SCOMM

#46:28

Proposed CS for HR 9

Title Change: Relating to energy resources.

WHEREAS effective April 15, 1985, the Department of Natural Resources assessed royalties on Cook Inlet Basin natural gas at current market rates instead of contracted rates, thereby raising the price of royalty gas the state sells to producers; and

WHEREAS the increase in the price of royalty gas has increased electric rates by no more than 4 percent to Southcentral energy consumers; and

WHEREAS Southcentral energy consumers enjoy the lowest electric rates in Alaska and some of the lowest electric rates in the United States; and

WHEREAS Southcentral energy consumers will continue to enjoy the lowest electric rates in Alaska and some of the lowest electric rates in the United States, notwithstanding this rate increase; and

WHEREAS the state is presently experiencing a $436,000,000 decline in FY 86 revenues due to a decrease in the value of crude oil; and

WHEREAS selling the royalty share of Cook Inlet Basin natural gas to producers at below-market contracted rates will decrease general fund revenues by an additional $7,000,000 per year; and

WHEREAS conflicting policies exist regarding the value and best use of the state's royalty share of energy resources;

WHEREAS these policy conflicts have led to regional disputes regarding energy costs;

BE IT RESOLVED that the House of Representatives urges the Governor to direct the administration to develop a comprehensive and equitable statewide energy policy that encourages the efficient use of energy; and

BE IT FURTHER RESOLVED that existing and proposed state energy subsidy programs be reviewed and that, where possible, these programs be made consistent with this policy.

MEMORANDUM State of Alaska

TO: Esther C. Wunnicke, Commissioner
Department of Natural Resources
and Kay Brown, Director
Division of Oil and Gas
Department of Natural Resources

DATE: April 26, 1985

FILE NO:

TELEPHONE NO:

FROM: NORMAN C. GORSUCH
ATTORNEY GENERAL

By: Mark P. Worcester
Assistant Attorney General
Oil, Gas and Mining-Anchorage

SUBJECT: Dale Teel "Letter to the Editor" in the Anchorage Daily News.

On April 24, 1985 the Anchorage Daily News published a "Letter to the Editor" from Dale Teel, President of Enstar Natural Gas Company. A copy of that letter is attached. If any response is made, the following comments would appear to be appropriate.

1. Mr. Teel states that the royalty enforcement action would be "with no established legal basis -- with no public hearings, no regulations, and no Alaska court decisions to support that decision ...." Of course, the "legal basis" for the action is found in the terms of the leases issued many years ago to the oil companies. Apparently, Mr. Teel will justify his position that there is no "established" legal basis for the state's action upon the proposition that no regulation and no Alaska court decision has interpreted the oil and gas leases to require current market valuation of the state's royalty shares. If this is Mr. Teel's argument, it is fatally flawed, because there is also no Alaskan court decision and no regulation which supports the position he would advocate. Alaskan case law is silent on the issue. In the absence of court decision and regulations, the only basis for construing the obligations of the gas producers must be found in the lease forms themselves. The lease forms are precisely what the state's enforcement action is based upon.

2. Mr. Teel asserts that the long-term contracts were the result of "tough arm's-length negotiations in 1971 and in 1974 ...." However, Mr. Teel does not explain to the readers that those "tough" negotiations resulted in Enstar's commitment to purchase the one-eighth royalty share of gas at the values required by the leases between the state and the oil companies. This contract term demonstrates that the oil companies and Enstar both fully recognized that the one-eighth royalty share could be valued at a level higher than the contract price. Accordingly, the action by the state does not frustrate any of the purposes of

the "tough" long-term contracts negotiated by Enstar in 1971 and 1974. Instead the contracts specifically anticipated and provided for the eventuality of this royalty enforcement action.

3. Mr. Teel states that the state's action means the royalty share of gas which Enstar buys under its 1974 contract with the oil companies "will be priced" according the new 1982 contracts rather than the 1974 contract. This is incorrect. The state is not party to the Enstar-oil company contract and hence has not set a "price" for it. Rather, the state is merely enforcing its lease (contract) with the oil companies that the one-eighth royalty share be value and paid according to its current market price or value. As stated above, Enstar's own 1974 contract sets Enstar's "price." In that contract Enstar agreed to be responsible for any additional royalty amounts.

4. Lastly, Mr. Teel claims that the state's action constitutes a departure from a "25 year standard." There is no "25 year standard." Historically, long-term contract prices fairly reflected the then-current market value. It was not until December 1982, when Enstar negotiated new contracts at rates between three and ten times higher than the long-term contracts that objective evidence of a disparity between old long-term contract prices and current market prices and values was available. Thus, if anything, there is a "two year standard." However, there really was no "standard" at all, even between December 1982 and the recent notices. In that period the state never agreed to the propriety of the oil company royalty payments, and the six year statute of limitations for challenging the adequacy of the payments had not run for any of the additional royalties due after December 1982.

I have also enclosed a "synopsis" of Peter Ginder's testimony before the Legislature on April 11, 1985. Mr. Ginder is counsel for Enstar. The synopsis appears to be a rewrite, rather than a true synopsis. I have not prepared any rebuttal to this statement (which Enstar is apparently planning on circulating widely). If a rebuttal is desired, please let me know.

MPW/ma

enclosure

cc: Norman C. Gorsuch
Attorney General

Alaska State Legislature
House

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811

MEMORANDUM

3/28/85

TO: ALL REPRESENTATIVES

FROM: REPRESENTATIVE VIRGINIA COLLINS

RE: HOUSE RESOLUTION 9

On March 19, 1985, Esther Wannicke, Commissioner of the Alaska Department of Natural Resources announced a far-reaching policy decision which will affect the rates consumers pay for gas-fired power for, literally, hundreds of thousands of citizens residing throughout South Central, Fairbanks and interior regions of our State. The policy decision assesses royalties on national gas at current market rates instead of contracted rates, thereby raising the price of royalty gas that the State sells to producers, which in turn is passed on to consumers.

This policy, which is scheduled to take effect April 1, 1985, will increase electric rates for South Central consumers by as much as 20%. Further, this policy will increase the cost of natural gas-fired electrical energy to be transmitted to the Fairbanks/Interior Region over the Anchorage-Fairbanks transmission intertie.

It is for these reasons that I ask you to join me in supporting a House Resolution which calls upon the Governor to direct the Department of Natural Resources to suspend its decision pending legislative review of its impact upon the utility consumers of our State.

Thank-you for your assistance and valued support.

How our rates compare

Chugach Electric Association
1984 Annual Report

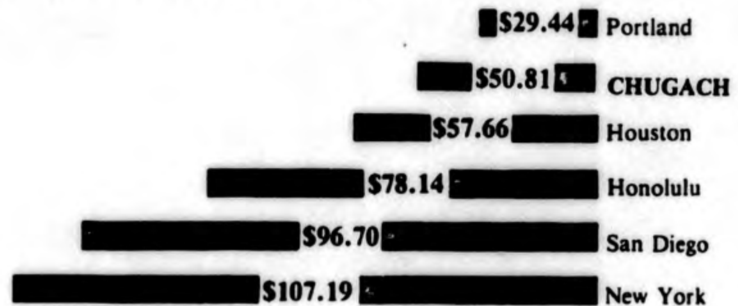
Chugach consumers enjoy some of the lowest electric rates in the nation, thanks in part to a long-term supply of inexpensive natural gas used to generate power.

Statistics compiled by the National Association of Regulatory Utility Commissioners show that consumers in New York City pay $107.19 for 750 kilowatt hours (kWh) of electricity, more than double the $50.81 charged by Chugach.

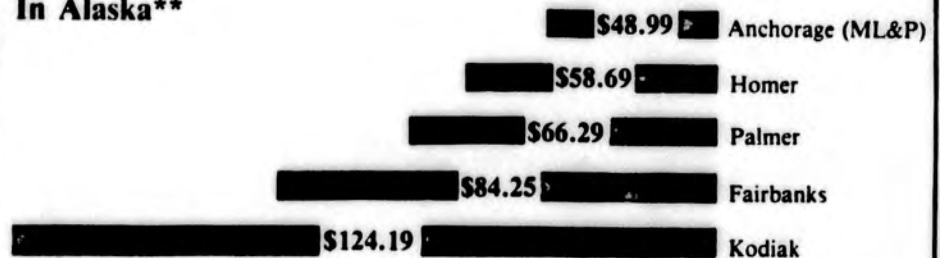
Residents of Tampa Fla., pay $60.74 for 750 kilowatt hours while those who live in Philadelphia pay $73.08.

Chugach's rates have remained suprisingly constant over the past 30 years, although electrical usage has soared. The average residential usage in 1984 was 805.4 kWh per month.

Outside: Residential electric bills at 750 KWH*



In Alaska**



*As of Feb. 1, 1984 **Source:** National Association of Regulatory Utility Commissioners
As of March 1, 1985 **Source: Alaska Public Utilities Commission

Electricity's Surging Cost

Average residential electric bills climbed 7.9 percent in 1984, nearly twice as fast as the 4.0 percent inflation rate.

A national survey by utility regulators found power costs varied widely, with consumers in the Northeast paying the most and those in the Northwest the least. New York City's rate was the highest in the nation.

The 25 most expensive and 25 least expensive cities by kilowatt hour in 1984:

25 Most Expensive

	Average KWH Cost	1-Year Change
New York City	16.17¢	+ 4.1%
Kahului, Hawaii	14.33¢	+ 8.3%
Nantucket, Mass.	14.31¢	+ 7.6%
Hilo, Hawaii	13.92¢	+10.7%
Middletown, N.Y.	13.78¢	+ 0.3%
Long Beach, N.Y.	13.05¢	+10.5%
Boston, Mass.	12.77¢	+30.8%
Poughkeepsie, N.Y.	12.14¢	+11.5%
Dover Township, N.J.	12.01¢	− 5.8%
San Diego, Calif.	11.79¢	− 6.1%
Fitchburg, Mass.	11.55¢	+20.1%
Bergen County, N.J.	11.43¢	−14.6%
Newark, N.J.	11.31¢	− 1.1%
Honolulu	11.30¢	+ 9.4%
Exmore, Va.	11.23¢	+ 1.5%
Gary, Ind.	11.20¢	+22.3%
Bridgeport, Conn.	11.14¢	+11.6%
Bridgeton, N.J.	11.07¢	− 2.0%
Chicago, Ill.	10.80¢	+ 4.6%
Philadelphia, Pa.	10.80¢	+20.9%
Pawtucket, R.I.	10.78¢	+21.8%
Wilmington, Del.	10.75¢	− 2.8%
Elkton, Md.	10.65¢	+21.0%
Fall River, Mass.	10.60¢	+12.2%
Davenport, Iowa	10.57¢	—

25 Least Expensive

	Average KWH Cost	1-Year Change
Billings, Mont.	3.55¢	−15.5%
Spokane, Wash.	3.61¢	+23.0%
Boise, Idaho	3.85¢	+ 8.5%
Ontario, Oreg.	3.85¢	+11.0%
Portland, Oreg.	3.91¢	+10.8%
La Grande, Oreg.	4.37¢	+21.1%
Casper, Wyo.	4.92¢	+ 7.4%
Bellevue, Wash.	4.96¢	+35.2%
Ashland, Ky.	5.20¢	+ 1.6%
Duluth, Minn.	5.45¢	+ 1.5%
Franklin, N.C.	5.46¢	+35.5%
Marietta, Ohio	5.48¢	− 0.1%
Cheyenne, Wyo.	5.55¢	+21.7%
Washington, Pa.	5.56¢	+ 3.3%
Las Vegas, Nev.	5.67¢	−27.4%
Rutland, Vt.	5.74¢	+ 5.7%
Kingsport, Tenn.	5.75¢	+ 2.2%
Flint, Mich.	5.82¢	+ 2.4%
Juneau, Alaska	5.85¢	+ 3.2%
Lexington, Ky.	5.85¢	0%
La Crosse, Wis.	5.89¢	+ 7.9%
South Beloit, Ill.	5.91¢	− 1.1%
Fargo, N.D.	5.95¢	− 3.8%
Burlington, Vt.	5.98¢	4.6%
Parkersburg, W.Va	6.08¢	− 1.8%

U.S. NEWS & WORLD REPORT, March 25, 1985

Resource policies not always popular

By ESTHER WUNNICKE

No decision is more difficult for a public official than one that may hit people in their pocketbooks. Such is the case with the Cook Inlet royalty gas decision you've been reading about recently.

There's more than money at stake here. There's also a fundamental question of fairness for Alaskans everywhere, including the people of Anchorage and the Southcentral area.

Alaskans living on the shores of Cook Inlet enjoy plentiful, inexpensive natural gas for home heating and power generation. A good share of that gas is produced from fields owned by all of the people of Alaska and leased to private industry for development, just as the giant Prudhoe Bay field is.

For years, the price local public and private utilities paid for this gas has remained very low, under long-term contracts between the utilities and the gas producers. And except for the share due the state as landowner, those prices will continue to stay low until the contracts expire in 1986, 1992 and 1994. We're all thankful for that.

While industry is producing Cook Inlet gas used by thousands of Alaskans in the Southcentral area, a portion of that gas is owned by all Alaskans. That smaller ownership share, called a royalty, equals 12.5 percent of the gas from these fields. The state reserved this 12.5 percent as the public's share when the leases were awarded.

It's this royalty gas — less than 5 percent of all gas used for home heating or power in the Anchorage area — that is at issue in a pricing decision I announced in mid-March. That decision which took effect April 15, seeks to capture the prevailing market value for this publicly owned gas, a value established by sales contracts for other gas produced in Cook Inlet.

That prevailing market value is \$2.05 per thousand cubic feet, compared to the 21 to 61 cents the public has been earning on its gas under the long-term contracts. The result of the March pricing decision could bring an extra \$7 million a year to the public treasury.

On the other hand, what does this decision mean to your utility bill?

The increase in monthly rates would be between 2 percent and 4 percent, according to estimates from Enstar and Chugach Electric. For the average home serviced by Chugach using approximately 800 kilowatt-hours a month — a total monthly bill of about \$57 that translates into an increase of about \$2.30 per month. For an Enstar customer who consumes a monthly average of 16,000 cubic feet of gas, the average monthly bill of \$44 would increase by about 90 cents.

No public official, elected or appointed, wants to take money out of people's pockets unless a greater public good is served. That's the case here.

The principle underlying the Cook Inlet gas decision is the same being pursued on the public's behalf on a wide variety of fronts, both in court and out. Last year, for example, the Phillips Petroleum Co. paid the state \$36 million in additional royalties for publicly owned gas from five Cook Inlet leases, following an agreement between the company and the state on how to value royalty gas. That agreement did not result in higher Anchorage area utility bills because the gas is not used by local consumers, but the principle is the same.

Likewise, the state is involved in several lawsuits seeking to establish accurate values for oil and gas on the North Slope. Billions of dollars are at stake in this ongoing effort to obtain for the people what is their due — a maximum benefit for their resources.

I fully appreciate the desire to keep consumer gas and electricity prices as low as possible. This cannot be done, however, by hidden subsidies to Southcentral consumers through a disregard of the state's oil and gas leasing laws and contracts.

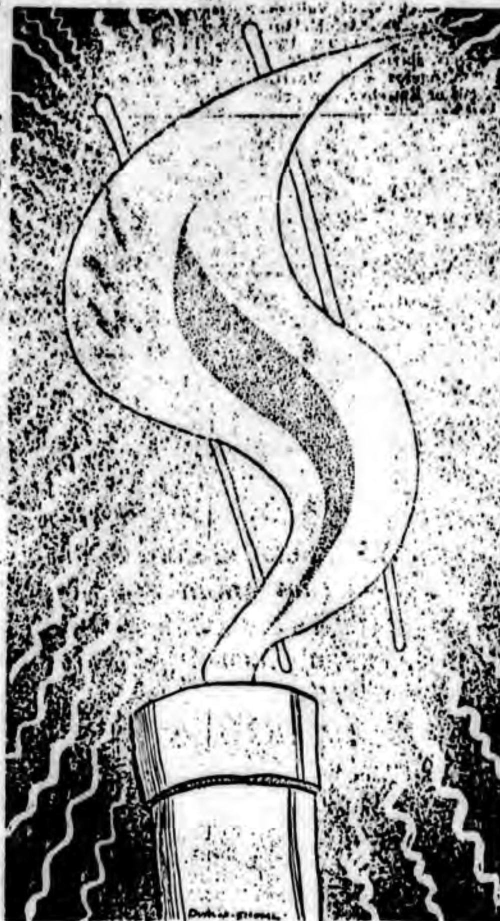
The state currently is investing hundreds of millions of dollars to ensure the energy needs of all Alaskans are met, including those in the Railbelt. Some of that investment has been directed first to the rural areas of Alaska, where residents often pay a quarter of their annual incomes for home heating and electricity. The state also is nearing completion of the \$150 million electrical intertie between Anchorage and Fairbanks, plans to begin construction next year to the Bradley Lake hydro project near Homer, and is continuing to pursue the Susitna hydro project. Toward those ends and more, Gov. Sheffield has worked with the legislature to appropriate \$250 million during this session to a power development fund.

As the governor told a statewide conference on alternative energy last month, Alaska may or may not build Susitna, depending on the future price of oil, agreement on power sales contracts, and the securing of financing.

"But I believe we're going to have to build something that will fulfill the growing demand for affordable, dependable power in Anchorage, the Kenai Peninsula and the Railbelt," the governor said. "It may be a series of coal-fired plants, the Susitna and Bradley Lake dams, or alternative energy facilities. More likely, it will be some combination of methods, including better conservation."

To help finance that affordable, dependable energy future for Alaska, as well as take care of all our other needs, the department of Natural Resources is required by law to maximize the people's return on natural resource development. That requirement may not always be popular, but it is a wise one for our state and our future.

☐ Esther Wunnicke is Alaska Commissioner of Natural Resources.



Energy decisions hurting Anchorage

BY VIRGINIA COLLINS

If there is equity in our statewide energy program, you won't find it in Anchorage.

From 1977 through 1985 the Anchorage area received only one-fifth of the \$1.65 billion appropriated for state energy projects and subsidy programs, including Susitna, yet Anchorage metropolitan area residents make up over one-half of the state's population! In other words, for every energy dollar appropriated over the last nine years, 20 cents was earmarked for Anchorage and 80 cents for the remainder of the state.

Now the state has implemented a new policy which will have the effect of a hidden state tax on Anchorage and Southcentral area utility customers. The cumulative impact of this policy will increase electric utility and gas bills by more than \$3 million annually or more than \$30 million over the next 10 years.

On April 15, 1985, the Department of Natural Resources began assessing higher royalty values on Cook Inlet natural gas it sells to producers. The royalty price increase will be passed on to Chugach Electric and Enstar customers comprising approximately 250,000 residents throughout the Mat-Su Valley, Anchorage and Kenai Peninsula.

In defense of its decision, the department of Natural Resources would have us believe that it is statutorily obligated to implement this new policy on the grounds that this action would "assure full and proper royalty collection for the benefit of all the citizens of Alaska."

In a nutshell, this new state policy implies that the citizens of Anchorage and Southcentral Alaska do not qualify to participate fully in the benefits accorded to other citizens of the state — namely, lower utility rates than would be possible without state assistance.

The state has clearly established its commitment to energy subsidies throughout most other areas of the state in an effort to reduce the escalating costs of power; examples include the \$500 million Four-Dam Pool for Southeast, Kodiak, Valdez and Glennallen; a much-needed \$21 million annual appropriation for power cost assistance in rural Alaska and a \$150 million Railbelt transmission line intertie that will enable the Fairbanks/Interior area to avail itself of low cost, natural gas-generated power from Anchorage.

It is true that Anchorage area residents currently enjoy reasonable power rates relative to rural communities; nonetheless these rates are due to increase dramatically within a few short years. The state's decision to assess higher royalty taxes which will be passed on to Anchorage area utility consumers raises fundamental questions about the fairness of subsidizing energy costs for one-half of the state's population while simultaneously taxing the other half; in effect creating two classes of citizens, the subsidized and the de-subsidized.

This issue is greater in scope than the question of whether or not the state should assess higher royalties on Cook Inlet natural gas.

The Alaska Constitution requires that "The legislature shall provide for the utilization, development and conservation of all natural resources belong to the state . . . *for the maximum benefit of its people.*" It is, therefore, the legislature's constitutional responsibility to determine if the state's policy to assess higher royalties for Cook Inlet gas meets the test of providing for the "maximum benefit" of all Alaskan citizens, rural and urban alike.

Clearly, that is not the case for the 250,000 people who live in our state's largest urban area — Anchorage.

The issue of "fairness" in the implementation of our state's energy policy will not fade away. If we fail to address it now, it will come back to haunt us another day and will galvanize public opinion of every utility ratepayer in Alaska.

☐ Virginia Collins, a Republican, represents Midtown Anchorage in the Alaska House of Representatives.

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

POUCH M
JUNEAU, ALASKA 99811
PHONE:

March 11, 1985

The Honorable Ben Grussendorf, Speaker
Alaska State House of Representatives
Pouch V
Juneau, Alaska 99811

Dear Speaker Grussendorf:

Attached for your information is a recently completed update of Cook Inlet Oil and Gas data prepared by the Division of Oil and Gas. This information updates figures in the Historical and Projected Oil and Gas Consumption report, which was submitted to you in January, 1985.

Total remaining Cook Inlet gas reserves were previously estimated to be 3.26 trillion cubic feet (Tcf) as of January 1, 1984. The revised estimate of Cook Inlet reserves is 4.46 Tcf as of January 1, 1985.

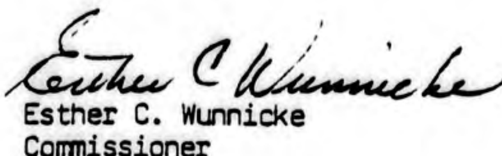
Inclusion of additional gas reserves from the Grayling gas sands (Trading Bay Unit) and incorporation of gas reserves from the Stump Lake Units, Cannery Loop Unit, and Pretty Creek Unit were primarily responsible for the increase in gas reserves.

Assuming current use patterns are maintained, we estimate that cumulative use of natural gas from Cook Inlet fields will be 3.3 Tcf between 1985 and 1999. Thus, it appears that there are sufficient gas reserves to meet projected needs in the railbelt for more than 15 years.

An estimate of state royalty oil available from Cook Inlet fields is also attached.

If you have questions about this information please do not hesitate to contact me.

Sincerely,



Esther C. Wunnicke
Commissioner

Attachments as stated

cc: Members of the House of Representatives

10-J9LH

AVAILABILITY OF
COOK INLET ROYALTY OIL

Year (1)	Barrels Per Day
1985	5935
1986	5032
1987	4290
1988	3645
1989	3097
1990	2645
1991	2226
1992	1903
1993	1613
1994	1387
1995	1181

(1) As of January 1 of each year

Department of Natural Resources
Division of Oil and Gas
March, 1985

COOK INLET GAS RESERVES *
(Billions of Cubic Feet)

FIELD	REMAINING RECOVERABLE GAS (as of Jan. 1, 1985)	STATE ROYALTY SHARE (as of Jan. 1, 1985)
Kenai	850	17
North Cook Inlet	650	81
Beluga River	800	60
Swanson River	260	0
Cannery Loop	300	9
McArthur River & Trading Bay	650	81
Beaver Creek	230	0
Cook Inlet Associated Gas	60	7
Ivan River - Lewis River - Pretty Creek - Stump Lake	600	75
Other	63	8
Totals	4463	338

* Department of Natural Resources
Division of Oil and Gas
Updated March 1985

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

POUCH M
JUNEAU, ALASKA 99811
PHONE: 907-465-2400

OFFICE OF THE COMMISSIONER

April 2, 1985

The Honorable Mike Davis
Alaska State House
Pouch V
Juneau, AK 99811

Dear ~~Representative~~ Mike Davis:

On March 18, 1985, the Department of Natural Resources (DNR) notified certain Cook Inlet gas producers that effective April 1, 1985, the state would no longer accept long-term contract prices as determinative of value of the state's royalty share of gas from the Kenai, Sterling, Beluga River, Trading Bay, and McArthur River Fields. The effective date of this notice has since been modified to April 15, 1985.

The mandate of DNR is to administer the state's leases in accordance with their terms and applicable law, and thereby to collect full and proper royalties for the extraction and use of the state's natural resources. DNR determined that royalties should be based on the current value of the gas which may or may not be reflected by long-term contract prices. The Department of Law has advised DNR that its action is supported by decisions in courts outside Alaska which have addressed this issue. It is also consistent with the position that the federal government and Cook Inlet Region, Inc. (CIRI) have expressed in current litigation with Union Oil Company under federal and CIRI leases in Cook Inlet.

As you can see from the enclosed exhibits, this decision affects only 4.4 percent of the gas stream allocated to consumer use. Chugach, the utility likely to be most affected by the Notice, testified before the Anchorage Caucus today that rates to their customers would increase approximately 4 percent as a result of the decision. The department estimates that the increase to Enstar consumers would be approximately 1/2 of 1 percent. The exhibits also explain the location of the fields, contract prices, current prices, producers, and how state royalty gas is allocated. I also believe my testimony before the Anchorage Caucus today will enable you to better understand both the Administration's efforts to enforce the provisions of the state leases and the fundamental issues of contract enforcement which are at stake. A copy of that testimony is enclosed.

We understand the concerns raised by our decision. My staff and I stand prepared to work with the Legislature to address these concerns.

Sincerely,

Esther C. Wunnicke
Commissioner

Enclosures:
- Testimony
- Charts (2)
- Pie Charts (2)
- Map

STATEMENT

BY

ESTHER C. WUNNICKE, COMMISSIONER

DEPARTMENT OF NATURAL RESOURCES

TO

ANCHORAGE CAUCUS

April 2, 1985

Thank you. You've asked that I provide the Anchorage Caucus with information about our recent decision regarding the valuation of state royalty gas.

It has been the consistent policy of the Department of Natural Resources in managing resources to obtain maximum benefit - in this case revenues - for the people of Alaska.

The department recently notified Cook Inlet lessees that the state will no longer accept royalty valuation based on long-term contract prices that are significantly below market value. This action will increase income to the state treasury by more than $8 million dollars a year.

Although this is not a popular decision since it may increase the price of electricity and gas in the southcentral area, I nonetheless determined that the best interests of the state required us to take this action. But because of the impact this may have on consumers, Governor Sheffield has asked me

to postpone the effective date of the decision, which was to be April 1, for two weeks to April 15 in order to give the Legislature, the public and the producers more time to consider their responses to the decision.

I'm going to explain the legal basis for the decision and briefly address some of the issues we considered.

The Cook Inlet gas situation is complex, involving multiple owners and uses. Cook Inlet gas goes to Japan as LNG, and is used locally to make ammonia and urea, pressurize an oil field, heat greenhouses, make electricity and heat homes and businesses. Staff from the Division of Oil and Gas will be covering this background material in more detail in a few minutes.

This action results from our obligation to enforce the provisions of the state's oil and gas leases, which are contracts between the producers and the state, and which entitle the state to receive current market value for royalty gas taken in-value. at the time of production.

Our position is grounded upon the principle of the sanctity of contracts. The state's leases explicitly obligate the producers to pay the state royalty payments based upon the price <u>or value</u> of the gas, whichever is higher. In this case, we are merely invoking the state's rights to royalty

payments based on the value of the gas, which is higher than the price under the long-term sales contracts. Our policy is totally consistent with the producer utility sales contracts. Those contracts explicitly anticipated that the royalty payment rate to the state might exceed the contract price, and provide that the burden of the higher royalties is to be passed through and borne by gas purchasers.

We advised the gas producers that effective April 1 - now April 15 - they should pay royalties based on a price of $2.05 per mcf. We did not arbitrarily pick the minimum $2.05 per mcf value. Rather, Enstar established this value in its recent negotiated contracts.

I decided not to seek retroactive royalty payments based on current market values. For both the retroactive and prospective periods, the gas sales contracts between the producers and the utilities provide that royalty adjustments will be passed through to Enstar and Chugach Electric. Prospective collection can be implemented in an orderly fashion. However, retroactive collection would create significant legal and financial risks for the state's utility companies, including Chugach - a consumer cooperative. In particular, it is uncertain how, and to what extent, retroactive royalty collections could be passed through to consumers. Since the main benefits of the royalty collection are prospective (the basis for the $2.05/mcf price was not established until

December 1982), I believe that the financial risks to the utilities and legal uncertainty far outweigh the desirability of seeking retroactive collection.

✓ This is a lease enforcement action and it is not optional. The Department of Natural Resources is the agency designated by statute to enforce the provisions of oil and gas leases. (AS 38.05.036)

The Legislature has required the department to obtain as royalty a minimum of 12 1/2 percent of the amount or value of oil and gas production from state leases. (AS 38.05.180(f)). The only exception is when the net profit share is used as the bid variable. Any lease form which is inconsistent with this directive would be void. Thus, "value" is the guiding standard. The "price" of the gas is acceptable for royalty valuation purposes only if that price fairly represents its value <u>at the time of production</u>.

Several statutes mandate or infer our obligation to obtain full value for oil and gas resources:

- AS 38.05.180(a) states that the people of Alaska have an interest in maximizing the economic and physical recovery of oil and gas resources;

- AS 38.05.180(f) requires that leases be awarded to the highest bidder and established bidding methods with a minimum royalty requirement of 12 1/2 percent of the amount or value of production;

- AS 38.05.183(a) provides that as a general rule, royalty gas or oil must be sold to the highest bidder.

There is thus a statutory mandate to obtain a minimum of 12 1/2 percent of the value or amount of production. There are some statutes which allow some discretion to relax a standard or to forgive strict compliance with a term of the lease. However, each of these exceptions to the general rule is specifically limited, and none of the exceptions would allow DNR to relax its lease enforcement practices solely for the purpose of benefitting southcentral consumers. Absent such statutory direction and authority, the department perceives its obligation as being to enforce the terms of the leases equally for all lessees.

Some of the statutes which allow relaxation include the following:

- AS 38.05.020(b)(5), states that the commissioner may extend the time for rental or royalty payments due whenever acts of God, war or riots prevent timely payment.

- AS 38.05.035(b)(8) states that the director may extend the rental payment deadline for up to 90 days upon a showing of good cause.

- AS 38.05.135(a) says that royalty may be reduced to a minimum of 5 percent, and other incentives provided, in unproven areas in order to encourage exploration. (This section does not appear to apply to existing leases, only to the lease issuance stage).

- AS 38.05.180(j) allows reduction of royalty to compensate for increasing costs of production after two years of initial production.

- AS 38.05.180(h) allows the commissioner to forgive work commitment stipulations upon certain showings.

- AS 38.05.180(i) allows the commissioner to give exploration incentive credits in certain circumstances.

- AS 38.05.180(p) allows the commissioner to change, establish or revoke drilling, producing and royalty obligations of the lease at the time of unitization with the consent of the holders of the leases.

- AS 38.05.810 authorizes disposal of state resources at below market value under certain circumstances. Specifically, it allows disposals at below market value to a state or federal agency or political subdivision, or disposal of coal to non-profit utility cooperatives for electrical generation. It does not mention disposal of state gas to utilities at below market value.

Many other statutes expressly grant limited discretion for DNR to treat some group of citizens in a preferential manner. However, none apply in this context.

I'd like now to briefly discuss the applicable provisions of the oil and gas lease form DL-1.

Paragraph 11 provides that the producers owe to the state 12 1/2 percent of the amount or value of production.

Paragraph 15 provides that royalty may be taken in-value, or in money, in lieu of royalty in-kind. Royalty owed is based upon the "field market price or value at the well."

Paragraph 16 establishes three alternative, independent floors for in-value royalty valuation. It says that the field market price or value "shall not be less than the highest of": 1) the actual price paid; 2) the posted price; and 3) the prevailing price.

The state is thus entitled to royalties based upon the "value" of the gas. The actual price at which the royalty share is sold by the producer is an acceptable basis for royalty valuation under Paragraph 16(1) only if it fairly represents "value" when compared against the other methods of valuation.

In this case, it is clear that the present value of gas being produced is not reflected in the 21¢ and 61¢ long-term contracts. Objective evidence of current value is provided by the December 1982 contracts between Enstar-Marathon, and Enstar and Beluga producers (Shell, Chevron, Arco). In both instances the contract price is currently about $2.05 per mcf.

Madam Chairman, the department cannot be arbitrary in the administration of oil and gas leases. All leases must be treated the same, and must be administered in accordance with their terms, the regulations and statutes.

Accepting less than current value for in-value royalty gas is not an appropriate mechanism for providing energy subsidies to southcentral Alaska. This would require the department - whose obligation is to all Alaskans - to relax our lease enforcement practices solely in order to benefit some Alaskans at the expense of the general treasury.

If we hope to prevail in the North Slope royalty litigation, it is our view that we must act across the board to collect full value for the state's resources. It would be improper to have one standard of enforcement where oil companies bear the burden and a different more lenient standard where some of that burden is passed on to Alaska consumers.

I'd like to talk for a moment about the specific impacts on consumers. I believe those impacts have been somewhat overstated in the press accounts of our decision. About two-thirds of the $8 million dollars we expect to collect annually from the producers as a result of the decision could be passed through to Chugach and Enstar. The royalty enforcement policy affects only the royalty share (one-eighth) of the volume of gas sold from state leases to the utilities. The policy has no effect upon the other seven-eighths of the gas sold under these contracts. South-central consumers will continue to enjoy seven-eights of the bargain prices contained in the long-term contracts.

Gas purchase costs are only a part - about 30 percent - of a utility's expenses, which also include operating and maintenance costs and debt service. By far, the greatest impact falls on the customers of Chugach Electric Association, which is a non-profit cooperative utility. We estimate that Chugach's gas purchase costs will increase by 47 1/2 percent above current rates as a result of our action. However,

residential electric bills are expected to increase by no more than 10 percent for Chugach customers.

As a 60.44 percent owner of the Beluga River gas field, the state's royalty share equals 7.5 percent of total Beluga River gas production. That is the share of production affected by the decision. The decision translates into an overall Beluga gas stream price increase of about 13.3¢ per mcf for Chugach.

Chugach will still be paying a weighted average price of only about 41.3¢ per mcf overall for Beluga gas, compared to their 21¢ and 28¢ contract prices. Forty-one cent gas is still a real bargain.

In the Kenai field, the state owns 16.68 percent of the land and that results in a state royalty share of about 2 percent of total field production. Consequently, the result for Enstar is a price increase of about 2.5¢ per mcf on its overall gas stream out of the Kenai field. With this increase, Enstar still pays a weighted average price of only about 96¢ per mcf for Kenai gas.

We estimate that Enstar's system-wide gas purchase costs will increase by only 1 percent as a result of our action, since that company consumes much less state royalty gas compared to Chugach. According to our calculations,

residential gas bills of Enstar customers should rise less than one-half of 1 percent as a result of the state action.

And, this is not to say that Cook Inlet gas and electric rates will not continue to rise. Chugach and Enstar will eventually pay more for natural gas than they do today, regardless of this action by the state.

Enstar is already paying $2.05 per mcf for about 30 percent of the gas it purchases for resale to the consumer. By about 1991, Enstar's cheap gas supplies will have been totally consumed.

Chugach will completely exhaust its cheap gas supplies by 1995. If, how and when Chugach blends in higher priced gas will determine consumer prices. But, we have no doubt that the new gas supplies will cost more and that consumer bills will reflect this additional expense.

I fully appreciate the desire to keep consumer gas and electric prices as low as possible statewide. However, if we embrace the notion of trying to maintain the status quo of currently low energy prices, then we are looking at a situation that is going to require an ever-increasing level of subsidy. The market value of gas is without doubt higher today than the long-term contract prices reflect.

If the status quo is desired, there are solutions other than not enforcing the leases. An in-kind, long-term sale of royalty gas could be considered, or the Legislature could include Anchorage in the current subsidy programs. Or, it possibly could authorize royalty reductions for gas or oil royalty shares devoted to domestic utility purposes.

The department stands ready to work with the Legislature in devising and implementing appropriate solutions. It appears to me that this question is best addressed in the context of the state's overall energy subsidy programs.

Several questions have arisen about on-going litigation over Cook Inlet gas values and about the impacts of the decision on rural areas of the state.

Briefly, there are three lawsuits presently pending that involve Cook Inlet gas issues. The first, Marathon v. U.S.A., Cook Inlet Region, Inc. and the State, is pending in U.S. District Court in Anchorage. The only issue in that suit is the value of gas that is sold as LNG in Japan. It does not involve gas sold under long-term contracts at below market rates, nor does it involve gas sold to local utilities. Further, the lawsuit does not involve state-owned leases. It has direct impact only on leases owned by the United States and CIRI.

However, the recent decision by Judge Fitzgerald in that suit is favorable to the state because the state receives 90 percent of federal royalties. Judge Fitzgerald recently held that Marathon must pay royalties based upon the price in Japan, less liquification and transportation cost. The state was named as a party to the Marathon lawsuit, but Judge Fitzgerald ruled that the royalty valuation issues for state leases should be determined by a state court. That suit, State v. Marathon, is pending in Alaska Superior Court in Juneau. This is a parallel case with the federal case I just mentioned and involves leases owned by the State. Again, no issue is involved relating to local utility contracts. The department is currently pursuing settlement negotiations with Marathon.

The final case is Union v. CIRI and United States, which is pending in U.S. District Court also before Judge Fitzgerald. This case involves only leases owned by CIRI and the United States. It involves all of Union's production, including production allocated to the so-called "APL-1" contract (Enstar's long-term 61¢ contract). The main issue is the valuation of gas committed to the urea ammonia plant at Nikiski.

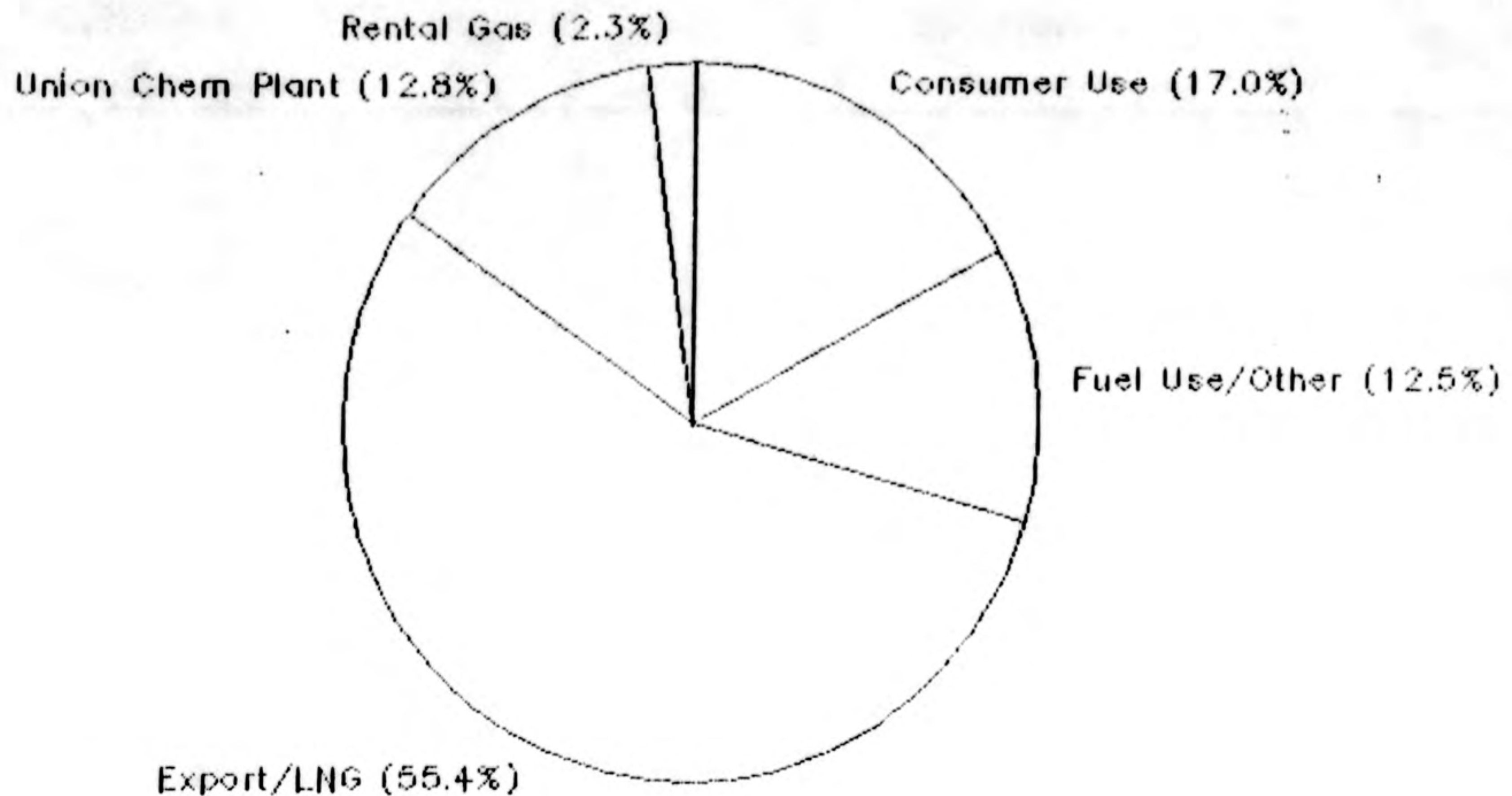
The position of the federal government and CIRI in that case parallels the notice issued by the state to Union this month. The federal government and CIRI are seeking a price

from Union of approximately $2.05 per mcf for both the plant volumes and the APL-1 contract.

With respect to the question raised about the impacts of our decision on rural areas, it appears from our analysis there will be no impact. We assume this question arises due to the relationship between urban rates and rural rates under the power cost equalization program. Our analysis indicates that the marker for rural subsidies is set by statute at 8.5¢ per kilowatt hour, and that this rate is unaffected by changes that might occur in urban power rates.

Thank you for the opportunity to discuss these issues with you. Kay Brown and members of her staff are with me today to assist in answering any questions the caucus may have. I'd now like to ask Bill Van Dyke to give you an overview of Cook Inlet gas reserves.

Uses of Cook Inlet State Royalty Gas

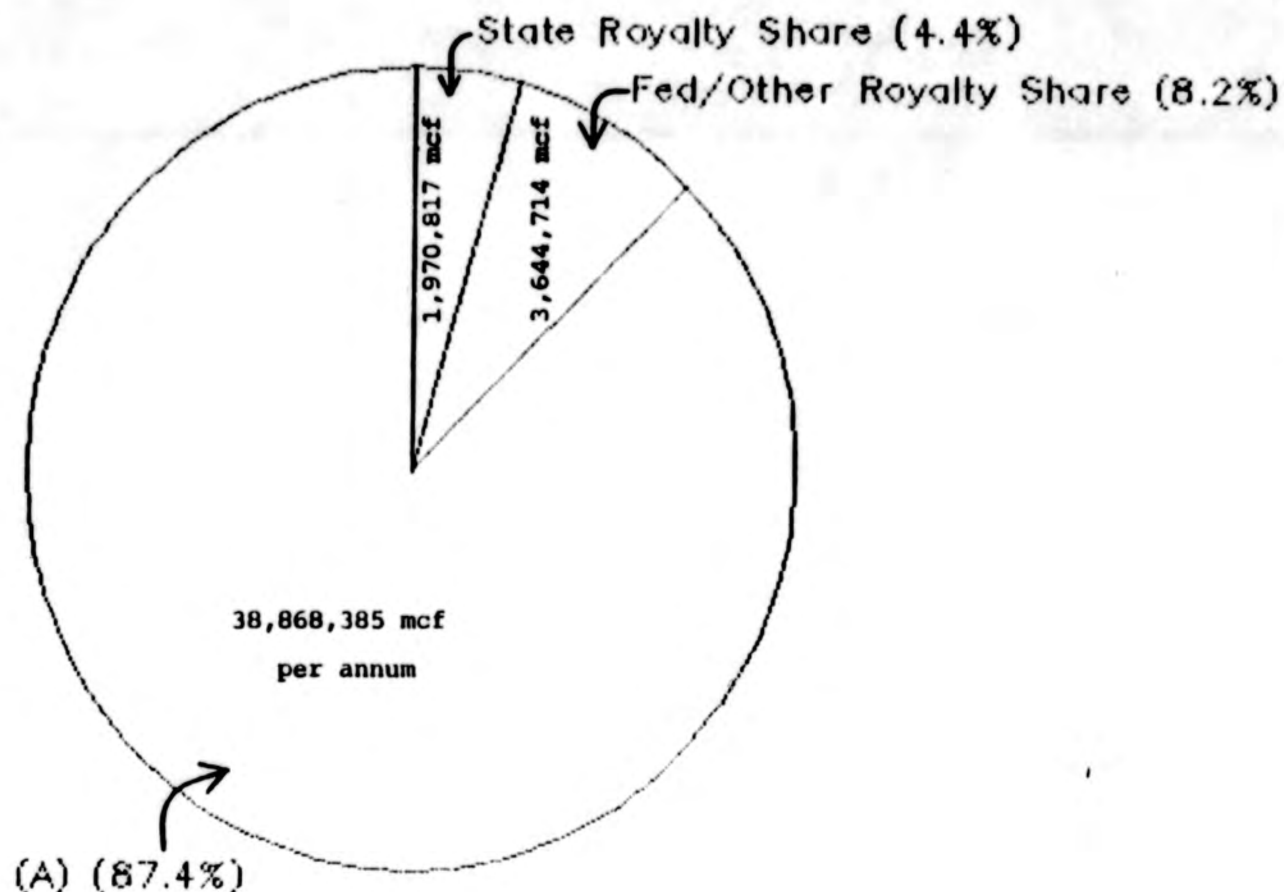


Note: See attached worksheet for an analysis of this chart.

3/30/85

Consumer Utility Use of Cook Inlet Gas

(Est. projections based on 1983 volume)



(A) Share of production by the working interest owners.

Estimated Total Annual Production allocated to consumer use = 44,483,916 mcf.

ALASKA DEPARTMENT OF NATURAL RESOURCES - DIVISION OF OIL AND GAS

File:C:Cookgas2
Date:03/30/85

COOK INLET GAS DISPOSITION OCTOBER 1984

FIELD Producers (% of Working interest)	PURCHASER OF GAS FROM THE PRODUCER	% of FIELD on sale by sale basis	ROYALTY VOLUME 12.5% sale by sale	PRODUCER/ PURCHASER CONTRACT VALUE	HIGHEST VALUE IN THE FIELD	DIFFERENCE BETWEEN REPORTED ROYALTIES/ HIGHEST FIELD VALUE	EFFECTIVE DATE	EXPIRATION DATE
NORTH COOK INLET								
Phillips (100%)	TOKYO UTILITIES	100.00%	555,702	2.343	2.343	0.00	6/1/69	1989 ***
BELUGA RIVER								
Chevron, ARCO, Shell	ENSTAR	3.53%	7,001	2.055	2.055	0.00	10/84	10/1999
Chevron, ARCO, Shell	CHUGACH	96.47%	212,658	0.210	2.055	392,727.00	5/14/65	1992 *
TOTAL	TOTAL	100.00%	219,659			392,727.00		
KENAI FIELD								
UNION (50%)	APL-ANCHORAGE	6.95%	10,700	0.617	2.055	15,500.92	5/13/60	12/31/94 *
	APL-CHEV NIK	0.19%	288	0.617	2.055	413.48		
	UNION-CHEV	0.20%	305	0.617	2.055	430.18	2/5/81	INDEFINITE
	CITY OF KENAI	0.31%	486	0.300	2.055	852.86	5/17/66	6/1986
	RENTAL GAS	5.91%	9,164	0.070	2.055	16,900.78	1/17/66	UNTIL BLOWDOWN
	ADDITIONAL RENTAL	2.92%	4,525	0.380	2.055	7,579.72		
	UNION CHEMICAL	37.11%	57,541	0.602	2.055	83,606.39	11/1/77	1990
TOTAL UNION SHARE		53.59%	83,009					
MARATHON (50%)	APL-I	14.47%	22,436	0.617	2.055	32,262.46		1992 *
	APL-II	5.73%	8,889	2.055	2.055	0.00	12/16/82	12/1997 *
	APL-NIKISKI	0.19%	288	0.617	2.055	413.48		
	CITY OF KENAI	0.31%	486	0.300	2.055	852.82		
	RENTAL GAS	5.91%	9,164	0.210	2.055	16,908.24		
	ADDITIONAL RENTAL	2.92%	4,525	0.380	2.055	7,579.72		
	TOKYO UTILITIES	16.88%	26,167	2.343	2.343	45,159.81		
TOTAL MARATHON SHARE		46.41%	71,955					
TOTAL		100.00%	155,044			228,476.36		
LEWIS RIVER								
CITIES SERVICE (100%)	APL & PAC AK	100.00%	30,420	1.930	1.930	0.00	5/1/84	1999 *
MCARTHUR RIVER								
UNION/MARATHON (50% each)		0.47%	221	0.000	0.000	0.00		
	RENTAL GAS	1.40%	697	0.210	2.055	1,432.85		
	UNION CHEMICAL	87.56%	41,265	0.617	2.055	84,799.32		
		9.39%	4,427	0.000	0.000	0.00		
		1.10%	519	0.000	0.000	0.00		
TOTAL		100.00%	47,129			86,232.17		
GRAND TOTALS			1,008,953			707,431.53		

* QUANTITY TERM COULD OPERATE TO EXTEND AND/OR SHORTEN THE CONTRACT PERIOD.
** FIELD NOT EFFECTED BY THE NOTICE AS PRODUCER IS NOW PAYING AT THE HIGHEST PRICE IN THE FIELD
*** ROYALTY VALUATION DETERMINED BY SETTLEMENT AGREEMENT

State of Alaska
Department of Natural Resources
Royalty Accounting Section
Cook Inlet Gas Disposition - 1983
From OGCC Production Figures
(MCF)

Field	TOTAL PRODUCTION: Casinghead Gas	Dry Gas	Total	State Share Of Field	Total Production State Land	Royalty Volume	DISPOSITION OF ROYALTY VOLUME: Consumer Use	Fuel Use/Other	Export/LNG	Warm Chem Plant	Rental Gas
Beluga		10,003,916	10,003,916	60.44%	10,973,919	1,366,240	1,366,240				
Kenai											
Sterling 3		10,970,032	10,970,032								
Sterling 4		24,200,436	24,200,436								
Sterling 5		27,572,442	27,572,442								
Sterling 6		24,900,052	24,900,052								
Undefined		10,221,687	10,221,687								
Tyonek		7,452,030	7,452,030								
		113,326,279	113,326,279	16.68%	18,902,023	2,362,853	604,577	27,717	416,198	1,049,557	264,804
McArthur River											
Hemlock	4,496,054		4,496,054								
Mid Kenai G	619,622		619,622								
W. Foreland	203,661		203,661								
Mid Kenai		4,235,750	4,235,750								
Undefined		3,695,563	3,695,563								
Field Totals	5,319,337	7,931,313	13,250,650	100.00%	13,250,650	1,656,331		1,221,910		434,421	
North Cook Inlet		47,077,215	47,077,215	100.00%	47,077,215	5,984,652			5,984,652		
Trading Bay											
Hemlock	242,055		242,055								
Undefined	7,302		7,302								
Mid Kenai B	132,067		132,067								
Mid Kenai C	100,010		100,010								
Mid Kenai D	249,101		249,101								
Mid Kenai E	132,730		132,730								
G-N/Hemlock	28,040		28,040								
West Foreland		631,024	631,024								
Field Totals	892,993	631,024	1,524,017	100.00%	1,524,017	190,502		190,502			
Totals	12,424,660	309,730,363	322,163,023		92,404,624	11,560,578	1,970,817	1,440,129	6,400,850	1,483,978	264,804

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FORM NO. DL-1

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES
Division of Lands

LEASE NO. ADL________

Competitive Oil and Gas Lease

11. ROYALTY ON PRODUCTION. Except for oil and gas used on said land for development and production or unavoidably lost, Lessee shall pay Lessor as royalty the following:

(a) On oil__________per cent in amount or value of the oil produced and saved and removed or sold from said land.

(b) On gas__________per cent in amount or value of the gas produced and saved and sold or used off said land or used for the extraction of natural gasoline or other products therefrom.

(c) On associated substances__________percent in amount or value of such substances produced and saved and ... from said land.

14. ROYALTY IN KIND. Whenever, at the option of Lessor, which may be exercised from time to time upon not less than six months notice to Lessee, Lessor elects to take its royalty in kind, Lessee shall deliver free of charge (on said land or at such place as Lessor and Lessee mutually agree upon) to Lessor or to such individual, firm, or corporation as Lessor may designate all royalty oil and/or gas produced and saved from said land. Such oil and/or gas shall be in good and merchantable condition. Lessee shall, if necessary, furnish storage for royalty oil free of charge for thirty days after the end of the calendar month in which the oil is produced from said land: provided, that Lessee shall not be held liable for loss or destruction of royalty oil and/or gas from causes beyond Lessee's reasonable control. Should Lessee dehydrate or clean the oil or gas produced from said land, Lessee shall be entitled to an allowance of the actual cost of dehydrating or cleaning said royalty oil or gas.

15. ROYALTY IN VALUE. At the option of Lessor, which may be exercised from time to time upon not less than six months' notice to Lessee, and in lieu of royalty in kind, Lessee shall pay to Lessor the field market price or value at the well of all royalty oil and/or gas. All royalty that may become payable in money to Lessor shall be paid on or before the last day of the calendar month following the month in which the oil or gas is produced. The payments shall be accompanied by copies of run tickets or other satisfactory evidence of sales, shipments, and amounts of gross production.

16. PRICE. The field market price or value of royalty oil or gas shall not be less than the highest of: (1) The price actually paid or agreed to be paid to Lessee at the well by the purchaser thereof, if any; or (2) The posted price of Lessee in the field for such oil or gas at the well, if any; or, (3) The prevailing price received by other producers in the field at the well for oil of like grade and gravity or gas of like kind and quality at the time such oil or gas is removed from said land or run into storage, or such gas is delivered to an extraction plant.

COOK INLET

ALASKA
OIL AND GAS
CONSERVATION COMMISSION
ANCHORAGE, ALASKA
FIELD AND FACILITY LOCATION MAP
COOK INLET AREA
LEGEND

MEMORANDUM — State of Alaska

DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL AND GAS

TO: Esther C. Wunnicke
Commissioner

DATE: November 6, 1984

FILE NO:

TELEPHONE NO: 265-4241

FROM: Kay Brown, Director
Division of Oil and Gas

SUBJECT: Decision Memo No. 25
Royalty Gas Valuation -- Cook Inlet

Statement of the issue: Should the state accept long-term gas contract prices as being determinative of royalty value where those prices have become significantly below current market prices because of escalating gas values?

Background: As a general matter, producers have calculated and paid their royalty as to each volume of gas based upon the contract price applicable to that volume of gas. As gas prices have escalated, the issue has arisen here, as it has in other jurisdictions, whether an older long-term contract price may control the royalty amount for gas produced and sold under that contract, even after the market value has escalated well above the contract price. Depending upon the particular jurisdiction and the governing language of particular leases, court cases have split on the issue. The issue has not been addressed by any court in the State of Alaska.

Considerations:

- Legal analysis. Although court cases interpreting various other lease forms have gone each way in other jurisdictions, the Department of Law advises us that the proper construction of state oil and gas lease form DL-1 is that a long-term contract price should not control royalty valuation when current market price or value is higher.

- Impact on oil and gas companies. Oil and gas companies have an obligation to diligently produce and market oil and gas. The companies believe it is unfair to have their royalty payments based upon high current market price values where (they argue) the only available means of marketing the gas in the past was by means of long-term contracts with either a fixed price or a defined escalation clause. Apparently in recognition of the possibility that the royalty value might be construed to be higher than the long-term contract price, however, the producers have mitigated, in large part, the impacts of escalating

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ANCHORAGE, ALASKA

values by means of pass-through provisions in their sales contracts. These provisions make the gas purchaser liable for any additional royalty. Also, producers increasingly are insisting upon price re-openers for their long-term contracts. Such price re-openers allow the producers to benefit from escalating values on their share of the gas, while also protecting the producers against an increased royalty burden. Thus, as a general matter, the producers can protect themselves against the possibility of higher royalty obligations. However, there are possible exceptions. For instance, Union Oil Company has committed a large volume of gas for use in its own major urea processing plant. Union's royalty obligation will be higher on the gas committed to that plant if long-term contracts are considered inappropriate references in the computation of market price or value. Union may not be able to pass any increased cost through to its urea customers. However, if the application of the royalty term as written becomes too onerous, the lease provides a mechanism for seeking royalty reduction. See DL-1, ¶ 13. Thus, even those producers which cannot pass higher royalty obligations on to their customers have a limited remedy under the lease.

- Impacts on gas purchasers. The principal long-term gas contracts in Cook Inlet which would be affected by this decision are between Chugach Electric and Chevron, ARCO and Shell (Beluga River Field), and between Enstar/Alaska Pipeline Company and Marathon and Union (Kenai Field). The long-term Chugach contract price is 21c/Mcf, and the long-term Enstar/APC contract price is 61c/Mcf. By contrast, prevailing current prices exceed $2.00/Mcf. For instance, the recent long-term contracts for Cook Inlet gas have fluctuated between a high of $2.32/Mcf and the present $2.055/Mcf. Although seven-eighths of the gas sold under the 21c/Mcf and 61c/Mcf contracts would continue to be bound by those contract prices, the governing contracts permit the producers to pass on through to Enstar/APC and Chugach the burden of higher royalty rates on the one-eighth of the flow attributable to the state's royalty. It is uncertain whether Enstar and Chugach could, in turn, legally pass the charges through to their customers if the state collects additional royalties retroactively. Moreover, even if the

royalties were collected at the higher valuation rate only prospectively, the ability of the companies to pass the costs through to their consumers would be subject to Alaska Public Utilities Commission rate proceedings. Thus, the imposition of royalty valuation based upon current market prices or values could have adverse impacts upon Anchorage area utility companies.

- Impacts on consumers of gas and gas-generated electricity. Ultimately, it is anticipated that the brunt of higher valuation on royalties attributable to long-term contract volumes will be borne by consumers of gas and electricity in the Anchorage area. It is estimated that this impact would probably be an increase over current rates of more than 10 percent but less than 20 percent.

- Impacts on state revenue. Obviously, the consequences of higher royalty valuation include increased royalty revenue to the state. It is estimated that eschewing long-term contract prices for current values would, under present conditions, result in additional royalty collections of approximately $8.5 million per year from the state's Cook Inlet area leases. The impact upon North Slope gas royalty revenue is relatively insignificant at this time.

- Uncertainty. The fluctuation of royalty value independently of the contract price under which gas is sold injects uncertainty into the long-term planning by oil companies and utilities. This uncertainty (and higher royalty rates) may reduce incentives to invest capital in oil and gas and utility enterprises, or affect the timing or structuring of such enterprises. For instance, the state's royalty treatment of long-term gas contracts might affect North Slope gas marketing.

- Impacts on royalty collection by the United States and CIRI. The United States and CIRI are also lessors of oil and gas leases in the Cook Inlet area. The United States distributes 90 percent of the onshore royalties it collects to the state. CIRI shares its royalties with other ANCSA corporations under section 7(i) of ANCSA. Alaska has previously joined other states in encouraging the United States to ensure full royalty

collection through, among other things, using current prices or values in calculating the royalties due for gas sold under long-term sales contracts. By requiring royalty valuation according to current market values for state leases, the state would further its relations with the ANCSA corporations and other states, and would lend support to current federal royalty litigation, which, if successful, will result in greater distributions to the state under its 90 percent share.

Options:

(1) Accept long-term contract prices as determinative of market value for royalty purposes, even when those prices have been eclipsed by market transactions at higher values.

(2) Reject long-term contract prices as determinative of royalty valuation where they are below current market value. In implementing this option, the state could also:

(a) Give consideration to electing to take royalty gas attributable to long-term contracts in-kind, rather than in-value. A host of practical difficulties exist with this suboption. In particular, taking gas in-kind is difficult because of the limited and inflexible transportation and storage capacities for gas (the "deliverability" factor). Nonetheless, the state could explore the possibilities, including possible sales to Enstar, Chugach, and the proposed CIRI LNG plant; and

(b) Apply the decision only to prospective royalty valuations. This would ease a number of problems, including the difficulties attendant to retroactive pass-through charges to utility consumers.

Recommendation:

Option 2, with suboptions 2(a) and 2(b).

Decision:

I concur with the recommendations:

Esther C Wunnicke
Esther C. Wunnicke
Commissioner

Nov 14, 1984
Date

Recommend Concurrence:

[signature]
Bob Arnold
Deputy Commissioner

11/25/84
Date

[signature]
James K. Barnett
Deputy Commissioner

11-19-84
Date

May 21, 1984

To: Sharon Barton
Commissioner's Office

From: Jim Eason
Oil and Gas

Subject: Cook Inlet Gas Contracts

As you requested this morning, I have reviewed the division's files on the contracts for gas sales to Anchorage Municipal Light and Power and Chugach Electric Association. It is my understanding that your request for this review is related to a determination of whether the department has subsidized local energy costs through its past gas sales contracts. My review indicates that there was no subsidy of costs in the only contract which the department negotiated for the sale of roylaty oil from the Kenai Feild to ML&P. The sale of gas from the Beluga Field is controlled by the terms of a long term contract negotiated between the producers, Standard Oil, Richfield Oil and Shell, and Chugach Electric. The department was not a party to the negotiation of this contract. Specific comments on the two contracts follow.

--- The ML&P contract was signed May 5, 1980. It provided for a sale of the state's royalty gas from the Kenai Field for a term of 20 years.
--- The price which ML&P was obligated to pay was the in-value price which the state would have received, plus any costs incurred by the state attributable to preparation and transportation of the gas to the buyer, ML&P.
--- On July 2, 1980, ML&P notified the state of its intent not to take delivery of any roylaty gas under the terms of the contract because "of the uncertainty regarding the gas price."
--- Consequently, no royalty gas was delivered to ML&P.

--- The CHugach contract for purchase of gas from the Beluga Field was signed May 14, 1965.
--- Term of the contract was for 20 contract years with the first contact year commencing on January 1st following the initial delivery of gas under the terms of the contract or January 1, 1968 whichever was earliest.
--- Production from the Beluga Field comes from a mixture of lease ownership including the State of Alaska, the federal government and C.I.R.I.
--- Approximately 60% of the royalty production belongs to the State of Alaska with the remaining 40% split between the federal government and C.I.R.I.
--- The producers sale the state's royalty gas to Chugach and pay the state its royalty in-value, as determined by the terms of the contract.
--- The price received by the producers for Beluga gas was

established by the negotiated contract. The price for the first through the fifth contract year was 15.2 cents per Mcf. The price for the sixth through the tenth year was 16.2 cents per Mcf. For the eleventh through the fifteenth year, the price was 17.2 cents per Mcf, and the price for the final five years of the contract was established at 18.2 cents per Mcf. However, the contract also provided for an adjustment of the price depending upon the gross heating value of the gas. As a result of this adjustment, the price received currently by the producers is approximately 21 cents per Mcf.

— This price represents what all parties to the contract agreed to be the "fair market value" of the gas in 1965.

If you have any additional questions, please call.

STATEMENT OF ENSTAR NATURAL GAS COMPANY

BEFORE LEGISLATIVE OIL AND GAS COMMITTEE

April 11, 1985

We appreciate your invitation to ENSTAR to comme t on the State's recently proposed change in the method of determining royalty values of gas subject to long-term contracts. Our knowledge of information previou ly provided the legislature is limited to press reports and a statement by Commissioner Wunnicke dated April 2, 1985.

ENSTAR provides gas service to approximately 70,000 businesses, households and electric utilities. An increase in royalty price will affect over half the State's population, both through our gas bills and the electric bills of utilities we serve.

We readily admit our bias in this matter and we do not suggest that the legislature should accept our analysis of the issues without independent confirmation. On the other hand, we believe the Administration has presented an extremely biased analysis and it should be subjected to equally critical scrutiny.

DNR has made a number of representations to members of the Legislature, apparently to explain the Administration's hasty action, that we believe to be misleading. Our comments will address certain of those representations.

DNR STATES THIS IS A LEASE ENFORCEMENT ACTION AND IS NOT OPTIONAL

The validity of this statement is based on a presumption that the term "value", as used in the lease, is intended to be a determination made on the date the gas is produced rather than on the date the gas is committed to an arms-length long-term contract.

ENSTAR believes the prevailing and equitable view contradicts DNR. It is a complex legal question and we believe this committee should obtain a legal analysis independent of the Administration.

DNR POSTPONED THE EFFECTIVE DATE TWO WEEKS FOR RESPONSE BY INTERESTED PARTIES

What's the rush? These contracts have been in effect for years. Why is a major change being undertaken without the usual procedural safeguards we expect. Why have there not been proposed regulations defining the terms of the leases? Why have there been no public hearings in the Anchorage area? Whose interests are served by acting in haste?

ENSTAR doesn't know the answers to these questions. ENSTAR believes the Administration does know them. ENSTAR believes the Legislature should know them.

DNR REPRESENTS THIS ACTION IS NECESSARY TO PROTECT THE STATE'S POSITION IN NORTH SLOPE ROYALTY LITIGATION

Legal counsel advises ENSTAR that this is simply incorrect. It is common to accept arms-length negotiated contract prices as a basis for royalty valuation of the production subject to the contract. Where no

arms-length contract is involved, it is necessary to develop alternate methods. The issues are simply not the same.

We urge the Legislature to obtain independent legal analysis of this issue.

DNR REPRESENTS THIS ACTION HAS
MINIMAL IMPACT ON ENSTAR'S CUSTOMERS

In an internal memorandum dated November 6, 1984, DNR asserts that this action"would lend support to current federal royalty litigation". In the April 2 memo to the Anchorage caucus DNR does not mention the impact that Federal repricing may have on consumers.

Without regulations defining value, the State in the future will be free to assert values based on delivery prices in Japan, prices paid under small industrial contracts (both positions are asserted in the Federal legislation referred to), or perhaps on the prices of alternative fuels.

We urge the Legislature to seek independent advice regarding the potential impact of the Administration's action, in the absence of protective regulations.

DNR ALLEGES THE PRESENT CONTRACT PRICES
REPRESENT A "SUBSIDY" TO OUR CUSTOMERS

When we enter into a long-term contract for gas, at determinable pricing, and with take-or-pay provisions, we (our customers) are guaranteeing the State protection against market declines. Our customers pay a high price for the security of a known supply with known

pricing terms. Our customers, having paid for the risk taken, have seen the value of gas increase and now the State proposes to confiscate that value.

To add insult to injury, the State maintains the "value" of its gas is equal to the price we pay for a secure 15 year contract with known pricing terms. Yet the State reserves its right not to sell us the royalty gas and to reprice it at will on an undefined "value" basis.

UNDER THE ADMINISTRATION'S PROPOSAL OUR CUSTOMERS WOULD SUBSIDIZE THE STATE

The State is purchasing about as much gas from us in Anchorage as the amount of State royalty coming to us under the contract to be repriced. The prices we charge to the State are fully reduced by its "share" of the low priced gas. The State now proposes to reprice its share of production and pass the extra cost on to all our consumers, but to continue to share the benefits of the low priced gas. This would be a subsidy to the State.

If the State really believes it is not receiving fair value for its gas, why doesn't it elect to take it in kind and sell it to the highest bidder (like North Slope oil)? If that price is still considered inadequate, then we can probably arrange through the regulatory process to deliver the State's own gas to it in Anchorage. What could be more fair?

OUR CUSTOMERS ARE NOT TREATED EQUALLY WITH OTHER PURCHASERS OF STATE RESOURCES

Using hindsight, DNR says we paid less than "value" for gas in the Kenai field. They say they can maximize values to the State by collecting an additional $8 million per year. Using the same hindsight, couldn't DNR also say that its failure to negotiate long-term contracts with the North Slope producers five years ago has cost the State billions?

The State is entitled to receive the maximum value the market will allow for Slope oil because the State, not the producers, has elected to assume the risk of value declines. A very expensive decision.

On the other hand, we and our customers have assumed those risks as to our gas purchases. It is absolutely unfair for the State to present the consumers this "heads-I-win, tails-you-lose" proposal.

THE STATE IS USING MONOPOLY POWER TO EXACT AN EXCESSIVE PRICE FROM THE CONSUMERS

Alaska is unique in that the Federal and State governments control substantially all royalty. The governments have a monopoly and it is not possible to negotiate royalty valuation terms of lease agreements. Terms are dictated, not negotiated. This is effectively a monopoly action at work, not a free market. DNR admitted in an internal memorandum that its present pricing proposal would "further its relations with the ANCSA corporations... and lend support to current federal royalty litigation...". If business corporations made pricing deci-

sions in concert with or to accommodate other suppliers, they probably would be subject to prosecution.

When we, as purchasers, enter into a long-term contract with a producer, we are not assured of the royalty share since the State retains the right to take its gas in kind. Yet we cannot refuse to take the royalty share, no matter what price may be exacted. Obviously, if a free market prevailed, we simply would not purchase State royalty on such terms. The concept of the State receiving fair value for its resources does not mean using its monopoly power to squeeze the last bit of revenue from the consumer. It does mean receiving the value that would be arrived at in a free market system. That is exactly what arms-length negotiations do.

We believe the Administration is misleading the legislators and the public when it alleges that a subsidy to our customers has resulted from our arms-length gas contracts. We believe that since we do not have the option not to accept royalty gas, while the State has the option not to deliver it to us, arbitrary pricing of the royalty by the State at any price higher than we negotiated, on the working interest gas which produces the royalty gas, is confiscatory to our customers.

The Administration knows full well that where we have had an option to buy royalty gas, we have done our utmost to avoid unreasonable pricing of that gas and in fact have refused to accept it. I refer to the North Cook Inlet gas produced by Phillips. We paid, under protest, as much as $3.74 per Mcf; we stopped taking this gas; and we

replaced that supply with gas from the Lewis River field priced at only $1.80 in a contract negotiated in 1984. This contract is for our peaking purposes only, with essentially no take or pay. Royalty gas from any source is truly not worth as much to us as working interest gas from that same source, in our opinion, because the State is free to take the royalty gas in kind and we have to be prepared to do without it. In a free market we would never pay more for royalty gas than for the working interest gas except if we could take it at our own option. We have demonstrated this fact to DNR, on the North Cook Inlet royalty.

We regard the repricing of royalty gas, as proposed by the State, to be in effect a discriminatory and unlawful tax, which a majority of Alaskans would reject if given the awareness and opportunity to do so.

CONCLUSION

Royalty pricing as it relates to arms-length negotiated contracts involves complex economic, social and legal issues. These have not been addressed in the information we have seen. We urge the Legislature obtain the appropriate information from experts independent of the Administration and the utility industry. We expect it will take more than two weeks.

A grace period

THE RAW DEAL in natural gas prices is scheduled to hit Anchorage and the rest of Southcentral Alaska on April 15, a week from Monday. Only special action by the governor or the legislature can stave it off.

The change in price is necessary to bring it in line with the price on the open market. A discrepancy came about because the price remained stationary as market conditions changed. The boost was to become effective April 1, but the governor ordered a 15-day delay.

In discussing this official action that discriminates against Southcentral Alaska, an editorial in this newspaper appeared to blame the Department of Natural Resources. It should be noted that the department is complying with the law in ordering the higher prices. It cannot change the law.

If the governor has the power to order a 15-day delay, he should be able to order another delay to allow time for the legislature to consider changing the law.

THE CHANGE COULD be a simple amendment to an existing law that provides exceptions in pricing. It allows the sale of coal to nonprofit utility cooperatives. The amendment could authorize the same treatment for natural gas destined for the generators of Chugach Electric and the Municipality of Anchorage.

In all other areas Alaskans are subsidized by the state so as to enjoy lower power and fuel costs. If the proposed higher prices become effective here, the state will be discriminating against Southcentral Alaska.

That's a raw deal.

ANC TIMES 4/6/85

A raw deal

THE PROPOSAL by the state to raise the price of natural gas in Southcentral Alaska deserves unanimous disapproval.

It would, in effect, penalize Alaskans here while the state is helping Alaskans almost everywhere else. This would be in the form of higher electric power and fuel bills for Southcentral. The extra money would go into the general fund.

At this moment, the state is using general fund money to subsidize cities and rural areas in Southeastern, Western and some areas of Southcentral Alaska. These subsidies include more than $21 million for Interior villages and more than $200 million for certain Southeastern and Southwestern cities and villages.

It is astonishing that the same state officials who administer those special favors to selected villages and cities propose to raise the cost of natural gas to residents of Anchorage and Southcentral Alaska. They would raise the price of the state's natural gas in the Cook Inlet area so as to take $8 million extra away from local residents each year. This money would go into the fund that helps the other areas.

EVEN THOUGH the basis for the proposed raise may be legal, it is not justified. The state's oil and gas leases provide for the prevailing market price to be paid and that is higher than the price actually being collected.

But by applying that clause blindly and without consideration of other circumstances, the state would be grossly unfair. It would penalize the Alaskans who have done well for themselves through their business contracts signed years ago with the natural gas suppliers.

The Anchorage area has low power and fuel costs because its utility agencies have done well. It was because of the favored position here that the state officials sought to subsidize others to bring their costs down.

The governor went so far as to propose a power-cost equalization program that inevitably would have raised power rates here. His scheme ran into such opposition that he dropped it like a hot potato.

Since then, the Department of Natural Resources took the intiative to enforce the fine print in the oil and gas leases looking toward an extra $8 million for the general fund. It hasn't dropped the idea yet, but it ought to.

THANKS TO the Anchorage caucus in the legislature, this inequitable position has been brought to the attention of all in Juneau. The chiefs of the Natural Resource Department have had to explain the terms of the oil leases and why the higher costs are proposed.

But there is no hint that there has been any satisfactory explanation. Nobody has said why Anchorage residents should have to pay more while the state is helping others to pay less.

Instead, the state should continue to honor the long-term contracts that have a stated price. The market value of the gas may have increased since those constracts were signed, but that doesn't justify inflicting punishment on the Alaskans here.

Gov. Sheffield ordered a postponement of the department's first announcement of the higher prices in order for the legislature, the public and the producers to have time to consider their responses.

The response should be immediate and it should be without equivocation. It won't be fair to Southcentral Alaska unless and until other Alaskans are paying their own power and fuel costs without state subsidy.

Anchorage Times
4/4/85

ANC TIMES 4/3/85

Utility: Bills will increase only 4 percent

Times Juneau Bureau

JUNEAU — Utility bills will increase about 4 percent — not 10 to 20 percent — if the state boosts its price for Cook Inlet royalty gas, a Chugach Electric Association official said Tuesday.

When the Department of Natural Resources last month announced its decision to increase the price of state royalty gas, it estimated utility bills would go up by 10 to 20 percent. This brought criticism from legislators and the introduction of a House resolution last week for the administration to rescind its decision.

However, Larry Markley, director of governmental and environmental affairs for Chugach Electric, told the Anchorage caucus Tuesday that any increase in consumer bills would average about 4 percent.

He said Chugach retail customers' bills would increase slightly under 4 percent, while wholesale customers, including Matanuska Electric Association, Homer Electric Association and the city of Seward, would find their bills going up slightly higher than 4 percent.

Markley said Chugach Electric, the largest electric utility in the state, had delayed releasing any possible rate figures until it had time to review the state's actions and its effect on the utility's gas bills.

"Virtually all of our power comes from gas," he said.

"We don't know yet whether we will legally oppose it," Markley said of the state's action to boost Cook Inlet royalty gas prices.

The utility could not pass along the higher gas prices to its customers without approval by the Alaska Public Utilities Commission, Markley said, adding that any protest, either by the utility or by the oil and gas companies involved in Cook Inlet production, could delay any cost increase to consumers, he added.

Enstar Natural Gas Co., which serves 70,000 customers in the Southcentral area, has said the proposed price increase would mean a 2 percent increase to its retail customers.

Department of Natural Resources Commissioner Esther Wunnicke said a state statute requires the department to get current market value for state royalty gas, which results in higher prices.

The price increase, projected to earn an additional $8 million a year in state revenue, was to take effect Monday. But Gov. Bill Sheffield delayed the increase for two weeks.

Anchorage Times
4/3/85

ANC TIMES 4/2/85

Sheffield delays gas price increase

by Larry Persily
Times Juneau Bureau

JUNEAU — The Sheffield administration has postponed for two weeks an increase in the royalty price of Cook Inlet natural gas, stalling — but not halting — a move that will raise area electric rates.

The gas price hike's new effective date of April 15 will cost the state $[illegible] in lost royalty revenue, according to Department of Natural Resources Commissioner Esther Wunnicke. The commissioner discussed royalty gas prices Monday before the Senate Resources Committee.

Wunnicke had said March 19 that the state would boost its royalty gas price from current rates based on long-term contracts between oil companies and utilities to higher rates based on market value. The increase was to have become effective Monday.

"This is a lease enforcement action," Wunnicke said the [illegible]. "It is not optional."

Gov. Bill Sheffield Sunday requested that Wunnicke delay the gas price increase "to give us a chance to explain it to the residents who will be impacted by the [illegible]," said Molly McCammon, the governor's deputy press secretary.

"It's still going into effect," McCammon said, and the two-week reprieve is intended only to allow time to explain the price increase to the public.

The increase in the price the state charges for its share of Cook Inlet natural gas is expected to produce an additional $8 million a year for the state treasury, Wunnicke told the Senate committee.

In making the decision to boost the gas prices, she explained, the department moved "to obtain the maximum benefit for the people of Alaska." She added, "Though it may be an unpopular decision," the price increase "merely involves the state's rights to set royalty payments equal to the value of the gas."

An increase in the state royalty gas price will drive Southcentral gas and electricity rates higher, though Wunnicke said, "I do believe the press accounts have overstated some of these impacts."

In a letter to Wunnicke, Sen. Arliss Sturgulewski, R-Anchorage and chair of the resources committee, stated, "Anchorage consumers are faced with the possibility of sudden and dramatic increases in their utility bills due to recent decisions regarding rates charged for Cook Inlet royalty natural gas."

Enstar Natural Gas Co. spokesman Dan Dieckgraeff said Monday the state's decision would mean about a 2 percent price increase to its 70,000 customers in Southcentral Alaska.

"The effect of the state increase to us is not that substantial," he said, because most of Enstar's gas is covered by long-term contract prices unaffected by the state's action.

Dieckgraeff did note that Enstar is having its attorneys review the state's action.

Lena Johnson, spokesperson for Chugach Electric Association, said state royalty gas provides a small portion of its supply for natural gas-generated electricity.

Though Chugach has yet to figure exactly how much the state's decision would cost its customers, Johnson said reports of a 20 percent boost in electric bills probably are too high.

The Department of Natural Resources estimates that electric utility rates will increase between 10 and 20 percent.

Anchorage Times
4/2/85

Local gas bills could increase

by John Knowlton
Times Business Writer

Nearly 100,000 businesses and residences in Southcentral Alaska could see their natural gas bills rise by up to 20 percent, as the result of a decision by the state to raise the price of royalty gas it sells five oil companies operating in Cook Inlet.

The state on Thursday announced that effective April 1, it will value Cook Inlet gas at current market rates instead of at long-term contracted rates.

Current market value of Cook Inlet gas is about $2.05 per thousand cubic feet (mcf) while contracted rates range from 21 cents to 65 cents per mcf, officials said Thursday. The market value was $2.32 per mcf but fluctuates depending on demand.

The oil companies, which purchase the gas from five Cook Inlet fields, will pass on the increase in gas price to Enstar Natural Gas Company and Chugach Electric Association, officials said. Enstar and CEA will pass those costs on to consumers if permitted to by the Alaska Public Utilities Commission.

Larry Markley of CEA today said the price increase could mean consumers would pay up to 20 percent more for natural gas but he stressed that no firm figures have yet been arrived at. CEA serves about 100,000 homes and businesses in the southcentral part of the state.

Chugach gets most of its natural gas from Beluga, paying 21 cents per mcf under terms of a 1973 state contract. The state owns 98 percent of the Beluga gas field with Cook Inlet Region Inc. owning the rest.

Bill Hickman, executive vice president of Enstar Natural Gas, said its residential customers initially will see rates rise only about 2 percent because the state owns a small portion of the Kenai gas field, where Enstar gets most of its gas.

But rates will rise significantly if Enstar's suppliers, Marathon Oil Company and Union Oil Company, pass on gas price increases being sought by CIRI and the federal government, which own most of the Kenai gas field, Hickman said. Enstar is paying about 65 cents per mcf for the 26 million mcf of natural gas it buys annually from the Kenai field. It is already paying the $2.05 price for 4 to 5 million mcf of Beluga gas it will purchase this year.

Even though the higher price charged the oil companies goes into effect April 1, it's unknown when any rate increases might be passed on to consumers.

In a release issued this morning, Enstar called the state's action "fundamentally unfair" and said their attorneys are looking into the matter.

Kay Brown, head of the state's division of oil and gas, said the state was basing royalty payments on current market value because it "has an obligation to get the maximum value of its resources for all the people."

But she acknowledged that the state could have asked for back royalty payments totalling millions of dollars from the oil companies. That "policy decision" not to ask for back payments was made by Department of Natural Resources Commissioner Esther Wunnicke, Brown said. Wunnicke was unavailable for comment. The state expects to collect $8 million a year in additional income as a result of the higher prices.

Brown said one of the reasons back royalty payments weren't sought was because the oil companies could pass those costs on to utilities, but utilities wouldn't be allowed to recoup those costs from consumers. The oil companies involved include Marathon Oil Company, Union Oil Company of California, Atlantic Richfield Company, Shell Oil Company and Chevron U.S.A.

The state's action comes after a federal court last month ruled that the federal government acted properly when it raised to current market rates the price it charges Marathon for natural gas it collects from federal lands the Kenai gas field. That ruling could cost Marathon $20 million in back royalty payments. Union Oil, which also sued the federal government over the issue, may have to pay up to $40 million in back royalties if it loses its lawsuit, officials said.

ANC TIMES 3/22/85

Cook Inlet royalty plan defended

By ANN CONY
Daily News reporter

JUNEAU — The Sheffield administration Monday defended its plan to collect higher royalty payments from Cook Inlet natural gas producers, a move that could spark rate increases of 10 to 20 percent for 100,000 Chugach Electric Association customers.

But Natural Resources Commissioner Esther Wunnicke told the Senate Resources Committee that her department has postponed the plan, which was supposed to begin Monday, until April 15. However, it will not be posptoned further, she said.

She said the state has subsidized Southcentral Alaska utility rates for nearly two decades by allowing natural gas producers to calculate the state's one-eighth royalty share on the basis of long-term contract prices that have fallen far below real market value.

If the legislature wants to continue to subsidize Anchorage electric rates, which are the lowest in the state, it can do so directly. But the state has an obligation to enforce its land leases and collect the full market value of its royalty gas, which would increase revenues by more than $8 million a year, Wunnicke said.

"We feel that accepting less than current value for royalty gas is not an appropriate mechanism for providing energy subsidies to Southcentral Alaska. This would require the department — whose obligation is to all Alaskans — to relax our lease enforcement practices solely in order to benefit some Alaskans at the expense of the general treasury."

The state has to be consistent, Wunnicke said.

"It would be improper to have one standard of enforcement where oil companies bear the burden and a different, more lenient standard where some of that burden is passed on to Alaska consumers."

Wunnicke said she decided in November, after consultations with Sheffield, to press for higher payments on state royalty gas. The decision was announced two weeks ago.

Sen. Joe Josephson, D-Anchorage, said low natural gas prices in Southcentral Alaska figured into his vote last year for higher electric rate subsidies in the Bush.

He also said he wondered how collection of the maximum value of the state's royalty gas, to the detriment of local utility customers, squares with state subsidy of the propoed Susitna River hydrolectric project.

"It might be better to make the subsidy here (on Cook Inlet gas) instead of in the form of a much larger subsidy," he said.

Wunnicke said lawmakers could choose to subsidize electric rates in Southcentral Alaska by:

- Authorizing reduced royalty payments on state oil and gas devoted to in-state utilities.
- Including the Anchorage area in existing subsidy programs.
- Selling state royalty gas to utilities under long-term contracts.

"It appears to me that this question is best addressed in the context of the state's overall energy subsidy programs," Wunnicke said.

The Department of Natural Resources has estimated that Chugach Electric customers may face rate increases of 10 to 20 percent. Chugach uses natural gas to generate power, which it distributes to customers in the Anchorage area and to other utilities serving the Matanuska-Susitna Valley and Homer.

The impact on Enstar Natural Gas rates will be negligible, according to DNR calculations.

Wunnicke said the new policy on royalty gas payments will increase rates for Enstar customers by less than one-half of 1 percent, because Enstar consumes far less state royalty gas than Chugach.

Enstar supplies gas for heating to 70,000 customers in the Anchorage area, the Matanuska-Susitna Valley and Kenai.

Three House members from Anchorage introduced a resolution on Friday calling for Gov. Bill Sheffield to suspend the decision on state royalty gas.

Kay Brown, director of the department's Division of Oil and Gas, is scheduled to meet with the Anchorage caucus today to answer more questions about the new policy and its effect on utility customers.

ADN 4/2/85

Days of cheap natural gas may be running low

Goodbye cheap gas. Hello higher energy bills.

That's the meaning of the state's ...cision to raise the price of state-owned Cook ...let natural gas. The days of cheap natural gas for ...uthcentral residential and business consumers ...e all but over.

On Thursday, the state announced it will charge ...e oil companies the going market rate for ...yalty natural gas they buy from five Cook Inlet ...lds. The action affects Marathon Oil, Union Oil, ...evron U.S.A., Atlantic Richfield and Shell Oil Co.

The action will increase by nearly tenfold the ...ce Chugach Electric Association pays for most ...its gas. Prices of the Beluga River gas will rise ...om 21 cents per thousand cubic feet (mcf) to $2.05 ...r mcf.

Though Chugach doesn't have firm figures yet, ...e price increase of its feedstock could raise local ...s bills to consumers by 20 percent or more. Enstar Natural Gas Co. customers likewise will ...e their rates increase but not as quickly as ...ugach. Eventually, though, the price increase

Alaska's Business

John Knowlton

will cost Enstar, which gets most of its gas from the Kenai fields, millions of dollars as well.

The price increase was anything but a surprise to Enstar or Chugach. Officials with those utilities have known for two years that the days of cheap gas are running out.

That prospect became abundantly clear in 1983 when the federal government and the native regional corporation, Cook Inlet Region Inc., which combined own 83.5 percent of the Kenai gas field, raised to current market rates the price it charged Marathon Oil and Union Oil for royalty gas. In August of that year, Marathon sued the federal government and CIRI, charging they didn't have authority to raise the value of their gas. The state, which owns 16.5 percent of the Kenai gas field, joined CIRI and the federal government in defense.

Ever since then, Enstar and Chugach officials knew the cost of the gas they buy could go up dramatically if the courts ruled in favor of CIRI and the federal and state governments, and against Marathon. That's just what U.S. District Court Judge James Fitzgerald did recently. His ruling also calls for Marathon to pay $20 million in royalties to the gas owners dating back to when the 1983 lawsuit was filed. No judge's order has been filed in that suit yet but when it is, Marathon likely will have only 10 days to make the $20 million payment, officials said last week.

Union Oil, meanwhile, faces potential liability of up to $40 million in back royalties if it loses its lawsuit against CIRI and the state and federal governments, those same officials said.

All of that raises an interesting question about the state action raising its price for Cook Inlet natural gas. Why didn't the state insist that the oil companies pay retroactive royalties? The ma... value of Cook Inlet gas has been well above th... long-term rates contracted 10 and 12 years ag...

It is curious to me why the state, which is preaching austerity through paring its budget... restricting travel, would pass up the opportun... collect millions of dollars in back royalties fro... oil companies.

Kay Brown, head of the division of oil and g... said not asking for back royalties was a "polic... decision" made by her supervisor, Esther Wunnicke, commissioner of the Department o... Natural Resources. Wunnicke was unavailabl... comment.

If the state had sought back royalties from t... oil companies, those costs would have been pa... on to Enstar and Chugach. Even though the utilities knew an increase in price was coming, they didn't get hit as hard as they might have. ...state went easy on them and easy on the oil companies as well.

John Knowlton is The Times business edito...

Times 3/24/85