

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2281 SCOMM 94: SENATE SPECIAL COMMITTEE ON OIL & GAS, 1993-94

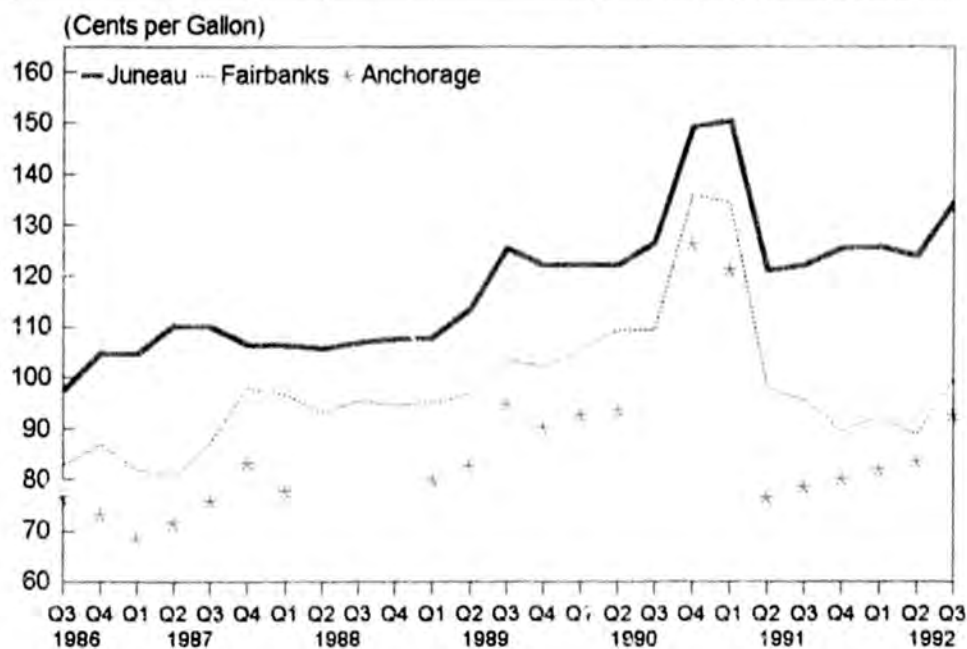
ALASKAN REFINED PRODUCT SUPPLY

- **Alaska's in-state refineries have become the dominant source of refined products to Alaska's consumers.** By the mid-1980s, Alaska became self-sufficient in refined products as in-state refinery supply increased, even though some seasonal imports and exports of products are required to balance supply and demand.
- **Refined products from the Interior and Kenai refineries supply consumers throughout Alaska, except for the Juneau/Southeast region.** Juneau, Ketchikan, and the remainder of Southeast Alaska continue to receive virtually all of their refined products by barge from Puget Sound and California refineries.
- **In the 1980s, the in-state refineries depended on royalty oil to support operations.** Production of gasoline, heating fuel, diesel and other petroleum products increased along with purchases of State of Alaska royalty oil.

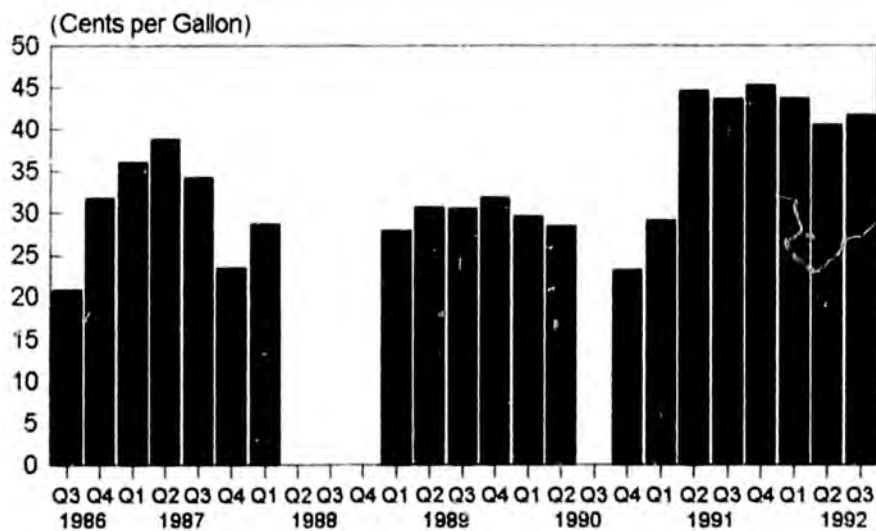
CONCLUSION

- **In-kind royalty oil sales have achieved their goal of building a strong and sustainable in-state refining industry.** Alaska's economy has benefited from increased availability of vital fuels and by the jobs created by the refining industry.

ALASKA EX TAX UNLEADED REGULAR PRICES



JUNEAU MINUS ANCHORAGE RETAIL EX TAX UNLEADED REGULAR PRICES



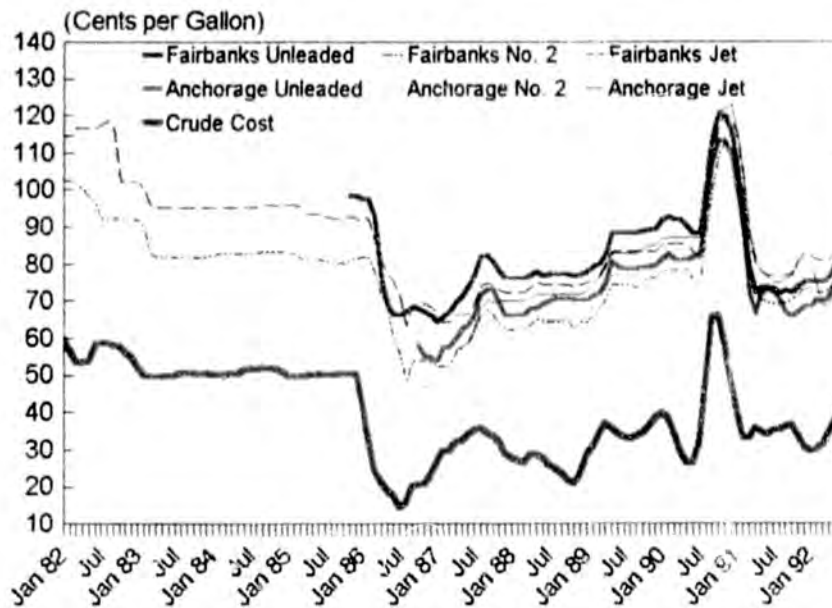
ALASKA RETAIL PRODUCT PRICES

- **Retail gasoline prices in Southeast Alaska are consistently higher than Railbelt prices.**
- **Juneau's higher prices are largely due to two factors: less competition and higher distribution costs.** The number of competitors on both the wholesale and retail levels is quite small. Previous legislative studies have concluded that the Southeast Alaska market exhibits a much lower degree of competition than the Railbelt. In addition, the limited market for refined products in Southeast, along with the area's physical isolation, increase product distribution costs.
- **Compared to Anchorage, consumers in Juneau paid an extra 30¢ per gallon (exclusive of taxes) over the 1986-92 period.** Market competition in Anchorage, as well as other Railbelt and Western Alaska communities, has clearly been enhanced by the availability of local supply from in-state refineries.

CONCLUSION

- **Railbelt and Western Alaska consumers have reaped the benefits of the growth of the in-state refining industry. Southeast Alaska's consumers have not shared in those benefits.** Increased refinery production has resulted in more local competition and, therefore, lower refined product prices in the Railbelt and Western Alaska, compared to Juneau and Southeast.

MAPCO WHOLESALE PRODUCT PRICES
AND CRUDE COST



CRUDE AND PRODUCT PRICES

- **Crude oil prices are the dominant influence on product prices.** Using statistical analysis, the changes in Mapco's crude costs were found to explain over 80% of the variation in posted product prices.

The prices of Mapco's products at Fairbanks and Anchorage, illustrated at left, clearly follow the movements in Mapco's crude costs. The major price movements in 1986, 1990 and 1991, as well as a number of smaller movements, can be seen equally well in both crude and products.

The spread between crude and product prices is indicative of the refiner's margin over the cost of crude, which must cover all operating and financing costs, as well as provide sufficient capital to support the continuing investments typical of the refinery industry.

- **Product price movements tend to lag behind crude price movements by about a month.** This indicates that crude price changes bring about changes in product prices.

CONCLUSIONS

- **Refined product prices and crude costs are firmly linked in Alaska.** Over the years, crude cost increases resulted in higher product prices, and crude cost declines resulted in lower product prices.

CONCLUSIONS

- **Alaska has benefited from the development of a healthy in-state refining industry.** Refined product availability and marketplace competition have increased, and local economies have enjoyed higher employment and improved economic activity.
- **Consumers have also enjoyed lower product prices in those regions supplied by in-state refineries.** Consumers in Southeast Alaska who rely on West Coast products have paid consistently higher retail prices, due to diminished marketplace competition.
- **Without the in-state refineries, all of Alaska's consumers would face the same conditions experienced in Southeast.**
- **Alaska's in-state refineries rely on royalty oil, and compete in the same product markets.** The cost of crude is the major component of any refiner's costs, and has been demonstrated to be the major influence on Alaskan product prices.
- **Higher royalty oil prices would have resulted in higher product prices.** Historical product prices in Alaska have closely followed the cost of crude oil for in-state refineries. Each of Alaska's refineries face those same costs for royalty crude oil. **The benefits of lower past royalty oil prices have already been passed on to Alaska's consumers.**

FEB-26-93 SAT 12:06

ZJ.MOON - Morse Note

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To	Buki Wright	From	Greg Burden
Co.		Co.	Tesoro
Dept.		Phone #	561-3521
Fax #	563-4749	Fax #	561-8218

**A response to Two Questions Regarding Capital Credit Legislation for
Royalty Oil Purchasers**

Legislation has been discussed that would allow purchasers of royalty oil who find themselves faced with delinquency assessments from the state (as a result of pricing or valuation controversies) to credit against those retroactive assessments the value of qualifying capital investments that the purchaser may make in Alaska in the future. The legislation, which would include a number of safeguards to ensure that the public receives benefits commensurate with the credit, is intended to further these public policy goals:

1.

Encourage job creation, increased tax revenues and economic stimulus by inducing Alaska's in-state refiners to expand their Alaska operations. The legislation proceeds on the premise that the stimulation of specific, long-term capital growth is a prudent investment for the one-time, extraordinary claims that the state has asserted against its in-state royalty oil purchasers. Indeed, a recent study prepared for Tesoro Alaska Petroleum by ECO Northwest indicates that a particular \$46.5 million refinery expansion would return to the state, in 1993 dollars, \$51.3 million in new tax revenues; \$126 million in new employee compensation; \$1.2 billion in increased industrial output; and \$632 million in property income increases. In addition, that investment would create 2,787 new person/years of employment. The report thus suggests that Alaska's return on investment from this legislation would be extraordinary;

2.

Assure the continued provision of reasonably priced refined products to the majority of Alaskans now served by those refiners. For nearly 20 years, the state has successfully pursued a policy of using royalty oil sales to generate

new in-state refining capacity, recognizing that stable and reasonably priced crude supplies were critical to providing Alaskans with reasonably priced refined products. To underscore that linkage between crude supplies and refined product prices, a recent Mapco study found a high correlation (approximately 80%) between crude prices and fluctuations in costs of gasoline and other fuels.

3.

Bring balance to the state's settlement of the Amerada Hess controversy. That litigation involved a dispute over the "value" of North Slope oil. That litigation was settled as a result of negotiations between the state and North Slope producers. The amount of that settlement was financially acceptable to those producers, and represented only 6 percent of the assessed value of their North Slope property. On the other hand, the state is now attempting to apply that settlement to its royalty oil purchasers, even though: (1) the State consistently maintained that these purchasers were precluded from participating in *Amerada Hess* negotiations; and therefore could not protect their interests through that process; and (2) the state's demands represent up to **100%** of the assessed valuation of these purchasers' property in **the entire state**. Moreover, the amount the state would seek to claim from these purchasers--about \$300 million--is nearly half the \$700 million that the state accepted from North Slope producers. This despite the fact that in-state refineries have taken only about 4% of all crude oil from the North Slope since Prudhoe Bay came into production.

* * *

Particularly in light of the ECO Northwest report, it appears that the direct returns to the public from this proposal will substantially exceed any reduction in state revenues. And as an investment in the economy, it is consistent with a number of other state programs designed to stimulate the private economy through government activism. Two questions that have been asked about the

proposed legislation focus on private benefits that could accrue from the legislation; however, there are significant public benefits of the proposals.

I. Isn't this Legislation Just A Subsidy for In-State Refiners?

No. It is, in fact, a firmly engrained concept in both federal and state revenue policy. The federal government long ago enacted the investment tax credit, which foregoes tax revenues when taxpayers devote resources to new capital investment. Not only has Alaska followed suit with a general investment tax credit ^{1/}, it has also enacted a special, more generous tax credit for new gas processing facilities and new mineral exploration. AS 43.20.042. Over the past six years, Alaska has also granted a tax credit from the fisheries tax--for new fisheries investment. AS 43.75.032.

The capital credit legislation now being discussed has a number of safeguards not present in other private-sector investment initiatives: (1) the credit cannot be granted if the particular investment will not yield benefits justifying the credit; (2) the time period for taking these credits is limited; and (3) credits cannot be taken for investments that pre-date passage of the law, or which are already compelled by law (such as mandatory pollution control equipment).

Whenever government proposes to invest in its economy, the issue can't be "is it a subsidy," because every government entry into the private sector will yield direct benefits to some identifiable businesses. The issue, rather, must be "*is it a good investment in terms of public benefits that will result.*" The ECO Northwest report prepared for Tesoro strongly suggests that, more so than in many cases, the capital credit legislation is a very good investment indeed.

^{1/} AS 43.20.021(d).

II. Why Should Only Purchasers of Royalty Oil Have This Program, Rather than All Taxpayers?

No other "taxpayer" has purchased royalty oil, and then been asked to retroactively pay more than they were originally charged. The amount sought from the royalty purchasers covered over ten (10) years of purchases with the oil processed and sold many years ago with the benefits of the lower crude oil prices enjoyed by the Alaska Consumer.

- As we have seen, the royalty oil purchasers are being asked to bear a disproportionate share of the *Amerada Hess* controversy--with demands against them approaching 100% of the assessed value of their Alaska property. And, even though in-state refiners have received only 4% of the North Slope crude oil they are being asked to pay approximately 30% of the total that the state hopes to receive from its *Amerada Hess* claims. The legislation, in part, is therefore aimed not at creating disparity, but curing it.

The issue isn't whether one industrial sector might benefit from a particular legislation program, but whether the public benefits from that program outweigh the costs to the government. Every economic incentive program brought to the legislature must be judged under that yardstick, and we're confident that the capital recovery legislation will pass it.

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

WALTER J. HICKFI, GOVERNOR

P. O. BOX K—STATE CAPITOL
JUNEAU, ALASKA 99811-0300
PHONE: (907) 485-3800

August 17, 1992

Mr. James E. Barnes
Chairman and Chief Executive Officer
MAPCO, Inc.
P. O. Box 645
Tulsa, OK 74101-0645

Dear Mr. Barnes:

To avoid any misunderstanding about our discussions concerning the state's enforcement of its royalty-in-kind claim against MAPCO, I want to relate in writing my understanding of the state's commitment to you. There is too much at stake for us to have anything less than a clear understanding of our "agreement."

You will recall that when we met in Seattle, MAPCO asked for equitable reasons to be exonerated from the \$108 million claim. I replied that as Attorney General I had no authority, statutory or otherwise, to accede to that request. Moreover, I said that in my view, no one in the Executive Branch had that authority. I added, however, that MAPCO could, of course, present its equitable arguments to a court and that the legislature was another forum to which MAPCO may wish to turn.

You then expressed a desire to address your request to the legislature and asked that the state not send a formal bill or sue MAPCO until MAPCO had an opportunity to ask the legislature to forgive the obligation. I responded that the state would defer enforcement actions, provided Commissioner Olds agreed and the state and MAPCO immediately undertake serious settlement negotiations. Underlying my response was my view that the state could not allow itself to be prejudiced by allowing MAPCO this opportunity. You agreed that MAPCO would work cooperatively toward settlement during the interregnum.

We also talked about MAPCO's conversations with other RIK purchasers. The state's representatives expressed concern about

Mr. James E. Barnes
Chairman and Chief Executive Officer
MAPCO, Inc.

August 17, 1992
Page 2

those conversations.¹ At the close of the meeting, I told you that I would consider MAPCO's request to defer action and get back to you in about three weeks.

The state cannot defer formally billing MAPCO and filing suit beyond February 15, 1993. That allows MAPCO ample time to approach legislators before the session begins and to obtain any relief which the legislature is willing to grant. Any further delay will, in my judgment, prejudice the state. So long as MAPCO satisfies the following conditions, the state will not, prior to February 16, 1993, formally bill or sue MAPCO to enforce its royalty-in-kind obligation:

1. Signs the Tolling Agreement sent to MAPCO in July 1992;
2. Produces by September 15, 1992, the documents requested by the state in July 1992, and produces other documents and responds to other discovery requests in accordance with the Civil Rules as if suit had been filed;
3. Agrees not to object to or ask others to object to joinder of MAPCO in the *ANS Royalty Litigation* (1JU-77-847, pending in the Juneau Superior Court and scheduled for trial beginning in 1994), agrees that the state's RIK claim against MAPCO will be tried as part of that action, and agrees that if joinder is not permitted by the court that the action will be filed and tried in the Juneau Superior Court;
4. Negotiates in good faith with the state's settlement team between now and February 16, 1993, to resolve the claim;
5. Refrains from asking other royalty-in-kind purchasers not to pay their obligations or negotiate settlements with the state.

I remain at liberty to oppose MAPCO's request to the legislature and cannot, in good conscience, support MAPCO or remain silent if MAPCO asks the legislature to cancel the obligation. The state sold roughly half of its royalty oil to MAPCO and other royalty-in-kind purchasers. More than \$25 million of MAPCO's

¹ Recently, I have heard of repeated instances in which MAPCO representatives have spoken with other RIK purchasers about the pending claims. Implicit in these conversations, according to reports reaching me, have been urgings by MAPCO that the RIK bills not be paid and settlements not be reached. I find those conversations troubling.

Mr. James E. Barnes
Chairman and Chief Executive Officer
MAPCO, Inc.

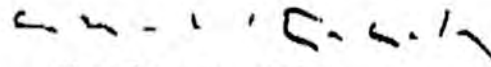
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Page 3

obligation belongs to the Permanent Fund. The state charged MAPCO less than MAPCO would otherwise have paid. MAPCO knew, in the words of the contract, that a "potentially large" price adjustment was possible and the contract provided for a long term payment of the obligation. MAPCO has the right to pay the obligation over approximately 10 years and we believe it only fair that it do so.

I believe that this proposal fairly accommodates your request without prejudicing the state's position. I have thought through the proposal very carefully and do not wish to negotiate it further. If MAPCO accepts these conditions, please sign the enclosed copy of this letter and return it to me with an executed copy of the Tolling Agreement by August 28, 1992. If MAPCO does not accept these conditions or, having accepted them, fails in the state's judgment to adhere to them, the state will immediately formally bill MAPCO and file suit to enforce its claim.

The state's representatives and I enjoyed the opportunity to meet with you and your group in Seattle. I hope that our next meeting will be before Thanksgiving to sign a settlement agreement.

Very truly yours,



Charles E. Cole
Attorney General

CEC:tg

MAPCO accepts and will abide by the conditions in this letter.

James E. Barnes
August ____, 1992

cc: The Honorable Walter J. Hickel
Governor

Patrick Ryan
Chief of Staff
Office of the Governor

August 17, 1992
Page 4

Executive Officer

Commissioner
Natural Resources

or
and Cas
Natural Resources

Deputy Attorney General

Patrick Coughlin, Assistant Attorney General
Department of Law

Julian Mason
Ashburn & Mason

17, 1992
Page 3

CORRECTION

**THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY**

Mr. James E. Barnes
Chairman and Chief Executive Officer
MAPCO, Inc.

August 17, 1992
Page 4

Hon. Glenn Olds, Commissioner
Department of Natural Resources

Jim Eason, Director
Division of Oil and Gas
Department of Natural Resources

Bruce Botelho, Deputy Attorney General
Department of Law

Patrick Coughlin, Assistant Attorney General
Department of Law

Julian Mason
Ashburn & Mason

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

WALTER J. HICKEL, GOVERNOR

REPLY TO:

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March 23, 1993

MAR 23 1993

The Honorable Loren Leman
Chair
Senate Oil and Gas Committee
Alaska Senate
Room 113
State Capitol
Juneau, AK 99801-1182

Re: State of Alaska
Royalty-In-Kind (RIK)
Oil Sales Agreements

Dear Senator Leman:

This letter responds to questions asked during hearings of the Senate Oil and Gas Committee held on March 16 and 17, 1993, regarding the state's RIK oil sales agreements.

The state has 12 long-term RIK sales contracts with retroactive price adjustment clauses tied to the resolution of the *ANS Royalty Litigation*.¹ These contracts are with Chevron, Golden Valley Electric Association ("GVEA"), MAPCO, Petro Star, and Tesoro.

Purchaser

Contract/Date

Chevron

"Chevron-1" (Mar. 10, 1980)
"Chevron-2" (Nov. 30, 1982)
"Chevron-3" (Dec. 9, 1983)
"Chevron-9" (Dec. 9, 1985)

GVEA

"GVEA-1" (Apr. 12, 1977)
"GVEA-2" (May 9, 1984)
"GVEA-3" (Feb. 8, 1985)

¹ The *ANS Royalty Litigation* was originally captioned *State of Alaska, et al. v. Amerada Hess Corp., et al.* The retroactive price adjustment clause is frequently referred to as the *Amerada Hess* price adjustment provision.

MAPCO²
Petro-Star
Tesoro

"North Pole-1" (Mar. 27, 1978)
"Petro-Star-1" (Dec. 9, 1985)
"Tesoro-1" (Mar. 10, 1980)
"Tesoro-2" (Mar. 10, 1980)
"Tesoro-4" (Feb. 26, 1982)
"Tesoro-5" (Dec. 9, 1983)

The state's claims under these contracts, inclusive of interest through October 1992, totals \$326 million. Table I attached to this letter summarizes these contracts and the amounts the state is owed under each. Table II shows the interest rate to be applied to the debt owed under each contract.

Retroactive *Amerada Hess* price adjustment provision was uniformly inserted into all long-term RIK oil sale contracts under a policy adopted in May 1977 by the Alaska Royalty Oil and Gas Development Advisory Board ("Royalty Board"). This policy declared that the base-line price of any royalty oil or gas taken in kind and sold by the state should be no less than the state would otherwise have received had it taken its royalty in value (i.e., in money).

There have been two limited exceptions to this long-standing practice of inserting *Amerada Hess* clauses into North Slope oil RIK sales contracts. IN December 1980 and in December 1984 the state sold North Slope oil at competitive auction. These were all short-term contracts which provided for delivery periods of a maximum of one year. Obviously, imposing a retroactive pricing provision with an uncertain time for resolution would have had a potentially depressing effect on the prices bid

² Under a February 8, 1985 State-GVEA-MAPCO agreement which was executed contemporaneously with the GVEA-3 contract, MAPCO agreed to assume substantially all of the GVEA's liability for the oil sold under that contract in consideration of the state's consent to GVEA's assignment of that oil to MAPCO.

Representatives of GVEA have recently informed the state's *ANS Royalty Litigation* attorneys that MAPCO has assumed GVEA's entire liability under all three of the GVEA contracts under a separate side agreement between MAPCO and GVEA to which the state is not a party.

MAPCO's contract is identified here as "North Pole 1" because the original purchaser was the North Pole Refining division of Earth Resources Company of Alaska. MAPCO acquired ERCA in late 1980 or early 1981, under a tender offer. That corporate acquisition was the means by which MAPCO succeeded to the North Pole-1 contract.

at those auctions. Accordingly, none of the contracts involving the oil auctioned in December 1980 or December 1984 had Amerada Hess clauses.

All of the contracts itemized above contain interim price formulas. Over the period of time reflected in the attached table, the state has used two different interim price formulas. During the tenure of Robert E. LeResche as Commissioner of Natural Resources, the interim formula was the so-called "Exhibit B" formula. A copy of Exhibit B to the North Pole-1 contract is enclosed with this letter.³

When John Katz succeeded Mr. LeResche as commissioner in July 1981, he concluded that the Exhibit B formula was too hard to administer and too confusing for many potential purchasers of RIK. Accordingly, Katz adopted the so-called "weighted-average" interim formula. With the exception of the December 1984 competitive sale noted above, under this formula, the interim price invoiced by the state equalled the monthly weighted average of the royalty values reported by the North Slope producers. All of the RIK contracts entered into from and after February 1982 contain the weighted-average interim formula.

How the Exhibit B interim pricing mechanism was intended to work and the scope and magnitude of retroactive price adjustments contemplated by Exhibit B is a matter of contention between Tesoro and the state and between MAPCO and the state. In November 1986, Natural Resources Commissioner Esther Wunnicke issued 30 pages of interpretative findings with respect to Exhibit B, which Tesoro then challenged by an administrative appeal. *Tesoro Alaska Petroleum Co. v. State*, Case No. 3AN-86-15298 Civil. On July 19, 1990, following a remand order issued by Judge Shortell in this litigation, Natural Resources Commissioner Lennie Gorsuch issued 84 pages of findings on remand reaffirming the Wunnicke findings. Tesoro's administrative appeal of the Gorsuch finding was settled recently.

On or about September 9, 1992, MAPCO initiated litigation against the state in Anchorage Superior Court which also

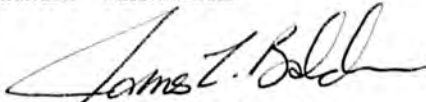
³ The following contracts all incorporated the Exhibit B interim pricing formula: Chevron-1, GVEA-1, North Pole-1, Tesoro-1, and Tesoro-2. In addition, the Alpetco contract (executed February 22, 1978) also incorporated the Exhibit B formula. The Alpetco project, a proposed world-scale petrochemical complex to be located in Valdez, failed in 1981. The state's retroactive price adjustment claims against Alpetco and its successor Alaska Oil Company were settled in bankruptcy proceedings in 1982-1983.

turns on the issue of how Exhibit B was designed to function. *MAPCO Alaska Petroleum Inc. v. State*, Case No. 3AN-98-7813 Civil.⁴ Litigation is also pending between the state and Chevron on similar retroactive reimbursement clauses.⁵ Table III attached to this letter shows the present value of the repayment stream under MAPCO's main (North Pole) contract. Table III depicts the present value under three assumed discount rates. The table also shows the opportunity cost to the state of MAPCO's interest free possession of the reimbursements for approximately 12 years.

If you would like further briefing about Exhibit B or the issues involved in the Tesoro or MAPCO lawsuits, or if anything in this letter is unclear, please do not hesitate to contact me.

Sincerely,

CHARLES E. COLE
ATTORNEY GENERAL

By: 
James L. Baldwin
Assistant Attorney General

JLB:tg
Attachment

⁴ Also, on August 26, 1992, MAPCO's litigation counsel John A. Donovan wrote Natural Resources Commissioner Olds demanding that the state submit to arbitration with MAPCO under the GVEA-1 contract. The state believes that there is no agreement between it and MAPCO under which MAPCO is entitled to arbitrate, and has commenced action in Juneau Superior Court for a judicial declaration to this effect. *State v. MAPCO Alaska Petroleum Inc.*, Case No. 1JU-92-1684 Civil.

⁵ *In the Matter of ANS Royalty Litigation*, (Chevron counter-claim), Case No. 1JU-77-847; *Chevron U.S.A. v. Tesoro Petroleum Co.*, Case No. 949111 (Cal. Superior Court).

TABLE I

Summary of Retroactive Price Adjustments for Royalty In-Kind Contracts¹

Contract For Royalty In Kind Sales	Principal Amount of Retroactive Price Adjustments	Interest On retroactive Price Adjustments ²	Total Interest and Principal
Tesoro 1	\$ 574,649	\$ 827,393	\$ 1,402,043
Tesoro 2	(89,369)	(132,755)	(222,123)
Tesoro 4	86,056,559	64,950,524	151,007,083
Tesoro 4/Chevron	(21,311,855)	(23,529,590)	(44,841,445)
Tesoro 5	<u>(5,596,229)</u>	<u>(4,668,827)</u>	<u>(10,285,056)</u>
Sub Total	\$ 59,633,756	\$ 37,426,745	\$ 97,060,501
Chevron 1	\$ 570,268	\$ 813,453	\$ 1,383,721
Chevron 2	10,526,738	11,456,049	21,982,787
Chevron 3	20,698,620	11,488,629	32,187,250
Chevron 9	4,472,284	1,890,338	6,362,622
Petro Star Purchases	1,209,114	522,831	1,731,945
Tesoro Purchases	<u>21,311,855</u>	<u>23,529,590</u>	<u>44,841,445</u>
Sub Total	\$ 58,788,878	\$ 49,700,891	\$108,489,769
GVEA 1	\$ 4,432,954	\$ 4,767,784	\$ 9,200,738
GVEA 2	1,522,287	1,423,029	2,945,316
GVEA 3	<u>4,591,116</u>	<u>1,831,317</u>	<u>6,422,433</u>
Sub Total	\$ 10,546,357	\$ 8,022,130	\$ 18,568,487
Mapco	\$ 51,224,843	\$ 46,816,531	\$ 98,041,374
Mapco TAPS Interest	<u>1,931,294</u>	<u>1,211,107</u>	<u>3,142,401</u>
Sub Total	\$ 53,156,137	\$ 48,027,638	\$101,183,775
Petro Star	\$ 1,498,397	\$ 596,690	\$ 2,095,087
TOTAL	\$183,623,526	\$143,774,094	\$327,397,620

¹ Subtotals may not foot perfectly due to computer rounding conventions.

² Petro Star interest through settlement in September 1992. Tesoro interest through settlement in December 1992. Mapco, GVEA, and Chevron (except Tesoro purchases) through October 1992 billing.

TABLE II
INTEREST RATES USED FOR EACH CONTRACT

CONTRACT	INTEREST RATE
Tesoro 1 & 2, Chevron 1, Mapco (North Pole-1)	Prime + 1.25 percent
Tesoro 4 & 5, Chevron 2, 3, & Tesoro purchases, and GVEA 2 & 3	Prime + 3 percent
Chevron 9 & Petro Star purchases, GVEA 1, and Petro Star	Statutory*

* Statutory interest is 8 percent simple through June 1980; 10.5 percent simple from July 1980 through November 1991; and 11 percent, compounded quarterly from December 1991 to present.

TABLE III

<u>Discount Rate</u>	<u>Present Value of Repayment Stream</u>	<u>Present Value of Transaction</u>
5%	\$35 million	(\$15 million)
10%	\$25 million	(\$25 million)
15%	\$17 million	(\$33 million)

NOTE: MAPCO currently owes \$101 million under the ERCA contract, of which \$51 million is principal. Receiving the principal under MAPCO's conditions would yield a present value as shown above.

RECEIVED

Department of Law

AM 1993 PM
7 8 9 10 11 12 1 2 3 4 5 6

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

March 11, 1986

BILL SHEFFIELD, GOVERNOR

REPLY TO:

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The Honorable Bill Sheffield
Governor
State of Alaska
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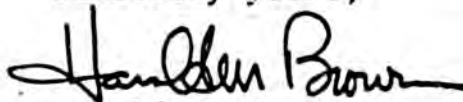
Dear Governor Sheffield:

Enclosed is my office's report on Fairbanks gasoline prices, as requested by your letter of January 13, 1986. As you know, during the last year gasoline prices in Fairbanks have increased, during a time when crude oil prices have decreased substantially.

Our investigation looked at all levels of the gasoline distribution system in Fairbanks: retail, wholesale, distributor, and refinery. Our conclusion is that the higher prices are the result of price increases at the refinery level. That is, the refineries are charging more for refined gasoline, even though they are paying less for the crude oil they use to make the gasoline. This price increase has been entirely passed on through the distribution chain to the Alaska consumer.

There is no law against charging high prices, as far too many Alaskans can testify. However, this situation is particularly deplorable. Alaskans are being paid less and less for the state royalty oil that goes into the refinery, but are being charged more for the product that comes out of the refinery.

Sincerely yours,



Harold M. Brown
Attorney General

HMB:RDM:cck
Enclosure:

cc: Hon. Mike Davis
Alaska State House of
Representatives

FAIRBANKS GASOLINE REPORT

February, 1986

The Fairbanks North Star Borough Assembly passed a resolution on December 9, 1985, requesting that the Governor investigate the price of gasoline and fuel oils in Interior Alaska. The Assembly asked for an explanation of why retail prices for gasoline and fuel oils in Interior Alaska have increased during a time when (1) world oil prices have declined, (2) the supply of crude oil exceeds the demand, and (3) retail gasoline and fuel oil prices have declined in many Lower 48 markets. The Governor referred the matter to the Attorney General for investigation.

The Attorney General's investigation focussed primarily on the price of motor gasoline at the refiner, wholesale, and retail levels in the Fairbanks and North Pole area. Where appropriate, the Fairbanks gasoline market was compared to the Anchorage and Juneau markets. Additionally, the investigation examined the Fairbanks home heating oil market, as requested by the Borough Assembly's resolution.

In preparing this report, the Attorney General's Office interviewed numerous petroleum product distributors, gasoline retailers in Fairbanks and North Pole, state economists, and industry representatives familiar with the Anchorage, Fairbanks,

and Juneau gasoline markets. 1/ Several subpoenas for testimony and documents were issued pursuant to the Attorney General's authority under the Alaska Restraint of Trade Act, AS 45.50.562 -- AS 45.50.596.

This report contains a general summary of our findings. Most of the individuals and corporations who provided information did so under the condition that some or all of the specific information related to us be kept confidential from their competitors. Additionally, information received pursuant to the Alaska Restraint of Trade Act is confidential as a matter of law. AS 45.50.492(e). Therefore, the material presented in this report is of necessity general in nature. In all instances, the prices charged, volumes of gas sold, and other information have been verified independently from more than one source.

A. General Market Characteristics and Comparisons

1. Fairbanks

Most gasoline retailers in Fairbanks purchase their gasoline from independently-owned distributors known as "jobbers," who own bulk fuel storage facilities. The jobbers purchase bulk fuel either from Tesoro's bulk fuel storage

1/ For a more complete description of the Juneau gasoline market, please refer to the Attorney General's report concerning that subject dated May 13, 1985.

facility in Fairbanks, from Tesoro's Nikiski refinery via Alaska Railroad shipments, or from the Mapco refinery in North Pole. The Mapco refinery began selling motor gasoline as of October 31, 1985.

The four motor gasolines sold on the retail level in Fairbanks are Chevron, Tesoro, Texaco, and Union Oil of California. The Chevron, Texaco, and Union jobbers each mix a unique additive package into the Tesoro or Mapco fuel they purchase before selling it as brand-name gasoline.

Within a rough five-mile radius of the downtown Fairbanks core area there are 32 retail gas stations. This area includes the City of Fairbanks and the Chena Gold Stream, University, and Steese fire service areas, and has an approximate population of 48,000 persons. Consequently, there is one gas station in the Fairbanks area for about every 1,500 people. These stations range from complete-service branded gas stations to convenience stores with gas pumps to unbranded "pumps-only" self-serve operations.

2. Anchorage

The Anchorage retail market offers the same four branded motor gasolines sold in Fairbanks. All motor gasolines sold in Anchorage originate from Tesoro's Nikiski refinery. Chevron, Texaco, and Union each have product exchange agreements with Tesoro under which they receive gasoline in Anchorage in

return for delivering a similar quantity of crude oil or refined gasoline to Tesoro at designated Lower 48 locations. Chevron, Texaco and Union "additize" Tesoro gasoline before selling it in the Anchorage area as their own branded product. Unlike the jobber system in Fairbanks, most retailers in Anchorage buy gasoline directly from bulk plants owned by the major companies. There is approximately one gas station for every 2,300 persons in Anchorage.

3. Juneau

Juneau area retailers buy gasoline directly from one of just two bulk fuel suppliers: a Chevron commission agent and a Union distributor. Juneau area gasoline originates from west coast refineries in the Lower 48 and from Tesoro's Nikiski refinery. There is approximately one gas station per 3,200 persons in the Juneau-Douglas area.

B. Alaska Gasoline Retailers Passed on Wholesale Price Increases to Consumers during 1985

According to retail gas price data compiled by the Community Research Center of the Fairbanks North Star Borough, the average per gallon retail price of leaded regular gas in Fairbanks increased by 7.9 cents between January 1985 and December 1985. This figure exceeds the 7.3 cent per gallon increase over the same period in the leaded regular wholesale price by .6 cents per gallon. See Appendix A, Price Comparison Charts, and Appendix B, Price Comparisons.

Fairbanks Community Research Center data shows a 7.4 cent per gallon increase in the average retail price of unleaded regular between January 1985 and December 1985. This also exceeds the 6.8 cents per gallon increase over the same period in the wholesale price paid by Fairbanks retailers by .6 cents per gallon. It appears that Fairbanks retailers passed the wholesale price increases they experienced in the last year on to Fairbanks consumers without significantly increasing their profit margins.

Anchorage retail prices for leaded and unleaded regular gas increased by an average of about 8 cents and 9.7 cents per gallon, respectively, between January 1985 and January 1986. These average retail price increases match the average wholesale price increase of 8.0 cents per gallon during the same period in the case of leaded regular, and slightly exceed the average wholesale price increase of 8.0 cents per gallon in the case of unleaded regular. Thus, Anchorage retailers also passed along wholesale price increases directly to local consumers.

Juneau retail prices for leaded and unleaded gas each increased by an average of 2.5 cents per gallon between January 1985 and January 1986. The retail price increases considerably exceeded the average wholesale price increases of .8 cents (leaded) and 1.8 cents (unleaded) over the same period. Therefore, Juneau retailers not only passed along wholesale price

increases to the local consumer, but increased their profit margins as well.

C. Profit Comparisons

"Gross Profit Margin Per Gallon" is used by the industry to describe the difference between a retailer's per gallon sales price and the per gallon wholesale price, including federal tax (9 cents per gallon), state tax (8 cents per gallon in Alaska) and any local tax (4 percent in Juneau, none in Fairbanks or Anchorage). The "gross profit margin per gallon" is calculated prior to deduction of overhead costs such as utilities, salaries, insurance, rents/mortgages, etc., and often varies according to grade of gasoline (leaded, unleaded, supreme, or diesel), type of service (self-serve or full serve), and method of payment (cash or credit). Many, but not all, stations charge more for credit card purchases than for cash transactions. Sales volume also varies according to grade, type of service, and method of payment.

When the weighted average is computed for all gross profit margins at a particular service station, the result is what the industry refers to as the "pool margin." Pool margins for Fairbanks dealers average about 18 to 22 cents per gallon, as compared to 9 to 11 cents per gallon for Anchorage dealers and about 21 to 23 cents per gallon for Juneau dealers.

Fairbanks dealers pump an average of about 65,000 -- 70,000 gallons of gas per month, although there are a number of gasoline retailers in Fairbanks that sell either substantially above or below that average. At 70,000 gallons per month, and with a 20 cent per gallon pool margin, a Fairbanks retailer's annual gross profits from gasoline sales would total \$168,000.

Anchorage and Juneau dealers, on the average, pump about 100,000 gallons monthly, although as with Fairbanks retailers, there are a number that sell substantially above or below the average. At 100,000 gallons per month, and with a 10 cent per gallon pool margin, an Anchorage retailer's annual gross profits from gasoline sales would total \$120,000. At 100,000 gallons monthly, and with a 22 cent per gallon pool margin, a Juneau retailer's annual gross profits from gasoline sales would total \$264,000. Thus, Fairbanks is squarely in the center of Alaska's three largest cities as far as retail gasoline profits are concerned.

Slightly higher average overall operating expenses translate into an average 3 cents per gallon higher cost of doing business for Fairbanks retailers as compared with their Anchorage counterparts. Utilities and rents/mortgages are chiefly responsible for the operating cost differential between Anchorage and Fairbanks. Salaries paid by Fairbanks retailers are, on the average, only marginally higher than those paid by Anchorage

retailers, and insurance costs run about the same for each location.

Thus, Fairbanks retailers make greater profits per gallon than their Anchorage counterparts. To illustrate, the Fairbanks-Anchorage average retail price differential is 22.5 cents per gallon. Subtracting the 11.8 cent per gallon average wholesale price differential and the 3.0 cent per gallon higher cost of doing business from this figure leaves a 7.7 cent per gallon higher average profit margin for Fairbanks retailers than for Anchorage retailers. This 7.7 cent per gallon difference translates into annual profits of about \$65,000 for the average Fairbanks retailer.

D. Comparative Market Dynamics: Fairbanks and Anchorage

Although Anchorage and Fairbanks are both railbelt communities, the market dynamics of the two cities are quite different. The 22.5 cent per gallon average retail price difference between Fairbanks and Anchorage is only partially explained by the approximately 11.8 cent per gallon higher wholesale prices paid by Fairbanks retailers and the 3.0 cent per gallon higher cost of doing business in Fairbanks.

Anchorage profit margins have been less than half of those of Fairbanks dealers for the last several years. This is primarily because of the presence of high volume discount retailers in the Anchorage market. Low profit margins in

Anchorage means that retail prices there have been held at the lowest levels in Alaska for a protracted period. Industry officials consistently characterize the Anchorage market as "fiercely competitive."

It appears that the absence in Fairbanks of a high volume price cutter along the lines of those currently found in Anchorage has enabled Fairbanks dealers to hold on to their higher profit margins. With one gas station in Fairbanks for every 1,500 people, compared with one for every 2,300 people in Anchorage, competition should be stronger. 2/

E. North Pole: Potential Retail Price Reductions

North Pole is a community of about 1,600 people and is located 13 miles southeast of downtown Fairbanks. There are three gas stations at the intersection of the Richardson Highway and Badger Road/Santa Claus Lane that, according to a November 4, 1985 article in The North Pole Paper, were engaged at the time in a "gas war." All three stations were selling gas at self-serve cash prices of \$1.149 (leaded) and \$1.209 (unleaded), and one

2/ This is not to say that there are no high volume gas stations in the Fairbanks area. Two high volume stations are found in the South Cushman Street area of Fairbanks. However, after differences in wholesale prices and operating costs are taken into account, high volume stations in Fairbanks do not cut prices anywhere near as much as the Anchorage discount stations.

station reportedly claimed to be selling gasoline below cost. During the week of January 13, 1986, prices at these stations had increased slightly to \$1.189 (leaded) and \$1.249 (unleaded). This was roughly 12.5 cents per gallon cheaper than the Fairbanks price.

The prices at the North Pole stations have over a period of months remained at least 12 to 13 cents below average self-serve cash prices in Fairbanks. The station owners we interviewed stated that these low prices were a direct result of intense competition among the three stations for the commuter trade. The North Pole stations still make an approximate 5.0 cents per gallon profit on these sales.

Even though the three North Pole stations are 13 miles from downtown Fairbanks, if this price difference persists over a long period of time, it may very well have a lowering effect on Fairbanks prices. The retailers we interviewed were acutely aware of the North Pole prices. One Fairbanks dealer expressed great concern over this price difference. Another reported that his customers have asked him for explanations of why retail prices are higher in Fairbanks than in North Pole. A third dealer stated that he is watching the gas pricing of the North Pole stations very closely; and that if the North Pole retail marketing strategy of waging gas wars reaches the Fairbanks market, it will have a considerable effect on Fairbanks prices.

F. Heating Oil Prices

Unlike motor gasoline prices, number 1 and number 2 heating oil prices in the Fairbanks areas have been on the decline. The Fall 1985 Community Research Quarterly published by the Fairbanks North Star Borough Community Research Center indicates that the average retail prices for number 1 and number 2 heating oil have decreased by 5.5 cents and 5.2 cents per gallon respectively, between September 1984 and September 1985; (see page 83 of that publication).

The average per gallon price in September 1985 for number 1 heating oil was \$1.098 and the average for number 2 was \$1.04. A January 1986 phone survey of home heating oil prices in Anchorage revealed an average per gallon price for number 1 of \$1.195 and an average price for number 2 of \$1.115. (Both Fairbanks and Anchorage prices cited here are based on automatic delivery of 500 gallons of heating oil.) Thus, home heating oil prices in Fairbanks are not only declining, but also average 9.7 cents (number 1) and 7.5 cents (number 2) per gallon less than Anchorage home heating oil prices.

CONCLUSIONS

A. Higher Margins in Fairbanks Due to Weak Competition

The Attorney General's Office examined the possibility that price differences between Anchorage and Fairbanks are due in part to violations of the state's antitrust laws. However, we have found no evidence to date which indicates any widespread conspiracy on the part of Fairbanks retailers to engage in price fixing, nor is there any indication that such activity has occurred at the jobber or refiner levels. 3/

Instead of uncovering antitrust violations, the investigation revealed that the higher Fairbanks profit margins are the result of unaggressive pricing by retailers. Price competition in the Fairbanks retail gas market is sluggish, despite a comparatively high concentration of retail gas stations. The high per capita gas station ratio in Fairbanks should encourage much more vigorous competition than presently exists.

3/ There are indications that at least one gas station attempted to fix prices by trying to convince a nearby competitor to join in a plan to raise prices. Further investigation, however, revealed that the competitor who was approached with the price-fixing proposal did not agree to it. In the absence of an agreement by two or more competitors to fix, raise, maintain, or otherwise manipulate prices, there is no conspiracy in restraint of trade actionable under state antitrust laws.

Instead, Fairbanks dealers are able to maintain consistently high prices and thus high profit margins. When asked to explain this phenomenon, one Fairbanks dealer offered the following explanation:

Everybody here seems to have a feel for what it costs to operate, and they're not really trying to prove anything to anybody. Tomorrow, if I wanted to, I could knock 10 cents a gallon off of all of my prices. I'll pick up volume for maybe one or two days. But the minute that's up, (my competitors) are going to see that I went down and I guarantee that within two or three days they'll match me. So therefore, there's no advantage for me to be down there. The only advantage is, it would make us all go broke, and that's just common sense. In this area up here, we know that, and we know that's basically how it's worked for years up here. Everybody watches everybody. By watching everybody in that aspect, you really kind of, I would say, control the market. I would never say it's a form of price fixing, but it's a form of maintaining your margins, I would say.

To the extent that these comments are representative of Fairbanks dealers generally, they reflect a less-than-aggressive attitude toward competitive pricing, and are consistent with some of the conclusions reached in a February 1, 1983 report entitled, "Alaska Petroleum Product Pricing" prepared for the Alaska Senate Resources Committee by Louis F. DeLong and Lloyd M. Pernela of Pacific-Alaska, Inc. The DeLong and Pernela report, which covered the period of 1980 -- 1982, arrived at the following conclusions:

The prices of motor gasoline in Fairbanks at the retail level increased significantly during 1980,

a period of increased costs of crude oil. Starting in early 1981 until today (February 1, 1983), gasoline prices have remained steady in spite of significant decreases in crude costs. The motor gasoline retail market has reacted to cost increases on the upside but not on the downside. This lack of a market reaction to declining costs seems to indicate a "structured" noncompetitive retail environment in Fairbanks.

DeLong and Pernela, 1983, at 83.

We were told by several sources that by summer's end this year, between 4 and 12 additional gas stations of various types will have opened in the Fairbanks area. This would result in the highest concentration of gas stations per capita in Alaska, if not in the entire Northwest. There is speculation that these new stations will sell gasoline substantially below current prices to establish a market share. In that event, existing gas stations would be forced to lower prices to preserve their current market share. Whether this scenario actually becomes a reality, of course, remains to be seen.

As matters stand, we conclude that weak competition and tacit agreement between Fairbanks retailers "not to rock the boat" has kept their profit margins high during the last several years. This does not explain, however, why Fairbanks gasoline retail prices have increased during the last year, when in-state oil prices have dropped significantly. The increase in retail prices does not appear to be the result of increased profit margins at the retail level. Rather, the retailers have simply

passed on price increases at the wholesale level to the Fairbanks consumer. These wholesale price increases, we have determined, are due to price increases at the refinery level. 4/

B. Alaska Price Increases Result from High Refinery Prices

The price of crude oil purchased by Tesoro, Alaska's principal in-state refiner of motor gasoline during 1985, is governed largely by a long-term royalty oil supply contract with the State of Alaska. Under this contract, Tesoro's purchase price is set at the weighted average of in value amounts reported monthly by Prudhoe Bay producers and is subject to adjustment in accordance with the current litigation over the value of North Slope oil production. Unlike the rapidly fluctuating world spot prices, the reported in value North Slope royalties, and hence the price under Tesoro's long-term contract, generally react slowly to changes in the world oil market. 5/

4/ See Appendix B. The refinery price for leaded gasoline increased by 6.2 cents per gallon between January, 1985 and January, 1986. The jobbers passed this increase (with a little extra) on to the retailers, increasing the wholesale price by 7.3 cents per gallon during the same period. Unleaded gasoline went up 6.4 cents per gallon at the refinery, and 6.8 cents per gallon at the wholesale level. Thus, the refinery price increase for unleaded was passed-through by the jobbers to the retailers with only a slight surcharge.

5/ Between early December 1985 and mid-February 1986, world spot

The slow decline in royalty contract prices does not provide an explanation of why gas prices in Fairbanks have increased over the last year. Despite a documented one dollar per barrel decline in reported Prudhoe Bay royalty oil prices over the last year, our office has independently verified that Alaska's major gasoline producer has actually raised its selling prices during that time.

Tesoro is the only in-state refiner which produced motor gasoline throughout the entire calendar year 1985. As mentioned earlier, Mapco only started refining motor gasoline as of October 31, 1985. All gasoline sold in Fairbanks and Anchorage is either Tesoro or Mapco gasoline, regardless of what brand name is on the pump. The bulk of Tesoro's Nikiski refinery feedstock in 1985, approximately 40,000 barrels per day, comes

market prices have dropped by more than \$10 per barrel, to the \$15 per barrel range. However, the posted price of a major Prudhoe Bay producer, Sohio, has only fallen \$4 per barrel in that period. Further, that decline did not occur until February 1986.

The decline resistance of North Slope crude oil prices is amplified for in-state refiners since there is a two-month lag period before price changes are passed on to Alaska refiners. This is due to the method used to report and calculate the value of royalty oil. Thus, the current decline in spot market prices will not be reflected in state royalty oil contracts until this spring.

from the long-term state Prudhoe Bay royalty oil contract described above.

Because of the lag in the price changes under the royalty oil contracts, the per barrel price billed to Tesoro for royalty oil in January, 1985 was based on the in value amount reported by the Prudhoe Bay producers for the month of November 1984. That price, as most recently revised, was \$17.96 under Tesoro's 40,000 barrel-per-day contract.

The per barrel price billed to Tesoro under the same contract in January 1986, based on November 1985's reported in value amount, was \$16.99. Therefore, the per barrel price paid by Tesoro for the bulk of its 1985 Prudhoe Bay feedstock decreased by 97 cents between January 1985 and January 1986. This amounts to a 2.3 cent reduction on a per gallon basis.

Despite the decrease in Tesoro's price for the bulk of its 1985 feedstock, the wholesale prices for all four brands of gasoline in Anchorage and Fairbanks increased by an average of about 6.5 cents per gallon over the last year.

The inverse relationship between decreasing 1985 royalty oil prices and increasing 1985 selling prices is a strong indication that Tesoro and the oil companies which sell Tesoro gasoline under their brand names have been pursuing a "what the market will bear" pricing strategy for selling motor gasoline in Alaska. Over the last year, increases established by oil

companies in their Alaska selling prices have been passed on throughout the petroleum distribution chain to retailers, and ultimately to Alaskan consumers.

Conversely, reductions in crude acquisition costs during 1985, insofar as such data is available to us, do not appear to have been passed along by the oil companies. In this regard, the DeLong and Pernela report, on page 82, asserts that one reason Alaska refineries are highly profitable is that "... the reductions in crude pricing are not being reflected in the Alaska market price of the refined products."

A sustained lowering of crude supply prices, in traditional economic theory, should result in an eventual lowering of retail prices to consumers. However, Alaska refiners appear to be stretching their profit margins by increasing their prices despite the lower cost of crude oil. As reported in an Anchorage Daily News article dated February 12, 1986, titled "Alaska Won't See Cheaper Gas Soon," oil industry officials expressed uncertainty as to whether and when Alaska's consumers will benefit from the kind of retail gas price reductions currently enjoyed by consumers in many Lower 48 markets. The consumer certainly will not see lower gas prices at the pump when prices at the refinery are going up.

APPENDIX A
PRICE COMPARISON SHEET
(Self-Serve Cash Prices)

I. January 1985 Leaded Regular Gas Average Per Gallon Prices

	Fairbanks	Anchorage	Juneau
Average Jobber Buying Price	\$1.031	\$0.943	N/A
Average Wholesale Price	\$1.080	\$0.955	\$1.165
Average Retail Price	\$1.237	\$0.990	\$1.405
Average Retail Profit Margin	\$0.157	\$0.035	\$0.240

II. January 1986 Leaded Regular Gas Average Per Gallon Prices

	Fairbanks	Anchorage	Juneau
Average Jobber Buying Price	\$1.093	\$1.008	N/A
Average Wholesale Price	\$1.153	\$1.035	\$1.173
Average Retail Price	\$1.316	\$1.070	\$1.430
Average Retail Profit Margin	\$0.163	\$0.035	\$0.257

III. January 1985 Unleaded Regular Gas Average Per Gallon Prices

	Fairbanks	Anchorage	Juneau
Average Jobber Buying Price	\$1.077	\$0.989	N/A
Average Wholesale Price	\$1.132	\$1.002	\$1.205
Average Retail Price	\$1.301	\$1.070	\$1.464
Average Retail Profit Margin	\$0.169	\$0.068	\$0.259

IV. January 1986 Unleaded Regular Gas Average Per Gallon Prices

	Fairbanks	Anchorage	Juneau
Average Jobber Buying Price	\$1.141	\$1.056	N/A
Average Wholesale Price	\$1.200	\$1.108	\$1.223
Average Retail Price	\$1.375	\$1.167	\$1.489
Average Retail Profit Margin	\$0.175	\$0.059	\$0.266

Note: All prices include 17 cents federal/state tax.

APPENDIX B
PRICE COMPARISONS

I. JOBBER BUYING PRICES

Many fuel purchaser who buy motor gasoline at jobber buying prices hold a qualified dealer's license which enables them to make fuel purchases on a tax-exempt basis. Some companies who are not qualified dealer license holders are able to purchase motor gasoline from an oil company at jobber buying prices, but such purchases are not tax-exempt. For the sake of uniformity and for ease of comparison with wholesale and retail prices presented later in this report, the jobber buying prices presented in this section are inclusive of federal and state tax.

A. Fairbanks

In January 1985, the average per gallon price of gasoline paid by Fairbanks jobbers to the major oil companies, including 17 cents federal/state tax, was \$1.031 for leaded regular and \$1.077 for unleaded regular. By January 1986, the average price for these products had increased to \$1.093 (leaded) and \$1.41 (unleaded). This resulted in an average per gallon increase over the last year of 6.2 cents (leaded) and 6.4 cents (unleaded).

B. Anchorage

Even though most Anchorage retailers do not buy gasoline from jobbers, the major oil companies maintain jobber buying prices for the Anchorage area, as some retailers are served by

jobbers. In January 1985, the average per gallon jobber buying price of gasoline in Anchorage, including 17 cents federal/state tax, was \$.943 (leaded) and \$.989 (unleaded). By January 1986, these averages had increased to \$1.008 (leaded) and \$1.056 (unleaded), representing average per gallon annual increases of 6.6 cents and 6.7 cents, respectively.

C. Juneau

Since branded motor gasolines in Juneau are sold to retailers by bulk facilities owned by Chevron and Unocal rather than by independently-owned jobbers, no jobber buying prices are available for Juneau.

D. Fairbanks/Anchorage Jobber Buying Prices

In January 1985, Fairbanks jobber buying prices averaged 8.8 cents per gallon higher than for both leaded and unleaded gasoline than Anchorage jobber buying prices. In January 1986, Fairbanks jobber buying prices averaged 8.5 cents per gallon higher for both leaded and unleaded gasoline than Anchorage jobber buying prices.

II. WHOLESALE PRICES

A. Fairbanks

In January 1985, the average per gallon delivered wholesale price of gasoline paid by Fairbanks retailers, including 17 cents federal/state tax, was \$1.08 for leaded regular and \$1.132 for unleaded regular. By January 1986, the

average price paid by Fairbanks retailers for these products increased to \$1.153 and \$1.20 respectively. Thus, over the last year, the average wholesale price increased by 7.3 cents per gallon for leaded regular and 6.8 cents per gallon for unleaded regular.

B. Anchorage

In January 1985, the average per gallon delivered wholesale price of gasoline paid by Anchorage retailers was \$.955 for leaded regular and \$1.002 for unleaded regular. By January 1986, these averages increased to \$1.035 and \$1.108 respectively. Thus, over the last year, the average wholesale price increased by 8.0 cents per gallon for leaded regular and 8.0 cents per gallon for unleaded regular. In early 1985, Anchorage average wholesale prices were lower than those in Seattle. However, at present, Seattle wholesale prices average about 10 cents lower than those in Anchorage.

C. Juneau

In January 1985, the average per gallon delivered wholesale price of gasoline paid by Juneau retailers was \$1.165 for leaded regular and \$1.205 for unleaded regular. By January 1986, these figures were \$1.173 and \$1.223 respectively. This represents an average net increase of .8 cents (leaded) and 1.8 cents (unleaded) as between January 1985 and January 1986. However, Juneau wholesale prices actually rose to a mid-1985

average of about 4 cents per gallon higher than 1985 year-end levels.

D. Fairbanks/Anchorage/Juneau Wholesale Price Comparison

In January 1985, Fairbanks retailers paid an average of 12.5 cents per gallon more for leaded regular and 13.0 cents per gallon more for unleaded regular than did Anchorage retailers. At the same time, Juneau retailers paid an average of 8.5 cents (leaded) and 7.3 cents (unleaded) per gallon more than Fairbanks retailers.

In January 1986, Fairbanks retailers paid an average of 11.8 cents per gallon more for leaded regular and 11.8 cents per gallon more for unleaded regular than did Anchorage retailers. In the same month, Juneau dealers paid an average of 2.0 cents (leaded) and 2.3 cents (unleaded) more than Fairbanks retailers.

Freight and loading costs associated with transporting motor gasoline from Anchorage to Fairbanks have ranged from about 9 to 12 cents per gallon, depending upon the quantity of fuel shipped.

III. RETAIL PRICES

A. Leaded Regular

During the week of January 13, 1986, with one or two exceptions, cash prices for self-serve leaded regular gasoline in the Fairbanks area (excluding North Pole) ranged from \$1.279 to \$1.349 per gallon, and averaged \$1.316 per gallon. During the

same week, leaded gas at self-serve cash prices in Anchorage sold at between \$1.039 and \$1.099, with an average of about \$1.07 per gallon. In Juneau, with one or two exceptions, self-serve cash prices for leaded regular ranged from \$1.319 to \$1.469, with an average of \$1.43 per gallon.

B. Unleaded Regular

During the week of January 13, 1986, with one or two exceptions, cash prices for self-serve unleaded regular gasoline in the Fairbanks area ranged from \$1.319 to \$1.409 with an average of \$1.375. Unleaded self-serve cash prices in Anchorage during the same week ranged from \$1.139 to \$1.199, and averaged about \$1.167. In Juneau, with one or two exceptions, unleaded regular cash prices ranged from \$1.369 to \$1.519, and averaged \$1.489. (Note: For about a 35-day period at the end of 1985, several Juneau retailers lowered their prices by approximately 20 cents per gallon.)

C. Average Retail Price Comparisons

Fairbanks leaded regular self-serve cash prices during the week of January 13, 1986 averaged 24.6 cents per gallon higher than those in Anchorage, and 11.4 cents per gallon lower than those in Juneau. Fairbanks unleaded regular self-serve cash prices during the same week averaged 20.8 cents per gallon higher than those in Anchorage, and 10.5 cents per gallon lower than those in Juneau. Overall, Fairbanks self-serve cash prices

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February, 1986
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averaged about 22.5 cents per gallon higher than Anchorage prices, and about 11.0 cents per gallon lower than Juneau prices during mid-January 1986.

SCOMM

94:8

FISCAL NOTE

No. 2STATE OF ALASKA
1993 LEGISLATIVE SESSIONBill V¹ #: SB 150
(S) Publish Date: 3-5-93

Revision Date Original Department Affected: Natural Resources
 Title: "An Act providing for oil and gas exploration
licenses and leases in certain areas of the state" BRU: Resource Development
 Sponsor: Senate Rules for the Governor Components: Oil & Gas Development
 Requestor: _____ Component Serial No. 439

EXPENDITURES/REVENUES:

(Thousands of Dollars)

OPERATING	FY 94	FY 95	FY 96	FY 97	FY 98	FY 99
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL	0.0	0.0	0.0	0.0	0.0	0.0
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REVENUE fund source:	0.0	0.0	0.0	0.0	0.0	0.0
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FUNDING:

(Thousands of Dollars)

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

POSITIONS:

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

Estimate of current year (FY93) Impact: \$ No fiscal impact anticipated

ANALYSIS: (Attach a separate page if necessary)

The zero fiscal note is predicated on the Division of Oil & Gas being funded to the full level of the Governor's budget request. The Division of Oil & Gas will be the primary administrators of this program and need to be fully staffed to accomplish this task.

Prepared by: Jim Eason, Director Phone: 762-2547
 Division: Oil & Gas Development Date: 2-Mar-93
 Approved by Commissioner: Glenn A. Olds Date: 2-Mar-93
 Agency: Department of Natural Resources

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FISCAL NOTE

No. 1

STATE OF ALASKA 1993 LEGISLATIVE SESSION

BI

Bill Version: SB 150

(S) Publish Date: 3-5-93

Revision Date:

Dept. Affected: Revenue

Title: Oil & Gas Exploration Licenses and Leases

BRU: Revenue Operations

Component: Oil & Gas Audit Divison

Sponsor: Governor

Requestor: Governor

COMPONENT SERIAL NO. 115

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING	FY94	FY95	FY96	FY97	FY98	FY99
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL						
---------	--	--	--	--	--	--

REVENUE FUND SOURCE:						
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FUNDING:

(Thousands of Dollars)

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

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

Estimate of current year (FY93) impact: \$ 0.00

ANALYSIS: (Attach a separate page if necessary)

Prepared by:

Rod R. Maurant

Phone: 465-2300

Division:

Commissioner's Office

Date: 3/2/93

Approved by Commissioner:

Darrel J. Rexwinkel

Date: 3/2/93

Agency:

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STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 5, 1993

The Honorable Rick Halford
President of the Senate
Alaska State Legislature
State Capitol
Juneau, AK 99801-1182

Dear Mr. President:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill authorizing oil and gas exploration licenses for tracts of state land up to 500,000 acres in size and providing for subsequent leasing of some or all of the acreage subject to the license.

The bill is designed to encourage the exploration and development of areas within the state with undetermined oil and gas potential. In contrast to the provisions of the state's existing competitive oil and gas leasing program, the bill would allow the state to issue licenses covering relatively large tracts to licensees based upon their commitment to perform certain exploration programs, the monetary value of which has been predetermined. The bill is not intended to replace the state's competitive leasing program; rather, it is intended to provide an effective alternative to encourage exploration in those areas that traditionally have not attracted the interest of explorationists under the state's current leasing regime.

Under the bill, either the state or a prospective licensee could nominate an area of unidentified oil and gas potential, consisting of reasonably compact and contiguous acreage that should be subject to a license. The commissioner of natural resources would be authorized to impose reasonable work commitments on the licensee with respect to the license area. Subsequent to the successful completion of the predetermined work commitment, the licensee could convert portions or all of the

The Honorable Rick Halford

March 5, 1993

Page 2

acreage to one or more leases, each not to exceed 30,000 acres in size. The imposition of the required work commitment and the requirement to pay an annual rental on acreage subject to lease are together intended to discourage warehousing of acreage that the licensee does not intend to explore or develop. The commissioner is authorized to include reasonable conditions and obligations in the leases arising from conversion of licenses.

A license proposal would require public notice and the opportunity for competing proposals by other prospective licensees as well as the opportunity for public comment. The commissioner of natural resources would be required to make a finding that issuing a license is in the best interest of the state.

The exploration and potential development of Alaska's remote and underexplored basins will be further encouraged by the adoption of the licensing and leasing methodology contained in this bill.

I urge your prompt and favorable consideration of this bill.

Sincerely,

A handwritten signature in cursive script, reading "Walter J. Hickel". The signature is written in dark ink and is positioned above the printed name and title.

Walter J. Hickel
Governor

Position Paper
Department of Natural Resources
Exploration Licensing Legislation
HB 199 & SB 150

The Exploration Licensing Bill allows the State to offer large tracts of land (up to 500,000 acres) to potential licensees, with the option of later converting part (or all) of the license to lease, contingent upon the successful completion of the required work commitments. Exclusive licenses will be granted to the company submitting the most comprehensive work plan as expressed in dollars of work commitment.

A bond covering the proposed work commitment expense is required, and will be forfeited for that portion of the work that is not completed. The same Best Interest Finding procedures that are currently used for competitive leasing under the state's Five Year leasing program, and the public process that is part of the Finding, remains in-place for exploration licensing. At the end of the license period a lease covering some (or all) of the license area may be awarded.

The Department of Natural Resources will administer this program as it administers competitive lease sales under the existing Five Year Oil and Gas leasing program. The Departments of Fish and Game, Environmental Conservation and Law, as well as other interested local, state and federal agencies, will be involved in the Best Interest Finding. In addition, there will be ample opportunity for public review and comment on the award of proposed licenses, as well as on the terms and conditions of those licenses and any resulting leases.

Governor Hickel's proposal in HB 199 and SB 150 expands the exploration options available in, but does not replace, competitive leasing under the existing Five Year program. Its main purpose is to get companies working in areas of the State that have drawn little (or no) attention under the current leasing program. Similar license/lease programs are offered by most countries worldwide.

The Governor's goal is to get more money "into the ground." The State makes the majority of its income from royalties and severance taxes on oil and gas production, not bonuses and lease rentals. In order to obtain new royalties and severance taxes, we must have new oil being explored for and produced. The only way to find new reserves that may eventually be produced is to have companies actually drilling wells. This bill is intended to expedite the exploration process, which, hopefully, will lead to new commercial discoveries of oil and gas.

Oil and gas exploration always means money and jobs. Likewise, increasing the opportunity to explore and develop new areas can only mean more money and more jobs. Exploring the remaining "underexplored" basins in the state will certainly provide jobs during the exploration phase—jobs for all sorts of people—from geologists to camp cooks. If discoveries are made, more jobs will be created and new revenues will accrue from taxes and royalties. These jobs will be created in geographically diverse areas of the state, contributing to the expansion and diversification of the state's economy.

* = Change

SECTIONAL ANALYSIS OF 2nd CS SB 150(O&G)

By: Senate Special Committee on Oil and Gas Staff

March 11, 1994

Title

The title references current oil and gas statutes applicable to the new exploration licensing program.*

Section 1.

Force Majeur clause: Adds Exploration licenses to the list of transactions for which payments may be delayed in the event of an act of God. *(Was Section 2 in CS SB 150(FIN)am)- No Changes.*

Section 2.

Geographic exclusion section - excludes from this exploration licensing Cook Inlet (using boundaries cited) and the North Slope north of the Umiat baseline. Sets out notice standards of AS 38.05.945(b) ; and states the provisions of public land statutes which apply to exploration licensing. *(Was Section 1 in CS SB 150(FIN)am)- No Changes.*

Section 38.05.132*

Oil and Gas Exploration License:

- right to explore for 10 years or less

- right to convert to lease

- not subject to acreage limitations of 5,760 acres (38.05.140(c)) or the 1,000,000 aggregate amount in 38.05.180(m)

- license size from 20,000 acres* to 500,000 acres

- prerequisite to license: work commitment

 - *must complete 25% of work commitment in 4 years or forfeit the license

 - *must complete 50% of work commitment in 4 years or begin to relinquish land

- *bond renewed annually in the amount of the entire work commitment minus expenditures for end of the project year divided by years remaining in the license.

- License rental fee \$1/acre or fraction

Section 38.05.133

License Procedures:

- Proposals accepted by the Commissioner or initiated by Commissioner

- Proposals accepted at minimum annually.

- Written, published notice of Commissioner's solicitation of proposals.

After public comment on proposals, Commissioner issues written finding addressing matters in 38.05.035(e) and (g);
Finding describes limitations, stipulations, conditions or changes from the initiating proposal(s);
If more than one bid, competitive sealed bidding ensues with successful bidder being the highest bid in terms of minimum work commitment dollar amount. *(No Changes from CS SB 150(FIN)am).*

Section 38.05.134

Conversion to Lease:

Work Commitment must be met.
Lease subject to acreage limitations of 38.05.140(c) (1,000,000 acres).
Royalty of not less than 12.5 percent of production.
Annual rent of \$3/acre or fraction. *(No Changes from CS SB 150(FIN)am).*

Section 3.

Leasing of Mineral Land:

Adds exploration licensing to this statute. *(Was Section 2 in CS SB 150(FIN)am) - No Changes*

Section 4.

Oil and Gas Leasing:

Adds exploration licensing to the state's oil and gas leasing program; allows the commissioner to convert licenses to leases. *(Was Section 4 in CS SB 150(FIN)am - No Changes.*

Section 5.

Oil and Gas Leasing:

Makes exception in the bidding method for exploration licensing. Exploration licensing is by competitive, sealed bid only. *(Was Section 5 in CS SB 150(FIN)am- No Changes.*

Section 6.

Notice:

Adds exploration licensing decisions to the list of requirements for notice. *(Was Section 6 in CS SB 150(FIN)am)- No Changes.*

Section 7.

Additional Excluded Area:

In addition to the Cook Inlet and North Slope lands excluded in Section 2; Lease Sales 80, 87 and 88 are excluded from exploration licensing. However, once these lease sales are held, thereafter they are subject to exploration licensing. *(Was Section 9 in CS SB 150(FIN)am) - No Changes.*

Section 8.

Commissioner to adopt regulations. *(Was Section 10 in CS SB 150(FIN)am) - No Changes.*

Section 9.

Section 8 immediate effective date. *(Was Section 11 in CS SB 150(FIN)am) - No Changes.*

8-GS1012AB
Chenoweth
3/10/94

2d CS FOR SENATE BILL NO. 150(O&G)
IN THE LEGISLATURE OF THE STATE OF ALASKA
EIGHTEENTH LEGISLATURE - SECOND SESSION

BY THE SENATE SPECIAL COMMITTEE ON OIL AND GAS

Offered:
Referred:

Sponsor(s): SENATE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to the exploration and production of oil and gas and related
2 hydrocarbons, to oil and gas exploration licenses, and to oil and gas leases in
3 certain areas of the state; and providing for an effective date."

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

5 * Section 1. AS 38.05.020(b) is amended to read:

6 (b) The commissioner may

7 (1) establish reasonable procedures and adopt reasonable regulations
8 necessary to carry out this chapter and, whenever necessary, issue directives or orders
9 to the director to carry out specific functions and duties; regulations adopted by the
10 commissioner shall be adopted under AS 44.62([THE] Administrative Procedure Act)
11 [(AS 44.62)]; orders by the commissioner classifying land, issued after January 3,
12 1959, are not required to be adopted under AS 44.62 ([THE] Administrative
13 Procedure Act) [(AS 44.62)];

14 (2) enter into agreements considered necessary to carry out the purposes

1 of this chapter, including agreements with federal and state agencies;

2 (3) review any order or action of the director;

3 (4) exercise the powers and do the acts necessary to carry out the
4 provisions and objectives of this chapter;

5 (5) notwithstanding the provisions of any other section of this chapter,
6 grant an extension of the time within which payments due on any exploration license,
7 lease, or sale of state land, minerals, or materials may be made, including payment of
8 rental and royalties, on a finding that compliance with the requirements is or was
9 prevented by reason of war, riots, or acts of God;

10 (6) classify tracts for agricultural uses and require the prequalification,
11 including the submission of conservation plans, development plans, or other plans,
12 schedules, or programs, of persons who apply to participate in an agricultural
13 development project under AS 44.33.475;

14 (7) waive, postpone, or otherwise modify the development requirements
15 of a contract for the sale of agricultural land if

16 (A) the land is inaccessible by road; and

17 (B) transportation, marketing, and development costs render the
18 required development uneconomic.

19 * Sec. 2. AS 38 is amended by adding new sections to read:

20 ARTICLE 5A. OIL AND GAS EXPLORATION LICENSES; LEASES.

21 Sec. 38.05.131. APPLICABILITY; DETERMINATION; REGULATIONS. (a)

22 Unless specifically provided otherwise in AS 38.05.132 - 38.05.134, the provisions of
23 AS 38.05.005 - 38.05.040, 38.05.180, 38.05.182 - 38.05.184, and 38.05.920 -
24 38.05.990 apply to the issuance of oil and gas exploration licenses and leases under
25 AS 38.05.132 - 38.05.134.

26 (b) The provisions of AS 38.05.131 - 38.05.134 do not apply to land

27 (1) north of the Umiat baseline; and

28 (2) in the vicinity of Cook Inlet that is within the area bounded by

29 (A) the north boundary of Township 17 North, Seward
30 Meridian;

31 (B) the Seward Meridian;

(C) the south boundary of Township 7 South, Seward Meridian;

and

(D) the west boundary of Range 19 West, Seward Meridian.

(c) The commissioner shall make preliminary written determinations of the state land that may be subject to the provisions of AS 38.05.132. The determinations shall be given public notice using the methods described in AS 38.05.945(b). After completion of the comment period and evaluation of the comments received, the commissioner shall issue a written determination of the state land that is subject to the provisions of AS 38.05.132.

(d) The commissioner may adopt regulations necessary to implement AS 38.05.131 - 38.05.134.

Sec. 38.05.132. OIL AND GAS EXPLORATION LICENSE. (a) To encourage exploration for oil and gas on state land, the commissioner may issue oil and gas exploration licenses.

(b) An oil and gas exploration license issued under this section gives the licensee

(1) the exclusive right to explore, for a term not to exceed 10 years, for deposits of oil and gas on unleased state land described in the exploration license unless the exploration license is terminated under (d)(1) of this section or the land is earlier relinquished, removed, or deleted under (d)(2) of this section; and

(2) unless the exploration license is terminated under (d)(1) of this section, the option to convert the exploration license for all or part of the state land, except the land that is deleted or removed from the land described in the exploration license under (d)(2) of this section, into an oil and gas lease upon fulfillment of the work commitments contained in the exploration license.

(c) An exploration license awarded under this section

(1) is not subject to the acreage limitations imposed by AS 38.05.140(c) or 38.05.180(m);

(2) may cover an area of not less than 20,000 acres and not more than 500,000 acres, that must be reasonably compact and contiguous;

(3) must be conditioned upon an obligation to perform a specified work

1 commitment, in total for the term of the license, expressed in dollars of direct
2 exploration expenditures; and must include a requirement that the licensee complete
3 at least 25 percent of the licensee's total specified work commitment by the fourth
4 anniversary of the effective date of the issuance of the oil and gas exploration license;

5 (4) must be conditioned upon the posting of a bond or other security
6 acceptable to the commissioner, in favor of the state and subject to the following
7 requirements:

only modifies bond ⊗

8 (A) the bond or other security must be renewed annually;

9 (B) the annual bond or other security shall be calculated as the
10 entire work commitment expressed in dollars, less the cumulative direct
11 exploration expenditures of the licensee as of the last day of the most recent
12 project-year, divided by the number of years remaining in the term of the
13 exploration license;

14 (5) is subject to an annual review and revocation if the commissioner
15 determines that the licensee has failed to provide or maintain in effect the bond or
16 other security required by (4) of this subsection;

17 (6) must be conditioned upon the licensee's payment to the state of a
18 nonrefundable oil and gas exploration license fee in an amount determined by the
19 commissioner, not to exceed \$1 for each acre of land or fraction of each acre that is
20 subject to the exploration license; and

21 (7) must be conditioned upon an agreement that exploration
22 expenditures are subject to audit by the commissioner.

23 (d) If, on the fourth anniversary of the effective date of the issuance of the
24 exploration license awarded under this section,

25 (1) the licensee has not completed at least 25 percent of the licensee's
26 total specified work commitment, as measured by the licensee's direct exploration
27 expenditures, the exploration license terminates;

28 (2) the licensee has completed at least 25 percent but has not completed
29 at least 50 percent of the licensee's total specified work commitment, as measured by
30 the licensee's direct exploration expenditure, the commissioner shall remove or delete
31 or shall require the licensee to relinquish a portion of the area within the exploration

1 license; relinquishment, removal, or deletion of an area from the state land described
2 in the exploration license terminates the licensee's rights under AS 38.05.131 -
3 38.05.134 in the area that is relinquished, removed, or deleted; a relinquishment,
4 removal, or deletion of a portion of the area described in the exploration license must
5 be in areas that are reasonably compact and contiguous; the areas relinquished from
6 the state land described in the exploration license must be areas identified by the
7 licensee but, if the licensee fails to identify sufficient area, the commissioner may
8 identify any additional acreage required to be removed or deleted from the area under
9 license to meet the requirements of this paragraph; within the area described in the
10 exploration license issued under (a) - (c) of this section,

11 (A) 25 percent must be relinquished, removed, or deleted not
12 later than the fourth anniversary of the effective date of the issuance of the
13 exploration license;

14 (B) an additional 10 percent of the acreage remaining after
15 relinquishment, removal, or deletion of acreage required by (A) of this
16 paragraph and by previous relinquishments, removals, or deletions under this
17 paragraph must be removed or deleted on each of the succeeding anniversaries
18 of the effective date of the issuance of the exploration license;

19 (C) the cumulative total of the acreage relinquished, removed,
20 or deleted under (A) and (B) of this paragraph may not be required to exceed
21 50 percent of the area awarded within the original exploration license area.

22 (e) If, immediately before the beginning of the period for annual renewal of
23 the bond or other security under (c)(4)(A) of this section, the licensee fails to provide
24 or maintain in effect the bond or other security required by (c) of this section for the
25 period covered by the annual renewal and the commissioner revokes the exploration
26 license, the bond or other security then in effect for the licensee's obligations under
27 the exploration license is forfeited to the state.

28 (f) In this section,

29 (1) "direct exploration expenditure" means cash expenses undertaken
30 in performance of a specified work commitment under the provisions of AS 38.05.131
31 - 38.05.134 and necessarily incurred by the licensee in the permitting, mobilization,

1 conducting, demobilization, and evaluation of geophysical and geological surveys, or
2 the drilling, logging, coring, testing, and evaluation of oil and gas wells; the term

3 (A) includes direct labor costs, including the cost of benefits,
4 for employees directly associated with the work commitment programs, the cost
5 of renting or leasing equipment from parties not affiliated with the licensee, the
6 reasonable costs of maintaining and operating equipment, payments to
7 consultants and independent contractors not affiliated with the licensee, and
8 costs of materials and supplies;

9 (B) does not include noncash expenses such as depreciation and
10 reserves, interest or other costs of borrowed funds, return on investment,
11 overhead, insurance or bond premiums, or any other expense that is
12 unreasonable or that the licensee has not incurred to satisfy the licensee's work
13 commitment;

14 (2) "work commitment" includes the drilling of one or more exploration
15 wells or the gathering of data from activities described in (1) of this subsection, or
16 both.

17 Sec. 38.05.133. LICENSE PROCEDURES. (a) The procedures in this section
18 apply to the issuance of an oil and gas exploration license under AS 38.05.132.

19 (b) The licensing process is initiated by the commissioner preparing, or a
20 prospective licensee submitting to the commissioner, a proposal that identifies a
21 specific area to be subject to the exploration license, proposes specific minimum work
22 commitments, and states that the licensee has met the minimum qualifications as
23 established by regulations adopted by the commissioner. A prospective licensee may
24 initiate a proposal only in response to a call for proposals by the commissioner or
25 during a period specified in regulations adopted by the commissioner. The regulations
26 must provide for at least one period for that purpose during each calendar year.

27 (c) If the commissioner initiates the licensing process under (b) of this section,
28 the commissioner shall publish notice of the commissioner's proposal in order to solicit
29 comments and competing proposals.

30 (d) Within 30 days after receipt of a proposal from a prospective licensee
31 under (b) of this section, the commissioner shall either reject it in a written decision

1 or give public notice of the intent to evaluate the acceptability of the proposal. The
2 commissioner shall solicit comments on a proposal for which public notice is given
3 under this subsection, and shall request competing proposals.

4 (e) The commissioner may make a written request to a prospective licensee for
5 additional information on the prospective licensee's proposal. The commissioner shall
6 keep confidential information described in AS 38.05.035(a)(9) that is voluntarily
7 provided if the prospective licensee has made a written request that the information
8 remain confidential.

9 (f) After considering proposals not rejected under (d) of this section and public
10 comment on those proposals, the commissioner shall issue a written finding addressing
11 all matters set out in AS 38.05.035(e) and (g), except for AS 38.05.035(g)(1)(K). If
12 the finding concludes that the state's best interests would be served by issuing an oil
13 and gas exploration license, the finding must (1) describe the limitations, stipulations,
14 conditions, or changes from the initiating proposal or competing proposals that are
15 required to make the issuance of the exploration license conform to the best interests
16 of the state, and (2) if only one proposal was submitted, identify the prospective
17 licensee whom the commissioner finds should be issued the exploration license. The
18 commissioner shall attach to the finding a copy of the exploration license to be issued
19 and the form of lease that will be used for any portion of the exploration license area
20 subsequently converted to an oil and gas lease under AS 38.05.134.

21 (g) If only one prospective licensee submits a proposal and the finding under
22 (f) of this section concludes that an exploration license should be issued to that
23 prospective licensee, the prospective licensee has 30 days after issuance of the finding
24 within which to accept or reject the issuance of the exploration license, as limited or
25 conditioned by the terms contained in the finding. The exploration license to be issued
26 and the form of lease that will be used must be attached to that finding.

27 (h) If competing proposals are submitted, and the commissioner's finding
28 under (f) of this section concludes that an oil and gas exploration license should be
29 issued, the commissioner shall issue a request for competitive sealed bids, under
30 procedures adopted by the commissioner by regulation, to determine which prospective
31 licensee should be issued the exploration license. The finding provided to the

prospective licensees under (f) of this section must contain notice that (1) the commissioner intends to request competitive sealed bids, (2) a prospective licensee who intends to participate in the bidding must notify the commissioner in writing by the date specified in the notice, and (3) a prospective licensee's notice of intent to participate in the bidding constitutes acceptance of issuance of the exploration license, as limited or conditioned by the terms contained in the finding and by the exploration license to be issued and the form of lease to be used that have been attached to that finding, if the prospective licensee is the successful bidder. The successful bidder is the prospective licensee who submits the highest bid in terms of the minimum work commitment dollar amount.

Sec. 38.05.134. CONVERSION TO LEASE. If the licensee requests and the commissioner determines that the work commitment obligation set out in an oil and gas exploration license issued under AS 38.05.132 has been met, the commissioner shall convert to one or more oil and gas leases all or part, as the licensee may indicate, of the area described in the exploration license that remains after the relinquishments, removals, or deletions required by AS 38.05.132(d)(2). A lease issued under this section

(1) is subject to the acreage limitations imposed by AS 38.05.140(c);

(2) is subject to AS 38.05.180(j) - (m), (o) - (u), and (x) - (z);

(3) must be conditioned upon a royalty in amount or value of not less than 12.5 percent of production;

(4) must include an annual rent of \$3 per acre or fraction of an acre initially paid to the state at inception of the lease and payable annually after that until the income to the state from royalty under that lease exceeds the rental income to the state under that lease for that year; and

(5) is subject to other conditions and obligations that are specified in the lease.

* Sec. 3. AS 38.05.135(a) is amended to read:

(a) Except as otherwise provided, valuable mineral deposits in land belonging to the state shall be open to exploration, development, and the extraction of minerals. All land, together with tide, submerged, or shoreland, to which the state holds title to

1 or to which the state may become entitled, may be obtained by permit or lease for the
2 purpose of exploration, development, and the extraction of minerals. Except as
3 specifically limited by AS 38.05.131 - 38.05.181 [AS 38.05.135 - 38.05.181], land may
4 be withheld from lease application on a first-come, first-served basis, and offered only
5 on a competitive bid basis when determined by the commissioner to be in the best
6 interests of the state. In unproven areas the commissioner may offer additional
7 incentives, including a reduction of royalty to a minimum of five percent in the case
8 of oil and gas, and other terms in and granting a permit or lease for exploration and
9 development whenever it appears to be in the best interests of the state to do so.

10 * Sec. 4. AS 38.05.180(d) is amended to read:

11 (d) The commissioner may issue oil and gas leases in an area that has not been
12 included in a leasing program submitted, in accordance with (b) of this section, to the
13 legislature if the land to be leased

14 (1) [THE LAND TO BE LEASED] was previously subject to a valid
15 state or federal oil and gas lease; [OR]

16 (2) [THE LAND TO BE LEASED] is contiguous to land already under
17 state, federal or private lease and the commissioner makes a written finding, after
18 hearing, that leasing of the land would result in a substantial probability of early
19 evaluation and development of the land to be leased; [OR]

20 (3) [THE LAND TO BE LEASED] is adjacent to land owned or
21 controlled by another party on which a discovery of commercial quantities of oil or
22 gas has been made, and the commissioner finds, after hearing, that there is a
23 reasonable probability that the land to be leased contains oil or gas in communication
24 with the oil or gas discovered on the land of the other party; [OR]

25 (4) [THE LAND TO BE LEASED] is adjacent to land included in the
26 federal five-year Outer Continental Shelf leasing program under 43 U.S.C. 1344, and
27 the commissioner makes a written finding, after hearing, that the coordinated or
28 simultaneous leasing with the federal government is in the public interest; or

29 (5) is the subject of an oil and gas exploration license issued under
30 AS 38.05.131 - 38.05.134.

31 * Sec. 5. AS 38.05.180(f) is amended to read:

1 (f) Except as provided by AS 38.05.131 - 38.05.134, the [THE]
2 commissioner may issue oil and gas leases on state land to the highest responsible
3 qualified bidder determined by competitive bidding under regulations adopted by the
4 commissioner. Bidding may be by sealed bid or according to any other bidding
5 procedure the commissioner determines is in the best interests of the state. Whenever,
6 under any of the leasing methods listed in this subsection, a royalty share is reserved
7 to the state, it shall be delivered in pipeline quality and free of all lease or unit
8 expenses, including but not limited to separation, cleaning, dehydration, gathering, salt
9 water disposal, and preparation for transportation off the lease or unit area. Following
10 a pre-sale analysis, the commissioner may choose at least one of the following leasing
11 methods:

12 (1) a cash bonus bid with a fixed royalty share reserved to the state of
13 not less than 12.5 [12 1/2] percent in amount or value of the production removed or
14 sold from the lease;

15 (2) a cash bonus bid with a fixed royalty share reserved to the state of
16 not less than 12.5 [12 1/2] percent in amount or value of the production removed or
17 sold from the lease and a fixed share of the net profit derived from the lease of not
18 less than 30 percent reserved to the state;

19 (3) a fixed cash bonus with a royalty share reserved to the state as the
20 bid variable but no less than 12.5 [12 1/2] percent in amount or value of the
21 production removed or sold from the lease;

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

24 (5) a fixed cash bonus with a fixed royalty share reserved to the state
25 of not less than 12.5 [12 1/2] percent in amount or value of the production removed
26 or sold from the lease with the share of the net profit derived from the lease reserved
27 to the state as the bid variable;

28 (6) a cash bonus bid with a fixed royalty share reserved to the state
29 based on a sliding scale according to the volume of production or other factor but in
30 no event less than 12.5 [12 1/2] percent in amount or value of the production removed
31 or sold from the lease;

(7) a fixed cash bonus with a royalty share reserved to the state based on a sliding scale according to the volume of production or other factor as the bid variable but not less than 12.5 [12 1/2] percent in amount or value of the production removed or sold from the lease.

* Sec. 6. AS 38.05.945(a) is amended to read:

(a) This section establishes the requirements for notice given by the department for the following actions:

(1) classification or reclassification of state land under AS 38.05.300 and the closing of land to mineral leasing or entry under AS 38.05.185;

(2) zoning of land under applicable law;

(3) a decision under AS 38.05.035(e) or 38.05.132 - 38.05.134 regarding the sale, lease, or disposal of an interest in state land or resources;

(4) a competitive disposal of an interest in state land or resources after final decision under AS 38.05.035(e);

(5) a public hearing under AS 38.05.856(b); - *def not apply to 132-134*

(6) a preliminary finding under AS 38.05.035(e) and 38.05.855(c) concerning sites for aquatic farms and related hatcheries.

* Sec. 7. ADDITIONAL EXCLUDED AREA. In addition to the area designated in AS 38.05.131(b), added by sec. 2 of this Act, the provisions of AS 38.05.131 - 38.05.134, added by sec. 2 of this Act, do not apply to land within proposed Competitive Oil and Gas Lease Sales 80, 87, and 88, as the area to be offered in each of those proposed competitive oil and gas lease sales was delineated in the Five-Year Oil and Gas Leasing Program prepared by the Department of Natural Resources and dated January 1993. However, the exclusion of the land in any one of those lease sales that is required by this section ceases on the date the land described in the lease sale is first offered for competitive oil and gas leasing under AS 38.05.180, and that land is thereafter subject to the provisions of AS 38.05.131 - 38.05.134, added by sec. 2 of this Act.

* Sec. 8. REGULATIONS. The commissioner of natural resources may proceed to adopt regulations necessary to implement AS 38.05.131 - 38.05.134, added by sec. 2 of this Act. The regulations take effect under AS 44.62 (Administrative Procedure Act), but not before the effective date of secs. 2 - 7 of this Act.

WORK DRAFT

WORK DRAFT

WORK DRAFT

1

* Sec. 9. Section 8 of this Act takes effect immediately under AS 01.10.070(c).

SENATE COMMITTEE REPORT
FIRST COMMITTEE OF REFERRAL

DATE: 3/5/93

FURTHER: JUDICIARY
FINANCE

Date of 5-Day Notice: 3-11-93
(in accordance with Uniform Rule 23)

DATE TURNED
INTO OFFICE: 4-14-93

Senate Special Committee on Oil and Gas considered SB 150

"An Act providing for oil and gas exploration licenses, and oil and gas leases, in certain areas of the state; and providing for an effective date."

and recommends:

[] replace with _____ CS SB 150 O&G [] same title
[] attaches amendment(s) [X] new title
[] technical title change (HB only)

[] adopts _____ Letter of Intent

[] further referral to the _____

[] do pass

[] do not pass

[] no recommendation

[] individual recommendations

FISCAL NOTE INFORMATION

Department	Date	Zero	Fiscal
DNR	3/2	✓	
REV	3/2	✓	

Department	Date	Zero	Fiscal

[] Appropriation No Fiscal Note

~~X~~ Governor's Bill with Previous Fiscal Notes (enter information above)

DO PASS.

OTHER RECOMMENDATIONS:

Rich Hafford

Judy Salo (No Rec)
Best Among N.B.

Loren J. Herman DP
Chair: Signature and Recommendation



Alaska State Legislature

Session:
State Capitol
Juneau AK 99801-1182

**Senate Special Committee
on Oil & Gas**

Interim:
716 W 4th Avenue
Anchorage AK 99501-2133

SUMMARY OF CHANGES IN PROPOSED AMENDMENT TO CS SB150(FIN)am

Large and small operators came together during the interim to work on areas of concern in SB 150/HB 199 - exploration licensing. In a unique action, these 18 companies and the state division of oil and gas agreed to a document they created called the October 25th draft.

Senator Leman, on behalf of the Senate Special Committee on Oil and Gas is introducing an amendment to adopt the changes agreed to by these parties. The issues agreed to by the group are not foreign to the Oil and Gas Committee. After considering the proposed language in two Oil and Gas work sessions, the chairman introduces this amendment.

- 1) Amends 38.05.132 to add a lower limit for license areas of 20,000 acres.
- 2) Adds requirement that 25 percent of the work commitment be completed in the first four years of the license or the license is terminated.
- 3) At least 50 percent of the work commitment must be completed in the first four years of the license or 25 percent of the license area must be relinquished. If 50 percent of the work commitment is completed in four years, there is no relinquishment.
- 4) Deletes Section 3: 90-Day Lease Sale provision.
- 5) Deletes Sections 7 and 8: Financial Responsibility provisions.

2/11/94

SYNOPSIS OF PROPOSED AMENDMENT TO CS SB 150(FIN)am
Using CS SB 150(FIN)am as guide

TITLE:

Page 1, Lines 3-7:

Remove reference to proof of financial responsibility (Section 7, AS 46.04.040(b)) and extending the period in which a sale on the five-year oil and gas lease sale schedule may be delayed (Section 3, AS 38.05.180(c)).

*Section 1 AS 38.05.020(b):

Adds exploration licenses to the list of transactions for which an act of God allows an extension of the time on payments due to the state.

Rationale: Technical amendment

Section 2 AS 38, Article 5A, Section 38.05.131 APPLICABILITY; DETERMINATION;
REGULATIONS - No Change

Geographic restriction

Occurs in CS SB150(FIN)am as Section 1.

Section 38.05.132 OIL AND GAS EXPLORATION LICENSE.

Delete:

**(1) FOR UNLEASED STATE LAND FOR WHICH
INSUFFICIENT OR UNDOCUMENTED GEOLOGICAL AND GEOPHYSICAL
INFORMATION EXISTS CONCERNING THE OIL AND GAS POTENTIAL OF
THAT LAND; OR**

**(2) FOR STATE LAND THAT WAS SUBJECT TO A COMPETITIVE
LEASE SALE UNDER AS 38.05.180 BUT FOR WHICH AN OIL AND GAS
LEASE HAS NOT BEEN ISSUED.]**

Rationale: With geographic exclusion, this language is superfluous and is difficult to quantify. "Insufficient or undocumented" are undefined terms and would supply fertile legal ground for lawsuits by dissatisfied program participants.

Page 3, Line 1, Section 38.05.132, INSERT after "unless":

unless **the exploration license is terminated under (d)(1) of this section or** the land is earlier relinquished, removed, or deleted under (d)(2) of this section; and

(2) **unless the exploration license is terminated under (d)(1) of this section,** the option to convert the exploration license for all or part of the state land, except the land that is deleted or removed from the land described in the exploration license under (d)(2) of this section, into an oil and gas lease upon fulfillment of the work commitments contained in the exploration license.

Rationale: Technical amendment.

Page 3, Line 10, Section 38.05.132 : INSERT

(2) may cover an area of not **less than 20,000 acres nor** more than 500,000 acres, that must be reasonably compact and contiguous;

Rationale: State feels that although the Commissioner of DNR can deny any application for license area, it is best to set a lower limit since it costs the state to do best interest findings in the licensing process.

Page 3, Lines 12-14 Section 38.05.132: DELETE/INSERT:

(3) must be conditioned upon an obligation to perform a specified work commitment, in total **[AND] for [EACH YEAR OF] the term of the license, expressed in dollars of direct exploration expenditures; [FOR PURPOSES OF THIS PARAGRAPH,] must include a requirement that the licensee complete at least 25 percent of the licensee's total specified work commitment by the fourth anniversary of the effective date of the issuance of the exploration license.**

DELETE (and reinsert as Section 38.05.132(f)(1) and (2)) Page 3, lines 15-31, and Page 4, Lines 1-4. (DEFINITIONS OF direct exploration expenditure and work commitment)

Rationale: Work Commitment, Relinquishment and Bonding are integrated throughout SB 150. Adds requirement that 25 percent of the work commitment be completed by the end of the fourth year. Removes the necessity for the Division of Oil and Gas to annually monitor a licensee's compliance with a work commitment. This was deleted in favor of the language below.

Page 4, Lines 5-17 Section 38.05.132: DELETE:

[(4) MUST BE CONDITIONED UPON AN OBLIGATION TO PERFORM AN ANNUAL WORK COMMITMENT;]

Rationale: With the requirement above that 25% of the work commitment be completed within the first four years, the state's interests are served. The obligation to perform an annual work commitment would mean that the Division of Oil and Gas would have to be funded to oversee all work commitments annually.

(5) [IS SUBJECT TO AN ANNUAL REVIEW AND REVOCATION IF THE COMMISSIONER DETERMINES THAT THE LICENSEE HAS FAILED TO

(A) PERFORM THE PREVIOUS YEAR'S ANNUAL WORK COMMITMENT; OR

(B) PROVIDE OR MAINTAIN IN EFFECT THE BOND OR OTHER SECURITY REQUIRED BY (6) OF THIS SUBSECTION;

(6) MUST BE CONDITIONED UPON THE POSTING OF A BOND OR OTHER SECURITY ACCEPTABLE TO THE COMMISSIONER IN FAVOR OF THE STATE AND SUBJECT TO THE FOLLOWING REQUIREMENTS:

(A) THE BOND OR OTHER SECURITY MUST BE RENEWED ANNUALLY;]

(B) [THE BOND OR OTHER SECURITY MUST BE IN THE AMOUNT OF 10 PERCENT OF THE LICENSEE'S ANNUAL WORK COMMITMENT;]

Page 4, Lines 5-17 Section 38.05.132: INSERT:

(4) must be conditioned upon the posting of a bond or other security acceptable to the commissioner, in favor of the state and subject to the following requirements:

(A) the bond or other security must be renewed annually;

(B) the annual bond or other security shall be calculated as: the entire work commitment expressed in dollars, less the cumulative direct exploration expenditures of the licensee as of the last day of the most recent project-year, divided by the number of years remaining in the term of the exploration license;

Rationale: It is difficult to establish a bonding formula which satisfies the small and larger exploration companies. However, the working group agreed to the above formula instead of the previous 10% of annual work commitment.

(5) is subject to an annual review and revocation if the commissioner determines that the licensee has failed to provide or maintain in effect the bond or other security required by (4) of this subsection:

Rationale: Only the wording about performing the previous year's annual work commitment is deleted from this renumbered section. Again, because 25% of the entire work commitment must be performed within four years, this is enough incentive to get companies to work.

Page 4, Lines 18-20: DELETE AND INSERT:

(6)[7]) must be conditioned upon the licensee's payment to the state [COMMISSIONER] of a nonrefundable oil and gas exploration license fee, [OF] the amount of which may be set by the commissioner, provided, however, such fee may not be more than \$1 per acre or fraction thereof for each acre of land that is subject to the exploration license;

Rationale: Makes this language parallel in structure to \$3/acre fee in Sec. 38.05.134. Also, recognizes the sliding fee scale available to the Commissioner.

Page 4, Lines 23-31 Section 38.05.132 OIL AND GAS EXPLORATION LICENSE

(d) [THE AREA WITHIN AN EXPLORATION LICENSE AWARDED UNDER THIS SECTION MAY BE RELINQUISHED, REMOVED, OR DELETED FROM THE LICENSE. R] If, on the fourth anniversary of the effective date of the issuance of the exploration license awarded under this section,

(1) the licensee has not completed at least 25 percent of the licensee's total specified work commitment, as measured by the licensee's direct exploration expenditures, the exploration license terminates;

(2) the licensee has completed at least 25 percent, but has not completed at least 50 percent of the licensee's total specified work commitment, as measured by the licensee's direct exploration expenditure, the commissioner shall remove or delete or shall require the licensee to relinquish a portion of the area within the exploration license; relinquishment, removal, or deletion of an area from the state land described in the exploration license terminates the licensee's rights under AS 38.05.131 - 38.05.134 in the area that is relinquished, removed, or deleted; a relinquishment, removal, or deletion of a portion of the area described in the exploration license must be in areas that are reasonably compact and contiguous; the areas relinquished from the state land described in the exploration license must be areas identified by the licensee but, if the licensee fails to identify sufficient area, the commissioner may identify any additional acreage required to be removed or deleted from the area under license to meet the requirements of this **paragraph [subsection]**; within the area described in the exploration license issued under (a) - (c) of this section,

(A)[(1)] 25 percent must be relinquished, removed, or deleted not later than the fourth anniversary of the effective date of the issuance of the exploration license;

(B)[(2)] an additional 10 percent of the acreage remaining after relinquishment, removal, or deletion of acreage required by (A) of this paragraph and by previous relinquishments, removals, or deletions under this paragraph must be removed or deleted on each of the succeeding anniversaries of the effective date of the issuance of the exploration license;

(C) THE CUMULATIVE TOTAL OF THE ACREAGE RELINQUISHED, REMOVED, OR DELETED UNDER (A) AND (B) OF THIS PARAGRAPH MAY NOT BE REQUIRED TO EXCEED 50 PERCENT OF THE AREA AWARDED WITHIN THE ORIGINAL EXPLORATION LICENSE AREA.

(e) If, immediately before the beginning of the period for annual renewal of the bond or other security under **(c)(4)(A)** **[(c)(5)(A)]** of this section,...

Rationale: The relinquishment provision is revised in conjunction with the work commitment language. Fifty percent of the work commitment must be accomplished in four years or 25 percent of the license area must be relinquished. The explorer loses an additional 10 percent per year of the remaining acreage for up to 50 percent of the area originally licensed. If 50 percent of the approved work commitment is completed before four years, there is no relinquishment.

INSERT DEFINITIONS OF DIRECT EXPLORATION EXPENDITURES AND WORK COMMITMENT FROM Pages 3 and 4 with the following amendments:

(1) [(A)] "direct exploration expenditure" means cash expenses undertaken in performance of a specified work commitment under the provisions of AS 38.05.131 - 38.05.134 and necessarily incurred by the licensee in the permitting, mobilization, conducting, demobilization, and evaluation of geophysical and geological surveys, **[INCLUDING SEISMIC, MAGNETIC, AND GRAVITY SURVEYS]** or the drilling, logging, coring, testing, and evaluation of oil and gas wells;

(2) [B] "work commitment includes the drilling of one or more exploration wells or the gathering of **[GEOPHYSICAL]** data **from activities described in (1) of this subsection**, or both;

Rationale: Technology is changing. Listing this in the statute is inappropriate, because it is impossible to predict future possible technology advances. Also, in conjunction with the change on Page 3, 19-20.

Section 38.05.133. LICENSE PROCEDURES. INSERT

Page 5, Line 19:

commitments, and states that **the licensee has met** the minimum qualifications **[FOR A LICENSEE]** as established by

Rationale: Technical Amendment.

Page 6, Line 4:
provided [.] if the prospective licensee has made a written request that the information remain confidential.

Rationale: Technical Amendment, same procedure as in the 5-yr. plan.

Section 38.05.133. LICENSE PROCEDURES. DELETE:

Page 6, Lines 16 -19:

subsequently converted to an oil and gas lease under AS 38.05.134. **[THE COMMISSIONER SHALL PROMPTLY PROVIDE A COPY OF THE FINDING AND REQUIRED ATTACHMENTS TO ALL PROSPECTIVE LICENSEES WHOSE PROPOSALS WERE CONSIDERED BEFORE THE COMMISSIONER'S ISSUANCE OF THE FINDING.]**

Rationale: Redundant language, covered in the regulatory process.

Section 38.05.133 LICENSE PROCEDURES. DELETE:

Page 6, Lines 25027:

and the form of lease that will be used must be attached to that finding. **[THE PROSPECTIVE LICENSEE MUST ACCEPT OR REJECT THE ISSUANCE OF THE EXPLORATION LICENSE IN WRITING.]**

Rationale: Handled in regulation.

Section 38.05.134 CONVERSION TO LEASE.

Page 7, Line 17: INSERT:

removals, or deletions required by AS 38.05.132(d)(2). A lease issued under this section...

Rationale: Technical Amendment.

Section 2. AS 38.05.135(a) No Change

Adds exploration licensing statutes.

Section 3. AS 38.05.180(c) is DELETED.

Deleted at Department of Natural Resources request (90-day lease sale provision). Renumber following sections accordingly.

Section 4. AS 38.05.180(d): No change

Adds exploration licensing statutes.

Section 5. AS 38.05.180(f): No Change

Adds exploration licensing statutes, changes 12.5 from fraction to decimal figure.

Section 6. AS 38.05.945(a): No Change
Adds exploration licensing statutes.

Section 7. AS 46.04.040(b): DELETED
Financial Responsibility is covered in another bill.

Section 8. AS 46.04.040: DELETED
Financial Responsibility is covered in another bill.

Section 9. ADDITIONAL EXCLUDED AREA:
Appears in amendment as Section 7; Lease Sales 57 and 77 have been
deleted because they have taken place.

Section 10. REGULATIONS.
Changed to reflect that AS 38.05.131 begins at Section 2, not Section 1 in the
amendment; and renumbered sections to which effective date refers (2-7 instead of 1-
9).

Section 11. EFFECTIVE DATE.
Changed to reflect regulation clause is Section 8, not Section 10 in
amendment.

Proposed Amendment

for

CS FOR SENATE BILL NO. 150(FIN) am

(In Secretary's Pending File)

February 11, 1994

Compliments of

Senator Loren Leman

Chairman, Senate Special Committee on Oil and Gas

AMENDMENT

OFFERED IN THE SENATE

BY SENATOR LEMAN

TO: CSSB 150(FIN) am

Page 1, line 1, through page 13, line 3:

Delete all material and insert:

1 **""An Act relating to the exploration and production of oil and gas and related**
2 **hydrocarbons, to oil and gas exploration licenses, and to oil and gas leases in certain**
3 **areas of the state; and providing for an effective date."**

4 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

5 *** Section 1.** AS 38.05.020(b) is amended to read:

6 (b) The commissioner may

7 (1) establish reasonable procedures and adopt reasonable regulations
8 necessary to carry out this chapter and, whenever necessary, issue directives or orders
9 to the director to carry out specific functions and duties; regulations adopted by the
10 commissioner shall be adopted under AS 44.62([THE] Administrative Procedure Act)
11 [(AS 44.62)]; orders by the commissioner classifying land, issued after January 3,
12 1959, are not required to be adopted under AS 44.62 ([THE] Administrative
13 Procedure Act) [(AS 44.62)];

14 (2) enter into agreements considered necessary to carry out the
15 purposes of this chapter, including agreements with federal and state agencies;

16 (3) review any order or action of the director;

17 (4) exercise the powers and do the acts necessary to carry out the
18 provisions and objectives of this chapter;

19 (5) notwithstanding the provisions of any other section of this chapter,
20 grant an extension of the time within which payments due on any exploration license,
21 lease, or sale of state land, minerals, or materials may be made, including payment
22 of rental and royalties, on a finding that compliance with the requirements is or was

1 prevented by reason of war, riots, or acts of God;

2 (6) classify tracts for agricultural uses and require the prequalification,
3 including the submission of conservation plans, development plans, or other plans,
4 schedules, or programs, of persons who apply to participate in an agricultural
5 development project under AS 44.33.475;

6 (7) waive, postpone, or otherwise modify the development
7 requirements of a contract for the sale of agricultural land if

8 (A) the land is inaccessible by road; and

9 (B) transportation, marketing, and development costs render the
10 required development uneconomic.

11 * Sec. 2. AS 38 is amended by adding new sections to read:

12 ARTICLE 5A. OIL AND GAS EXPLORATION LICENSES; LEASES.

13 Sec. 38.05.131. APPLICABILITY; DETERMINATION; REGULATIONS.

14 (a) Unless specifically provided otherwise in AS 38.05.132 - 38.05.134, the
15 provisions of AS 38.05.005 - 38.05.040, 38.05.180, 38.05.182 - 38.05.184, and
16 38.05.920 - 38.05.990 apply to the issuance of oil and gas exploration licenses and
17 leases under AS 38.05.132 - 38.05.134.

18 (b) The provisions of AS 38.05.131 - 38.05.134 do not apply to land

19 (1) north of the Umiat baseline; and

20 (2) in the vicinity of Cook Inlet that is within the area bounded by

21 (A) the north boundary of Township 17 North, Seward
22 Meridian;

23 (B) the Seward Meridian;

24 (C) the south boundary of Township 7 South, Seward
25 Meridian; and

26 (D) the west boundary of Range 19 West, Seward Meridian.

27 (c) The commissioner shall make preliminary written determinations of the
28 state land that may be subject to the provisions of AS 38.05.132. The determinations
29 shall be given public notice using the methods described in AS 38.05.945(b). After
30 completion of the comment period and evaluation of the comments received, the
31 commissioner shall issue a written determination of the state land that is subject to the
32 provisions of AS 38.05.132.

1 (d) The commissioner may adopt regulations necessary to implement
2 AS 38.05.131 - 38.05.134.

3 Sec. 38.05.132. OIL AND GAS EXPLORATION LICENSE. (a) To
4 encourage exploration for oil and gas on state land, the commissioner may issue oil
5 and gas exploration licenses.

6 (b) An oil and gas exploration license issued under this section gives the
7 licensee

8 (1) the exclusive right to explore, for a term not to exceed 10 years,
9 for deposits of oil and gas on unleased state land described in the exploration license
10 unless the exploration license is terminated under (d)(1) of this section or the land is
11 earlier relinquished, removed, or deleted under (d)(2) of this section; and

12 (2) unless the exploration license is terminated under (d)(1) of this
13 section, the option to convert the exploration license for all or part of the state land,
14 except the land that is deleted or removed from the land described in the exploration
15 license under (d)(2) of this section, into an oil and gas lease upon fulfillment of the
16 work commitments contained in the exploration license.

17 (c) An exploration license awarded under this section

18 (1) is not subject to the acreage limitations imposed by
19 AS 38.05.140(c) or 38.05.180(m);

20 (2) may cover an area of not less than 20,000 acres and not more than
21 500,000 acres, that must be reasonably compact and contiguous;

22 (3) must be conditioned upon an obligation to perform a specified
23 work commitment, in total for the term of the license, expressed in dollars of direct
24 exploration expenditures; and must include a requirement that the licensee complete
25 at least 25 percent of the licensee's total specified work commitment by the fourth
26 anniversary of the effective date of the issuance of the oil and gas exploration license;

27 (4) must be conditioned upon the posting of a bond or other security
28 acceptable to the commissioner, in favor of the state and subject to the following
29 requirements:

30 (A) the bond or other security must be renewed annually;

31 (B) the annual bond or other security shall be calculated as the
32 entire work commitment expressed in dollars, less the cumulative direct