment or
25 resale of the royalty oil or gas. The primary beneficiary is the
26 party receiving the greatest savings or net profit from the assignment
27 or resale of the royalty oil or gas.

28 * Sec. 3. AS 38.06.020 is amended to read:

29 Sec. 38.06.020. ESTABLISHMENT. There is established in ...e
Department of Natural Resources [COMMERCE AND ECONOMIC DEVELOPMENT]

1
2 the Alaska Royalty Oil and Gas Development Advisory Board.

3 * Sec. 4. AS 38.06.025(a) is amended to read:

4 (a) The board consists of the commissioner of commerce and
5 economic development; the commissioner of revenue; the commissioner of
6 natural resources [, WHO IS A NONVOTING MEMBER]; and three public
7 members.
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**STATE OF ALASKA 1985 LEGISLATIVE SESSION
FISCAL NOTE**

Revision Date: _____

REQUEST

Bill/Resolution No.: HB 366
Title: Royalty Oil Statute
Amendments
Sponsor: Oil and Gas Committee
Requestor: _____
Date of Request: _____

FISCAL DETAIL

Agency Affected: Natural Resources
Program Category Affected: NRMEC
BRU, Program or Subprogram(s) Affected:
Minerals and Energy Management

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 85	FY 86	FY 87	FY 88	FY 89	FY 90
OPERATING						
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 SUPPLIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS						
800 MISCELLANEOUS						
TOTAL OPERATING		-0-	-0-	-0-	-0-	-0-

CAPITAL						
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REVENUE						
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL		-0-	-0-	-0-	-0-	-0-

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: Attach a separate page if necessary

No fiscal impact. There is a separate budget increment that will support the Royalty Board under the Division of Oil and Gas.

Prepared By: Ned Farquhar **Phone:** 465-2400
Division: Commissioner's Office **Date:** April 16, 1985

Approved by Commissioner: *Leslie C. Wunniche* **Date:** April 16, 1985
Agency: Natural Resources

Distribution (by Agency preparing fiscal note):

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7/1/84