

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2330 SCOMM 96: HOUSE SPEC. COMM. ON OIL & GAS, 1995-1996

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Do any of the other incentive programs require a fee for processing the applications?
In Section 2, page 3, line 9: the bill says that the commissioner may require the lessee to pay the costs of a 3rd party contractor to evaluate the application - should the bill be changed to require the lessee to pay the costs?

**ALASKA SUPPORT INDUSTRY ALLIANCE
TESTIMONY ON
HB 207, ADJUSTMENTS TO OIL AND GAS ROYALTIES
TO THE
HOUSE OIL AND GAS COMMITTEE
MARCH 15, 1995**

Good afternoon Chairman Rokeberg and members of the House Oil and Gas Committee. My name is Keith Burke. I am General Manager of the Alaska Support Industry Alliance. I have been a participant in Alaska's oil industry for the past 20 years. I am here today to represent The Alliance, myself and my family. I am here to encourage you to support HB 207.

This legislation will be a great step forward in reversing the downward trend in oil and gas exploration and development activities in Alaska. It also would encourage continued investment in development of Alaska resources by many major multi-national oil companies, the very companies who allow members of The Alliance to provide many quality jobs to our Alaskan employees.

Since 1990, four oil and gas companies have closed their offices and have suspended upstream operations in Alaska: Chevron, Conoco, Amoco, and Texaco.

Downturn in Labor Force/Loss of Jobs

Oil and gas companies have downsized and consolidated operations in an effort to affect maximum cost savings to remain competitive.

With the completion of GHX2, the last major construction project currently planned on the North Slope, job levels are anticipated to continue a slow and steady decline.

According to Neil Fried, Dept. of Labor, producers will probably experience a statewide decrease of 20 percent or more in 1995 over 1994. Producer employment from February, 1994 to February, 1995 shows a decrease of 18 to 19 percent. The combined downturn, factoring in support industry jobs, will probably be around 10 to 11 percent.

Since its peak in 1991 of more than 10,541 jobs, industry employment has declined substantially and is predicted to be approximately 8,000 in 1995, about the same level of employment as in 1987. Attached to copies of my testimony is a graph from the Dept. of Labor titled "Alaska's Oil Industry Employment is on the Wane".

According to the University of Alaska, Institute of Social and Economic Research, oil revenues provide 30 percent of Alaskans' personal income and account for one in every three jobs. As oil production and revenues decline, so too will the number of Alaska jobs supported by petroleum revenues.

Alaska Production/Revenue Decline

Alaska's revenue future closely tracks the continued depletion of petroleum reserves. (Table 1. (attached to my testimony) shows the Dept. of Revenue's Base Case projected petroleum revenues as a percent of total projected state unrestricted revenues.)

Current forecast scenarios project total Alaska oil production to decline at an average annual rate of 6 percent Fiscal Year 95 to Fiscal Year 2000, falling to one-half of current production levels by 2006, in the base case scenario. Although higher oil prices would offset some of the negative impact of lower production levels, ultimately revenues will fall barring some unforeseen oil discovery. (Table 2. (attached to my testimony) shows current and projected oil production through FY 2010.

Half of the oil production projected for the year 2000 and beyond depends on investments yet to be made. This means the fiscal outlook could be worse than current projections unless the state acts to ensure that the new investments implicit in Dept. of Revenue projections are actually made. If the industry is forced to cut back on investment, we'll not only sacrifice significant future growth, but near-term production could plummet as well.

Downturn in Exploration Indicative of Alaska's Lack of Competitive Edge

Lease sale activity is a first indication of industry interest - and exploration interest - in Alaska. It's one way to tell how well Alaska is competing with other areas around the world. Although the number of sales varies from year to year and areas offered varies, data indicate some long term trends. The most notable is that fewer companies are bidding, fewer rigs are active and fewer wells are being drilled.

Alaska Oil and Gas Association statistics indicate that the amount of acreage under lease for potential exploration has declined by nearly 40 percent since 1990.

The Key--Implement a strategy to make Alaska competitive in the world market to encourage capital investment to provide a sustainable economic base for future revenues and jobs.

Throughout the world, relationships between governments and companies are much more positive and creative than only a few years ago. Most governments understand that investors deserve a fair return on capital investment--returns that are comparable with what they could earn elsewhere with similar risk. They realize that investment resources are scarce and they realize there are significant mutual benefits to working cooperatively to develop their resources and share the rewards equitably.

Alaska is competitively disadvantaged:

- High transportation costs;

- Crude oil characteristics that discount North Slope oil compared to other crudes in the market;

- High exploration and development costs, long lead times;

- A state revenue structure that takes a bigger share of profits and no clear tax rules.

World oil prices plummeted in 1986 and, with the exception of a short-lived spike caused by the gulf war, have remained low. Adjusted for inflation, prices are about the same today as they were in the late sixties. Considering the distance to market and crude quality, Alaska North Slope crude averages only \$10 per barrel at the wellhead.

The bottom line is that returns on Alaska investments are at least \$1-2 per barrel lower than in similarly mature oil provinces.

The ability of the industry to bring investment capital into Alaska and the performance of investments also determine the flow of revenues to the state. This, in turn, increases or decreases state revenues.

New exploration is important for long term development, however, development of existing reserves is crucial to the state in the near term. There are a number of undeveloped North Slope oil accumulations, many of which would be on production if they were located in the Lower 48. (Attached, for your reference, is a listing of the accumulations and dates discovered.) Here, low oil prices, high development costs and high transportation costs make them uneconomic.

Alaska Support Industry Alliance
Testimony on HB 207
March 15, 1995
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If the state and the industry can work together to change the economic equation for marginal fields, Alaska's ability to compete for oil industry investment capital will improve and the common goal of sustained economic development that leads to stabilized revenues and stabilized jobs...for the industry and for Alaska...could become reality.

The three hundred Alliance member companies and their thousands of employees urge you to pass HB 207.

Thank you.

Attachments

B:ag5.NR.stats

FISCAL OUTLOOK **STATE OF ALASKA**

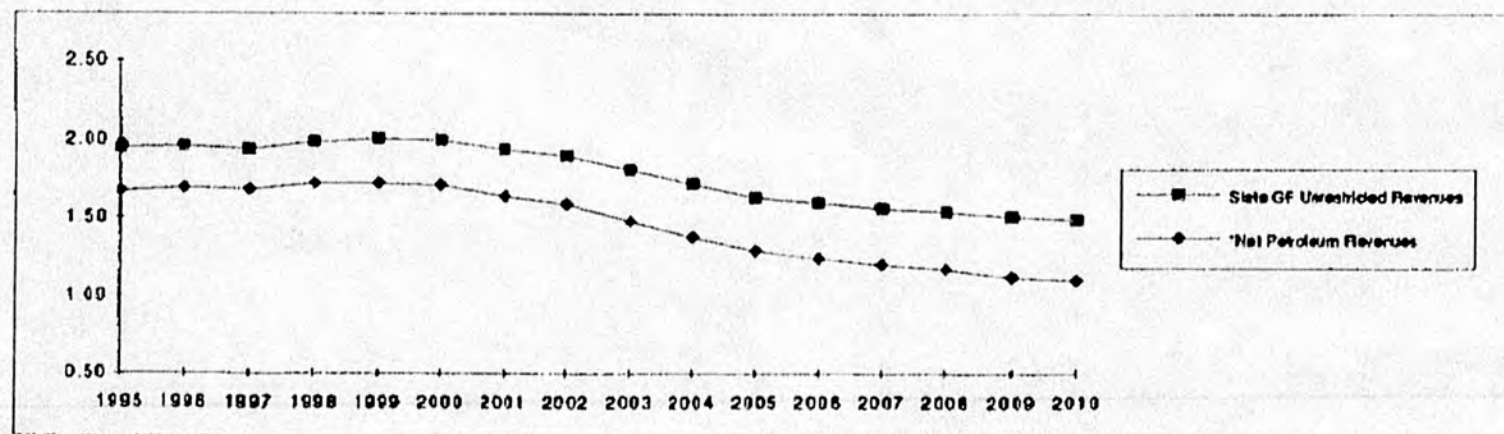
Alaska's revenue future closely tracks the continued depletion of petroleum reserves. Table 1. shows Dept. of Revenue's Base Case projected petroleum revenues as a percent of total projected state unrestricted revenues. Petroleum revenues are projected to account for approx. 80 % of state unrestricted revenues through 2010. Current forecast scenarios project total Alaska oil production to be one-half current levels (approx. .8 million bbl/day) by FY 2006 in the base case scenario.

Although higher oil prices would offset some of the negative impact of anticipated lower production levels, ultimately revenues will fall barring some unforeseen oil discovery.

For the base case scenario, oil prices are assumed to increase at .5 percent per year with inflation increasing from 3.86% in FY 96 to 4.38% FY 1997-FY 2000, and to 4.58% FY 2001- FY 2010.

Table 1.
**Projected Net General Fund
Unrestricted Revenues/ Projected Net-Petroleum Revenues
(Billions of Dollars)**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
State GF Unrestricted Revenues	1.95	1.96	1.94	1.99	2.01	2.00	1.94	1.90	1.81	1.72	1.63	1.60	1.56	1.54	1.51	1.49
*Net Petroleum Revenues	1.67	1.69	1.68	1.72	1.72	1.71	1.64	1.59	1.48	1.38	1.29	1.24	1.20	1.17	1.12	1.10
	86%	86%	86%	86%	85%	85%	84%	84%	82%	80%	79%	77%	77%	75%	74%	74%



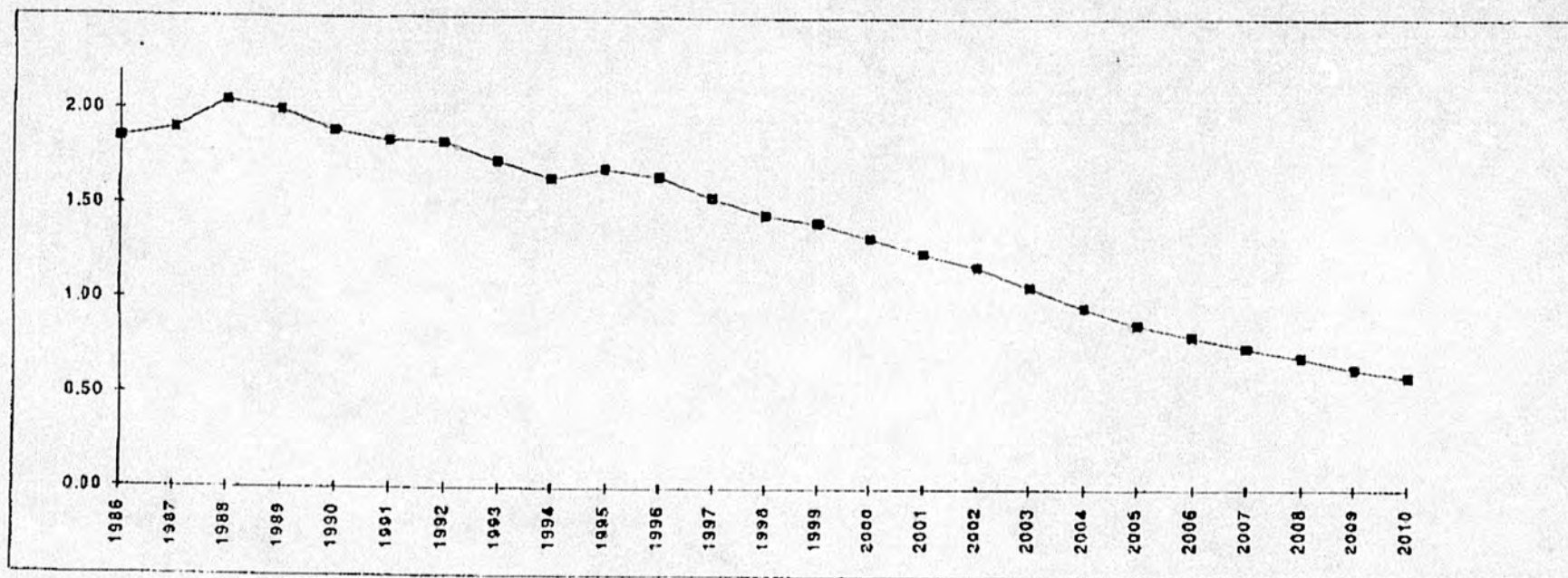
Source: Ak. Department of Revenue
*Net of Permanent Fund Contribution

As production from existing fields continues to decline, state revenues will decline accordingly. Table 2 shows current and projected oil production through 2010. Production is projected to decline 43% in the next 10 years, falling to 1978 production levels of .8 million barrels per day by FY 2006.

Table 2

**STATE OF ALASKA
PRODUCTION FORECAST 1986-2010
(MILLIONS BARRELS PER DAY)**

1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
1.85	1.87	2.05	2.00	1.89	1.84	1.83	1.73	1.64	1.69	1.65	1.54	1.45	1.41	1.33	1.25	1.18	1.07	0.95	0.87	0.81	0.75	0.70	0.64	0.60



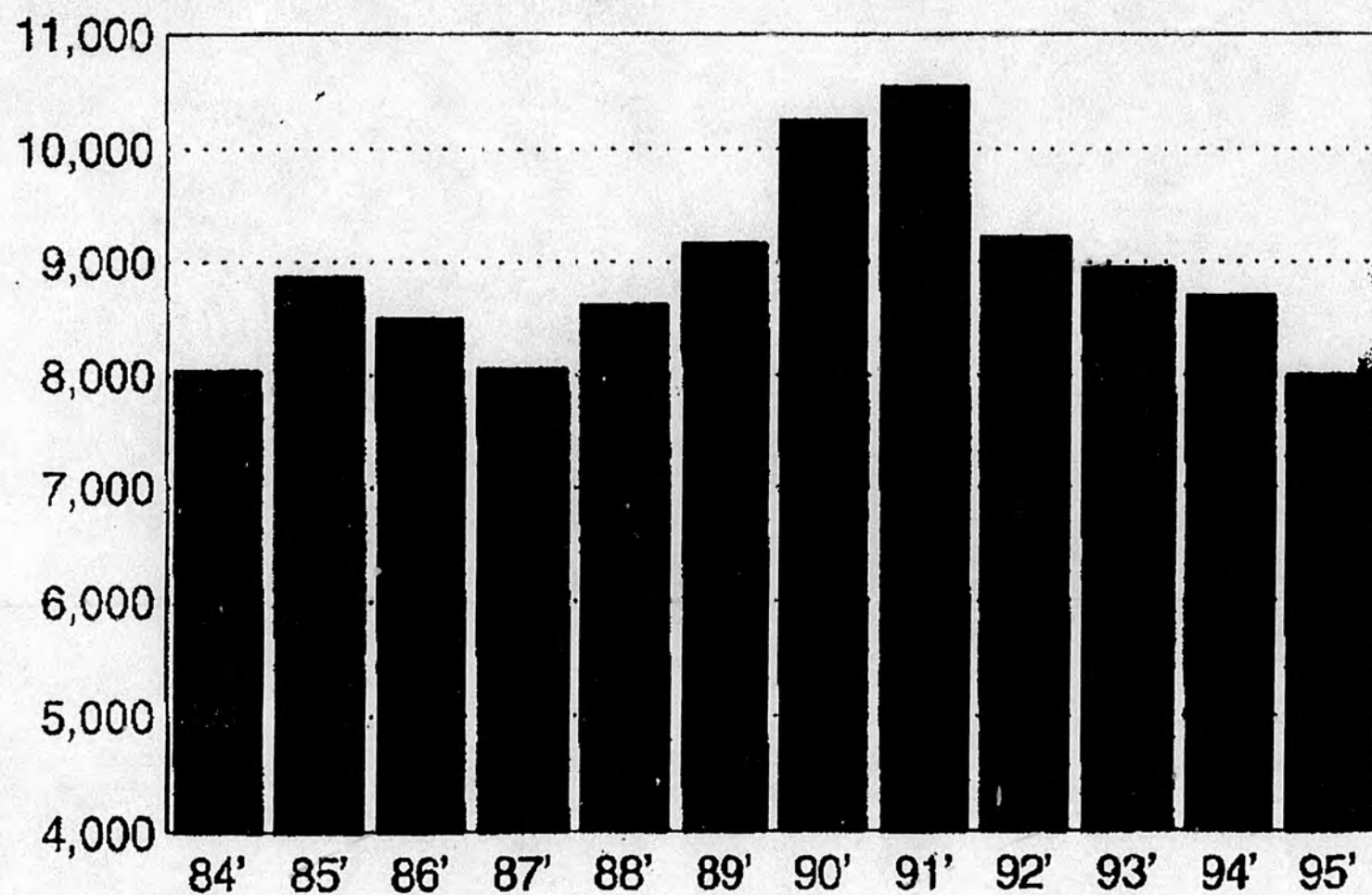
Source:

Al. Department of Revenue FY 1986-2010

Undeveloped North Alaska Hydrocarbons

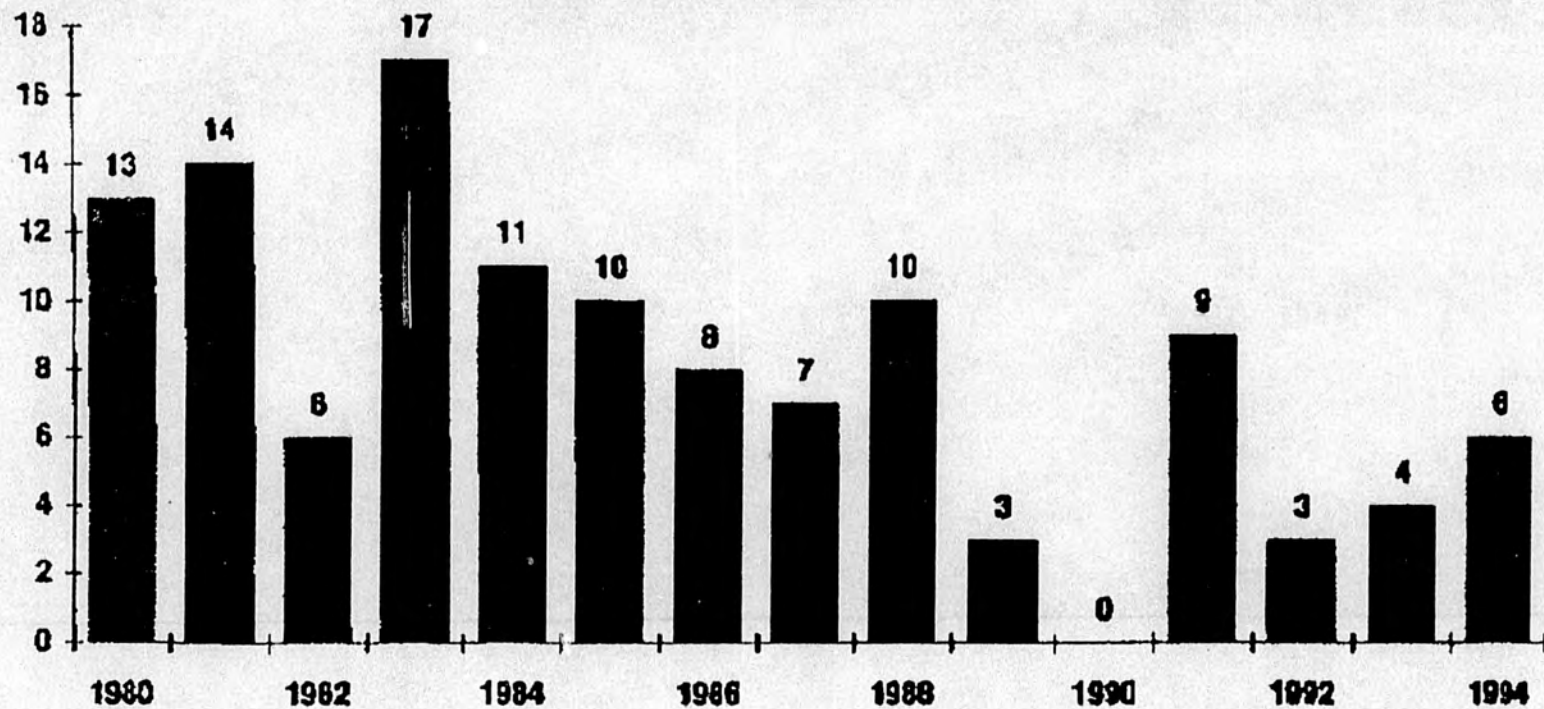
Umiat	1946	Point Thomson	1977
Fish Creek	1949	Tern Island	1982
Simpson	1950	North Star	1982
NS Natural Gas	1968	Hammerhead	1985
West Sak	1969	Colville Delta	1985
Ugnu	1969	Sandpiper	1986
Gwyder Bay	1969	Badami	1990
Flaxman Island	1975	Kuvlum	1992

Alaska's Oil Industry Employment Is On The Wane



Alaska Oil & Gas Lease Sales

Average Number of Bidders per Sale



3/10/95

ALASKA WELLS SPUDDED BY YEAR

YEAR SPUD	TALLY
70	68
71	30
72	28
73	38
74	46
75	73
76	82
77	72
78	98
79	109
80	138
81	197
82	229
83	183
84	213
85	311
86	200
87	121
88	149
89	139
90	161
91	151
92	148
93	193
94	140
95	2
	4332

Union Oil Company of California
Testimony on HB207
House Committee on Oil and Gas
March 16, 1995

Mr. Chairman and members of the Oil and Gas Committee—My name is Kevin A. Tabler, Land Manager for Union Oil Company of California (Unocal) in Alaska. I appreciate this opportunity to be heard today and to present Unocal's comments on House Bill 207. First I'd like to say, we are very encouraged with the positive atmosphere and effort expended, thus far, by the Legislature and Administration in trying to develop incentive legislation to enhance and stimulate further exploration and development throughout the State. We recognize and appreciate the concerted in-depth effort being made by your committee to fully assess the utilization and applicability of this Bill prior to subsequent referral. This time, spent early on, understanding the implications of the Bill, and providing the opportunity for intended users to clarify and augment specific sections, will greatly enhance its acceptability and help ensure its passage into legislation.

By broadening the applicability of AS 38.05.180 (j), we believe this Bill is a step in the right direction toward revising existing Statutes. This approach provides additional opportunity for certain marginally economic fields to compete both, internally within a company and externally on a global basis. But, before I address specifics under Section 2., I would like to make a brief comment about Section 1.

Unocal is taking a neutral position on the appropriateness or need to revise the funding mechanism previously established for the Alaska permanent fund under AS 37.13.010(a). The sharing of revenues and proceeds derived through leasing, exploration and development of the States mineral wealth, split between the permanent fund and general fund, is not the focus of our analysis of this Bill. Our focus and concern of the Bill is one of clarification, administration and utilization as it pertains to our Cook Inlet operations.

Section 2.

Last Thursday, I listened to a discussion during the first hearing on this Bill regarding the need to define the term "field". Bill Van Dyke did an excellent job of explaining the differences between fields, pools, horizons, and the delineation of same, in the context of the applicability of each, regarding this Section. To help clarify and more accurately describe the aerial extent of an accumulation for which this Section would apply, we offer the following suggestions. On line 29, page 2 after the word field, insert ", pool or portion of a field or pool". On line 30, we would suggest that the word "an" be eliminated and the words "a producing" be inserted between "of" and "oil". The same wording suggested on line 29,

would apply after the word "field" on line 30. The application here is that the AOGCC has clearly defined pools and separate horizons or zones associated with any recognized field. Similar testimony was provided Tuesday by DNR and we support their modification.

Our second comment is related to lines 8 thru 10 on page 3. As a condition of evaluating an application and data, the commissioner may require the lessee to pay the costs of contractors selected by the commissioner to assist in the evaluation. We feel all attempts should be made to utilize existing DNR staff wherever possible to reduce costs. On Thursday, the commissioner indicated the intent of this subsection was to have mutual agreement between the applicant and the commissioner as to the selection of contractors. We believe it is important to spell this out in the Bill. Equally important is the need to mutually agree on the costs contemplated for expenditure by lessee, prior to the hiring of a contractor. For extremely marginal properties, such as our Stump Lake Unit, the cost of hiring a consultant (at say \$20,000 -- a likely amount) could eliminate most of the benefit derived from royalty reduction. This Bill currently has no control over costs. Alternatively we heard from commissioner Dave Johnston of AOGCC on Tuesday, recommending that the applicant hire and pay for the contractor in support of its application to control costs. The commissioner of DNR would provide a list of contractors that would be acceptable to DNR and the applicant would then have the ability to select one for the analysis. This approach makes the most sense, in that the company would then be able to negotiate the best price possible and thereby have some control on costs. We would support this concept. This preferred approach would also eliminate the need for the costly and time consuming RFP process DNR would have to employ.

The elimination of the reasonable rate of return criteria on lines 13 thru 17 page 3 is a positive step in cleaning up the Statute. This determination is too subjective and open to debate. It is unrealistic to think that common agreement will ever be reached by any two parties. This requirement is unnecessary and therefore is better left out.

We need a very clear understanding that modifications made to existing Statutes do not inadvertently have a debilitating or limiting effect on the mature, marginally economic future development of Cook Inlet. There is a monumental difference between the exhausted fields typically found in Cook Inlet as opposed to those on the North Slope.

The next two comments are very important to Unocal and its operations in Cook Inlet, but first, let me give you an example of one economic scenario involving our platform operations:

Four (4) of the ten (10) Unocal operated producing platforms produce less than 2,000 BOPD each. One (1) produces less than 900 BOPD. Expenses on all of these properties make them marginally profitable. In an effort to increase production, Unocal committed over \$80 million in capital investments over the last two years, with the potential to spend an additional \$31 million in 1995 on these four (4) platforms. At this point, it is difficult to commit additional capital to develop these properties due to their short remaining platform lives and marginal profitability. Reducing or eliminating the state's royalty on these marginal properties could make the projects economically viable and significantly increase the economic life of the platforms, thereby maintaining employment and the associated community benefits. For fields or platforms facing abandonment today, such as a platform with less than 1000 BOPD, complete royalty relief is warranted. These properties provide minimal income to the state and complete royalty relief will extend field life and employment by about years.

Lines 17 thru 21 provide for a modification and change to the existing Statue, limiting the commissioners ability to reduce royalty by specifying certain limits. We propose this additional language and limitation be taken out in its entirety. We believe it is in the state's best interest for the commissioner to have the flexibility to reduce royalty down to 0, as currently provided, given a finding on the part of the commissioner, supported by financial and technical data which demonstrates the benefits of such action is warranted.

Lines 23 and 24 need revisions to eliminate the unilateral right of the commissioner to increase royalty beyond the state's original royalty share prior to any reduction on a previously producing mature field or re-establishment of commercial production of shut-in oil or gas. The big upside potential of a field, as discussed last Thursday and again at Tuesday's hearing, only applies to delineated but not previously produced fields where one may reasonably expect a pleasant surprise. A previously negotiated change in royalty at the time of the initial reduction, under strict criteria, may be warranted in the case of a delineated but not previously produced field. Bids were made on leases and evaluated on known parameters and an economic analysis at the time of bidding. Companies need the opportunity to evaluate any royalty change upward in light of field economics and overall company economics, and agree to any royalty modifications prior to committing manpower and capital to a project. It's not realistic to anticipate that mature producing fields hold the same type of promise. For the commissioner to have unilateral authority to increase the royalty rate to whatever level beyond the royalty originally specified in the lease, is not warranted in these mature fields. For mature fields, the impact of price only effects extending field life. If we are opening ourselves to the possibility of higher future royalty by applying for a reduction today, we may be eliminating the incentive to apply. Companies need certainty for planning and capital commitment purposes.

Line 1 on page 4 indicates the commissioner's decision regarding a request is final and not appealable. This really is no change from the current Statute. If this provision is of concern to the committee or the Legislature, then perhaps a peer review of the decision could be conducted. In Tuesday's hearing, the AOGCC provided a couple of alternative approaches to address the concern of oversight and appealability, both of which are acceptable to Unocal.

In conclusion, We believe this Bill has the potential to add certain attractive parameters to the administration of the royalty reduction process. For Unocal, at this time, this Bill has application only to our existing producing fields. Page 3 changes proposed in the bill, further restrict Unocal's ability to seek royalty relief beyond what is currently in Statute and make it difficult to support in its current form. With the changes we have proposed, we believe the interests of all parties are protected while at the same time afford the commissioner the discretion he is entitled under current Statute.

Unocal already has in place a vehicle under current Statute to address the concerns of its marginal fields in Cook Inlet, as they reach their economic limit. Albeit not an ideal vehicle, at least one which is less onerous than that which is proposed. Although we like the ability to expand the applicability of this Statute, and eliminate the requirement for a subjective reasonable rate of return determination, the potential for increased royalty beyond that which was originally agreed and an arbitrary floor placed on the amount royalty may be reduced, eliminates flexibility and hurts our efforts toward field life extension in Cook Inlet.

We look forward to working with the Legislature as this Bill progresses through the legislative process.

Thank You

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MAR 10 1995

March 6, 1995

Senator Loren Leman
State Senate - Resources Committee
Alaska Legislature
Mail Stop 3100
State Capitol
Juneau, Alaska 99801-1182

✓ Representative Norman Rokeberg
State House - Oil and Gas Committee
Alaska Legislature
Mail Stop 3100
State Capitol
Juneau, Alaska 99801-1182

Re: SB 101/HB 207 - Royalty reduction for non-producing oil and gas leases.

Dear Senator Leman and Representative Rokeberg:

I am very much opposed to the substance of Governor's proposed changes to AS 38.05.180(j) and (p), embodied in SB 101/HB 207. If enacted, the changes would signal the abandonment of the open and fair competitive bidding framework that has successfully guided exploitation of our natural resources since statehood. The changes would also entirely preclude any public questioning of DNR commissioner decisions that are of the greatest importance to the development of Alaska oil and gas reserves and to future state revenues.

Under current law in AS 38.05.180(j), the DNR commissioner is allowed to reduce royalties "(t)o prolong the economic life of an oil and gas field or to reestablish commercial production of shut-in oil or gas that would not otherwise be economically feasible." Id. Royalty reduction is not permitted, however, unless the lessee makes a "clear showing" that the lessee's revenue from the field "is and is likely to continue to be insufficient to produce a reasonable rate of return with respect the lessee's total investment in the field." Long ago, the commissioner was directed by law to adopt regulations implementing subsection (j), regulations which are now at 11 AAC 83.185. These regulations require a lessee seeking a royalty reduction to make a formal application to the commissioner that contains all the relevant facts needed for an informed commissioner decision, including such elementary information as the "expenses and costs" of operating the lease. See 11 AAC 83.185(a)(1) - (4). The regulations further require the commissioner to give notice of and hold a public hearing concerning the application, to make a formal written finding, and to give the public notice of it. The commissioner decision is subject to court review, via 11 AAC 02 and settled principles of law, including AS 44.62 (the Alaska Administrative Procedure Act).

The substantive and procedural provisions of current law strike a delicate balance. They allow the commissioner to make mutually advantageous adjustments to leases in older, faltering oil and gas fields, but only if there is adequate public notice and the potential for judicial review. Public notice and the potential of judicial review are needed to prevent the unfair treatment of a lessee's competitors, to prevent any unnecessary decline in state revenues, and to insure that the commissioner will not make a decision for corrupt or otherwise illicit reasons.

The Governor's proposed changes to AS 38.05.180(j) (in section 2 of both the House and Senate bill) strip away many, if not most, of the foregoing substantive and procedural protections. The bill adds to the existing reasons for royalty reduction a new one: "(t)o allow for production from a delineated but not previously produced field that would not otherwise be economically feasible...." The proposal does not expressly define "delineated" or "field," but clearly a field can be bigger, or smaller, than the boundaries of a lease. Moreover, it is the obvious intent of the bill that the changes be broadly encompassing, since section 3 of the bill also proposes changes to AS 38.05.180(p) which would allow the commissioner to "reduce royalty on leases in connection with a cooperative or unit plan ... as provided in (j) of this section." The effect of all this creates the potential of a general re-opener for all non-producing leases, no matter how new or old, and perhaps even for those non-producing leases in "fields" of otherwise high continuing production.

Even under the narrowest of constructions, however, if enacted the Governor's proposal would represent a major change in how the state leases its oil and gas lands. The state has always relied on free market forces, operating through open competitive bidding, to determine the best value for its resources. Under existing law and standard lease terms, a lessee which has not produced paying quantities of oil and gas during the lease term may assign the lease to another or let the lease expire instead of making further investment in the leased lands. If the lease expires, the state may re-offer the lands for lease and gain whatever economic benefit that competitive, open, and fair bidding will produce. The economic benefit may turn out to be the same, a different, a lower, or a higher royalty, but this is a result produced by free market forces, not through the guesswork of government bureaucrats.

The Governor's bill would substitute for free market forces an entirely private process open to outright skullduggery, to the subtleties of political favoritism and influence peddling, or to just plain stupid decision-making. This is because the proposed changes include deletion of the command under existing law that commissioner "shall adopt regulations," thus creating the clear implication that the existing regulations would no longer operate. It is these regulations which now require that the lessee submit a factually detailed application, that the public, including competing bidders and competing lessees, be notified, and that a public hearing be held, all protections designed to make sure the commissioner's decision has solid grounding in the public interest. 11 AAC 83.185. I urge you to inquire whether it is the intent of the drafters of the bill to abandon the existing regulations, or whether they believe that public notice and hearing would be required by other provisions in AS 38.05, particularly AS 38.05.035.

Under the Governor's proposal, the lessee is required "to disclose financial and technical data that demonstrate that the requirements of this subsection for a reduction are

met." However, there are no additional or special "requirements of this subsection" set out, unless the vague mandate that the royalty reduction be in the "best interests of the state" is deemed a "requirement," or unless one views the one of the justifications for royalty reduction, delineated in existing law and the opening clause of the Governor's proposed version of AS 38.05.180(j), as establishing "requirements." By the way, the "best interests" language of the Governor's proposal merely restates a mandate already on the books. See AS 38.05.035(e).

While the "best interests" language adds nothing new, the Governor's bill would eliminate restrictions expressly designed to protect the state's --- as opposed to a pleading lessee's --- best interests. The bill proposes the deletion of the existing statutory requirement that the commissioner find that "the state has obtained the maximum possible economic return that is compatible with allowing a reasonable rate of economic return for the lessee." AS 38.05.180(j). While the Governor's proposal would put side bars on the amount of royalty reduction allowed (extremely generous side bars at that, 50% to 75%, depending on the age of the lease), and would allow the royalty to rise if the conditions changed, the royalty can never go higher than that called for in the original lease. This obviously is very one sided; the state can get less royalty than it originally bargained for, but it never can get more. Certainly, if bad times are to be shared with a lessee, shouldn't good times should be shared as well?

While the defects in the Governor's bill might not be so bad if the important, paramount value of public notice and oversight was clearly preserved, under the Governor's proposal the lessee can demand that the data submitted in connection with a royalty reduction application be kept completely confidential. Wholesale confidentiality would effectively preclude any real legislative, much less public, review and oversight. And what lessee won't demand confidentiality?! It is almost a sham, then, for the Governor's proposal to add the requirement that the commissioner "make public a written finding that the reduction meets the requirements of this subsection and is in the best interests of the state."

(Underscored material proposed by section 2 of the Governor's bill.) What good does a publicized finding do a public not allowed to see the data supporting the decision? Why suddenly can't the public be trusted with the lessee's supporting data, as has been allowed in the past under existing law?

Of equal concern is the fact that the Governor's proposal forbids any judicial review of a commissioner decision: "The commissioner's decision regarding a request for reduction under this subsection is final and not appealable to the court." [Second to the last sentence, section 2 of the bill, amending AS 38.05.180(j).] It may make sense to forbid a lessee denied a royalty reduction the right to appeal, but why shouldn't a member of the public --- and in particular, other lessees --- be allowed to challenge the fairness of a royalty reduction? Why shouldn't such an important public policy decision be subject to judicial review? And what good does it do the public to find out, after the fact, about a decision it is then forbidden to challenge? The Legislature should be gravely concerned about the lack of appeal rights in the Governor's bill. The concept raises serious legal questions concerning the amount of authority that can be delegated to an appointed official, and concerning the extent of the Legislature's power to prohibit a court from taking jurisdiction of a challenge to a natural resource disposal alleged to be consistent with the Alaska Constitution.

It is very distressing that responsible public officials might so quickly buy into certain oil and gas companies' arguments that existing leases or fields may not be "economic." Milne

Point serves to illustrate the important point that each oil company has a different set of abilities and motivations, economic and otherwise, and government bureaucrats and politicians are ill advised to try and sort them out. Conoco could not make a go of Milne Point --- for whatever reason --- and traded it out to BP. While Conoco was the operator, many would have called Milne Point a marginal area, perhaps not "economically feasible." BP, however, with a different set of abilities and motivations, is now going great guns with Milne Point, and will pay the same royalty rate, 20%, that Conoco's lease called for. Who would have predicted this five years ago? The point is that the best remedy for a non-producing lease that the lessee claims cannot be made economic is not an amended lease, negotiated behind closed doors, but a new lessee selected by the free market forces.

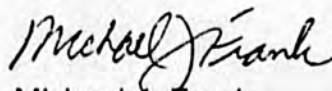
Ironically, if enacted the Governor's proposal might actually induce bidders for oil and gas leases to overbid lease royalties, knowing that there always exists the possibility that the DNR commissioner might later rescue them from their imprudence. This will encourage unreliable speculators into the market for oil and gas leases, the kind of companies least able and least likely to explore successfully for oil and gas and produce it for market when found.

There are a couple of items in the Governor's bill I support, such as clarifying the burden of proof on the applicant for a royalty reduction, and giving the commissioner the authority to require the applicant to pay the state's costs in retaining experts to evaluate the application. As it stands, however, the existing law already provides the commissioner sufficient latitude, acting subject to important safeguards of the public's interest, to reduce royalties in situations of severely declining or shut-in production. This latitude should not be broadened. The Governor's bill would grant appointed state officials too much power to do what government bureaucrats routinely prove they are unable to do well --- second guess the free market system.

I have an interest, but no expertise, in Alaska oil and gas law, so I can't guarantee that my statutory and bill analysis is correct. I also am not sufficiently familiar with the lease and royalty array in Alaska's oil and gas fields to understand what the Governor's bill might portend in terms of revenue loss to the state, both in the near and long term. I therefore urge you to skeptically and critically examine the Governor's bill with the help of *objective* experts, and in particular analyze the monetary implications of what is being proposed, field by field.

Thank you for considering my comments.

Sincerely,


Michael J. Frank

cc: Governor Tony Knowles

9-GH0039\K
Chenoweth
3/23/95

CS FOR HOUSE BILL NO. 207()
IN THE LEGISLATURE OF THE STATE OF ALASKA
NINETEENTH LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): HOUSE RULES COMMITTEE BY REQUEST OF THE GOVERNOR
A BILL

FOR AN ACT ENTITLED

1 "An Act relating to adjustments to royalty reserved to the state to encourage
2 otherwise uneconomic production of oil and gas; and providing for an effective
3 date."

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

5 * Section 1. LEGISLATIVE INTENT. In amending AS 38.05.180(j) in sec. 2 of this Act
6 to permit the commissioner of natural resources to initiate a reduction of royalty to encourage
7 otherwise uneconomic production of oil and gas from marginal fields and pools upon a finding
8 that the royalty reduction is in the best interests of the state, it is the intent of the legislature
9 that the commissioner of natural resources shall determine, in all cases, that the person or
10 persons app'ying for the royalty reduction would not make the additional investments that are
11 necessary to develop or prolong the economic life of the oil or gas field without the approval
12 of the royalty reduction.

13 * Sec. 2. AS 38.05.180(j) is amended to read:

14 (j) The [TO PROLONG THE ECONOMIC LIFE OF AN OIL AND GAS

1 FIELD OR TO REESTABLISH COMMERCIAL PRODUCTION OF SHUT-IN OIL
2 OR GAS THAT WOULD NOT OTHERWISE BE ECONOMICALLY FEASIBLE,
3 THE] commissioner

4 (1) may [SHALL ADOPT REGULATIONS TO] allow reduction of
5 royalty on individual leases or leases unitized as described in (p) of this section or
6 subject to an agreement described in (s) or (t) of this section

7 (A) to allow for production from an oil or gas field, pool, or
8 portion of a field or pool if

9 (i) the oil or gas field, pool, or portion of the field or
10 pool has been sufficiently delineated to the satisfaction of the
11 commissioner;

12 (ii) the field, pool, or portion of the field or pool has
13 not previously produced commercial quantities of oil or gas; and

14 (iii) oil or gas production from the field, pool, or
15 portion of the field or pool would not otherwise be economically
16 feasible;

17 (B) to prolong the economic life of an oil or gas field, pool,
18 or portion of a field or pool as per barrel or barrel equivalent costs
19 increase or as the sale value of oil or gas decreases, and the increase or
20 decrease is sufficient to make future production no longer economically
21 feasible; or

22 (C) to reestablish commercial production of shut-in oil or
23 gas that would not otherwise be economically feasible;

24 (2) [. THE COMMISSIONER] may not grant a reduction of royalty
25 unless the lessee or lessees requesting the reduction make [MAKES] a clear and
26 convincing showing that a reduction of royalty meets the requirements of this
27 subsection and is in the best interests of the state;

28 (3) shall, if the royalty reduction agreement is approved, [THE
29 REVENUE FROM THE LESSEE'S SHARE OF ALL HYDROCARBONS
30 PRODUCED FROM THE FIELD IS AND IS LIKELY TO CONTINUE TO BE
31 INSUFFICIENT TO PRODUCE A REASONABLE RATE OF RETURN WITH

1 RESPECT TO THE LESSEE'S TOTAL INVESTMENT IN THE FIELD. THE
2 COMMISSIONER MAY] condition the [A] royalty reduction granted under this
3 subsection in any way necessary to protect the state's best interests; under this
4 subsection, the commissioner shall include provisions to modify the state's royalty
5 share by a sliding scale royalty or other mechanism upon a showing, by clear and
6 convincing evidence, that, because of a sufficient change in one or more of the
7 following factors, further development or continued production of the field, pool,
8 or portion of the field or pool is not economically feasible: [INTEREST,
9 INCLUDING RESTORATION OF THE STATE'S ROYALTY SHARE IN THE
10 EVENT OF AN INCREASE IN] the sale price of oil or gas, proved reserves, field
11 productivity, or capital investment in the oil or gas field, pool, or portion of the
12 field or pool;

13 (4) shall, as part of the royalty reduction application, require the
14 lessee or lessees to submit, with the application for the royalty reduction, financial
15 and technical data that demonstrates that the requirements of this subsection are
16 met; the commissioner

17 (A) may require disclosure of only the financial and
18 technical data relating to production that is reasonably available to the
19 applicant; and

20 (B) shall keep the data confidential under AS 38.05.035(a)(9)
21 upon the lessee's request;

22 (5) shall give notice of the written findings and determination to the
23 lessee and to any other person who has filed a written request for it; subject to
24 (7) of this subsection, the commissioner's determination of royalty reduction is
25 final and not appealable to the court;

26 (6) may require the lessee or lessees making application for the
27 royalty reduction to retain and pay for the services of a contractor, selected by
28 the lessee or lessees from a list of nationally recognized consultants in
29 hydrocarbon production and economics provided by the commissioner, to assist
30 the commissioner in evaluating the application and financial and technical data;
31 when the commissioner requires the lessee or lessees to retain the services of a

1 contractor under this paragraph, the commissioner shall determine the relevant
2 scope of the work to be performed by the contractor;

3 (7) may not make a determination that gives final approval to an
4 application for a royalty reduction under this subsection unless the commissioner
5 first

6 (A) requests and receives the recommendation of the Alaska
7 Oil and Gas Conservation Commission, which shall, within 30 days of
8 submission of the proposed royalty reduction decision by the commissioner,
9 determine whether the proposed royalty reduction meets the requirements
10 of this subsection and is in the best interests of the state;

11 (B) transmits copies of the commissioner's final approval
12 determination and of the determination made by the Alaska Oil and Gas
13 Conservation Commission, if any, to

14 (i) the presiding officer of each house [. BEFORE
15 APPROVING A ROYALTY REDUCTION, THE COMMISSIONER
16 SHALL MAKE A WRITTEN FINDING THAT THE STATE HAS
17 OBTAINED THE MAXIMUM POSSIBLE ECONOMIC RETURN
18 THAT IS COMPATIBLE WITH ALLOWING A REASONABLE
19 RATE OF ECONOMIC RETURN FOR THE LESSEE, AND SEND
20 COPIES OF THE FINDING TO ALL MEMBERS] of the legislature;

21 (ii) the chairs of the legislature's standing committees
22 on resources; and

23 (iii) the chairs of the legislature's special committees
24 on oil and gas, if any;

25 (8) is not limited by the provisions of AS 38.05.134(3) or (f) of this
26 section in the commissioner's determination under this subsection.

27 * Sec. 3. AS 38.05.180(p) is amended to read:

28 (p) To conserve the natural resources of all or a part of an oil or gas pool,
29 field, or like area, the lessees and their representatives may unite with each other, or
30 jointly or separately with others, in collectively adopting or operating under a
31 cooperative or a unit plan of development or operation of the pool, field, or like area,

1 or a part of it, when determined and certified by the commissioner to be necessary or
2 advisable in the public interest. The commissioner may, with the consent of the
3 holders of leases involved, establish, change, or revoke drilling, producing, and royalty
4 requirements of the leases and adopt regulations with reference to the leases, with like
5 consent on the part of the lessees, in connection with the institution and operation of
6 a cooperative or unit plan as the commissioner determines necessary or proper to
7 secure the proper protection of the public interest. The commissioner may not
8 reduce royalty on leases in connection with a cooperative or unit plan except as
9 provided in (j) of this section. The commissioner may require oil and gas leases
10 issued under this section to contain a provision requiring the lessee to operate under
11 a reasonable cooperative or unit plan, and may prescribe a plan under which the lessee
12 must operate. The plan must adequately protect all parties in interest, including the
13 state.

14 * Sec. 4. This Act takes effect immediately under AS 01.10.070(c).

CS FOR HOUSE BILL NO. 207(O&G)

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE SPECIAL COMMITTEE ON OIL AND GAS

Offered:

Referred:

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

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to adjustments to royalty reserved to the state to encourage
2 otherwise uneconomic production of oil and gas; and providing for an effective
3 date."

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

5 * Section 1. AS 38.05.180(j) is amended to read:

6 (j) The [TO PROLONG THE ECONOMIC LIFE OF AN OIL AND GAS
7 FIELD OR TO REESTABLISH COMMERCIAL PRODUCTION OF SHUT-IN OIL
8 OR GAS THAT WOULD NOT OTHERWISE BE ECONOMICALLY FEASIBLE,
9 THE] commissioner

10 (1) may [SHALL ADOPT REGULATIONS TO] allow reduction of
11 royalty on individual leases or leases unitized as described in (p) of this section

12 (A) to allow for production from an oil or gas field, pool, or
13 portion of a field or pool if

14 (i) the oil or gas field, pool, or portion of the field or

1 pool has been sufficiently delineated to the satisfaction of the
2 commissioner;

3 (ii) the field, pool, or portion of the field or pool has
4 not previously produced oil or gas; and

5 (iii) production from the field, pool, or portion of the
6 field or pool would not otherwise be economically feasible;

7 (B) to prolong the economic life of an oil or gas field, pool,
8 or portion of a field or pool, as per barrel or barrel equivalent costs
9 increase in the later stages of production decline; or

10 (C) to reestablish commercial production of shut-in oil or
11 gas that would not otherwise be economically feasible;

12 (2) [THE COMMISSIONER] may not grant a reduction of royalty
13 unless the lessee or lessees requesting the reduction make [MAKES] a clear and
14 convincing showing that a reduction of royalty meets the requirements of this
15 subsection and is in the best interests of the state;

16 (3) shall, if the royalty reduction agreement is approved, in the
17 royalty reduction agreement, [THE REVENUE FROM THE LESSEE'S SHARE OF
18 ALL HYDROCARBONS PRODUCED FROM THE FIELD IS AND IS LIKELY TO
19 CONTINUE TO BE INSUFFICIENT TO PRODUCE A REASONABLE RATE OF
20 RETURN WITH RESPECT TO THE LESSEE'S TOTAL INVESTMENT IN THE
21 FIELD. THE COMMISSIONER MAY] condition a royalty reduction granted under
22 this subsection in any way necessary to protect the state's best interests; under this
23 subsection, the commissioner shall include provisions to increase or otherwise
24 modify the state's royalty share by a sliding scale royalty or other mechanism
25 upon the occurrence of a change [INTEREST, INCLUDING RESTORATION OF
26 THE STATE'S ROYALTY SHARE IN THE EVENT OF AN INCREASE] in the price
27 of oil or gas, and may consider other relevant factors, such as proved reserves,
28 well productivity, or capital investment in the oil or gas field, pool, or portion of
29 the field or pool;

30 (4) may not grant a royalty reduction for a field, pool, or portion
31 of a field or pool under (1)(A) of this subsection that exceeds 75 percent of the

1 royalty originally specified in a lease entered into under the provisions of (f) of
2 this section or AS 38.05.134;

3 (5) shall, as part of the royalty reduction application process,
4 require the lessee or lessees to submit, with the application for the royalty
5 reduction, financial and technical data that demonstrates that the requirements
6 of this subsection are met; the financial and technical data required by the
7 commissioner

8 (A) may not require disclosure of data relating to
9 production before the lessee or lessees obtained ownership of the lease if
10 the reduction application involves a lease described in (1)(B) or (C) of this
11 subsection; and

12 (B) shall be kept confidential under AS 38.05.035(a)(9) upon
13 the lessee's request;

14 (6) shall give notice of the written findings and determination to the
15 lessee and to any other person who has filed a written request for it; subject to
16 (8) of this subsection, the commissioner's determination is final and not appealable
17 to the court;

18 (7) may require the lessee or lessees making application for the
19 royalty reduction to retain and pay for the services of a contractor, selected by
20 the lessee or lessees from a list provided by the commissioner, to assist the
21 commissioner in evaluating the application and financial and technical data; when
22 the commissioner requires the lessee or lessees to retain the services of a
23 contractor under this paragraph, the commissioner shall determine the relevant
24 scope of the work to be performed by the contractor;

25 (8) may not make a determination that gives final approval to an
26 application for a royalty reduction under this subsection unless the commissioner
27 first

28 (A) submits the proposed royalty reduction decision to and
29 obtains the approval of at least three of the five members of the Alaska
30 Royalty Oil and Gas Development Advisory Board other than the
31 commissioner of natural resources; for purposes of this subparagraph,

1 after submission of the proposed royalty reduction under this
2 subparagraph, the Alaska Royalty Oil and Gas Development Advisory
3 Board has 30 days in which to evaluate the commissioner's submission and
4 to determine that the proposed royalty reduction meets the requirements
5 of this subsection and is in the best interests of the state;

6 (B) transmits copies of the determination made by the
7 Alaska Royalty Oil and Gas Development Advisory Board to

8 (i) the presiding officer of each house [. BEFORE
9 APPROVING A ROYALTY REDUCTION, THE COMMISSIONER
10 SHALL MAKE A WRITTEN FINDING THAT THE STATE HAS
11 OBTAINED THE MAXIMUM POSSIBLE ECONOMIC RETURN
12 THAT IS COMPATIBLE WITH ALLOWING A REASONABLE
13 RATE OF ECONOMIC RETURN FOR THE LESSEE, AND SEND
14 COPIES OF THE FINDING TO ALL MEMBERS] of the legislature;

15 (ii) the chairs of the legislature's standing committees
16 on resources; and

17 (iii) the chairs of the legislature's special committees
18 on oil and gas, if any;

19 (9) is not limited by the provisions of AS 38.05.134(3) or (f) of this
20 section in the commissioner's determination under this subsection.

21 * Sec. 2. AS 38.05.180(p) is amended to read:

22 (p) To conserve the natural resources of all or a part of an oil or gas pool,
23 field, or like area, the lessees and their representatives may unite with each other, or
24 jointly or separately with others, in collectively adopting or operating under a
25 cooperative or a unit plan of development or operation of the pool, field, or like area,
26 or a part of it, when determined and certified by the commissioner to be necessary or
27 advisable in the public interest. The commissioner may, with the consent of the
28 holders of leases involved, establish, change, or revoke drilling, producing, and royalty
29 requirements of the leases and adopt regulations with reference to the leases, with like
30 consent on the part of the lessees, in connection with the institution and operation of
31 a cooperative or unit plan as the commissioner determines necessary or proper to

1 secure the proper protection of the public interest. The commissioner may not
2 reduce royalty on leases in connection with a cooperative or unit plan except as
3 provided in (j) of this section. The commissioner may require oil and gas leases
4 issued under this section to contain a provision requiring the lessee to operate under
5 a reasonable cooperative or unit plan, and may prescribe a plan under which the lessee
6 must operate. The plan must adequately protect all parties in interest, including the
7 state.

8 * Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

9-GH0039F ✓
Chenoweth
3/21/95

CS FOR HOUSE BILL NO. 207(O&G)

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE SPECIAL COMMITTEE ON OIL AND GAS

Offered:
Referred:

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

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to adjustments to royalty reserved to the state to encourage
2 otherwise uneconomic production of oil and gas; and providing for an effective
3 date."

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

5 * Section 1. AS 38.05.180(j) is amended to read:

6 (j) The [TO PROLONG THE ECONOMIC LIFE OF AN OIL AND GAS
7 FIELD OR TO REESTABLISH COMMERCIAL PRODUCTION OF SHUT-IN OIL
8 OR GAS THAT WOULD NOT OTHERWISE BE ECONOMICALLY FEASIBLE,
9 THE] commissioner

10 (1) may [SHALL ADOPT REGULATIONS TO] allow reduction of
11 royalty on individual leases or leases unitized as described in (p) of this section

12 (A) to allow for production from an oil or gas field, pool, or
13 portion of a field or pool if

14 (i) the oil or gas field, pool, or portion of the field or

pool has been sufficiently delineated to the satisfaction of the commissioner;

(ii) the field, pool, or portion of the field or pool has not previously produced oil or gas; and

(iii) production from the field, pool, or portion of the field or pool would not otherwise be economically feasible;

(B) to prolong the economic life of an oil or gas field, pool, or portion of a field or pool, as per barrel or barrel equivalent costs increase in the later stages of production decline; or

(C) to reestablish commercial production of shut-in oil or gas that would not otherwise be economically feasible;

(2) [THE COMMISSIONER] may not grant a reduction of royalty unless the lessee or lessees requesting the reduction make [MAKES] a clear and convincing showing that a reduction of royalty meets the requirements of this subsection and is in the best interests of the state;

(3) shall, if the royalty reduction agreement is approved, in the royalty reduction agreement, [THE REVENUE FROM THE LESSEE'S SHARE OF ALL HYDROCARBONS PRODUCED FROM THE FIELD IS AND IS LIKELY TO CONTINUE TO BE INSUFFICIENT TO PRODUCE A REASONABLE RATE OF RETURN WITH RESPECT TO THE LESSEE'S TOTAL INVESTMENT IN THE FIELD. THE COMMISSIONER MAY] condition a royalty reduction granted under this subsection in any way necessary to protect the state's best interests; under this subsection, the commissioner shall include provisions to increase or otherwise modify the state's royalty share by a sliding scale royalty or other mechanism upon the occurrence of a change [INTEREST, INCLUDING RESTORATION OF THE STATE'S ROYALTY SHARE IN THE EVENT OF AN INCREASE] in the price of oil or gas, and may consider other relevant factors, such as proved reserves, well productivity, or capital investment in the oil or gas field, pool, or portion of the field or pool;

(4) may not grant a royalty reduction for a field, pool, or portion of a field or pool under (1)(A) of this subsection that exceeds 75 percent of the

1 royalty originally specified in a lease entered into under the provisions of (f) of
2 this section or AS 38.05.134;

3 (5) shall, as part of the royalty reduction application process,
4 require the lessee or lessees to submit, with the application for the royalty
5 reduction, financial and technical data that demonstrates that the requirements
6 of this subsection are met; the financial and technical data required by the
7 commissioner

8 (A) may not require disclosure of data relating to
9 production before the lessee or lessees obtained ownership of the lease if
10 the reduction application involves a lease described in (1)(B) or (C) of this
11 subsection; and

12 (B) shall be kept confidential under AS 38.05.035(a)(9) upon
13 the lessee's request;

14 (6) shall give notice of the written findings and determination to the
15 lessee and to any other person who has filed a written request for it; subject to
16 (8) of this subsection, the commissioner's determination is final and not appealable
17 to the court;

18 (7) may require the lessee or lessees making application for the
19 royalty reduction to retain and pay for the services of a contractor, selected from
20 a list provided by the commissioner, to assist the commissioner in evaluating the
21 application and financial and technical data; when the commissioner requires the
22 lessee or lessees to retain the services of a contractor under this paragraph, the
23 commissioner shall determine the relevant scope of the work to be performed by
24 the contractor;

25 (8) may not make a determination that gives final approval to an
26 application for a royalty reduction under this subsection unless the commissioner
27 first

28 (A) obtains the concurrence of the attorney general;

29 (B) submits the proposed royalty reduction decision to and
30 obtains the approval of at least three of the five members of the Alaska
31 Royalty Oil and Gas Development Advisory Board other than the

commissioner of natural resources; for purposes of this subparagraph,
after submission of the proposed royalty reduction under this
subparagraph, the Alaska Royalty Oil and Gas Development Advisory
Board has 30 days in which to evaluate the commissioner's submission and
to determine that the proposed royalty reduction meets the requirements
of this subsection and is in the best interests of the state;

(C) transmits copies of the determination made by the
Alaska Royalty Oil and Gas Development Advisory Board to

(i) the presiding officer of each house [. BEFORE
APPROVING A ROYALTY REDUCTION, THE COMMISSIONER
SHALL MAKE A WRITTEN FINDING THAT THE STATE HAS
OBTAINED THE MAXIMUM POSSIBLE ECONOMIC RETURN
THAT IS COMPATIBLE WITH ALLOWING A REASONABLE
RATE OF ECONOMIC RETURN FOR THE LESSEE, AND SEND
COPIES OF THE FINDING TO ALL MEMBERS] of the legislature;

(ii) the chairs of the legislature's standing committees
on resources; and

(iii) the chairs of the legislature's special committees
on oil and gas, if any;

(9) is not limited by the provisions of AS 38.05.134(3) or (f) of this
section in the commissioner's determination under this subsection.

* Sec. 2. AS 38.05.180(p) is amended to read:

(p) To conserve the natural resources of all or a part of an oil or gas pool,
field, or like area, the lessees and their representatives may unite with each other, or
jointly or separately with others, in collectively adopting or operating under a
cooperative or a unit plan of development or operation of the pool, field, or like area,
or a part of it, when determined and certified by the commissioner to be necessary or
advisable in the public interest. The commissioner may, with the consent of the
holders of leases involved, establish, change, or revoke drilling, producing, and royalty
requirements of the leases and adopt regulations with reference to the leases, with like
consent on the part of the lessees, in connection with the institution and operation of

1 a cooperative or unit plan as the commissioner determines necessary or proper to
2 secure the proper protection of the public interest. The commissioner may not
3 reduce royalty on leases in connection with a cooperative or unit plan except as
4 provided in (j) of this section. The commissioner may require oil and gas leases
5 issued under this section to contain a provision requiring the lessee to operate under
6 a reasonable cooperative or unit plan, and may prescribe a plan under which the lessee
7 must operate. The plan must adequately protect all parties in interest, including the
8 state.

9 * Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

9-GH0039\C✓
Chenoweth
3/20/95

CS FOR HOUSE BILL NO. 207(O&G)
IN THE LEGISLATURE OF THE STATE OF ALASKA
NINETEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE SPECIAL COMMITTEE ON OIL AND GAS

Offered:
Referred:

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

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to adjustments to royalty reserved to the state to encourage
2 otherwise uneconomic production of oil and gas and relating to the treatment of
3 net profit shares of oil and gas leases as it relates to certain oil and gas lease
4 royalty; and providing for an effective date."

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

6 * Section 1. AS 38.05.180(g) is amended to read:

7 (g) The share of the net profit derived from a lease reserved to the state under
8 (f) of this section is royalty [SALE PROCEEDS] for purposes of (f), (j), and (p) of
9 this section, and for the purposes of the Alaska permanent fund under AS 37.13.010.

10 * Sec. 2. AS 38.05.180(j) is amended to read:

11 (j) The [TO PROLONG THE ECONOMIC LIFE OF AN OIL AND GAS
12 FIELD OR TO REESTABLISH COMMERCIAL PRODUCTION OF SHUT-IN OIL
13 OR GAS THAT WOULD NOT OTHERWISE BE ECONOMICALLY FEASIBLE,
14 THE] commissioner

1 (1) may [SHALL ADOPT REGULATIONS TO] allow reduction of
2 royalty on individual leases, leases in a participating area formed under a unit
3 agreement for a single area of oil or gas productivity, or leases unitized as
4 described in (p) of this section

5 (A) to allow for production from an oil or gas field, pool, or
6 portion of a field or pool if

7 (i) the oil or gas field, pool, or portion of the field or
8 pool has been sufficiently delineated to the satisfaction of the
9 commissioner;

10 (ii) the field, pool, or portion of the field or pool has
11 not previously produced oil or gas; and

12 (iii) production from the field, pool, or portion of the
13 field or pool would not otherwise be economically feasible;

14 (B) to prolong the economic life of an oil or gas field, pool,
15 or portion of a field or pool, as per barrel or barrel equivalent costs
16 increase in the later stages of production decline; or

17 (C) to reestablish commercial production of shut-in oil or
18 gas that would not otherwise be economically feasible;

19 (2) [. THE COMMISSIONER] may not grant a reduction of royalty
20 unless the lessee or lessees requesting the reduction make [MAKES] a clear and
21 convincing showing that a reduction of royalty meets the requirements of this
22 subsection and is in the best interests of the state;

23 (3) shall, if the royalty reduction agreement is approved, in the
24 royalty reduction agreement, [THE REVENUE FROM THE LESSEE'S SHARE OF
25 ALL HYDROCARBONS PRODUCED FROM THE FIELD IS AND IS LIKELY TO
26 CONTINUE TO BE INSUFFICIENT TO PRODUCE A REASONABLE RATE OF
27 RETURN WITH RESPECT TO THE LESSEE'S TOTAL INVESTMENT IN THE
28 FIELD. THE COMMISSIONER MAY] condition a royalty reduction granted under
29 this subsection in any way necessary to protect the state's **best interests; under this**
30 subsection, the commissioner shall include provisions to increase or otherwise
31 modify the state's royalty share by a sliding scale royalty or other mechanism

1 upon the occurrence of a change [INTEREST, INCLUDING RESTORATION OF
2 THE STATE'S ROYALTY SHARE IN THE EVENT OF AN INCREASE] in the price
3 of oil or gas, proved reserves, well productivity, or capital investment in the oil or
4 gas field, pool, or portion of the field or pool;

5 (4) may not grant a royalty reduction for a field, pool, or portion
6 of a field or pool under (1)(A) of this subsection that exceeds 75 percent of the
7 royalty originally specified in a lease entered into under the provisions of (f) of
8 this section or AS 38.05.134;

9 (5) shall, as part of the royalty reduction application process,
10 require the lessee or lessees

11 (A) to apply for the reduction; an application for a royalty
12 reduction must

13 (i) state all the facts entitling the applicant to a
14 royalty reduction;

15 (ii) state the location and status of all past and
16 present activities on the lease;

17 (iii) include a detailed report of all production during
18 the six months preceding the filing of the royalty reduction
19 application; and

20 (iv) include an agreement by the applicant to defray
21 the cost of publishing the notice as provided by (6) of this
22 subsection;

23 (B) to submit, with the application for the royalty reduction,
24 financial and technical data that demonstrates that the requirements of
25 this subsection are met; the financial and technical data required by the
26 commissioner

27 (i) may not require disclosure of data relating to
28 production before the lessee or lessees obtained ownership of the
29 lease;

30 (ii) must, if the reduction application involves a lease
31 described in (1)(B) or (C) of this subsection, include at least five

1 years of the lease's production history; and

2 (iii) shall be kept confidential under

3 AS 38.05.035(a)(9) upon the lessee's request;

4 (6) shall, upon receipt of an application complying with (5) of this
5 subsection, publish a notice of public hearing on the application; the notice must

6 (A) state the time and place of hearing;

7 (B) describe the land involved;

8 (C) state the name of the royalty reduction applicant and
9 the nature of the reduction applied for; and

10 (D) be published at least once a week for at least two
11 consecutive weeks in advance of the hearing date, which must be at least
12 15 days after the last date of publication, in at least one newspaper of
13 general circulation in the vicinity of the principal office of the department,
14 and must be posted at the principal office for the same period;

15 (7) shall,

16 (A) at the time and place specified in the notice published
17 under (6) of this subsection, hear evidence offered by the applicant and
18 any other interested person;

19 (B) within a reasonable time following the hearing or any
20 continuation of it, make written findings together with the commissioner's
21 determination as to the reduction that should be granted;

22 (C) give notice of the findings and determination to the
23 lessee and to any other person who has filed a written request for it;
24 subject to (9) of this subsection, the commissioner's determination is final
25 and not appealable by the royalty reduction applicant to the court;

26 (8) may require the lessee or lessees making application for the
27 royalty reduction to retain the services of a contractor, selected from a list
28 provided by the commissioner, to assist the commissioner in evaluating the
29 application and financial and technical data; when the commissioner requires the
30 lessee or lessees to retain the services of a contractor under this paragraph, the
31 commissioner shall determine the relevant scope of the work to be performed by

1 the contractor;

2 (9) may not make a determination that gives final approval to an
3 application for a royalty reduction under this subsection unless the commissioner
4 first

5 (A) obtains the concurrence of the attorney general;

6 (B) submits the proposed royalty reduction decision to and
7 obtains the approval of at least three of the five members of the Alaska
8 Royalty Oil and Gas Development Advisory Board other than the
9 commissioner of natural resources; for purposes of this subparagraph,
10 after submission of the proposed royalty reduction under this
11 subparagraph, the Alaska Royalty Oil and Gas Development Advisory
12 Board has 30 days in which to evaluate the commissioner's submission and
13 to determine that the proposed royalty reduction meets the requirements
14 of this subsection and is in the best interests of the date;

15 (C) transmits copies of the determination made by the
16 Alaska Royalty Oil and Gas Development Advisory Board to

17 (i) the presiding officer of each house [BEFORE
18 APPROVING A ROYALTY REDUCTION, THE COMMISSIONER
19 SHALL MAKE A WRITTEN FINDING THAT THE STATE HAS
20 OBTAINED THE MAXIMUM POSSIBLE ECONOMIC RETURN
21 THAT IS COMPATIBLE WITH ALLOWING A REASONABLE
22 RATE OF ECONOMIC RETURN FOR THE LESSEE, AND SEND
23 COPIES OF THE FINDING TO ALL MEMBERS] of the legislature;

24 (ii) the chairs of the legislature's standing committees
25 on resources; and

26 (iii) the chairs of the legislature's special committees
27 on oil and gas, if any;

28 (10) may not adopt regulations to implement this subsection;

29 (11) is not limited by the provisions of AS 38.05.134(3) or (f) of this
30 section in the commissioner's determination under this subsection.

31 * Sec. 3. AS 38.05.180(p) is amended to read:

1 (p) To conserve the natural resources of all or a part of an oil or gas pool,
2 field, or like area, the lessees and their representatives may unite with each other, or
3 jointly or separately with others, in collectively adopting or operating under a
4 cooperative or a unit plan of development or operation of the pool, field, or like area,
5 or a part of it, when determined and certified by the commissioner to be necessary or
6 advisable in the public interest. The commissioner may, with the consent of the
7 holders of leases involved, establish, change, or revoke drilling, producing, and royalty
8 requirements of the leases and adopt regulations with reference to the leases, with like
9 consent on the part of the lessees, in connection with the institution and operation of
10 a cooperative or unit plan as the commissioner determines necessary or proper to
11 secure the proper protection of the public interest. The commissioner may not
12 reduce royalty on leases in connection with a cooperative or unit plan except as
13 provided in (j) of this section. The commissioner may require oil and gas leases
14 issued under this section to contain a provision requiring the lessee to operate under
15 a reasonable cooperative or unit plan, and may prescribe a plan under which the lessee
16 must operate. The plan must adequately protect all parties in interest, including the
17 state.

18 * Sec. 4. 11 AAC 83.185 is annulled.

19 * Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

HOUSE BILL NO. 207

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

Introduced: 2/27/95

Referred: House Special Committee on Oil and Gas, Resources, Finance

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to adjustments to royalty reserved to the state to encourage
2 otherwise uneconomic production of oil and gas; relating to the depositing of
3 royalties and royalty sale proceeds in the Alaska permanent fund; and providing
4 for an effective date."

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

6 * Section 1. AS 37.13.010(a) is amended to read:

7 (a) Under art. IX, sec. 15 of the state constitution, there is established as a
8 separate fund the Alaska permanent fund. The Alaska permanent fund consists of

9 (1) 25 percent of

10 (A) all mineral lease rentals, royalties, royalty sale proceeds, net
11 profit shares under AS 38.05.180(f) and (g), and federal mineral revenue
12 sharing payments received by the state from mineral leases issued on or before
13 December 1, 1979, except that, regarding royalties and royalty sale
14 proceeds, for leases for which the royalty is reduced or modified under

Don't know
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production of shut-in oil or gas that would not otherwise be economically feasible, the commissioner ~~may~~ ^{SHALL} ADOPT REGULATIONS TO ³ allow reduction of royalty on individual leases or leases unitized as described in (p) of this section. As part of an application for a reduction under this subsection, the commissioner shall require the lessee ^{or lessee} requesting the reduction of royalty to disclose financial and technical data that demonstrate that the requirements of this subsection for a reduction are met. Such data shall be kept confidential upon the lessee's request. As a condition of evaluating an application and data, the commissioner may require the lessee to pay the costs of ^{a mutually agreeable} contractors selected by the commissioner to assist in the evaluation. The commissioner may not grant a reduction of royalty unless the lessee requesting the reduction makes a clear and convincing showing that a reduction meets the requirements of this subsection and is in the best interests of the state ^{because} [THE REVENUE FROM THE LESSEE'S SHARE OF ALL HYDROCARBONS PRODUCED FROM THE FIELD IS ^{is an} ~~AND IS LIKELY TO CONTINUE~~ TO BE INSUFFICIENT TO PRODUCE A REASONABLE RATE OF RETURN WITH RESPECT TO THE LESSEE'S TOTAL INVESTMENT IN THE FIELD]. The commissioner may not grant a reduction that exceeds 75 percent of the royalty originally specified in a lease issued on or before December 1, 1979 under the provisions of (f) of this section, or 50 percent of the royalty originally specified in a lease issued after December 1, 1979 under the provisions of (f) of this section or AS 38.05.134. The commissioner ^{shall} ~~may~~ condition a royalty reduction granted under this subsection in any way necessary to protect the state's best interests [INTEREST], including increasing or otherwise modifying [RESTORATION OF] the state's royalty share ^{in the new royalty} if any relevant factor, such as [IN THE EVENT OF AN INCREASE IN] the price of oil or gas, changes. Before approving a royalty reduction, the commissioner shall make public a written finding that the reduction meets the requirements of this subsection and is in the best interests of the state [THE STATE HAS OBTAINED THE MAXIMUM POSSIBLE ECONOMIC RETURN THAT IS COMPATIBLE WITH ALLOWING A REASONABLE RATE OF ECONOMIC RETURN FOR THE LESSEE], and send copies of the finding to all members of the legislature. The commissioner's decision

3.125%
things could
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definition of clear and convincing

CORRECTION

THE FOLLOWING DOCUMENT(S)
HAVE BEEN REFILMED TO
ASSURE LEGIBILITY OR PAGINATION



Rev. 6/98

Central Microfilm Services
Department of Education
State of Alaska

HOUSE BILL NO. 207

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

Introduced: 2/27/95

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A BILL

FOR AN ACT ENTITLED

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

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10 (A) all mineral lease rentals, royalties, royalty sale proceeds, net
11 profit shares under AS 38.05.180(f) and (g), and federal mineral revenue
12 sharing payments received by the state from mineral leases issued on or before
13 December 1, 1979, except that, regarding royalties and royalty sale
14 proceeds, for leases for which the royalty is reduced or modified under

1 AS 38.05.180(j), the permanent fund shall receive the greater of

2 (i) the royalties and royalty sale proceeds that the
3 fund would have received if a reduction under AS 38.05.180(j) had
4 not been granted; or

5 (ii) 25 percent of the royalties and royalty sale
6 proceeds received by the state under a modified royalty under
7 AS 38.05.180(j); and [25 PERCENT OF]

8 (B) all bonuses received by the state from mineral leases issued
9 on or before February 15, 1980;

10 (2) 50 percent of

11 (A) all mineral lease rentals, royalties, royalty sale proceeds, net
12 profit shares under AS 38.05.180(f) and (g), and federal mineral revenue
13 sharing payments received by the state from mineral leases issued after
14 December 1, 1979, except that, regarding royalties and royalty sale
15 proceeds, for leases for which the royalty is reduced or modified under
16 AS 38.05.180(j), the permanent fund shall receive the greater of

17 (i) the royalties and royalty sale proceeds that the
18 fund would have received if a reduction under AS 38.05.180(j) had
19 not been granted; or

20 (ii) 50 percent of the royalties and royalty sale
21 proceeds received by the state under a modified royalty under
22 AS 38.05.180(j); and [50 PERCENT OF]

23 (B) all bonuses received by the state from mineral leases issued
24 after February 15, 1980;

25 (3) any other money appropriated to or otherwise allocated by law
26 to the Alaska permanent fund.

27 * Sec. 2. AS 38.05.180(j) is amended to read:

28 (j) To allow for production from a delineated but not previously produced
29 field that would not otherwise be economically feasible, to [TO] prolong the
30 economic life of an oil and gas field as per barrel or barrel equivalent costs
31 increase in the later stages of production decline, or to reestablish commercial

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production of shut-in oil or gas that would not otherwise be economically feasible,
the commissioner ~~may~~ ^{SHALL} ADOPT REGULATIONS TO ^{allow} reduction
of royalty on individual leases or leases unitized as described in (p) of this
section. As part of an application for a reduction under this subsection, the
commissioner shall require the lessee ^{requesting} the reduction of royalty to
disclose financial and technical data that demonstrate that the requirements of
this subsection for a reduction are met. Such data shall be kept confidential
upon the lessee's request. As a condition of evaluating an application and data,
the commissioner may require the lessee to pay the costs of ^{a mutually agreeable} contractors selected
by the commissioner to assist in the evaluation. The commissioner may not grant
a reduction of royalty unless the lessee requesting the reduction makes a clear and
convincing showing that a reduction meets the requirements of this subsection and
is in the best interests of the state ^{because} THE REVENUE FROM THE LESSEE'S
SHARE OF ALL HYDROCARBONS PRODUCED FROM THE FIELD IS
AND IS LIKELY TO CONTINUE ^{is an} TO BE INSUFFICIENT TO PRODUCE A
REASONABLE RATE OF RETURN WITH RESPECT TO THE LESSEE'S TOTAL
INVESTMENT IN THE FIELD]. The commissioner may not grant a reduction
that exceeds 75 percent of the royalty originally specified in a lease issued on or
before December 1, 1979 under the provisions of (f) of this section, or 50 percent
of the royalty originally specified in a lease issued after December 1, 1979 under
the provisions of (f) of this section or AS 38.05.134. The commissioner ^{may}
condition a royalty reduction granted under this subsection in any way necessary to
protect the state's best interests [INTEREST], including increasing or otherwise
modifying [RESTORATION OF] the state's royalty share ^{in the new royalty} if any relevant factor, such
as [IN THE EVENT OF AN INCREASE IN] the price of oil or gas, changes. Before
approving a royalty reduction, the commissioner shall make public a written finding
that the reduction meets the requirements of this subsection and is in the best
interests of the state [THE STATE HAS OBTAINED THE MAXIMUM POSSIBLE
ECONOMIC RETURN THAT IS COMPATIBLE WITH ALLOWING A
REASONABLE RATE OF ECONOMIC RETURN FOR THE LESSEE], and send
copies of the finding to all members of the legislature. The commissioner's decision

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HB 207a

definition of clear and convincing

1 *will provide*
2 *by the applicant.* regarding a request for reduction under this subsection is final and not appealable
3 to the court. The provisions of this subsection are not limited by the provisions
4 of (f) of this section or AS 38.05.134(3).

5 * Sec. 3. AS 38.05.180(p) is amended to read:

6 (p) To conserve the natural resources of all or a part of an oil or gas pool,
7 field, or like area, the lessees and their representatives may unite with each other, or
8 jointly or separately with others, in collectively adopting or operating under a
9 cooperative or a unit plan of development or operation of the pool, field, or like area,
10 or a part of it, when determined and certified by the commissioner to be necessary or
11 advisable in the public interest. The commissioner may, with the consent of the
12 holders of leases involved, establish, change, or revoke drilling, producing, and royalty
13 requirements of the leases and adopt regulations with reference to the leases, with like
14 consent on the part of the lessees, in connection with the institution and operation of
15 a cooperative or unit plan as the commissioner determines necessary or proper to
16 secure the proper protection of the public interest. The commissioner may not
17 reduce royalty on leases in connection with a cooperative or unit plan except as
18 provided in (j) of this section. The commissioner may require oil and gas leases
19 issued under this section to contain a provision requiring the lessee to operate under
20 a reasonable cooperative or unit plan, and may prescribe a plan under which the lessee
21 must operate. The plan must adequately protect all parties in interest, including the
22 state.

* Sec. 4. This Act takes effect immediately under AS 01.10.070(c).

SCOMM

96:10

FISCAL NOTE

STATE OF ALASKA
1995 LEGISLATIVE SESSION

BILL NO. HB 209

Revision Date: 3/14/95 Dept. Affected: Revenue
 Title: Oil and Gas Royalty Reduction BRU: Revenue Operations
 Component: Oil & Gas Audit
 Sponsor: Green, Rokeberg
 Requester: Green (H) D+G **COMPONENT SERIAL NO.** 115

Expenditures/Revenues

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 96	FY 97	FY 98	FY 99	FY 00	FY 01
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	*	*	*	*	*	*

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

CHANGE IN REVENUES ()	*****See Analysis*****
-------------------------------	------------------------

FUND SOURCE

(Thousands of Dollars)

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

Estimate of any current year (FY95) cost: \$ _____

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

This Bill would grant the Commissioner of Natural Resources the authority to reduce the royalty terms of an oil and gas lease if the lessees can demonstrate that such reduction is necessary to allow new commercial development, prolong field life, or reestablish commercial production from idle leases. The Commissioner may condition a royalty reduction to protect the state's interest including the restoration of the original royalty share in the event of an increase in the price of oil or gas. The Commissioner must make a written finding that the state has obtained the maximum possible economic return consistent with allowing a reasonable rate of return for the lessee.

New production from this royalty reduction would most likely pay little severance tax because the Economic Limit Factor is designed to provide almost total tax relief to the kind of marginal fields this legislation is aimed at benefiting. Each new barrel of production would be subject to the \$.05/bbl or \$.03/bbl hazardous release surcharge (depending on the balance in the 470 fund) and the \$.004/bbl conservation tax. The impact on the corporate income tax would be too small to measure because of the world-wide apportioned tax base and since by definition these fields would have marginal profitability.

Prepared by: Chuck Logsdon Phone: 277-5627
 Division: Oil and Gas Audit Division Date: 3/14/95
 Approved by Commissioner: Deborah Vogt Date: 3/15/95
 Agency: Revenue

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CO-CHAIR, RESOURCES COMMITTEE
VICE CHAIR, JUDICIARY COMMITTEE
MEMBER, STATE AFFAIRS COMMITTEE

FINANCE SUBCOMMITTEES:
DEPT. OF NATURAL RESOURCES
DEPT. OF COMMERCE & ECONOMIC DEVELOPMENT
DEPT. OF ENVIRONMENTAL CONSERVATION

Representative Joe Green

District 10

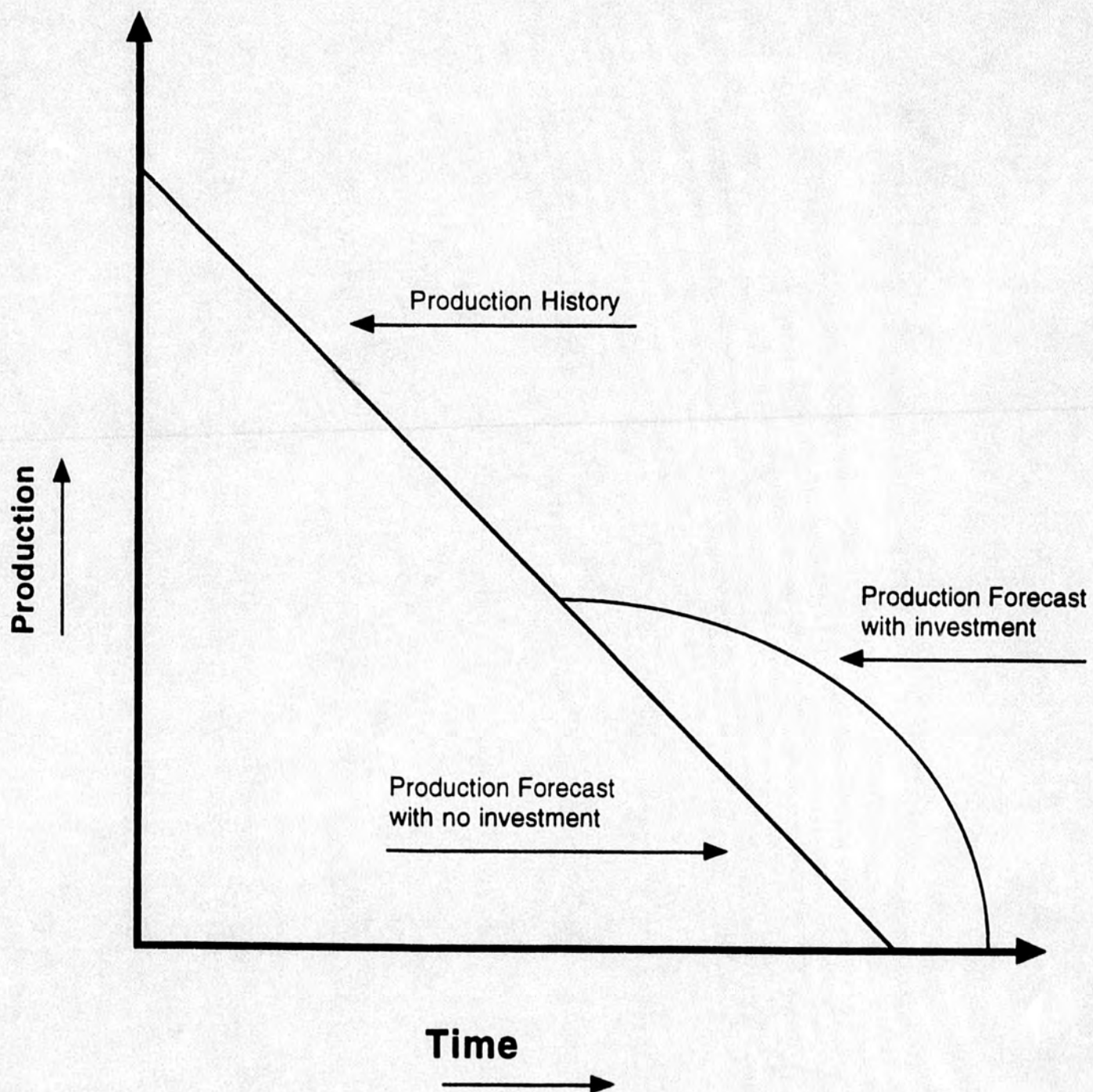
Sponsor Statement

HB 209 - Reductions of royalty on oil & gas leases

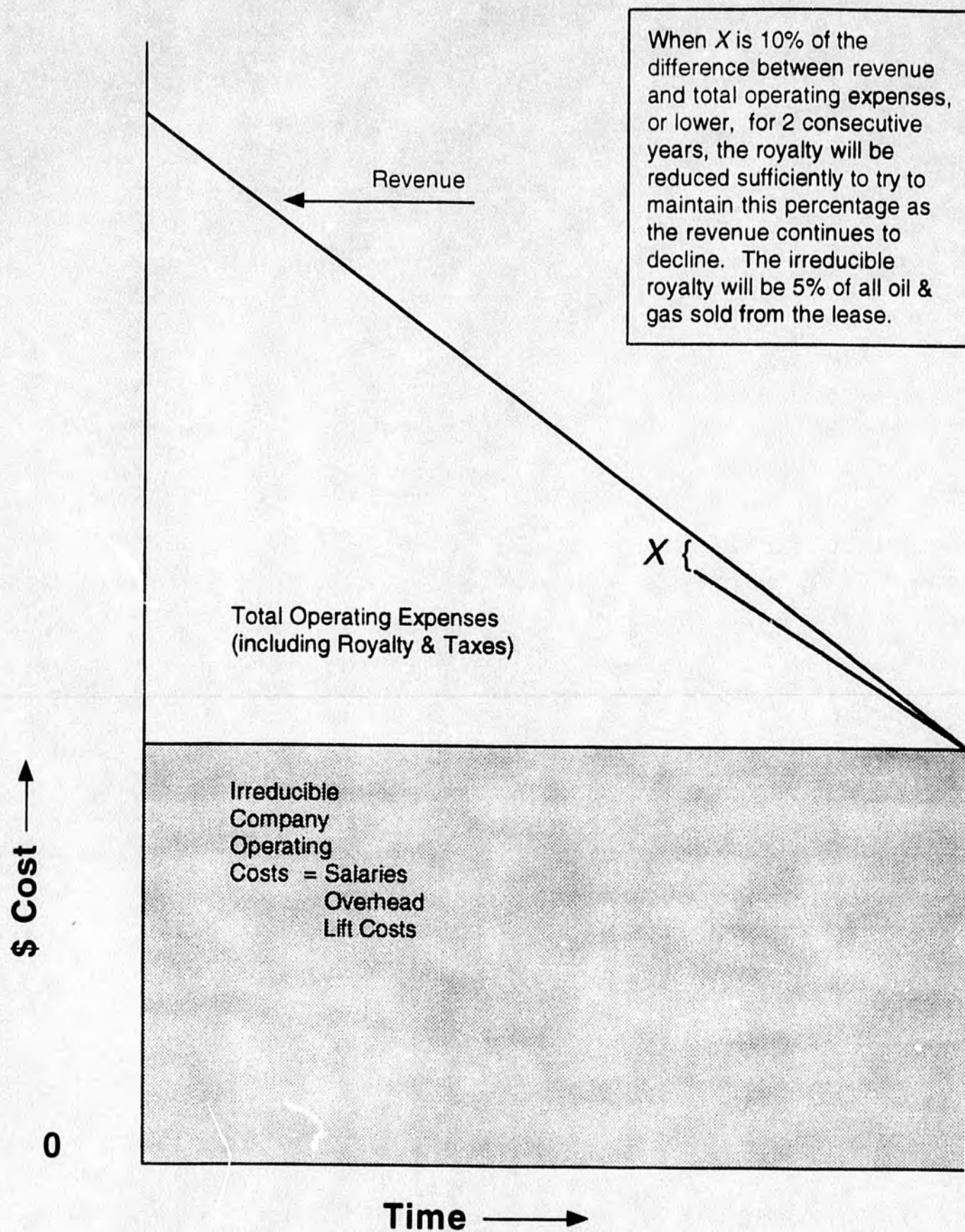
HB209 expands the list of statutory tools available to the Commissioner of DNR to respond to economic changes affecting Alaska's oil and gas producers. HB209 would allow the commissioner to reduce the royalty paid to the state for oil and gas production.

While the commissioner has the authority to reduce royalties as part of a unitization plan, or to "prolong the economic life of a ...field", the latitude to consider reductions for other reasons, and at other stages of production, is limited. HB209 expands that authority to allow the commissioner to consider other factors.

Mature Field Illustration # 2



Mature Fields Illustration #1



SCOMM

96:11

Revision Date: _____ Dept. Affected: Revenue
Title: Royalty Suspension: N. Slope Heavy Oil BRU: Revenue Operations
Component: Oil and Gas Audit
Sponsor: Representative Green
Requestor: H (O&G) Committee COMPONENT SERIAL NO. 115

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

CHANGE IN REVENUES ()	-1,800.0	-2,400.0	-5,700.0	-11,000.0	-12,000.0	-24,500.0
-------------------------------	-----------------	-----------------	-----------------	------------------	------------------	------------------

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY96) cost \$ _____

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

(See Attached Analysis)

Prepared by: Chuck Logsdon
Division: Oil & Gas Audit
Approved by Commissioner: [Signature]
Agency: Department of Revenue

Phone: 276-1363 ext. 265
Date: 1/19/96
Date: 1/19/96

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Analysis of Bill/Program Effects

This bill has two main parts. The first addresses the ability of the Commissioner of the Department of Natural Resources to modify the payment of royalty on leases, and the second suspends the royalty obligation for wells producing less than 500 barrels a day of Alaska North Slope (ANS) heavy oil for five years of production.

The Department of Revenue Fall 1995 forecast assumptions for Alaska North Slope heavy oil production, wells, and revenues FY 1997 to FY 2002 is contained in the following table:

	Production	Wells	Severance Tax	Royalties
1997	3000 bb/d	14	0	\$1800 thousand
1998	4000	16	0	2400
1999	5700	22	0	5700
2000	11100	42	0	11000
2001	18100	65	0	12000
2002	24500	85	0	24500

The bill would effectively reduce projected heavy oil royalties to zero.

FISCAL NOTE

STATE OF ALASKA

BILL NO. HB325

1996 LEGISLATIVE SESSION

Revision Date: Original Dept Affected Natural Resources
 Title: An Act authorizing suspension of payment BRU: Resource Development
 of a portion of the royalty due the state for initial production... Component: Oil & Gas Development
 Sponsor: Representative Green
 Requestor: _____ Component Serial No. 439

Expenditures/Revenues	(Thousands of Dollars)					
OPERATING EXPENDITURES	FY97	FY98	FY99	FY00	FY01	FY02
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
----------------------	-----	-----	-----	-----	-----	-----

CHANGE IN REVENUES (1004)	(228.0/well)	(228.0/well)	(228.0/well)	(228.0/well)	(228.0/well)	(228.0/well)
---------------------------	--------------	--------------	--------------	--------------	--------------	--------------

FUND SOURCE	(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

Estimate of any current year (FY96) cost: \$ none

POSITIONS

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

ANALYSIS: (Attach a separate page if necessary)

It is not possible at this time to accurately predict the number of new wells that will be drilled that will qualify for the proposed royalty reduction. Nor is it possible to accurately predict the timing of the drilling of any of these new wells. For each new well that is drilled, if it produces at a rate of 500 barrels per day and oil is valued for royalty purposes at \$10 per barrel, then the annual royalty reduction will be \$228,000 for each of the first five years of well life. Assuming that the well produces at the 500 b/d rate for five years and oil prices stay flat, the total royalty reduction would amount to \$1.14 million per well – close to the cost to drill the well. For a new demonstration project equal in size and scope to the existing Milne Point Schrader Bluff heavy oil project, the royalty reduction would range from \$1.5 million per year at current well rates to \$3.7 million per year at well rates of 500 b/d/well.

Long term production behavior also is unknown for these wells. It is suspected that the wells will produce at a fairly constant rate for at least five years then production decline will begin. Behavior of the Milne Point Schrader Bluff wells is being analyzed to see if any production trends are evident to date.

Prepared by: Ken Boyd, Director Phone: 269-8800
 Division: Oil & Gas Date: 18-Jan-96
 Approved by Commissioner: [Signature] Date: 18-Jan-96
 Agency: Natural Resources

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE

FISCAL NOTE

BILL NO: HB325

Revision Date: _____ Dept. Affected: Revenue
 Title: Royalty Suspension: N. Slope Heavy Oil BRU: Revenue Operations
 Component: Oil and Gas Audit
 Sponsor: Representative Green
 Requestor: H (O&G) Committee COMPONENT SERIAL NO. 115

Expenditures/Revenues:

(Thousands of Dollars)

OPERATING EXPENDITURES	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ()	-1,800.0	-2,400.0	-5,700.0	-11,000.0	-12,000.0	-24,500.0

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY96) cost \$ _____

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

(See Attached Analysis)

Prepared by: Chuck Logsdon
 Division: Oil & Gas Audit
 Approved by Commissioner: [Signature]
 Agency: Department of Revenue

Phone: 276-1363 ext. 265
 Date: 1/19/96
 Date: 1/19/96

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2000	11100	42	0	11000
2001	18100	65	0	12000
2002	24500	85	0	24500

The bill would effectively reduce projected heavy oil royalties to zero.

HOUSE COMMITTEE REPORT

(7)

Date Referred: April 28, 1995

FURTHER REFERRALS:

Resources
FinanceDate of Committee Action: 1/23/96The HOUSE SPECIAL COMMITTEE ON OIL AND GAS Committee considered:HB 325

HOUSE BILL NO. 325

ROYALTY SUSPENSION: N. SLOPE HEAVY OIL

"An Act authorizing suspension of payment of a portion of the royalty due the state for initial production of heavy oil from wells on the Arctic Slope."

recommends it be replaced
with the following committee substituteCS HB 325 (046)☐ the same title
☒ a new title☐ additional referral to _____ Committee☐ attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept)

APPROVES PREVIOUS: (Dept/Date)

☒ fiscal note(s) ① DNR ② DOR☐ fiscal note(s) _____☐ zero fiscal note(s) _____☐ zero fiscal note(s) _____

SIGNING WITH RECOMMENDATIONS		DP	DNP	NR	AM
<u>Scott Ogan</u>	<u>Ogan</u>	✓			
<u>John Rokeberg</u>	<u>Rokeberg</u>	✓			
<u>William S. Williams</u>	<u>Williams</u>	X			
<u>G. Davis</u>	<u>G. Davis</u>			✓	
<u>Brice</u>	<u>Brice</u>	X			
<u>Engelstein</u>	<u>Engelstein</u>		X		
<u>Bette Davis by Shirley Loring</u>		X			

CHAIR'S SIGNATURE

Nann Rokeberg1-23-96



HOUSE SPECIAL COMMITTEE ON OIL
AND GAS

DATE: January 23, 1996

[REDACTED]

SIGN - IN

PLEASE PRINT!
NAME

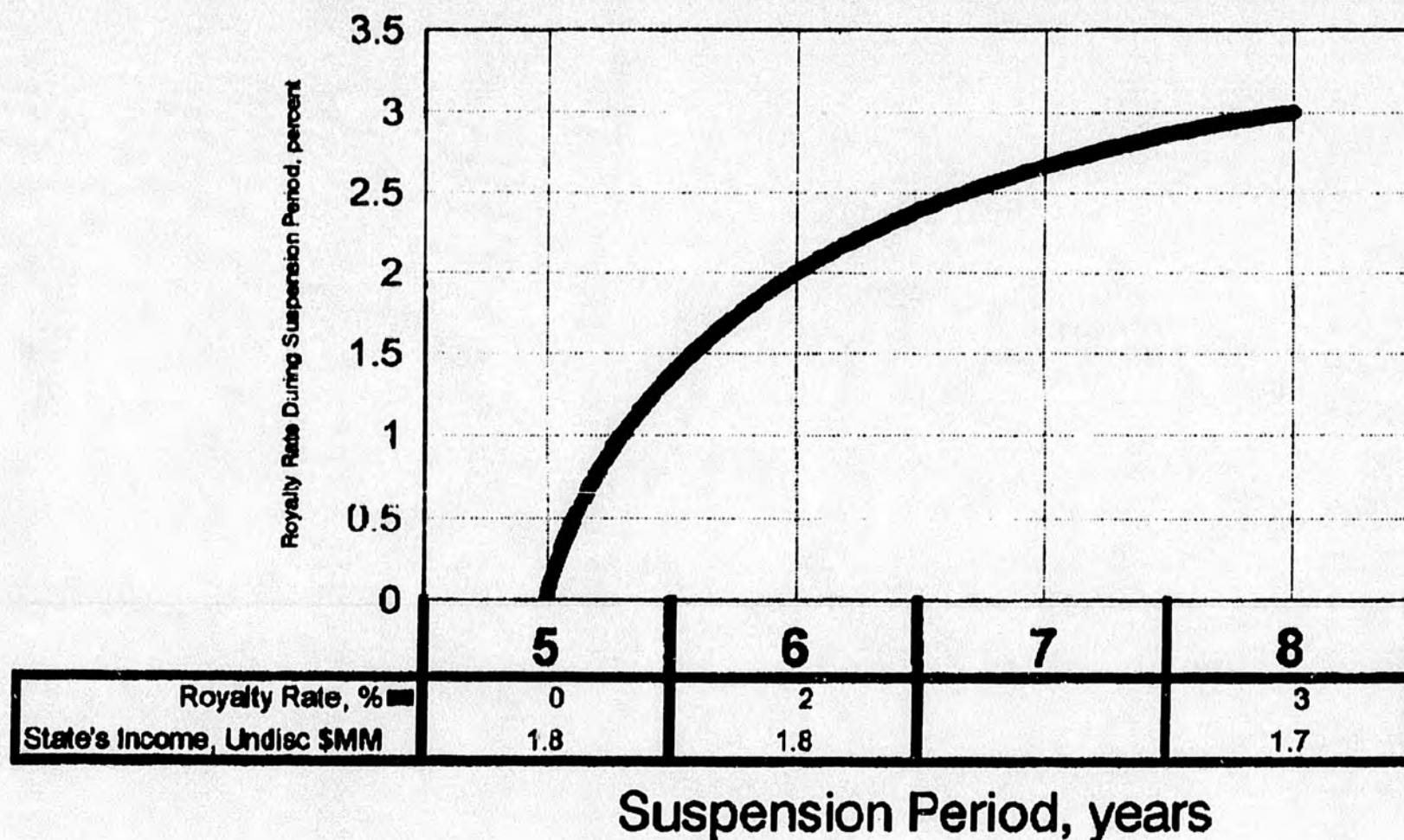
PHONE

REPRESENTING

DO YOU WANT TO TESTIFY?

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What combination of minimum royalty rate and suspension period yields a 15.9% ROR?



OXY per-well economics. January 19, 1996

**MARGINAL OIL FIELD DEVELOPMENT:
THE ECONOMIC IMPACT**

prepared for

BP Exploration (Alaska) Inc.

for presentation to

The State of Alaska Oil and Gas Policy Council

prepared by

**Oliver Scott Goldsmith
Professor of Economics**

**Institute of Social and Economic Research
University of Alaska Anchorage
3211 Providence Drive
Anchorage, Alaska 99508**

June 5, 1995

MARGINAL OIL FIELD DEVELOPMENT: THE ECONOMIC IMPACT

EXECUTIVE SUMMARY

Marginal oil field development in Alaska can generate jobs and income for Alaska workers, sales for Alaska businesses, and an increase in the state tax base more than sufficient to offset any additional costs to government from resource management and public service requirements from population increase.

This conclusion is based on an analysis using existing information about the economy and public sector combined with a description of a hypothetical marginal oil field. In reality, each marginal field would have different characteristics, and the actual economic and public sector effects would differ from the description in this study. However, given the economics of field development, this study demonstrates that the general conclusions are consistent with a broad range of assumptions about both field characteristics and the economy.

The purpose of this study is to provide a framework for analysis of the economic effects of new, small marginal oil fields which may be typical of new petroleum industry activity in Alaska. The analysis is generic and hopefully will lead to more detailed and specific studies where appropriate. Some of the information used to develop the parameters for the analysis come from the ongoing study of the Badami oil field on the North Slope. Since that project is only in the earliest stages of its evolution, it would be inappropriate to interpret this analysis as a study of the Badami prospect.

The study examines a hypothetical marginal oil field on the North Slope with anticipated recoverable reserves of 100 million barrels of oil. We assume a total development budget of \$320 million, most of which would be spent in a two-year period during which the initial wells would be drilled, the pipeline constructed, the modules fabricated and put into place, and the operating facility built. Production would subsequently continue over a 20-year period at a cost of \$320 million. In the early production years, the drilling of wells would continue and after year 5, the drilling activity would switch to workovers of the existing wells. The purpose of these development and production cost figures is to calculate economic effects, and they should not be interpreted as reflecting the actual costs associated with any particular field.

Although some expenditures, in particular module fabrication and equipment for the modules and pipeline, would be purchased outside the state, much of the work would be carried out onsite during both field development and production. These tasks include site preparation, pipeline and module installation, and well drilling; and all have a large labor component. During production the operation of the field and drilling would continue around the clock so the number of workers employed would be 4

times the number of jobs to be done onsite. The development and production jobs would require highly trained and skilled workers so wages would be high and some specialized jobs would, of necessity, be filled by workers from Outside. Based on current experience, the share of jobs going to residents would be high, but some workers would choose to live outside the state.

Other costs associated with field development and production would generate sales, employment, and payrolls for Alaska vendors providing supplies, equipment, and services to the owner company, the oil service companies doing the contract drilling and other work, the construction contractors, etc. A large portion of the economic effect of marginal field development would come from the recirculation within the economy of the high payrolls paid the North Slope workers. These payrolls would generate sales, jobs, and tax base in the communities where the Slope workers live.

Figure 1 shows the size and composition of Alaska employment and payroll which the development and production of the field would generate after subtracting onsite jobs likely to be filled by nonresidents. Field development would be spread over several years, so the number of annual average jobs produced in the peak year would be about 500 with a payroll of \$25 million. As the figure shows, the majority of those jobs would be offsite in vendor businesses, in the communities where the workers reside, and in the public sector. During production the number of jobs would fall to under 250 for an average year, and the pattern again is that most of the jobs would be offsite. However, in both the development and production phases, the payrolls are concentrated onsite.

The actual economic impact in a real situation would depend on the development and production plan as well as the resident share of employment and purchase of other inputs. But once the field size has been estimated, the budget and with it the economic effect would be constrained within a narrowly defined range. Basically the budget must be economically feasible, and the economic effect would flow from that budget. While the economic effects are clearly defined once the development strategy has been identified, the revenues that the field would generate are much less so since they are sensitive to actual, rather than anticipated, production, wellhead price, and the tax and royalty rates in place.

The range of variation of state revenues from production, primarily royalties but also the state share of the property tax and the corporate income tax, in response to variation in these parameters is shown in Figure 2. For example, if over its life the field were to produce 150 million barrels, the wellhead averages \$8.31 (1995 \$) and the royalty rate is 6%, production revenues would be \$84 million. For the range from low to high price, production, and royalty, the range of production revenues is \$29 to \$328 million.

Two other sources of revenue, from the "full pipeline effect" and the payrolls generated by the new jobs, are less volatile and significant. Adding production from a marginal field to the existing throughput of the Alyeska pipeline marginally reduces

the tariff on existing throughput and increases its wellhead value. This "full pipeline effect" would increase severance tax and royalty revenues from production from all North Slope fields. The payroll generated by the marginal field activity represents a tax base which could be tapped to pay some of the state government costs imposed by the new workers and their families. Although the state currently has no vehicle to allow these workers to pay for some of the public services they receive, the tax capacity represented by their payroll should be included as a potential revenue source.

The costs to state government from marginal field development consist of management costs such as environmental monitoring, tax auditing, etc., and more importantly the costs of providing services for the families of the new workers both onsite and in Alaska's urban centers. These costs can be divided into those which support oil industry families, vendor families, and other private and public workers in the urban centers. The public management costs are about \$7 million, and the population-related costs are about \$4.4 million, totaling about \$51 million.

These public sector costs are contrasted with the range of revenues which the field could produce over its life in Figure 3. Subtracting the costs from the revenues yields a range for the state revenue "dividend" (Figure 4), which is the tax base generated by the marginal field over and above the amount necessary to pay for the costs of state government imposed by the field. The "dividend" ranges from \$1 to \$300 million depending upon production, price, and royalty rate.

Figure 5A shows the range of production revenues introduced as Figure 2, converted to an annual equivalent. It contrasts the potential range of revenues for the marginal field with the total annual revenues to the state generated by other natural resources based on a recent analysis of the sources of state revenues prepared by Legislative Research in 1993. The range for the marginal oil field is clearly consistent with the total revenues to the state from most other natural resources.

Finally, Figure 5B compares the state's natural resource revenues from various resources with the state's resource management expenditures for those same natural resources. The marginal oil field is the only case where resource management costs are covered by the revenues generated, and the substantial revenues are available to contribute to the general costs of government.

FIGURE 1A. MARGINAL FIELD ECONOMIC EFFECT
RESIDENT EMPLOYMENT

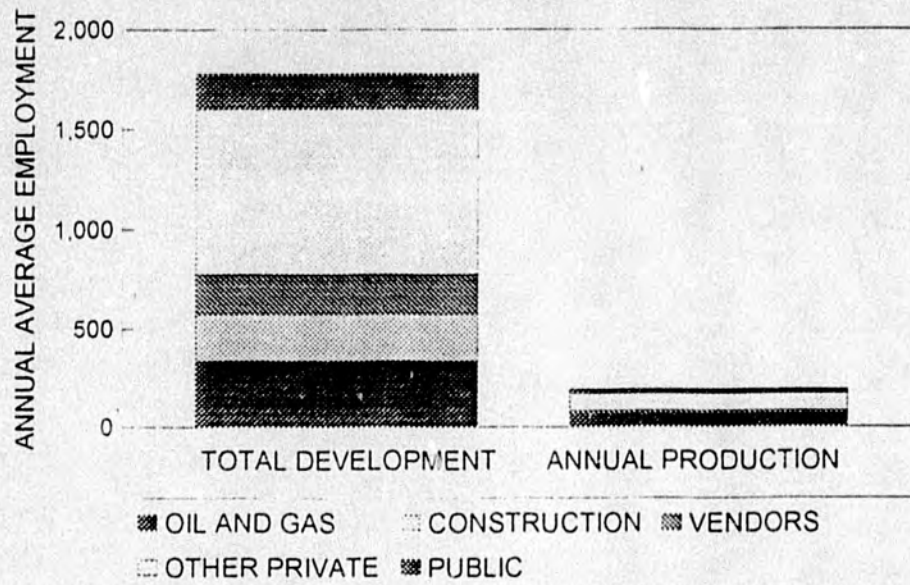


FIGURE 1B. MARGINAL FIELD ECONOMIC EFFECT:
RESIDENT PAYROLL

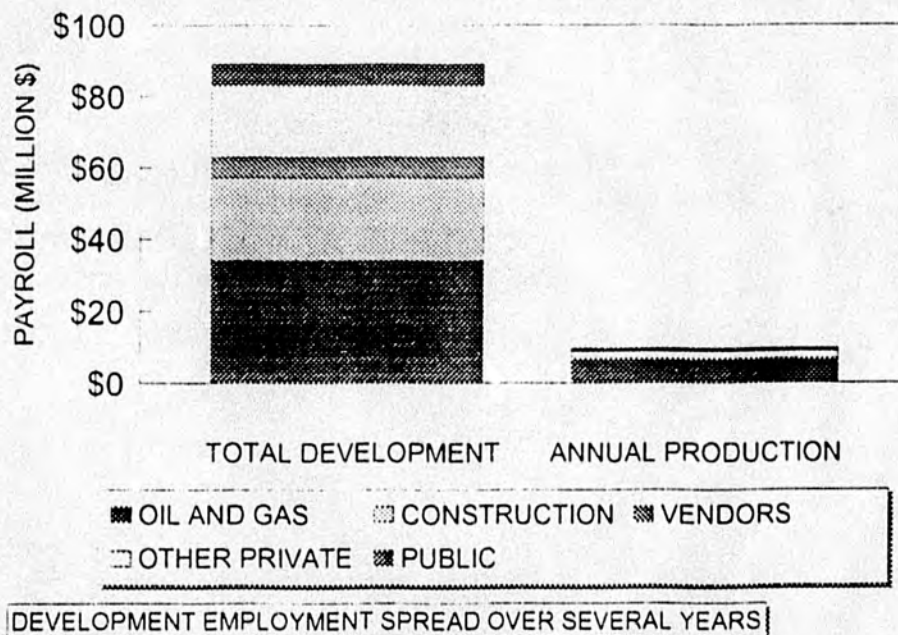
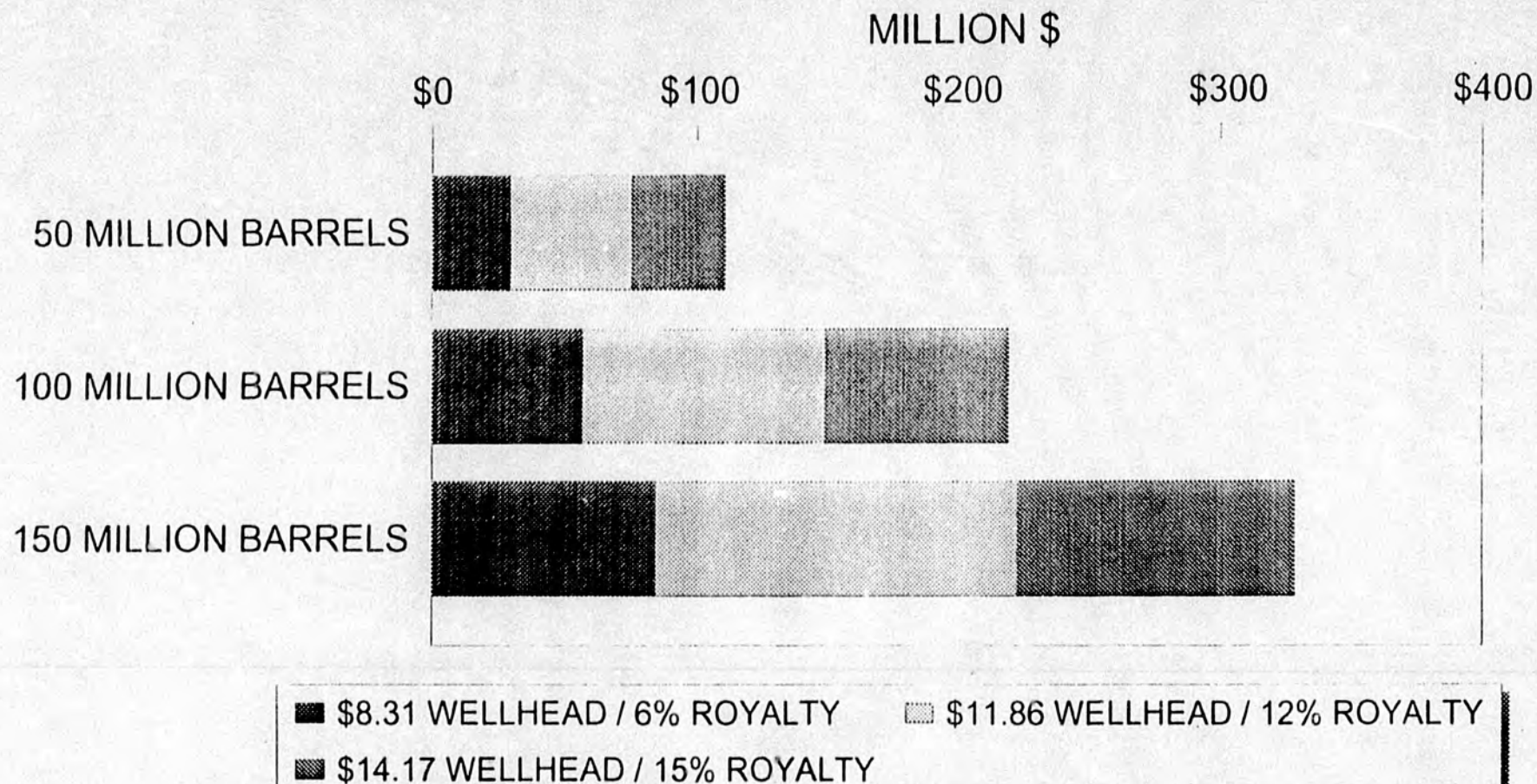
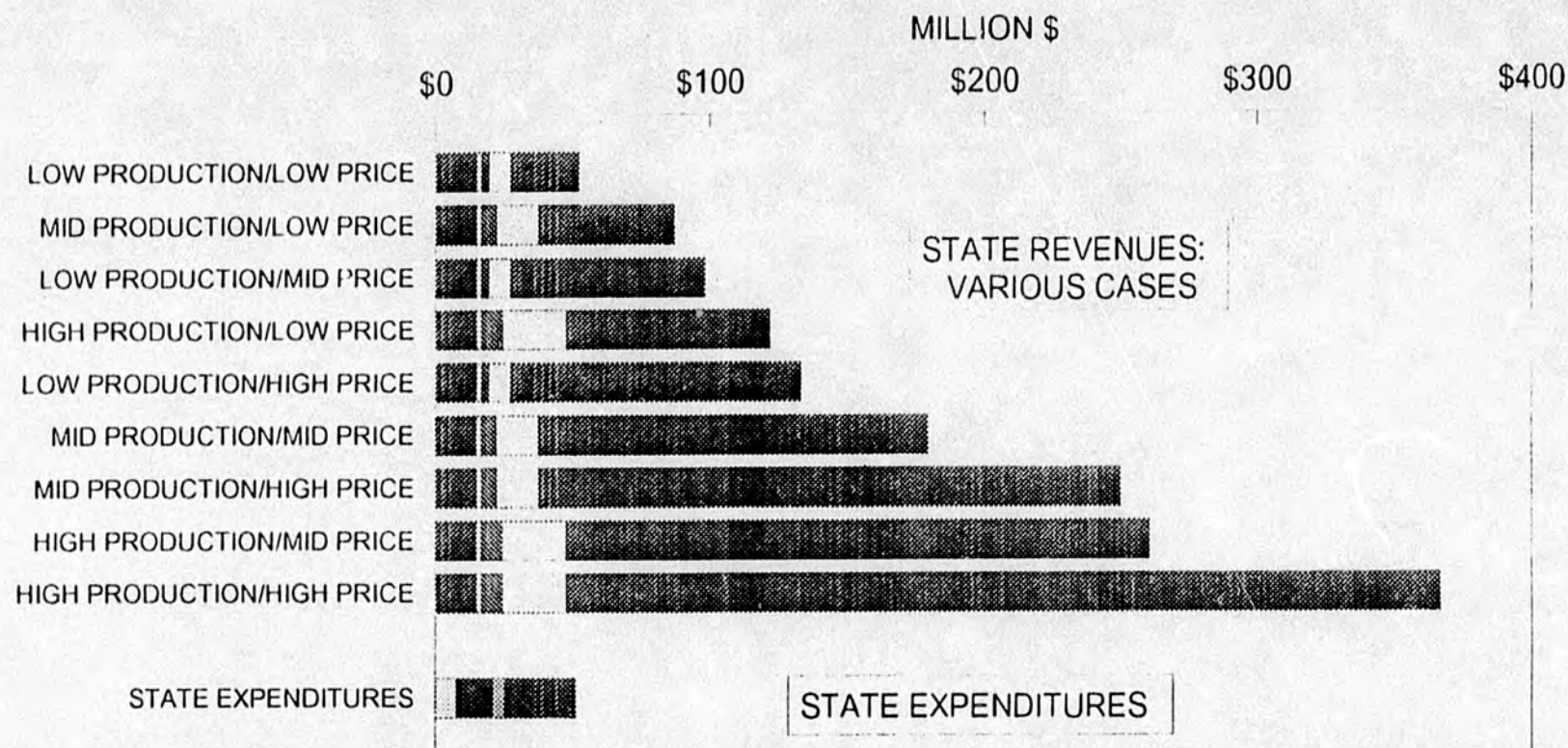


FIGURE 2. MARGINAL FIELD PRODUCTION REVENUES
 SENSITIVITY TO PRODUCTION, WELLHEAD PRICE, AND ROYALTY RATE



REVENUES OVER THE LIFE OF THE FIELD

FIGURE 3. STATE REVENUES AND EXPENDITURES: LIFE OF THE FIELD



PERSONAL INCOME TAX

PETROLEUM PROPERTY TAX

CORP INCOME

FULL PIPELINE

ROYALTY

RESOURCE MANAGEMENT

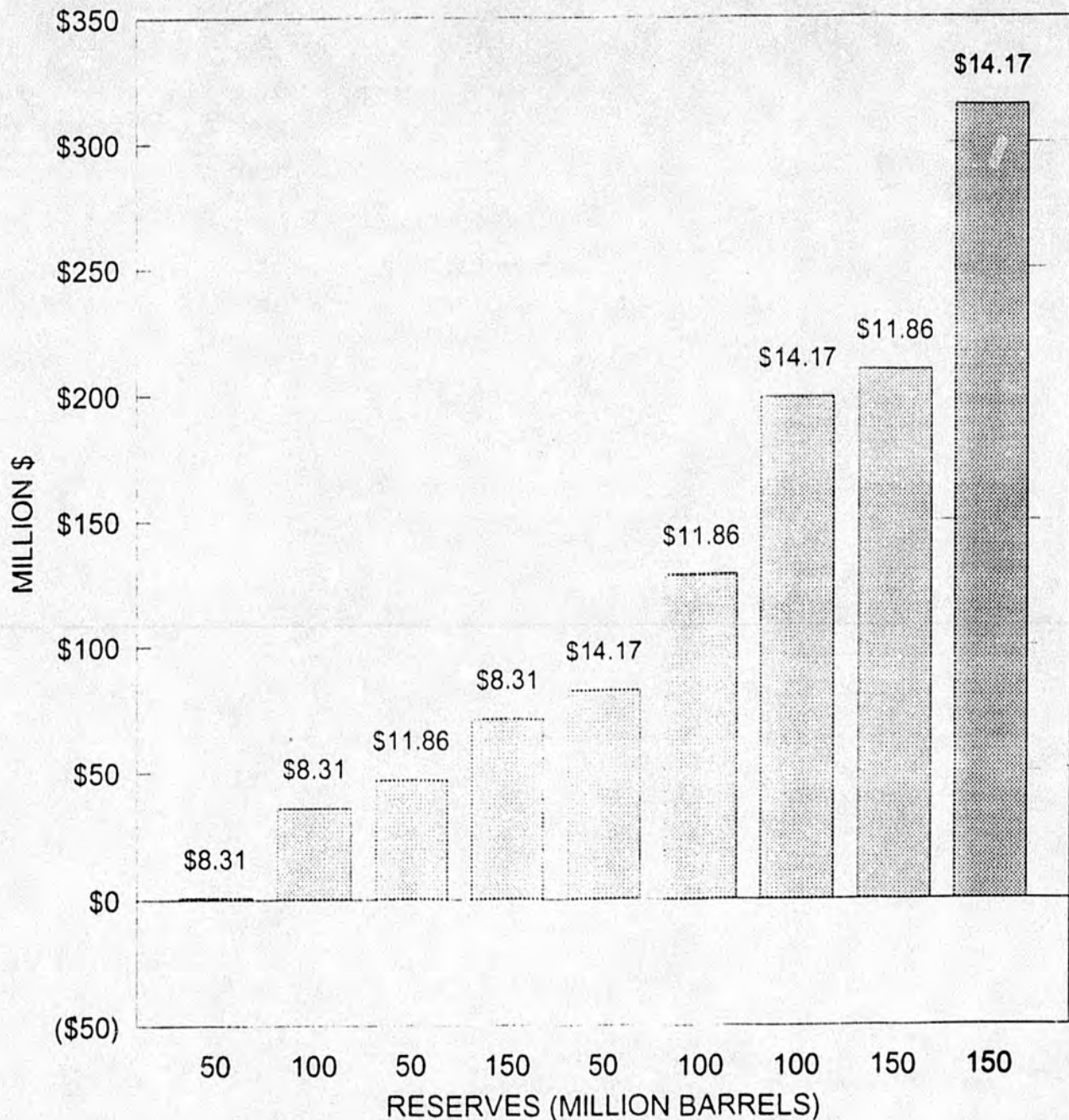
OIL POPULATION

VENDOR POPULATION

OTHER POPULATION

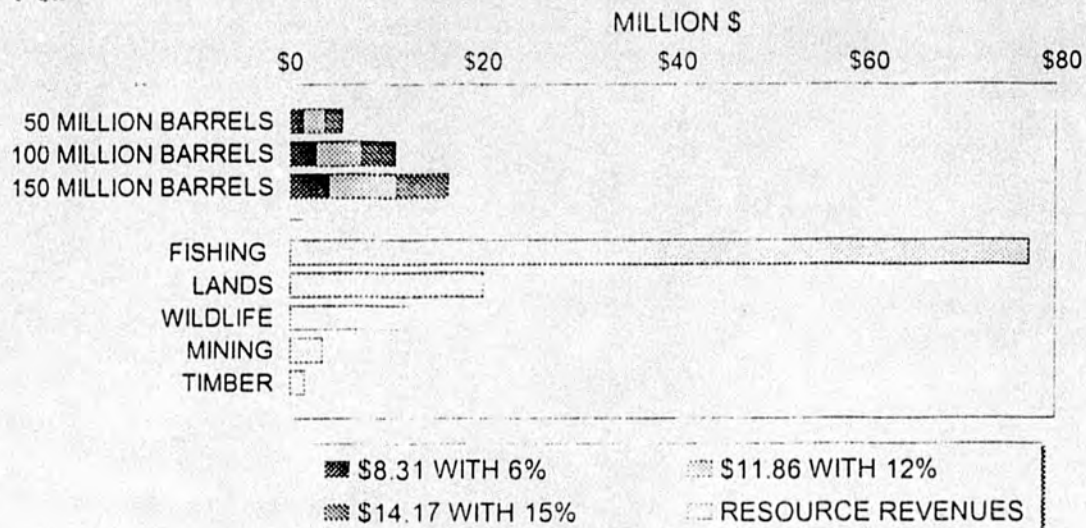
FIGURE 4. STATE REVENUE "DIVIDEND"

VARIATION IN RESERVES, PRICE, AND ROYALTY RATE



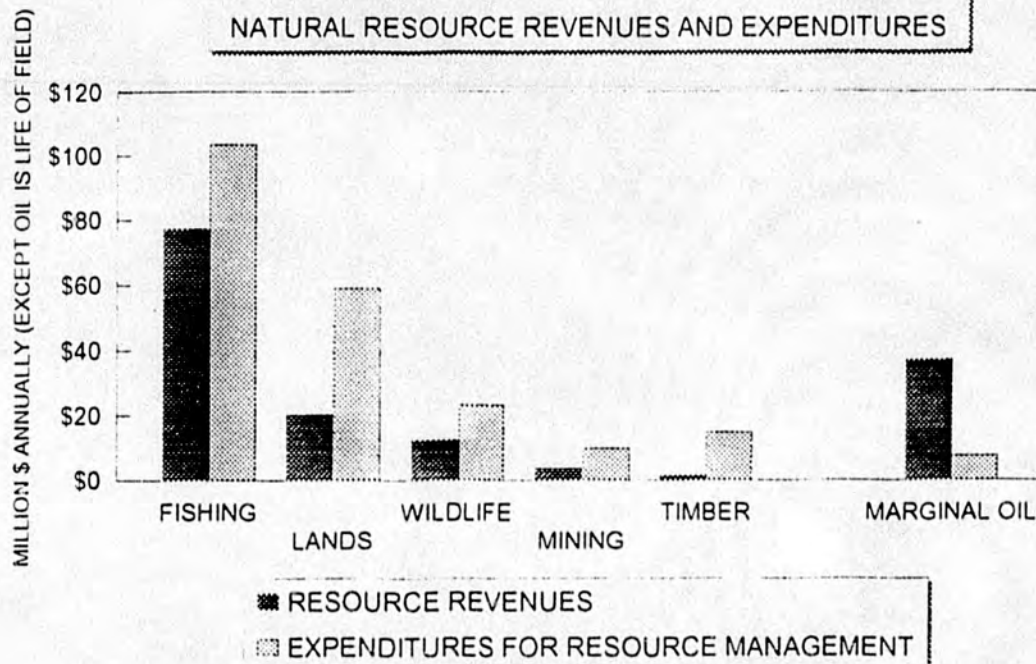
REVENUES IN EXCESS OF AMOUNT NEEDED
TO PROVIDE NEW PUBLIC SERVICES

FIGURE 5A. ANNUAL MARGINAL FIELD PRODUCTION REVENUES
COMPARISON TO TOTAL REVENUES FROM OTHER RESOURCES



SOURCE FOR OTHER RESOURCES. LEGISLATIVE RESEARCH 1993

FIGURE 5B. STATE OF ALASKA
NATURAL RESOURCE REVENUES AND EXPENDITURES



SOURCE. LEGISLATIVE RESEARCH, 1993.
EXCEPT MARGINAL OIL IS LOWEST REVENUE CASE FROM TEXT NET OF INCOME AND SALES TAX RE

MARGINAL OIL FIELD DEVELOPMENT: THE ECONOMIC IMPACT

INTRODUCTION

Since the characteristics of each marginal North Slope oil field are unique, we estimate the economic impact of a marginal field based upon the assumptions of a generic field in the current economic environment. We assume an initial period of field development followed by 20 years of production under constant conditions of employment and oil flow. To simplify the analysis, we consider a typical year midway through the production phase. Although we have chosen 2005 for this purpose, all dollar values should be interpreted as 1995 dollars.

The employment and payroll impacts depend primarily on the development and production plan for the field as well as the residence of the workers employed onsite and in supporting roles. Large numbers of highly paid workers are required during the development of the field. A portion of these workers must be employed onsite for drilling, site preparation, and fabrication of pipelines and other facilities. Employment associated with module construction is more likely to be located outside the state in lower cost locations with better access to the equipment and specialized labor required for this purpose. Once all the facilities are in place, the number of jobs required to operate and maintain the field is quite small.

Total employment and payroll depend on both the activities onsite and the activity of suppliers to the industry, such as transportation and wholesaling. The payrolls paid to resident workers in these industries will be spent in state and generate employment in the support industries of trade, finance, and services as well as smaller amounts of employment in construction, communications, transportation, and utilities. Furthermore, as the households of the new workers move into the state, they will require public services which in turn generate additional jobs in state and local government.

The public expenditure requirements generated by the marginal field are sensitive to the marginal cost of providing public services to another Alaska resident and the number of new Alaska residents generated by the new jobs. Nonresident workers require little in terms of government services like education which make up the bulk of the state budget. Likewise, to the extent that the jobs are filled by current Alaskans and no new migrants move into the state looking for work, the marginal cost of public services is also minimized.

Unlike employment, payroll, and public expenditure requirements, which are fairly well-determined by the development plan for the field, state revenues are very sensitive to field size, the wellhead price of oil, and the tax and royalty structure in place. Assuming that the marginal field will not be subject to the severance tax, the largest source of revenue is the royalty payment to the state with the corporate

income and state property taxes generating small additional revenues which are not as price- or production sensitive.

Two other sources of revenue are important. Production from the marginal field will increase the flow through the ALYESKA pipeline and marginally reduce the tariff faced by all the production on the North Slope. This will raise the wellhead price which will in turn increase severance taxes and royalties on all North Slope production. The size of this "full pipeline effect" depends on the percent increase in throughput from the marginal field development.

Alaska currently has neither a state personal income tax nor a statewide general sales tax. Consequently, when measuring the revenue burden faced by any new industrial development in Alaska, the payroll tax base generated by the new activity is generally not considered as a potential source of revenues to offset the public sector costs which the development would generate. However, this is clearly an increase in the tax base which would be available to pay at least some of the public sector costs which the new population associated with the development would require. Furthermore, there is some likelihood that in future years the state will impose one or both of these taxes to offset some of the revenue loss from the decline in petroleum revenues. Consequently, we include the potential revenues from both a state personal income tax and a state general sales tax in the calculation of revenues available from the marginal development. It is, of course, a policy decision whether the state would avail itself of these sources of revenue.

Using conservative assumptions which produce an upper bound estimate of the public sector costs of marginal field development combined with conservative assumptions which produce modest estimates of revenues available from the field, we conclude that the marginal field would produce a fiscal "dividend" under all but the most pessimistic assumptions regarding the lifetime production from the field.

MARGINAL OIL FIELD DEVELOPMENT: THE ECONOMIC IMPACT

DEVELOPMENT EXPENDITURES (Table 1)

The budget for development of a marginal field depends upon the development plan which will vary from case to case, based on many technical and economic factors. The development plan is contingent upon some estimate of recoverable reserves, but actual field performance will only become clear after production begins. Consequently, a large share of the total cost of the field will be determined at the time the decision is made to proceed with development. Furthermore, since the development cost has a fixed component, the size of the development budget will not necessarily vary proportionally with the estimated size of the field.

A primary consideration is that the sum of the development and operating costs of the field be low enough on a per-barrel basis to justify investment in the field. This is not a study of the economic viability of marginal field development, but we have chosen the size of the development budget in Table 1 combined with the production budget in Table 2 to be generally consistent with economic viability for a field with recoverable reserves of 100 million barrels on the North Slope.

The budget in Table 1 has six primary elements which are relatively self-evident. The development phase of the project would primarily occur over a two-year period, but the drilling of production wells would extend for several years into the production phase of the life of the field. Consequently, the estimate of 762 Alaska man years of labor would be spread out over time rather than occurring all in a single year. Pipeline installation would occur over a period of a few months. The equipment required for the modules (including their fabrication), pipeline, and other facilities would of necessity all be fabricated outside the state. Facility construction would occur onsite, and like the other onsite tasks would have a large labor component. Engineering would, in this hypothetical case, be conducted mostly outside the state. Company management is split between Alaska and headquarters outside of the state.

Of the total man years of labor required for this development, about half would occur in Alaska and half outside the state. The instate wage bill for this labor is high — \$76 million — because the jobs are skilled, remote, and require long hours. Consequently, we assume an average wage above the average for the industry as a whole since at least half the current jobs in the oil and gas industry are located in urban Alaska where there are many office-type jobs.

TABLE 1: MARGINAL FIELD ANALYSIS: DEVELOPMENT PHASE TOTAL EXPENDITURES

	SUM			DRILLING			PIPELINE INSTALLATION			EQUIPMENT			FACILITY CONSTRUCTION			ENGINEERING			COMPANY MANAGEMENT		
	TOTAL	ALASKA	OUTSIDE	TOTAL	ALASKA	OUTSIDE	TOTAL	ALASKA	OUTSIDE	TOTAL	ALASKA	OUTSIDE	TOTAL	ALASKA	OUTSIDE	TOTAL	ALASKA	OUTSIDE	TOTAL	ALASKA	OUTSIDE
EXPENDITURE (MILLION \$)	\$320	\$159	\$161	\$128	\$85	\$43	\$48	\$37	\$11	\$90	\$0	\$90	\$32.0	\$28.4	\$3.6	\$16.0	\$4.0	\$12.0	\$6.4	\$4.8	\$1.6
LABOR	\$147	\$99	\$48	\$51.2	\$51.2	\$0.0	\$24.0	\$24.0	\$0.0	\$36.0	\$0.0	\$36.0	\$16.0	\$16.0	\$0.0	\$14.4	\$3.6	\$10.8	\$5.8	\$4.3	\$1.4
EQUIPMENT	\$60	\$20	\$41	\$25.6	\$12.8	\$12.8	\$7.2	\$3.6	\$3.6	\$22.5	\$0.0	\$22.5	\$4.8	\$3.1	\$1.7	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
SUPPLIES	\$60	\$14	\$46	\$32.0	\$8.0	\$24.0	\$7.2	\$1.8	\$5.4	\$13.5	\$0.0	\$13.5	\$4.8	\$2.9	\$1.9	\$1.6	\$0.4	\$1.2	\$0.6	\$0.5	\$0.2
SERVICES	\$38	\$20	\$19	\$12.8	\$9.6	\$3.2	\$7.2	\$5.4	\$1.8	\$13.5	\$0.0	\$13.5	\$4.8	\$4.8	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
TRANSPORT	\$15	\$7	\$8	\$6.4	\$3.2	\$3.2	\$2.4	\$2.4	\$0.0	\$4.5	\$0.0	\$4.5	\$1.6	\$1.6	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
OTHER	\$0	\$0	\$0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
EMPLOYEES (MAN YEARS)	1,443	762	680	394	394	0	185	185	0	554	0	554	123	123	0	138	28	111	49	33	16
AVG PAYROLL (THOUSAND \$) (A)					\$100	\$60		\$100	\$50		\$100	\$50		\$100	\$50		\$100	\$75		\$100	\$70
TOTAL PAYROLL (MILLION \$)	\$113.4	\$76.2	\$37.1	\$39.4	\$39.4	\$0.0	\$18.5	\$18.5	\$0.0	\$27.7	\$0.0	\$27.7	\$12.3	\$12.3	\$0.0	\$11.1	\$2.8	\$8.3	\$4.4	\$3.3	\$1.1

DISTRIBUTION OF TOTAL FIELD DEVELOPMENT COST AS FOLLOWS

DRILLING	40%
PIPELINE INSTALLATION	15%
EQUIPMENT	33% INCLUDES MODULE SUPPLIES AND FABRICATION AS WELL AS PIPE
FACILITY CONSTRUCTION	5%
ENGINEERING	5%
MANAGEMENT	2%

(A) AVERAGE ANNUAL ALASKA PAYROLL (000\$) REMOTE SITE CONSTRUCTION \$100
OIL AND GAS \$100

THIS IS ABOVE THE AVERAGE FOR THE INDUSTRY BECAUSE THE JOBS ARE REMOTE SITE AND HIGHLY TECHNICAL

LABOR COST/PAYROLL RATIO 1.3

MARGINAL OIL FIELD DEVELOPMENT: THE ECONOMIC IMPACT

PRODUCTION EXPENDITURES (Table 2)

Production in an oil field typically occurs at a declining rate. We assume a 20-year production life, describe a typical year within that period, and multiply by 20 to cover the entire life of the field. During the first five years of production, the drilling of new wells budgeted in the development budget will continue. Subsequent to that, a smaller crew will operate a rig for workovers as long as the field produces. This production budget includes only the workover drilling expenses, and the average annual expenditure for this is shown in the table.

The main expenditures during production are the onsite employment associated with field operation and the crews for manning the workover rig. In addition, a small amount of headquarters employment has been allocated to the project.

The 75 employees required to operate the field are double the number that are onsite at any time and four times the number of actual jobs. This field is designed to operate with a very small level of employment, but it does operate around the clock so four employees are necessary for each job. This is necessary given the high cost of labor combined with the constraints on the economic viability of the project. Over 20 years the \$16 million annual production budget cumulates to a \$320 million budget which is identical to the development budget.

Labor is the largest expense during the production phase, and it must occur onsite either in the operation of the field or the reworking of wells. Other expenses represent a combination of purchases for goods and services instate such as transportation, food, and water, and out of state such as drilling mud and equipment.

Because of the technical nature of the work and the long hours, the average annual wage is higher than the industry average.

TABLE 2: MARGINAL FIELD ANALYSIS: PRODUCTION PHASE ANNUAL AVERAGE EXPENDITURES

	SUM			ON SITE FIELD OPERATION			WORKOVER DRILLING (B)			HEADQUARTERS		
	TOTAL	ALASKA	OUTSIDE	TOTAL	ALASKA	OUTSIDE	TOTAL	ALASKA	OUTSIDE	TOTAL	ALASKA	OUTSIDE
EXPENDITURE (MILLION \$)	\$16.0	\$14.5	\$1.5	\$8.1	\$7.1	\$1.0	\$6.8	\$6.3	\$0.5	\$1.1	\$1.1	\$0.0
LABOR	\$9.8	\$9.8	\$0.0	\$5.2	\$5.2		\$3.9	\$3.9		\$0.7	\$0.7	
EQUIPMENT	\$2.0	\$1.0	\$1.0	\$1.0	\$0.0	\$1.0	\$1.0	\$1.0		\$0.0		
SUPPLIES	\$2.0	\$1.5	\$0.5	\$1.0	\$1.0		\$1.0	\$0.5	\$0.5	\$0.0		
SERVICES	\$1.2	\$1.2	\$0.0	\$0.4	\$0.4		\$0.4	\$0.4		\$0.4	\$0.4	
TRANSPORT	\$1.0	\$1.0	\$0.0	\$0.5	\$0.5		\$0.5	\$0.5		\$0.0		
OTHER	\$0.0	\$0.0	\$0.0	\$0.0			\$0.0			\$0.0		
EMPLOYEES (MAN YEARS)	75	75	0	40	40	0	30	30	0	5	5	0
AVG PAYROLL (THOUSAND \$) (A)					\$100	\$60		\$100	\$50		\$100	\$50
TOTAL PAYROLL (MILLION \$)	\$7.5	\$7.5	\$0.0	\$4.0	\$4.0	\$0.0	\$3.0	\$3.0	\$0.0	\$0.5	\$0.5	\$0.0

SINCE PRODUCTION AND DRILLING CONTINUE AROUND THE CLOCK, EACH JOB REQUIRES 4 EMPLOYEES. WITH A 12 HOUR SHIFT AND WEEKLY ROTATION THERE WILL BE TWO SHIFTS "ON SITE" AT ANY GIVEN TIME.

(A) AVERAGE ANNUAL ALASKA PAYROLL (000\$) OIL AND GAS \$100
THIS IS ABOVE THE AVERAGE FOR THE INDUSTRY BECAUSE THE JOBS ARE REMOTE SITE AND HIGHLY TECHNICAL

LABOR COST/PAYROLL RATIO 1.3

(B) WORKOVER DRILLING COMMENCES IN YEAR 6 OF FIELD OPERATIONS AND CONTINUES THROUGH YEAR 20
THESE FIGURES REPRESENT THE TOTAL LIFETIME COST OF WORKOVER DRILLING DIVIDED BY THE 20 YEAR FIELD LIFE

THIS AVERAGING REPRESENTS A FIVE YEAR PERIOD WITH ONLY PRODUCTION RELATED EMPLOYMENT (DURING WHICH DEVELOPMENT DRILLING CONTINUES) FOLLOWED BY A FIFTEEN YEAR PERIOD WITH PRODUCTION RELATED EMPLOYMENT AND WORKOVER DRILLING

MARGINAL OIL FIELD DEVELOPMENT: THE ECONOMIC IMPACT

PETROLEUM REVENUES FROM MARGINAL FIELD PRODUCTION (Table 3)

The amount of state revenues collected over the life of the marginal field is very sensitive to the total oil produced from the field, the wellhead price of oil, and the royalty rate. For the range of assumptions discussed below, the range of lifetime revenues is from a low of \$29 million to a high of \$328 million.

We consider revenues from three sources: royalties, corporate income tax, and state property tax. We assume the severance tax rate on the marginal field will be zero due to its small size.

Royalties depend on the wellhead price, and we consider three price levels, based on the Alaska Department of Revenue (ADOR) Spring 1995 Petroleum Revenue Projections. We take the ADOR low, medium, and high Alaska North Slope (ANS) prices projected for 2005, deflate them to 1995 dollars, and subtract \$1 as a pipeline charge from the marginal field to the proximity of pump station 1 of the TAPS pipeline. The resulting net marginal field wellhead prices are \$8.31, \$11.86, and \$14.17. Royalties are calculated assuming 6% for the low price, 12% for the mid case, and 15% for the high case. Finally, we consider production levels of 50, 100, and 150 million barrels over a 20-year lifetime for the field.

We calculate the corporate income tax rate based on a cents-per-barrel amount. The average corporate income tax per barrel for Alaska production since 1986 has been \$.19. We arbitrarily assume the cents-per-barrel tax on the marginal field will be \$.05 per barrel.

We calculate the state property tax based on an initial value of capital in place of half the total cost of development. Although the state property tax rate is 20 mills, the North Slope Borough currently receives 18.77 mills of the total collected. We assume the same sharing of the property tax on this marginal field, so the annual state collection is \$80,000.

TABLE 3: MARGINAL FIELD ANALYSIS: PRODUCTION AND DIRECT PETROLEUM REVENUES

WELLHEAD PRICE DETERMINATION	LOW	MID	HIGH
ANS WELLHEAD PRICE IN 2005 (A)	\$11.53	\$17.47	\$23.62
DEFLATE TO 1995 \$ (B)	\$9.31	\$12.86	\$15.17
TRANSPORT DIFFERENTIAL (C)	\$1.00	\$1.00	\$1.00
NET MARGINAL FIELD WELLHEAD	\$8.31	\$11.86	\$14.17
ROYALTY RATE	6%	12%	15%

		LOW RESERVES 50 MILLION BARRELS						MEDIUM RESERVES 100 MILLION BARRELS						HIGH RESERVES 150 MILLION BARRELS					
		ANNUAL			20 YEAR FIELD LIFE			ANNUAL			20 YEAR FIELD LIFE			ANNUAL			20 YEAR FIELD LIFE		
WELLHEAD PRICE		\$8.31	\$11.86	\$14.17	\$8.31	\$11.86	\$14.17	\$8.31	\$11.86	\$14.17	\$8.31	\$11.86	\$14.17	\$8.31	\$11.86	\$14.17	\$8.31	\$11.86	\$14.17
PRODUCTION	MILLION BARRELS	2.5	2.5	2.5	50	50	50	5	5	5	100	100	100	7.5	7.5	7.5	150	150	150
WELLHEAD VALUE	MILLION \$	\$21	\$30	\$35	\$415	\$593	\$709	\$42	\$59	\$71	\$831	\$1196	\$1417	\$62	\$89	\$106	\$1246	\$1778	\$2126
ROYALTIES	MILLION \$	\$1.25	\$3.56	\$5.31	\$24.93	\$71.13	\$106.29	\$2.49	\$7.11	\$10.63	\$49.86	\$142.26	\$212.19	\$3.74	\$10.67	\$15.94	\$74.79	\$213.39	\$318.88
SEVERANCE (D)	"	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
INCOME (E)	"	\$0.13	\$0.13	\$0.13	\$2.50	\$2.50	\$2.50	\$0.25	\$0.25	\$0.25	\$5.00	\$5.00	\$5.00	\$0.38	\$0.38	\$0.38	\$7.50	\$7.50	\$7.50
PROPERTY (F)	"	\$0.10	\$0.10	\$0.10	\$1.97	\$1.97	\$1.97	\$0.10	\$0.10	\$0.10	\$1.97	\$1.97	\$1.97	\$0.10	\$0.10	\$0.10	\$1.97	\$1.97	\$1.97
TOTAL DIRECT REVENUES		\$1.47	\$3.78	\$5.54	\$29.40	\$75.60	\$110.76	\$2.84	\$7.46	\$10.98	\$56.83	\$149.23	\$219.55	\$4.21	\$11.14	\$16.42	\$84.26	\$222.86	\$328.35

(A) ADOR SPRING 1995 REVENUE SOURCES

(B) DEFLATION FACTORS BASE 0.736
LOW 0.807
HIGH 0.642

ADOR SPRING 1995 REVENUE SOURCES

(C) AUTHOR ASSUMPTION

(D) SEVERANCE TAX RATE 0.00%

(E) CORPORATE INCOME TAX ON PETROLEUM

FY	DAILY PRODUCTION	CORP TAX	TAX PER BARREL
86	1.847	\$133.90	\$0.20
87	1.896	\$120.40	\$0.17
88	2.048	\$158.00	\$0.21
89	2.003	\$166.00	\$0.23
90	1.888	\$117.20	\$0.17
91	1.839	\$185.10	\$0.28
92	1.833	\$165.50	\$0.25
93	1.728	\$105.70	\$0.17
94	1.639	\$17.80	\$0.03

NET OF SETTLEMENT

AVG \$0.19

ASSUME \$0.05 TAX PER BARREL

SOURCE: ADOR SPRING 1995 REVENUE SOURCES

(F) PROPERTY TAX BASED ON

HALF COST OF FIELD DEVELOPMENT \$160.00
TAX RATE 2.00%
LEVELIZED TO REFLECT DEPRECIATION OF VALUE \$1.60
STATE SHARE OF TAXES COLLECTED 6%
ANNUAL STATE COLLECTION \$0.10

STATE SHARE OF TAXES COLLECTED BASED ON NORTH SLOPE BOROUGH
MILL RATE OF 18.77 FROM ALASKA TAXABLE 1992

MARGINAL OIL FIELD DEVELOPMENT: THE ECONOMIC IMPACT

PETROLEUM REVENUES FROM HIGHER NORTH SLOPE WELLHEAD (Table 4)

If the development of a marginal field increases production on the North Slope, throughput of the ALYESKA pipeline will increase. Because the pipeline tariff includes a fixed cost component, the tariff will fall, the wellhead value of all production on the North Slope will increase, and royalties and severance taxes based on wellhead value will increase.

We consider the size of the revenues from the "Full Pipeline Effect" under different assumptions about marginal field production, wellhead price, pipeline tariff, and volume of ALYESKA throughput. The revenues from this effect are most sensitive to field production but not to wellhead price, tariff, or volume of throughput. The lifetime revenues range from \$7.8 million for a 50 million barrel field, \$15.6 million for a 100 million barrel field, to \$23.2 million for a 150 million barrel field.

We use the range of pipeline tariffs for 2005 published by the ADOR in their Petroleum Revenue Projection Forecast as well as the range of North Slope production rates for the same year.

Only a portion of the Alyeska tariff is based on the volume of throughput. The tariff agreement allows the operators to recover an operating cost, a profit on each barrel, and an offset for increased tax liability on the additional profit from higher production. The sum of these three factors is assumed to be \$1.22 per barrel. Since the tariff for the average barrel is estimated to be over \$2.00, there is a slight reduction of about \$.01 in the average tariff with the increase in throughput.

This raises the average wellhead by about \$.01 per barrel. We assume that the average barrel produced on the North Slope pays a combined severance tax and royalty rate of 18% of the wellhead value.

TABLE 4: MARGINAL FIELD ANALYSIS: REVENUES FROM HIGHER WELLHEAD

	LOW RESERVES 50 MILLION BARRELS				MEDIUM RESERVES 100 MILLION BARRELS				HIGH RESERVES 150 MILLION BARRELS			
DAILY MARGINAL PRODUCTION	6 849	6 849	6 849	6 849	13 699	13 699	13 699	13 699	20 548	20 548	20 548	20 548
PIPELINE TARIFF IN 2005 (A)	\$2 65	\$2 65	\$3 03	\$3 03	\$2 65	\$2 65	\$3 03	\$3 03	\$2 65	\$2 65	\$3 03	\$3 03
DEFLATE TO 1995 \$ (B)	\$2 10	\$2 10	\$2 23	\$2 23	\$2 10	\$2 10	\$2 23	\$2 23	\$2 10	\$2 10	\$2 23	\$2 23
DAILY TAPS THRUPUT (C)	950 000	1 300 000	950 000	1 300 000	950 000	1 300 000	950 000	1 300 000	950 000	1 300 000	950 000	1 300 000
CHARGES (MILLION \$)	\$727	\$995	\$773	\$1 058	\$727	\$995	\$773	\$1 058	\$727	\$995	\$773	\$1 058
AUGMENTED DAILY THRUPUT	956 849	1 306 849	956 849	1 306 849	963 699	1 313 699	963 699	1 313 699	970 548	1 320 548	970 548	1 320 548
ADDITIONAL CHARGES (D)	\$3 05	\$3 05	\$3 05	\$3 05	\$6 10	\$6 10	\$6 10	\$6 10	\$9 15	\$9 15	\$9 15	\$9 15
AUGMENTED THRUPUT TARIFF	\$2 09	\$2 09	\$2 22	\$2 22	\$2 08	\$2 09	\$2 22	\$2 22	\$2 08	\$2 08	\$2 21	\$2 21
REDUCTION IN TARIFF-- INCREASE IN WELLHEAD	\$0 01	\$0 00	\$0 01	\$0 01	\$0 01	\$0 01	\$0 01	\$0 01	\$0 02	\$0 01	\$0 02	\$0 02
INCREASE IN WELLHEAD VALUES (MILLION \$)	\$2 18	\$2 18	\$2 51	\$2 51	\$4 32	\$4 34	\$4 96	\$5 00	\$6 44	\$6 48	\$7 41	\$7 45
BLENDED TAX / ROYALTY RATE (E)	18%	18%	18%	18%	18%	18%	18%	18%	18%	18%	18%	18%
INDIRECT INCREASE IN REVENUE (MILLION \$)												
ANNUAL	\$0 39	\$0 39	\$0 45	\$0 45	\$0 78	\$0 78	\$0 90	\$0 90	\$1 16	\$1 17	\$1 33	\$1 34
20 YEAR FIELD LIFE	\$7 84	\$7 85	\$9 02	\$9 04	\$15 56	\$15 62	\$17 91	\$17 98	\$23 18	\$23 31	\$26 68	\$26 83

(A) LOW PROJECTED TARIFF FOR 2005 \$2 73
HIGH PROJECTED TARIFF FOR 2005 \$3 03
ADOR, SPRING 1995 REVENUE SOURCES

(B) SEE DIRECT REVENUE SHEET FOR MID CASE DEFLATION FACTOR

(C) ANS PETROLEUM PRODUCTION PROJECTION FOR 2005 963,000 BARRELS / DAY LOW
ADOR, SPRING 1995 REVENUE SOURCES 1,292,000 BARRELS / DAY HIGH

(D) TARIFF INCLUDES FIXED PROFIT PER BARREL @ \$0 54
AND VARIABLE OPERATING COST @ \$0 32
AND TAX ALLOWANCE @ \$0 36
TOTAL \$1 22

BASED ON CONVERSATIONS WITH ADOR PERSONNEL

(E) ASSUME 12% ROYALTY AND 6% SEVERANCE TAX

MARGINAL OIL FIELD DEVELOPMENT: THE ECONOMIC IMPACT

OIL-RELATED EMPLOYMENT (Table 5)

The most important source of new jobs to the economy comes from development and production of the field. Subsequent tables identify additional employment effects.

Oil-related employment is divided into three categories for both the development and production phases of marginal field life. The first category is the **DIRECT** employment in the oil and gas and construction industries involved with field development or production. Second is the **VENDOR** employment associated with providing the goods and services to the oil and construction sectors for development and production. This employment is in the transportation, wholesale trade, and business services sectors. The third is **INDIRECT** and **INDUCED** employment which consists of the private sector jobs throughout the economy stimulated by the multiplier effect of the development and production of the field.

The **VENDOR** and **INDIRECT** and **INDUCED** employment are calculated using the Alaska input-Output model based on the **DIRECT EMPLOYMENT** and instate purchases by the oil and construction industries in the development and production of the field. Alaska payrolls are calculated the same way.

We assume that a portion of **DIRECT** employment is nonresident, based on information provided by BP Exploration (Alaska), Inc., from their records and information from their contractors. We assume that all other employees are residents. Nonresident payroll is assumed to have a small impact on economic activity in Alaska. We assume 20% of nonresident payroll is spent in Alaska on the same market basket as resident payroll.

Total jobs (annual average) to Alaska residents from field development are 1,482. Since field development would take more than one year, these jobs would be spread over several years. Total jobs to Alaska residents from production are estimated at 157 for each of the 20 years of production. Total Alaska payroll from development is \$79.2 million, and total payroll from production is \$8.47 million annually.

TABLE 5: MARGINAL FIELD ANALYSIS: OIL RELATED EMPLOYMENT

	TOTAL DEVELOPMENT	ANNUAL PRODUCTION
EXPENDITURE IN ALASKA (MILLION \$)		
LABOR	\$99	\$10
EQUIPMENT	\$20	\$1
SUPPLIES	\$14	\$2
SERVICES	\$20	\$1
TRANSPORT	\$7	\$1
OTHER	\$0	\$0
DIRECT JOBS IN AK (MAN YEARS)	762	75
CONSTRUCTION	308	0
OIL AND GAS	455	75
JOBS HELD BY ALASKA RESIDENTS (A)	572	60
CONSTRUCTION	231	0
OIL AND GAS	341	60
DIRECT PAYROLL IN ALASKA (MILLION \$) (B)	\$76.25	\$7.54
CONSTRUCTION	\$30.77	\$0.00
OIL AND GAS	\$45.48	\$7.54
PAYROLL TO ALASKA RESIDENTS	\$57.18	\$6.03
CONSTRUCTION	\$23.08	\$0.00
OIL AND GAS	\$34.11	\$6.03
ITEM: NON-RESIDENT PAYROLL SPENT IN AK (C)	\$3.81	\$0.30
VENDOR JOBS IN ALASKA (D)	201	21
INDIRECT AND INDUCED JOBS IN ALASKA (D)	709	76
TOTAL JOBS	1,672	172
TOTAL JOBS TO ALASKA RESIDENTS	1,482	157
VENDOR PAYROLL (MILLION \$) (D)	\$5.86	\$0.71
INDIRECT AND INDUCED PAYROLL (D)	\$16.12	\$1.73
TOTAL PAYROLL	\$98.23	\$9.98
TOTAL PAYROLL TO ALASKA RESIDENTS	\$79.17	\$8.47
(A) RESIDENT SHARES OF DIRECT JOBS		
CONSTRUCTION	75%	80%
OIL AND GAS	75%	80%
(B) AVERAGE PAYROLL FROM ADOL	REMOTE SITE CONSTRUCTION	\$100
	OIL AND GAS	\$100
(C) PORTION OF NON-RESIDENT PAYROLL SPENT IN AK	20%	20%
(D) FROM ALASKA INPUT-OUTPUT MODEL		