ALASKA LEGISLATURE COMMITTEE FILES 1985-1986 8672

3598 HRES SB 294 - SB 309

474

REPORT CONCLUSION

Policy Issues

This report contains policy issues raised as a result of our evaluation of various Board practices. The final policy decisions affecting these practices are not within the scope of this report but require legislative consideration. In debating these issues, the oversight committees should take into consideration the findings and recommendations presented in this report so the potential impact of policy changes can be evaluated.

Report Conclusion

In our opinion, the Guide Licensing and Control Board should be reestablished. The regulation and licensing of qualified guides is necessary to protect the public's health, safety, and welfare. The Board provides this service by establishing minimum qualification and experience requirements that provide reasonable assurance that persons licensed are both capable of safely conducting guided hunts and familiar with their prospective guiding areas. Assurance that those licensed act in a competent manner is also provided by active investigation of complaints and revocation or suspension of licenses where appropriate.

However, the following findings describe areas where weaknesses or conflicts exist. We have made recommendations which, if implemented, will improve the efficiency and effectiveness of the Board.

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FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The Guide Licensing and Control Board (GLCB) should develop a prioritized set of criteria to use in assigning both exclusive and joint-use guiding areas (EGAs).

Alaska Statute 08.54.040(a)(8) allows GLCB to:

> Establish a quota of licensed operating guides who may operate within designated geographical units or subunits of the state and provide for an equitable and reasonable procedure for limiting the number of guides to that quota; preference shall be given to qualified available guides who reside within the designated game unit or subunit.

GLCB has implemented this provision through the establishment of both exclusive and joint-use guide areas (EGAs), which limit the number of guides who can conduct hunts in various regions of the State. The GLCB's authority to assign EGAs is supported by an April 1977 Attorney General memorandum which determined that GLCB's regulations and activities implementing exclusive guiding areas were within their statutory powers.

This limitation on the practice of guiding ostensibly provides public benefits by providing for better game management; promotion and enforcement of ethical guiding practices; enhancing the "wilderness" aspect of big game hunting experience by separating guided hunting parties; and allows for the separation of non-compatible forms of hunting. The limits are also designed to provide for a greater degree of safety to the guided hunter by allowing guides to become familiar with the terrain and seasonal weather conditions of their assigned area.

GLCB does not act consistently when considering the assignment of exclusive and joint-use guiding areas. The criteria on which any given area assignment decision is made varies from decision to decision. Additionally, GLCB often does not adequately document the basis on which they make their assignments. We found inconsistencies and contradictions in the way that GLCB applied the following criteria when awarding EGAs:

1. Game Management Information - GLCB does not consistently review game management information in their area assignment decisions. What game information they do consider usually is second hand and anecdotal, provided by applicants or current users (see Recommendation No. 2).

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CORRECTION

THIS DOCUMENT
HAS BEEN REPHOTOGRAPHED
TO ASSURE LEGIBILITY

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However, the following findings describe areas where weaknesses or conflicts exist. We have made recommendations which, if implemented, will improve the efficiency and effectiveness of the Board.

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2. Demonstration of Experience - When applying for an EGA, applicants must demonstrate that they have had guiding experience in the applicable game unit. Guides demonstrate their experience through the submittal to GLCB of a Statement of Financial Remuneration (SFR) for each guided hunt. SFRs list the names of hunters, guides assisting in the hunt, game units hunted, and the type of game taken.

   Under the Board's regulations, SFRs are the primary evidence of a guide's activity and familiarity with the game unit involved. However, we found instances where the Board awarded EGAs to guides with no SFRs in the appropriate game unit, while denying other EGA applicants because they had no SFRs on file demonstrating their experience or activity.

3. Transfers of guiding areas - GLCB has been essentially approving transfers of guiding areas with little or no consideration of any other criteria such as game management, objections of joint users, or experience of the guide receiving the transferred area (see Recommendation No. 3).

This inconsistency on the part of GLCB in its decision-making, along with the lack of proper documentation of its rationale, ultimately results in a loss of effective control over the activities and policy of the guiding industry.

During the past four years, hearing officers have repeatedly found Board decisions to be arbitrary and capricious with little or no support. In effect, the Board has abdicated much of its control over area assignments through its inconsistent application of criteria. Hearing officer decisions are beginning to effectively replace GLCB in setting quotas for guides. Essentially, GLCB has not fully met its statutory responsibility to adopt an equitable and reasonable procedure for the assignment of guide areas.

We believe GLCB's responsibility would be better met by identifying pertinent criteria to be used in area assignment decisions, assigning some priorities to those criteria, and applying them consistently.

Recommendation No. 2

GLCB should improve methods of obtaining game management information from independent sources, such as the Alaska Department of Fish and Game (ADFG).

One of the primary justifications for the whole concept of EGAs is to enhance overall management of the public's game resources. Guides are awarded exclusive or joint-use areas so that they have a long-term interest in managing the game

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This limitation on the practice of guiding ostensibly provides public benefits by providing for better game management; promotion and enforcement of ethical guiding practices; enhancing the "wilderness" aspect of big game hunting experience by separating guided hunting parties; and allows for the separation of non-compatible forms of hunting. The limits are also designed to provide for a greater degree of safety to the guided hunter by allowing guides to become familiar with the terrain and seasonal weather conditions of their assigned area.

GLCB does not act consistently when considering the assignment of exclusive and joint-use guiding areas. The criteria on which any given area assignment decision is made varies from decision to decision. Additionally, GLCB often does not adequately document the basis on which they make their assignments. We found inconsistencies and contradictions in the way that GLCB applied the following criteria when awarding EGAs:

1. Game Management Information - GLCB does not consistently review game management information in their area assignment decisions. What game information they do consider usually is second hand and anecdotal, provided by applicants or current users (see Recommendation No. 2).

in their EGA. GLCB has adopted regulations [12 AAC 38.053(d)(1)] that require it to consider an area's ability "... to sustain an additional guided hunting operation, in terms of game populations, terrain, methods of hunting, and use by other guides and hunters."

As stated in Recommendation No. 1, we found that GLCB rarely considers independent information regarding game populations and management concerns when assigning EGAs. GLCB relies on information provided by applicants and guides operating in the region under consideration. Certainly, the assessment of an active registered guide is important and should be considered. However, whether coming from an applicant or current user, it must be recognized that the guide has a vested interest in how the information is presented and interpreted.

Oftentimes, information presented to the Board is conflicting, depending on the desire of the guide. New applicants for areas claim game is plentiful, and the area is underutilized. Current users, on the other hand, emphasize game scarcity and hunting pressures.

If GLCB established better, more formal communications with ADFG they would better meet their regulatory and statutory obligation to enhance the management of the State's game resources. ADFG information may be no better than that of guides; however, it is more independent and more objectively developed. ADFG is charged with management of the State's game resources, and guided, non-resident hunters take up to an estimated 40% of the game in the State. We believe GLCB should attempt to improve communications and coordination with ADFG while taking steps to include their assessment of game populations and hunting pressures when considering assignment of EGAs.

Recommendation No. 3

GLCB should take more responsibility for area assignments by repealing regulations that allow a guide to designate to whom his EGA be reassigned.

Registered and master guides may each have a maximum of three EGAs. Typically, when a guide wishes to retire or perhaps become eligible for another, different EGA, he is allowed to turn back an existing EGA to the Board and designate the recipient of this reassignment. GLCB regulations currently allow, but do not necessarily require, this practice.

We found that these designated transfers override all other area assignment criteria. Essentially, GLCB has been automatically approving transfers of EGAs regardless of game management considerations, demonstration of experience

in the area by the transferee, and over the objections of affected joint users. Whereas GLCB evaluates, albeit inconsistently, regular area assignments, our review indicated they gave transfers much less scrutiny.

We believe that this lack of scrutiny encourages the practice of guides selling their EGAs to other guides in violation of GLCB regulations. With the Board giving little review to transfers, they greatly increase the potential of EGAs being awarded based solely on economic consideration; i.e., can the designated recipient afford to buy the area from its holder? This potential abuse is contrary to GLCB's statutory responsibility of establishing quotas for guide areas in an equitable and reasonable manner. We feel that all qualified guides for the area should receive equal chance at receiving an EGA, regardless of their ability to "buy" the rights from the previous holder.

By not adequately reviewing transfers of guide areas, the GLCB is missing an opportunity to achieve one of its stated policy goals. In the Board's FY 85 annual report, they state one of their policy objectives is to not allow additional joint use in areas that already have enough guides operating.

We feel that it would be better if the EGAs were surrendered to the Board; the Board review pertinent and prioritized criteria to determine if the region would support one or more additional guide operations; then consider all applications for the area under a equitable and reasonable method of allocation. Such a method could take into consideration unique qualifications such as a son or daughter who had worked as an assistant to their father, or perhaps a registered guide, who had "apprenticed" in the region under the surrendering EGA holder and accordingly, is more knowledgeable of the area than other applicants. By following such a procedure the Board would promote compliance with its own regulation restricting the transfer of guiding area permits.

Recommendation No. 4

GLCB should adopt procedures to improve the administration of the oral portion of the registered guide examination.

The oral portion of the registered guide examination is arbitrary and inconsistent in content and grading. This is because the examination content and grading guidelines are left to the discretion of the individual examiners.

To qualify for licensure as a registered guide, an applicant must successfully pass the registered guide examination. This examination, which is prepared and administered by GLCB, is composed of two parts, a written and an oral section. Passage of the examination requires the applicant to obtain a score of 80% on both sections.

GLCB procedures require the oral portion of the registered guide examination to be administered by three examiners, consisting of a Board member and two master guides. Questions asked by the examiners are based on an oral exam sheet, which does not limit examiners to specific questions nor does it provide predetermined question grading values.

This allows individual examiners to emphasize whatever subject areas they wish in the questioning of applicants. Despite the lack of specific grading criteria on which to base examination scores, instances were noted in which applicants narrowly failed exams by combined examiner scores as high as 79%.

The inconsistency of exam content and grading is demonstrated by the following example. In February 1985, an applicant failed the oral portion of the examination. The reason for failure noted by the examiners was that the applicant needed more hunting experience in the field. Examiners recommended the applicant obtain specific area experience along with spring, late fall, and winter experience. One month later, the applicant took the oral examination again, and was passed by an examination committee made up of three different examiners.

GLCB appears to have demonstrated its own doubts regarding the validity of oral examination results. GLCB's regulation 12 AAC 38.010(c), states the failure to achieve a passing score on either section of the examination constitutes failure of the entire examination. However, on several occasions, after having been petitioned by applicants who passed the written portion of the exam while failing the oral portion, the Board waived the requirement that the written portion of the examination be retaken.

The lack of specific guidelines dictating the objective administration of the oral portion of the registered guide examination has resulted in inconsistent content and grading between individual examinations. The likelihood of exam passage is as much affected by who the examiners are and their individual judgement as it is by the knowledge and competence of the applicant.

Structured guidelines governing the administration of the oral portion of the registered guide examination should be implemented by GLCB. These guidelines need to provide examiners with specific directions as to examination questions to be asked and their assigned grading values. If implemented, structured guidelines will provide a more objective means of administering the examination. This will provide the Board with more of a fair and consistent test of applicant competence.

Recommendation No. 5

GLCB should seek both statutory and regulatory changes in order to improve the protection of the public from unethical guiding practices.

One of the primary purposes of licensing and regulating guides is to protect the public from unethical guiding practices. We identified regulations and statutes that serve to block effective consumer protection action on the part of GLCB and serves to protect guides at the expense of the public. We recommend that GLCB enhance its consumer protection responsibilities by taking the following actions:

A. Pursue amendment of statutes that limit GLCB's authority to discipline guides for unethical activity.

B. Adopt regulations and/or recommend legislation to require guides to post performance bonds.

Statutory Constraints to Effective Disciplinary Action

Alaska Statute 08.54.200(a)(1) does not allow the Board to consider complaints of unethical or incompetent guiding practices until receiving complaints from "... three or more clients [hunters] of separate [hunting] parties."

In the course of our review we found four instances where guides had two allegations of unethical guiding activity, as defined by GLCB's regulations, but still had not been brought before the Board for review. Law enforcement officials told us that the statute requiring three separate complaints was particularly onerous for effective resolution of consumer complaints. Law enforcement officials are put in the position of consumer ombudsman, trying to mediate and negotiate settlements of hunter-and-guide or guide-and-guide disputes.

GLCB's effectiveness and visibility would be enhanced if all allegations regarding unethical guide practices was brought to it for review on a case-by-case basis. It appears that the intent of the statute was to keep down the number of frivolous and unfounded complaints against guides. Other professional licensing boards listen to, and sort through, all cases and complaints, no matter how trivial, as a means of keeping apprised of the conduct of their licensees. We recommend that GLCB begin doing the same.

Bonding of Guides

Almost all hunters who use guiding services are non-residents, a large number from outside of the United States. As a result, when disputes arise between guides and hunters it is often very difficult and expensive for the complaining

hunter to seek legal remedies or implement administrative action. This difficulty is compounded by the three complaint requirement of the statutes discussed previously.

In the course of our review, we noted four cases where a non-resident hunter and guide were disputing the refundability of a deposit. One example, two out-of-state hunters sent in deposits of $2,500 six months in advance of a hunt. Just prior to their departure for Alaska, the guide notified them that he would have to cancel their hunt. He offered to apply their deposits to a hunt the next year, but the hunters decided they wanted a refund. The guide did not respond to requests, and due to the statutory three complaint requirement, law enforcement officials were not able to bring the dispute before GLCB. The two hunters retained a Fairbanks attorney to pursue legal remedies, but soon abandoned the effort due to costs of litigation.

We recommend that GLCB pursue the necessary statutory and regulatory changes that would implement a mandatory requirement that guides post performance bonds. Performance bonds would allow hunters with legitimate grievances and claims against guides an easier, less expensive alternative in obtaining settlement of their claims. Guiding is a large industry in the State. It is important that GLCB do all it can to maintain the integrity of the guiding industry and uphold the reputation of the Alaskan guides with hunters outside of the State. The Board should recognize the unique type of consumer for guide services and take steps to adequately protect the interest of the out-of-state hunter/consumer.

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ANALYSIS OF PUBLIC NEED

Limited Analysis

The following analyses indicate both positive and negative factors as they relate to the public need as defined in the "sunset" law. These analyses are not intended to be comprehensive, but to address those areas we were able to cover during our review.

I. The extent to which the board, commission, or program has operated in the public interest.

A. The Board has adopted regulations defining unethical conduct which clarify and strengthen the professional's responsibility to the public.

B. The Board does not consistently review the Department of Fish and Game game management information prior to assignment or transfer of an exclusive guiding area (EGA) (see Recommendation No. 1).

II. The extent to which the operation of the board, commission, or agency program has been impeded or enhanced by existing statutes, procedures, and practices which it has adopted, and any other matter, including budgetary, resource, and personnel matters.

A. Regulation 12 AAC 38.054(b) allows an EGA permit holder to designate the qualified guide to whom he wishes to transfer his guide area. These transfers often take precedence over other guide area assignment criteria such as joint user objections, experience in the game unit, or game management considerations (see Recommendation No. 3).

B. Alaska Statute 08.54.200(a)(1) does not allow the Board to consider complaints of unethical or incompetent guiding practices until receiving complaints from three or more clients of separate parties regardless of the potential magnitude of the unethical act (see Recommendation No. 5).

III. The extent to which the board, commission, or agency has recommended statutory changes which are generally of benefit to the public interest.

A. Senate Bill No. 294, which was introduced in April 1985 by the Resources Committee, contains the following items which should enhance public protection if ratified:

1. An amendment to AS 08.54.010 would increase game management considerations in regulating guide activities (see Recommendation No. 2).

2. An amendment to AS 08.54.040 and a proposed new section (AS 08.54.195) would require consistency in procedures used in allocating EGAs (see Recommendation No. 1).

3. New sections would require those guides that contract with more than one client at a time (an outfitter) to maintain a surety bond of $5,000 (see Recommendation No. 5).

4. The bill would require closer supervision over assistant guides while in the field.

5. Unethical activities would be amended to include unsafe or unsportsmanlike actions that are detrimental to the game resources of the State.

6. Statutes dictating qualifications for, and restrictions on, transporters would be repealed. Many of the services now being provided by transporters would be subject to the proposed outfitter statutes contained in this bill.

B. Additional portions of SB 294 which do not appear to us to be in the public's best interest are as follows:

1. Current law limits the number of Board members that have guide licenses to no more than three of the seven members. SB 294's amendment of AS 08.54.010 would require that at least three Board members be active guides. This amendment would increase the potential for expanding the number of industry members on the Board at the expense of public participation.

2. Currently, AS 08.54.200(a)(1) does not allow the Board to consider complaints of unethical or incompetent guiding practices until receiving complaints from three or more hunters of separate parties. SB 294 contains an amendment of this statute which would require that these complaints be received within five years prior to the hearing date. This would compound those problems outlined in Recommendation No. 5.

3. Currently, AS 08.54.210(a)(6) makes it unlawful for a master or registered guide to employ or supervise more than three assistant guides at the same time.

   SB 294 would repeal this statute and could allow a master or registered guide to employ more assistants than they are capable of effectively supervising. The experience and professional judgement of the master or registered guide may not be available to clients when needed.

   Alaska Statute 08.54.141 of this bill also provides that assistant guides shall be supervised at all times while in the field on guided hunts. The potential problem noted above will depend on enactment of this new section and on the Board's interpretation of the term "supervised."

4. Enactment of amendments to AS 08.54.200(c)(3) may unnecessarily restrict those hunting statutes or regulations upon which the Board can take disciplinary action.

IV. The extent to which the board, commission, or agency has encouraged interested persons to report to it concerning the effect of its regulations and decisions on the effectiveness of service, economy of service, and availability of service which it has provided.

A. The public is invited to attend Board meetings and to give their input about the workings of the Board. Notices of meetings are advertised in at least five newspapers throughout the State. In addition, guides are notified by registered mail of meetings that might affect them.

B. Publication of meeting information does not always precede the meeting by a reasonable time period. We found that the public was given less than a one week notice for two of the last eleven Board meetings.

C. Teleconference meetings are not being noticed publicly. This limits public input at those meetings and may legally jeopardize Board decisions and actions.

V. The extent to which the board, commission, or agency has encouraged public participation in the making of its regulations and decisions.

A. As stated under IV, the public is invited, by published notices in newspapers, to attend Board meetings to give their input about Board regulations or submit written testimony.

B. Those problems noted in IV B and C above also represent potential problems in this public need area.

VI. The efficiency with which public inquiries or complaints regarding the activities of the board, commission, or agency filed with it, with the department to which a board or commission is administratively assigned, or with the Office of the Ombudsman have been processed and resolved.

A. Since July 1983, ten complaints have been filed with the Ombudsman's Office concerning Board activity. Only one of these complaints, alleging improper denial of a registered guide license, was found to be justified.

B. Since August 1984, 19 complaints against guides have been submitted to the Department of Commerce and Economic Development, Division of Occupational Licensing for investigation. These cases appear to have been investigated in a reasonable fashion and are pending Board action or court rulings.

C. As mentioned in III above and in Recommendation No. 5, AS 08.54.200(a)(1) does not allow the Board to consider complaints of unethical or incompetent guiding practices until receiving complaints from three or more hunters of separate parties.

VII. The extent to which a board or commission which regulates entry into an occupation or profession has presented qualified applicants to serve the public.

A. As of September 1985, 46 master guides and 361 registered guides were licensed in Alaska. These individuals were required to pass both a written and an oral exam, as well as obtaining practical experience in the field, prior to licensure.

B. The oral portion of the registered guide examination is arbitrary and inconsistent in content and grading. This is because the examination content and grading guidelines are left to the discretion of the individual examiners (see Recommendation No. 4).

VIII. The extent to which State personnel practices, including affirmative action requirements, have been complied with by the board, commission, or agency to its own activities and the area of activity of interest.

A. The Board established 12 AAC 38.010(c) whereby an applicant for licensure who:

> because of a language barrier, is unable to read and competently understand the English language may be excused from taking the written examination, and may be issued a license based on successful completion of the oral portion of the examination and demonstration of his capabilities and experience.

B. Regulations also provide that when assigning guide area permits,

> the board will give preference to qualifying guides whose permanent residence is within the district in which the area is located.

IX. The extent to which statutory, regulatory, budgeting, or other changes are necessary to enable the agency, board, or commission to better serve the interests of the public and to comply with the factors enumerated in this subsection.

Please refer to the previous section, Findings and Recommendations.

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APPENDIX A

GUIDE LICENSING AND CONTROL BOARD
REVENUES COMPARED WITH EXPENDITURES
June 30, 1985
(UNAUDITED)
(Note 1)

	FY 83	FY 84	FY 85
Revenues (Schedule 1, Note 2)	$46,000	$53,735	$88,678
Expenditures (Note 3)	21,663	13,483	11,777
Excess of Revenues over Expenditures	$24,337	$40,252	$76,901

Schedule 1
Types of Revenues
(Note 4)

Revenues	Amount	Collection Time
Master Guide License	$150	Biennially
Registered Guide License	150	Biennially
Class-A Assistant Guide License	30	Biennially
Assistant Guide License	20	Biennially
Transporter License	10	Biennially
Application For A Guide Examination	25	With Application

Note 1

This revenue/expenditure comparison was prepared from available reports prepared by Occupational Licensing personnel. The records were not audited by us and, accordingly, we do not express an opinion on the Board's Revenues Compared with Expenditures.

Note 2

Revenue amounts reported do not include revenue obtained from the sale of game tags or hunting licenses. They only include revenue obtained from fees required to obtain and/or renew guide licenses.

Note 3

Expenditures consist of direct costs resulting from Board activities. These include miscellaneous contractual, travel, and per diem costs incurred by Board members and the Board's licensing examiner. The amounts do not include the administrative expenditures of the Division of Occupational Licensing such as employee salaries or the expenditures made to other departments such as the Department of Law, which assist the boards and the Division.

Note 4

Amounts reflected are those established by statute for FY 85. Chapter 37, SLA 1985 provides that the Department of Commerce and Economic Development shall set license fees effective upon adoption of said regulations.

APPENDIX B

GUIDE LICENSING AND CONTROL BOARD EXAMINATION STATISTICS

Number of Examinations Given in FY 1984-1985 (Note 1)

Fiscal Year	Written Exam		Oral Exam		Total
	Passes	Fails	Passes	Fails	
1984	22	13	26	7	41
1985	19	9	17	4	30

Note 1

Licensure as a registered guide requires a passing score on both a written and oral examination. Licensure as a master guide requires a passing score on an oral examination only. Licensure as assistant guides and transporters does not require examination.

APPENDIX C

GUIDE LICENSING AND CONTROL BOARD
ADMINISTRATIVE STATISTICS
September 30, 1985

Currently Licensed

Master Guides	46
Registered Guides	361
Class-A Assistant Guides	139
Assistant Guides	829
Transporters	141

Board Meetings Between July 1, 1983 and June 30, 1985

July 17-22, 1983

October 25-26, 1983

December 7-13, 1983

March 12-17, 1984

December 13-14, 1984

February 9-17, 1985

March 18-19, 1985

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT

DIVISION OF OCCUPATIONAL LICENSING

POUCH D
JUNEAU, ALASKA 99811
PHONE: (907) 465-2534

December 23, 1985

Mr. Gerald L. Wilkerson
Legislative Auditor
Legislative Audit Division
Pouch W
Juneau, AK 99811

Dear Mr. Wilkerson:

Re: Preliminary Audit Findings
Guide Licensing and Control Board

Thank you for the opportunity to comment on your preliminary audit report on the Guide Licensing and Control Board.

Our position remains the same from previous correspondence in that, we concur with your findings and recommendations, and also support continuation of the board. We once again offer the following comments regarding your recommendations:

In reference to recommendation #1, it is important to note that many of the actions or decisions made by the Guide Licensing and Control Board were made upon advice and support of counsel from the Department of Law. This is done especially in relation to your finding that hearing officer decisions are replacing that of the Guide Licensing and Control Board where setting quotas for guides are concerned. However, we believe the board has demonstrated an honest effort to act accordingly within the parameters of what they perceived to be correct, based on legal advice.

Regarding recommendation #4, this matter was brought to the attention of the board by staff of the Division of Occupational Licensing during previous board meetings. Although the board did acknowledge the need to address this issue, no time was given to address the oral examination for registered guides.

We strongly support your suggestions in recommendation #5 and feel that, although performance bonds posted by master and registered guides may not be entirely adequate to rectify all complaints, it would certainly allow some means of restitution for injured parties from receiving unethical services.

Thank you once again for the opportunity to comment on your findings and for your cooperation.

Sincerely,

Loren H. Lounsbury
Commissioner

LHL/sal444s
122385b

The Legislature
Budget and Audit Committee
Jim Griffin, Auditor

Recommendation #1

The Guide Licensing and Control Board (GLCB) uses the Statements of Financial Remunerations as proof of use and experience in areas when assigning Exclusive Guide Areas (EGA). There have been discrepancies in the paste, the last year the GLCB have been adhereing closely to the critera of using SFRs. The GLCB seeks biological and Fish & Game surveys when they are available. This cannot always be done. Some areas Fish & Game haven't run surveys or recent surveys. Most of the time, the GLCB dosen't know which areas will be before them until the applicant comes before the GLCB with his application. This dosen't allow enough time to obtain the information. In cases that are held over and coming before the GLCB at a later date do allow time for soliciting biological information from the Fish & Game biologist located in the area involved. I have solicited Fish & Game information in several cases that are coming before the GLCB this next meeting in December 1985.
I hope to get a regulation passed that requires an applicant applying for an EGA to obtain this information from the Fish & Game for presentation to the GLCB.
Along these lines there also should be a regulation requiring the same critera for a transfer be the same as a new applicant. That is to show proof of experience in the area as would a new applicant. And going farther, an applicant for a transfer from an EGA holder to himself show proof of working with the EGA holder for a certain time. One or two years. Co-signing SFRS could be used as proof as well as additional proof, either in EGAS or joint use areas.

Recommendation #2

Regulation (12 AAC 38.053 (D) (1) applies mostly to applications for joint use areas and EGAs being applied for by more than one guide. The proposal to pass a regulation requiring the applicant to obtain Fish & Game biological information on the area applied for will help in this area.

Recommendation #3

I do not agree that an EGA holder should have to surrender his EGA to the GLCB and not have the opportunity to transfer the EGA to a guide of his choice with the approval of the GLCB.
There are many cases where an EGA holder has farmed his area, carefully not to over harvest, so has improved both game populations and size of the animals in the area. To enhance game populations and sportsmen enjoyment is one purpose of the GLCB.
Financial investments should also be cinsidered in transfers, land, buildings and equipment related to guiding in the area.
A guide who has spent many years building up an area with improvements to game populations should certainly have something to say about whom's care the area comes under. Son, Daughter, apprentice or aguide who is well qualified to guide in the area.

The GLCB has a policy not to issue a new applicant an area in joint use. In other words filing over an area that is already in joint use, or use by only one EGA holder. The GLCB is working to eliminate as much joint use as possible. This can only be done through natural attrition. The GLCB cannot choose two permit holders out of six joint users and pull their permits without due cause. I do think, and it has been the GLCB;s policy the last two years. A Ega holder is convicted of some violation that merits revoking his area that is in joint use with others, that area will not be reassigned ..
Where the area is extemely large and dosen't have many joint users some leeway should apply to a new applicant. The guide losing the area should not have a say one way or the other.in the matter. However, in cases such as this very careful scrutiny in all critera must be made. One thing along these lines. At one time the intent of GLCB to review and reassess all EGAS. Considering size, utilization and condition of game populations. This was never done, primarily because time and budget restrictions wouldn't allow it.

Recommendation #4

Oral guide examinations;

There are inconsistencies in administering oral tests. The purpose of the oral test is to determine the applicat's practical field experience and knowledge of game habits, size and the area he is being tested for. Most of this is impossible to determine with a tightly held oral tests with set questions and answers. The examiner should have some flexibility but should not be allowed to wonder far afield and asking impertinent questions. There should also be a standard time for the test, say 1 or 1½ hours. One problem that keeps cropping up is first aid. I propose that an applicant be required to have passed a first aid course with in the year prior to taking the guide exam.
The GLCB has been trying to upgrade this portion of the guide test. Here again, the increasing number af applications for testing each meeting is also increasing the work load of the GLCB.

Recommendation #5

There should be some changes in Statute 08.54.200 (A) (1). The change should give the GLCB some flexibility on guide complaints. Taking in consideration of theseverity of the complaint. Endangering life, flagrant game violations,and unethical practices, etc.
The GLCB does have a guiding ethics regulation (12AAC 38.180) The complaint are slowly being corrected since the adminstration was consolidated in the Department of Commerce, Division of Occupational Licensing. The GLCB investigator is investigating all compliants that come in now.

We are trying to get a section in the new guide bill, (Senate Bill #294) to satisfy the change mentioned above. Bonding is already addressed in S294.
The bill also creates an outfitter's license and repeals the transporters license. This should help to alleviate the wide spread unlicensed guiding. These unlicensed guides are a big factor in guiding complaints.

The bill also goes into more detail on what guiding is. Enforcement people say the present bill dosen't explain guiding enough for them to make a case on unlicensed guiding. The new bill should give them the tools they need to enforce that section.

The GLCB would like to conduct more work on all these programs and others as well.

It is very important to the guidin industry that the GLCB not be sun setted. If the guide bill is not extended or a new bill passed, the guiding industry will be plunged into a chaos that it could never recover from. Just about everyone with a super cub or 185 will become instant guides creating an impossible situation for game populations and sportsmen safety.

An addition to recomendation #4.
At this last GLCB meeting we appointed 2 master guides and a registered guide to study the oral test and make up a new one that would standardize the test. These men all have an educational background.

Comments Regarding Interim Letter #1
Sunset reveiw GLCB

Recomendation # 1.

I agree with all of Mr. McNutt's comments. In addition I might add. There have been a number of meetings to establish a point for awarding and transfering guiding areas. The suggested method that had the most merit was to award points for criteria relateing to use of the area, financial investment in the area, residence alternate areas, etc. I would suggest that those who did so much work on this system be contacted and a system be finalized and approved. This will eliminate most of the criticism related to transfers.

Recommendation # 2.

Agree with Mr. McNutt.

Recommendation #3.

I completely agree with Mr. McNutt's comments and would like to add emphasis here. The assigned area concept will do more to elevate the quality of guiding in Alaska than any change in years. It gives the area holders a responsibility toward the area and game. Now through leases from the state and permits from the federal government, it will be possible for guides to build permanent structures in many areas. The guides will continue to increase their investments in areas. As the investment both in time and monatary increases so does the guides financial responsibility increase. After working for years to build a high quality operation it seems only just that upon retirement the permit holder would be able to choose his successor, who in nearly every case would be the most qualfied person for the tranfer no matter what seletion criteria were used. There have been abuses of this in the past as there were some transactions that seemed to be merely real estate sales. The GLCB is aware of this and is taking a firm stance against real estate dealers,. It would seem that guiding like any other business would allow a successful and ambitious business man to build some value into his business so that when it came time for retirement he would have something to sell. Because the guiding business envolves land and resources that belong to the public, the burden of responsibility upon the area permit holder is great. aside from his investment in property and equipment the value lies in his concessionary right to the area and it's wildlife. If he has treated these right with regard and respect and obeyed all covenents both moral and legal it seems only right that he should be able to sell this right to another qualified individual of his Choosing. This would allow him to maximize the return for his investment.

Recommendation #4.
The GLCB commented on this in addition to Mr. McNutt's comments and covered it quite thoroughly.

Recommendation # 5.
Agreed with Mr. McNutt.

These comments were made by James Harrower, member GLCB.

Testimony: Mr Ed Whitecougar
Glennallen, Alaska.

I will began by stating that many of the following ideas are not only my own but those of long established guides, law enforcement officials and state employees.

We believe the only way to have proper control with fair and unbiased decisions would to put the guiding industry back under the control of F&G. These would be full time paid professionals who would be unbiased and objective in their decisions. Since they end up enforcing the laws it would make sense to give them control. The present system is biased, self serving and unfair not only to many guides but to the general public. We can't continue to let the foxes watch the chickens.

I would ask the resources committee and this legislature to delay passage of S.B. 294until a complete,professional, and objective investigation can be made of the complete guiding industry. The present guide statutes, regulations, S.B. 294, and many of the decisions made by the guide bd. are biased, discriminatory, and unfair. Since the present system will continue for a year it will give the state time to develop a new system to clean up the existing mess.

I propose that a panel consting of guides, reg. and assist.F&G , and public sector people review and rewrite acomplete new set of laws to regulate the guiding industry. Then and only then can we have laws that are fair and can be adminstered objectively, The guiding industry has had it's chance to poli ce itself and failed miserabley. Greed and utter disregard for individual fights have caused the guiding industry to cut it's own throat.

The present system is VERY COSTLY to the state and individuals who must resort to adminstrative hearings and court hearings with expensive attorney fees to attempt to obtain justice in a fair and equatible way. The bd. constantly makes mistakes and pleads ignorance of the laws which govern it.

Please review s.b. 294, the existing statutes and regs. and the minutes of previous gd. bd. meetings looking for driscriminatory and unfair laws and decisions. I will cite a couple examples.
08.54.200 Why should a guide be allowed TWO violations before his license is revoked? What citizen is allowed two violations? It also states may revoke n ot shall revoke. You can bet if you are a good ol boy it won't be revoked. Proposed legislation 12 AAC 38.140 Applicant must hold a current first aid certification. Why not ALL guides must hold such certification. In the minu tes you will find more than one reference to guide areas being sold. I b elieve all transfers of guide areas that were sold should be void.

No member of a bd. except for the 3 guides is supposed to have a vested interest in the profession the bd. regulates. Check the occuption of the gd. bd. members.

The laws also establish a double standard within the industry. Many assi st. class a guides are exploited by the good ol boys. Many of these are native guides. Also many guides make no attempt to train the assist. guides to help them move up; in fact many of them attempt to restrict their attempts to obtain a reg. license.

The practices of the guiding industry can and do erode public confidence in state government. Do not let the high pressure lobbying efforts of the guiding industry cause you to overlook the abuses fostered by the present system. S.B. 294 is only a continutition of the present unequatable system. There must be a set of laws that treat all citizens fairly and a bd. that administers those laws objectively.S.B. 294 and the present guide bd. does neither.

If you doubt what I say send a questionef to ALL guides requesting their opinions and comments. Keep it confendital as many of the guides fear repercussi ons

I have not bothered going into extensive and detailed account of either the discrimintory laws or biased decisions I have presnelly seen. I will not waste your time with war stories. I only ask for no gd. bill to pass so as to allow those of us who are intrested to have an input in an objective set of laws that will not only protect guides but be fair to all citizens and protect our wildlife recources. To allow these abuses to continue by passage of the presently introduced gd. bill would be a grave injustice not only to good guides but to all citizens of our state and to the clients who bring a lot of money into the state. The existing laws and decisions are probaly unconstitutional and are definately descriminatory and biased to a select few.

I have presonally been a victum of both a reg. guides illegal o opreation and the discriminatory practices of the bd. There is presently an investigation into my case by the division of occup. licensing. Mine is only one of many such incidents which have occured over the years. Since the gd. bd. has moved from the control of F&G it has had a very poor record and image. This is not to say that there have not been well meaning people who have given their time. I have never seen an occupation such as guiding with the ability to govern itself fairly and objectivly. Our government is filled with checks and balances to avoid the sitution we have with guiding.

The gu iding industry is facing a very uncertin future. The native land claims and their right to manage their own lands plus declining game populations and increased resident pressure will make it much more important to have a system that all citizens have confidence in.

The day of the GOOD OL BOYS and their monopoly of our recources is over and must be repleced with a fair andequatable system.

Integrity has a price and we must have the courage to pay it Now.

More money must be given to the enforcement division also. Each guide must believe each of his clients is an undercover agent. Because of the isolation where the hunts take place it is too easy to violate the law. The are too many illegal guides that serve too many illegal hunters and cheat everyone. The laws must be rewritten to force these outlaws out of business once and for all. Illegal guiding is too lucrative and the penalties must be severe enough to eliminate this practice. Too many guides are unable or rather unwilling to adapt to the new laws. They continue to operate as they did in the good ol days. The existing laws are also left over from the past and must have a through overhaul. Please insure this by not passing S.B. 294. This bill will insure we continue to have the problems that now exist. Please don't force us to put up with this un fair system another four years.

RECORDS CERTIFICATION

I, the undersigned, an employee of the State of Alaska, do hereby certify that the microfilm images on this microform are accurate reproductions of the original records of the State of Alaska as accumulated during the regular course of business, and that it is the established policy and practice of this State to microfilm its records and to dispose of the original records after microfilm reproductions have been made.

James O. Smith
Signature of Camera Operator

9/5/89
Date

02-519 (REV 8/78)

SB

309

May 1, 1986

TESTIMONY OF KAY BROWN, DIRECTOR, DIVISION OF OIL AND GAS
TO HOUSE RESOURCES COMMITTEE
ON PROPOSED HOUSE RESOURCES CS FOR CS SB309

Thank you, Mr. Chairman. For the record, I'm Kay Brown, Director of the Division of Oil and Gas for the Department of Natural Resources. I appreciate this opportunity to testify.

The bill before the committee was intended to benefit Alaska gas and electric consumers. We don't believe it is prudent to try to address other issues -- such as how to value the royalty share of gas production sold for industrial and export uses -- in this consumer bill.

The Department of Natural Resources supports the House Oil and Gas Committee Substitute for SB 309. We object to the proposed Resources Committee Substitute, which addresses industrial and export sales. If the legislature insists on addressing industrial and export sales, we have previously

provided language that would accomplish this in a way that protects the state's interest.

The approach suggested in the proposed Resources Committee Substitute is not acceptable. Let me explain why.

Fundamentally, we believe that the burden must be on the lessee to show that the royalty value is a fair value, and not on the Commissioner to show that it isn't.

The department believes it is appropriate to accept a contract price as the royalty value for arms-length sales to regulated utilities -- as provided in the House Oil and Gas Committee Substitute for SB 309 -- because Alaska consumers would be the direct beneficiaries of any royalties lost to the state as a result of using solely the contract price to establish royalty value. We do not believe that industrial and export gas uses should receive the same exception, since the likely effect would be to increase the profits of industrial and export concerns without a corresponding public benefit.

The proposed Resources Committee Substitute significantly erodes the state's rights under existing oil and gas leases. It would bind the state as landowner to prices established in contracts to which it was not a party, and, contrary to

the provisions of the leases, would forego royalties the state is entitled to receive.

Further, the proposed CS does not include language authorizing "below market" sales of royalty gas for consumer uses, which was included in previous versions of the bill and which is an important element of the department's preliminary settlement agreement with Chugach Electric. We recommend that this language be restored.

The proposed Committee Substitute expands the presumption that a contract price is the correct royalty value to cover virtually all arms-length contracts, whether for consumer or industrial purposes. There is no assurance that a contract would be structured to reflect the true value of the gas.

The department believes that adoption of the proposed Committee Substitute would adversely affect the state's ability to collect royalties in several important instances. For example, Marathon Oil Company has advised the department that it intends to take gas from new fields (not covered by past royalty settlements) to its LNG plant in Cook Inlet. Presumably Marathon will sell the gas as LNG to a Japanese purchaser not related to Marathon in management, ownership or other aspect. Thus, Marathon would be entitled to the presumption of use of the contract price under the proposed

Committee Substitute. However, the state would not be able to effectively challenge a low royalty value claimed by Marathon due to charges associated with liquifying and moving the gas. The contract price alone does not determine royalty value; other aspects of the transaction such as transportation and LNG facilities must be considered if the state's interests are to be protected.

Obviously the potential fiscal impacts of this bill are magnified with regard to the huge gas reserves of the North Slope. With North Slope gas, it is well known that pipeline, liquefaction and shipping charges will be very large. As with Cook Inlet LNG, the state will need to be vigilant to assure that the value of the gas is not attributed to these other segments of the export project. It is illuminating that millions of dollars and almost 10 years have failed to yield a concensus on the proper costs of the TAPS construction project. Yet this bill could require a Commissioner to make even more complex determinations, with no guaranteed access to necessary information, within 90 days.

At a minimum, the state must have the ability to scrutinize all elements affecting a sale for industrial and export purposes, such as pipelines, LNG facilities and LNG tankers. Further, the lessee must have the burden of providing all

information necessary for the commissioner to make an informed decision, as well as the burden of providing clear and convincing evidence that the value of the gas is reflected by the gas sales contract price rather than being attributed to transportation, marketing, manufacturing or other profit or cost centers.

Further, the commissioner should have the ability to approve use of a contract price for a lesser period of time than that covered by the lessee's gas sales contract, and to provide for a periodic review of the royalty value term by the commissioner.

Without these minimum protections for the state, the proposed Committee Substitute is unacceptable.

As drafted, the proposed Committee Substitute would require use of an arms-length contract price as the royalty value unless the commissioner makes a written finding based on clear and convincing evidence that

(A) the contract price is unreasonably low;

(B) the prospective reduction in royalty receipts would not be balanced by increased benefits to in-state consumers; and

(C) the contract price is not in the best interest of the state.

All three conditions would have to be satisfied before the commissioner could reject a contract price, a more difficult standard than finding that any one of the conditions exists. Thus, even if the Commissioner had clear and convincing evidence that using the contract price to establish royalty value would be adverse to the state's best interest, the Commissioner would nonetheless be obligated to bind the state to the disadvantageous royalty value if the other two standards could not be proven by the same high evidentiary standard.

As a practical matter, it would be virtually impossible for the commissioner to obtain clear and convincing evidence to show that a contract price was unreasonably low and not in the state's best interest within the 90-day timeframe provided. The lessee would control access to the necessary information. Lessees have an understandable desire to minimize royalty payments, and no incentive to cooperate by providing proprietary information that the commissioner might request in order to make a decision. The lessees conceivably could spend years devising a complicated pricing formula that the Commissioner would be asked to approve in only 90 days.

In summary, Mr. Chairman, we are disappointed that this bill which we have supported in order to benefit gas and electric consumers may be broadened to cover industrial and export uses without adequate protection for the state's interests. We urge the committee to adopt the House Oil and Gas Committee Substitute, with the addition of the words "based on clear and convincing evidence" after the word "finding" on page 1, line 28 of that bill. If the committee deems it necessary to address industrial and export uses, we recommend use of the language included in Commissioner Wunnicke's April 22 letter to Co-chairman Shultz.

Thank you for your time and consideration.

HOUSE

COMMITTEE REPORT

2/2

(9)

Date referred: 4/21/86

FURTHER REFERRALS: FINANCE

DATE: May 1, 1986

The RESOURCES Committee has considered CSSB 309(Rls)

"An Act relating to royalty gas contracts; and providing for an effective date."

and recommends:

[ ] do pass

[ ] do not pass

[ ] do pass with attached amendment(s)

[ ] no recommendation

[✓] replace with HCS CSSB 309 (Resources) [X] same title

[ ] new title

and recommends DO PASS

[ ] further referral to the _____ Committee

and attaches: [ ] letter of intent
[ ] first fiscal note
[ ] new fiscal note
[ ] zero fiscal note

SIGNING DO PASS:

Shultz Dick Shultz

Miller M. W. Miller

Jenkins Tom Jenkins

Pearce Sue Pearce

Cato Peter Cato II

Thompson David W. Thompson

SIGNING OTHER RECOMMENDATIONS:

Ray Wallis do not pass

Wallis

Edmund Herrmann

Herrmann

Do Not Pass

Not enough time spent in Resources on bill

Co-Chairman Dick Shultz

Shultz

STATE OF ALASKA 1986 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date: 2-11-86

REQUEST

Bill/Resolution No.: HB 425
Title: ...Royalty Value of a Natural Gas Lease

Sponsor: Rep. Pearce
Requestor: Oil & Gas Res Comm
Date of Request: 02-11-85

FISCAL DETAIL

Agency Affected: Natural Resources
BRU: Petroleum Management

Components:

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING						
CAPITAL						
REVENUE	(2,300)	(1,900)	(1,900)	(1,900)	(1,900)	(1,900)

FUNDING : (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL						

POSITIONS :

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : Attach a separate page if necessary

FY 86 revenue losses include obligations incurred by producers since March 1985 royalty enforcement notice. See attached explanation.

Prepared by: Ned Farquhar NF
Division: Commissioner's Office
Phone: 465-2400
Date: 02-11-86

Approved by Commissioner: Norm D Arnold, Deputy
Date: 2/11/86
Agency: Natural Resources

Distribution (by Agency preparing fiscal note):
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

10/25/85

1st DNR Fiscal Note.

Fiscal Note Background
for HB 425

Passage of HB 425 would prevent enforcement of existing royalty collection provisions in Beluga Field oil and gas leases, and enforcement of royalty gas provisions in other fields. This fiscal note represents the impact of the legislation only on the Beluga Field royalty collections, although there are likely to be impacts in other fields.

The State issued an enforcement order for the Beluga Field in March, 1985, effective April 15, 1985. While the notice is contested by producers, there have been no payments made; if the notice were implemented as written, the State would currently receive $2.8 million/year in increased royalty payments. Because the State has offered to settle the lawsuit at a lower value than embodied in the enforcement notice, however, the fiscal impact has been estimated at the proposed settlement value ($1.50/mcf) that would be lost if SB 309 passes rather than at the value that would be recovered under the original notice.

Some of the revenue loss will be felt by the Alaska Permanent Fund, which receives 25% of the revenues from state oil and gas leasing. The remainder of the impact will be on the General Fund.

There will be other significant but currently incalculable fiscal impacts from passage of the bill. If the bill passes, the State will not collect full royalty value (as stipulated in existing oil and gas lease forms) prospectively on other state leases producing gas. Additionally, producers may seek retroactive compensation for what they may regard as past royalty overpayments, including several recent settlements on royalty gas pricing in Cook Inlet.

If the Legislature's action affects the State's position regarding valuation of other State royalty oil and gas (most notably North Slope oil) there could be revenue losses amounting to tens or hundreds of millions of dollars.

Bannister
4/28/86

Original sponsors: Faiks, Kelly,
and V.Fischer

IN THE SENATE BY THE RESOURCES COMMITTEE

HOUSE CS FOR CS FOR SENATE BILL NO. 309 (Resources)

IN THE LEGISLATURE OF THE STATE OF ALASKA

FOURTEENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to royalty gas contracts; and providing for an effective date."

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

* Section 1. FINDINGS. The legislature finds that to provide for the utilization, development and conservation of gas resources for the maximum benefit of the people of the state, the value of production of gas for purposes of computing the royalty reserved to the state must be based primarily on the contract price of the gas. This will encourage stable markets, promote investment, assure reasonable energy prices and provide the maximum benefit to the people of the state. The legislature does not intend this Act to apply to the policies of the state regarding the sale of royalty oil.

* Sec. 2. AS 38.05.180 is amended by adding new subsections to read:

(aa) Within 90 days after the written request of a lessee of a lease issued under this section, the commissioner shall enter into an agreement with the lessee to use the price for the gas established in the contract between the lessee and a purchaser as the value of the state's royalty share of gas production sold by the lessee under the contract unless

(1) the lessee and purchaser are related in management, ownership, or other aspect; or

(2) the commissioner makes a written finding based on clear and convincing evidence that

(A) the contract price is unreasonably low;

(B) the prospective reduction in royalty receipts would not be balanced by increased benefits to in-state consumers; and

(C) the contract price is not in the best interest of the state.

(bb) In (aa) of this section

(1) "price for the gas established in the contract" includes tax reimbursement amounts, deliverability and other charges, and other forms of consideration paid by the purchaser under the contract;

(2) "state's royalty share of gas production" does not include the state's royalty share of gas production from land patented to the state under

(A) P.L. 84-830, 70 Stat. 709 (Alaska Mental Health Enabling Act);

(B) 38 Stat. 1214 (Act of March 4, 1915); or

(C) 43 U.S.C. 1635 in settlement of the claims of the state under 38 Stat. 1214.

* Sec. 3. AS 38.05.180(aa), enacted by sec. 2 of this Act, applies to agreements to establish for a lease issued under AS 38.05.180 the in-value royalties on gas production that is sold by the state's lessee under a contract entered into on or after the effective date of this Act.

* Sec. 4. This Act takes effect immediately in accordance with AS 01.-10.070(c).

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

BILL SHEFFIELD, GOVERNOR

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

April 28, 1986

The Honorable Drue Pearce
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Representative Pearce:

You have asked the Department of Natural Resources to articulate in writing the problems with the original version of Senate Bill 309, relating to royalty gas contracts.

The bill provides that if royalty gas is taken in value, "the value of production sold under a long-term sales contract may not be greater than the price received for the production under the long-term sales contract unless it is shown by clear and convincing evidence that the long-term price was unreasonably low at the time of the contract."

The Department believes the bill would not protect the state's interests for these reasons:

- The bill significantly erodes the state's rights under existing oil and gas leases, which are contracts entered into many years ago between the state and the lessees. The leases provide that the state is entitled to royalty payments determined by the higher of the price received by the lessee under its sales contract, or the value of the gas at the time of production. The price received under a long-term gas sales contract does not control royalty valuation in those instances where inflation and market forces have caused the current value of the gas to be higher than the contract price. Thus, adoption of SB 309 would result in lower royalties for the state.

- The bill does not distinguish between consumer and industrial uses, nor between arms-length and non-arms-length sales. The effect of the bill would be to require use of a contract price in virtually all cases.

The department believes it is appropriate to accept a contract price as the royalty value for arms-length sales to regulated utilities (as provided in the House Oil and Gas Committee Substitute for SB 309) because Alaska consumers would be the direct beneficiaries of any royalties lost to

10-J9LH

the state as a result of using solely the contract price to establish royalty value. The department is not persuaded that industrial gas uses should receive the same exception, since the likely effect would be to increase the profits of industrial concerns without a corresponding public benefit.

The department is particularly concerned about being required to use a long-term contract price as the royalty value for non-arms-length sales. For example, an integrated oil company which produces gas may sell that gas to its subsidiary at any price it chooses. This provision invites manipulations to avoid royalty obligations. Even "prices" set in bad faith with the sole intent of avoiding royalties would have to be accepted by DNR unless DNR proved not only that the "price" was low, but that it was "unreasonably low". Thus, the department does not believe the public interest in maximizing the value of state-owned oil and gas resources is protected by the language in SB 309, particularly in the case of non-arms-length sales.

- The bill provides a limited ability to reject a contract price as the royalty value if it can be shown by clear and convincing evidence that the long-term contract price was unreasonably low at the time of contract.

This exception to the presumption of use of the contract price is far too limited. A contract price that may have been reasonable years earlier but that is not adjusted to keep pace with the market through escalators or reopeners would not be a fair value for the state's royalty. Moreover, the history of the state's oil and gas royalty enforcement has demonstrated that the lessees' natural desire to minimize their royalty payments, when combined with their superior access to and control over information, has necessitated litigation to ensure the proper return to the state for its resources. Although federal law entitles the royalty enforcement agency's determination of royalty value to deference by the courts, in Alaska no such deference is due. The original SB 309 would take the unprecedented step of further handicapping DNR's lease enforcement capability by requiring that deference be given to contract price, even where it is set in bad faith in a non-arm's-length contract.

- The bill would apply retroactively. This provision is not in the state's interest. The lessees who acquired leases through competitive bidding formulated their bids on the basis of the specific lease provisions. To retroactively change material terms of a competitively bid lease contract is legally questionable, and would undermine the state's

ability to enforce other lease terms by encouraging lessees to lobby the legislature whenever DNR takes lease enforcement action.

• Some have asserted during legislative debate on SB 309 and the various committee substitutes that the state's interests are protected due to its ability to take royalty gas in kind. If the state thinks a contract value is too low, the state can take its gas in kind and sell it for a higher value, some have argued.

In kind taking is a safeguard of questionable value. The gas market is limited -- especially on a day-to-day basis. More importantly, the state is in a very disadvantageous marketing position. Royalty contracts must go through administrative and legislative procedures that discourage potential buyers. The state, unlike the producers, cannot control the volume of gas under any in kind sale, since the state simply takes a percentage of the amount produced and sold by the lessees. The state's ability to meet a potential customer's volume needs is obviously seriously handicapped by the fact that the state's royalty volume is a fixed 1/8th of whatever the lessees happen to produce in a given period. Lastly, while the state's royalty share is substantial, it comes from many wells in many fields. This provides a unique extra impediment to the state by augmenting the practical problems of collecting and delivering the gas.

• The original SB 309 may contravene important legal principles, and the policies upon which those principles are founded. Under separation of powers principles, the legislature is charged with passing laws, the executive is charged with implementing those laws, and the judiciary is charged with interpreting those laws. To date that constitutional scheme has been followed in oil and gas leasing. The legislature bestowed broad discretion upon DNR to specify the terms of competitive oil and gas leases. Pursuant to that authority, DNR has issued many oil and gas leases over the last quarter century. Lawsuits have been filed under which the judiciary would interpret those leases. In contrast, the original SB 309 would purport to legislatively establish the royalty due on existing leases, irrespective and in derogation of the terms of the leases and any judicial interpretation of those leases. For the legislature to rewrite the terms of valid lease contracts to which it is not a party violates the principle of separation of powers by invading both the executive and judicial functions. See State v. A.L.I.V.E. Voluntary, 606 P.2d 769 (Alaska 1980), Bradner v. Hammond, 553 P.2d 1 (Alaska 1976), Public Defender Agency v. Superior Court, Third Judicial District, 534 P.2d 947 (Alaska 1975), 1981 Inf. Op. Att'y Gen. (Nov. 3; J66-159-82) and 1976 Inf. Op. Att'y Gen. (Feb. 11).

The original SB 309 may also contravene the public purpose requirement of Alaska Constitution art. IX, § 6. To the extent the bill may be construed to override recent settlement agreements and to require a refund to specific oil companies of payments made under those settlements, the bill could be held to be invalid because of the lack of a public purpose. See 1980 Op. Att'y Gen. No. 19 (Sept. 22).

In summary, the original SB 309 does not protect the state's interests because it binds the state as land owner to contracts to which it was not a party, without adequate provision to assure a fair value for the state's royalty. The legislature previously has directed the department to maximize the value of the state's oil and gas resources for the benefit of Alaska citizens. Adoption of the original SB 309 would be a major departure from this goal.

Sincerely,

Esther C. Wunnicke

Esther C. Wunnicke
Commissioner

cc: Members of the House Resources Committee

YUKON PACIFIC CORPORATION

April 24, 1986

Hon. Richard Shultz, Co-Chairman
House Resources Committee
Alaska State Legislature
Juneau., Alaska 99811

Dear Representative Shultz:

Thank you for taking time recently to discuss Senate Bill 309, the bill relating to valuation of royalties collected by the state from oil and gas production.

This bill, as it comes to your committee, is more than a "tax" on Railbelt consumers, raising the price of Beluga royalty gas supplied to Chugach Electric Association from 26 cents to 75 cents per thousand cubic feet. In effect, this bill denies Alaska's oil and gas producers the ability to make promises they can keep when they negotiate terms on long-term contracts.

We believe that is very dangerous. At a time when we are involved with a large group of Japanese and Korean companies in efforts to develop the potential of North Slope gas, it is wrong to send the signal that the State of Alaska wants to establish the right to change prices unilaterally, without regard for any contract which may come about.

Some have argued that the state has had that right to revalue its royalty share all along, that the right to interfere was agreed to up front with producers in the original lease form. And while courts in Texas have backed up that interpretation, later decisions in Oklahoma have agreed that a contract is a contract and that if the price is negotiated in good faith that is the price the royalty owner deserves.

Here, in Alaska, we can afford no other approach. To succeed as an economy, Alaska must sell more and more of our resources in the highly competitive international market. Several gas contracts from production on state

P.O. Box 101700 • Anchorage, Alaska 99510 • 907-279-1598 • Telex 25-340 Capt. Cook AHC
515 South Post Oak Road • Suite 225 • Houston, Texas 77027 • 713-960-1889 • Telex 775202 SUPRA

leases are under discussion or negotiation right now, both in the North Slope and the Cook Inlet. As an owner, the state would be foolish to install a "trap door" in the contracting process.

As you consider this legislation, I hope you will keep the following points in mind:

First, private producers making long-term contracts need the flexibility to act quickly in a competitive situation, and they are hampered in their negotiation if their results must later be approved by the royalty owner.

Second, these people are in business to make a profit. Their interest is the same as the state: to collect as much as they can from production. But first production must start, and financing production and transportation facilities requires the stability of long-term contracts.

Third, in the gas market, not all gas from the same field has the same value. Just as you might pay different prices for a seat on the same airplane, depending on when you committed and where you're ultimately going, gas fetches different prices for different uses. There is no prevailing price.

Fourth, in all cases, the state maintains the ability to take its oil and gas in kind and to sell it at a higher value if it believes it is not getting the best value under the contract.

If legislation is to pass this committee, it is our hope that you will not deny those you've invited to help develop Alaska's potential the right they have to have--to keep their promises to their customers.

With best regards,

Sincerely,

Mead Treadwell

Mead Treadwell
Vice President and Treasurer

Background Paper
U.S. - Japan Prefeasibility Study
Alaska Asian Gas System (AAGS)

Purpose:

To develop a capital cost estimate for and to test the market receptivity to a project to move natural gas off the North Slope of Alaska.

A gas transportation system out of Prudhoe Bay is likely to be one of the largest private projects in world history. Making it happen will require the efforts of several companies and several countries.

The American side, with Atlantic Richfield Company as study operator, will develop a capital costs estimate for an approximately 800 mile pipeline from Prudhoe Bay to the south coast of Alaska, with conditioning facilities at Prudhoe Bay and liquefaction and port facilities at Point Gravina. The choice of Gravina in this study does not preclude other potential pipeline terminuses, such as Nikiski, Valdez, and Drift River, in later determinations.

The Japanese side, with the Institute of Energy Economics as study operator, will develop cost estimates for shipping, regasification, and domestic distribution, as well as devising several scenarios for the post-1990 LNG market in Japan.

Participants:

U.S. Side

Representative/Operator

Atlantic Richfield Co.

Other sponsor

Yukon Pacific Corporation

Observer

State of Alaska

Japanese Side

Representative: The Committee for Energy Policy Promotion

Operator: The Institute of Energy Economics

Other sponsors:

C. Itoh & Co.	The Bank of Tokyo
Marubeni Corporation	The Industrial Bank of Japan
Mitsubishi Corporation	Long-Term Credit Bank of Japan
Mitsui & Co.	Sumitomo Trust and Banking Co.
Nissho Iwai Corporation	Sumitomo Corporation

Timetable:

The study officially began June 1, 1985 and is expected to last approximately 18 months.

Cost of the studies:

Total costs of the studies to be performed by both sides will amount to approximately $3.8 million, with about equal division in responsibility between the buying and selling sides.

Contractors:

The American study operator has contracted with Bechtel Petroleum to undertake the engineering studies required for a capital cost estimate.

Historical Background:

Since discovery of the Prudhoe Bay oil field in 1968, several attempts have been made to design and construct natural gas transportation facilities from Alaska to the Lower 48 states. Since commencement of oil production and shipment through the Trans Alaska pipeline system, in June 1977, gas produced with the oil has been reinjected into the field. The field reserve of about 26 trillion cubic feet could be produced at a rate of two billion cubic feet or more per day over a period of 25 years. As LNG, that production equates to 10-15 million tons per year.

In 1977, President Carter selected the Alaska Natural Gas Transportation System (ANGTS) as the preferred project to bring gas into the Lower 48 states on an overland route through Canada. The project has obtained most of the permits necessary for construction; however, lack of a gas market for the project caused sponsors in 1982 to postpone indefinitely the commencement of construction.

That same year, Governor Jay Hammond asked two of the his predecessors, Walter J. Hickel and the late William A. Egan, to undertake a screening study of alternative methods to market North Slope gas. The report of the Governor's Economic Committee on North Slope Gas proposed an 820 mile Trans Alaska Gas System estimated to cost approximately $14.6 billion. Estimated costs of financing, inflation, and taxes during construction escalated the figure to $26.2 billion. Governor William Sheffield accepted the report. That spring, Alaska's legislature endorsed further pursuit of gas exports.

In January of 1983, President Reagan and Prime Minister Nakasone set up a subcabinet level Joint Energy Working Group to discuss energy cooperation between the U.S. and Japan. Examining the opportunities of joint development of North Slope gas was part of the charge of that group, chaired on the U.S. side by Undersecretary of State for Economic Affairs, Allen Wallis. The working group, and a subsidiary group of experts, met several times and made one visit to Prudhoe Bay. In November 1983, at a summit meeting in Tokyo, President Reagan and Prime Minister Nakasone issued a joint statement endorsing the idea of a private prefeasibility study on joint development of an Alaska gas transportation system.

During late 1983 and 1984, leaders of Atlantic Richfield Company and Yukon Pacific Corporation met with representatives of Japanese companies to make arrangements for the next step -- an international study which would give both sides the information they need to make a decision concerning construction of the project.

The study agreement was signed April 26, 1985. Successful formation of the study group was reported to President Reagan by Prime Minister Nakasone at the Bonn summit in May 1985.

STATE OF ALASKA

THE LEGISLATURE

'131

Source

Legislative Resolve No.

SCR 131(FIN)

'3

Relating to marketing and transporting Alaska's natural gas.

BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

WHEREAS the largest gas field in the North American continent was discovered 15 years ago at Prudhoe Bay, on Alaska's North Slope; and

WHEREAS since that time it has been the policy of Alaska's state government to promote an environmentally sound, privately financed transportation system that would allow North Slope natural gas to come to market, while providing a new source of energy for Alaska's interior and raw material for future industry throughout the state; and

WHEREAS efforts by the United States and Canadian governments and private industry to move natural gas from the North Slope to supply the midwestern and pacific states have been supported by the State of Alaska and shall continue to have the state's support; and

WHEREAS in order to explore all possibilities of marketing North Slope gas, it is also in the state's best interest to explore all markets; and

WHEREAS successful marketing of Alaska's North Slope energy reserves can result in increased energy exploration, in a secure source of energy supply, contributing to both the economic and energy security of the United States; and

WHEREAS an Alaskan natural gas transportation system is committed to deliver natural gas to Alaska's interior for energy and raw material for industry in order to support economic diversification; and

WHEREAS the State of Alaska wishes to be on record as supporting any natural gas transportation system that would deliver gas to any market; and

WHEREAS it is in the best interests of the people of Alaska that the state government immediately enter into negotiations for the sale of the state's royalty interest in North Slope natural gas for in-state use as a catalyst for construction of a transportation system for Alaska's natural gas;

BE IT RESOLVED by the Alaska State Legislature that the State of Alaska fully supports the efforts of all owners of the gas and other parties to market the North Slope gas; and be it

FURTHER RESOLVED that the State of Alaska requests the federal government to remove any impediments to freely marketing North Slope gas or oil that would not affect the ongoing efforts of private industry to construct a gas transportation system overland from Alaska; and be it

FURTHER RESOLVED that all trading partners of Alaska are strongly urged to consider and take advantage of the benefits that a secure, long-term trading relationship with Alaska would offer; and be it

FURTHER RESOLVED that the legislature calls upon the owners of the gas, Alaska's delegation in Congress, and all other parties with an interest in the gas to explore every means to privately finance and construct a transportation system for Alaska's natural gas; and be it

FURTHER RESOLVED that the State of Alaska immediately enter into negotiations for the sale of its royalty interest in North Slope gas to in-state users in order that they and the state serve as a catalyst for the construction of a transportation system for Alaska's natural gas.

COPIES of this resolution shall be sent to the Honorable Ronald Reagan, President of the United States; the Honorable George Schultz, Secretary of State; the Honorable James Watt, Secretary of the Interior; the Honorable Malcolm Baldrige, Secretary of Commerce; the Honorable George Bush, Vice-President of the United States and President of the U.S. Senate; the Honorable Thomas P. O'Neill, Jr., Speaker of the U.S. House of Representatives; and to the Honorable Ted Stevens and the Honorable Frank Murkowski, U.S. Senators, and the Honorable Don Young, U.S. Representative, members of the Alaska delegation in Congress.

HJR 38 RELATING TO MARKETING AND TRANSPORTING ALASKA'S NATURAL GAS

AMENDED TITLE: SCS CS*(FIN)

PRIME SPONSORS: CRUDERY

CO-SPONSORS:

ABOOD	BARNES	BETTISWORTH	BUSSELL	CATO	FLOOD
FRITZ	FULLER	FURNACE	GRUSSENDORF	HURLBERT	KOPONEN
LACHER	LARSON	LINDAUER	LISKA	MARTIN	MILLER,M.N.
PESTINGER	PHILLIPS	RINGSTAD	SHULTZ	TISCHER	UEHLING
WARD	WENDTE	WAYES			

DATE	SEQ. NO.	JOURNAL PAGE	HOUSE ACTION
03/18/83	01	0538	FIRST READING -- COMMITTEE REPORTS
04/06/83	02	0745	RES -- CS07
04/11/83	03	0811	SECOND READING
04/11/83	04	0812	RES CS ADOPTED BY UNAN CONSENT
04/11/83	05	0812	ADVANCED TO 3RD READING BY UNAN CONSENT
04/11/83	06	0812	THIRD READING
04/11/83	07	0812	PASSED BY DIV 36-00-04
04/11/83	08	0812	NOTICE OF RECONSIDERATION GIVEN
04/12/83	09	0834	RECONSIDERATION NOT TAKEN UP
06/21/83	19	1874	CONCURRED IN SENATE AMS BY DIV 37-02-01
06/22/83	20	1914	TRANSMITTED TO GOVERNOR
06/29/83	21	2127	SIGNED BY GOVERNOR
AM 06/29/83	22	2127	LEGISLATIVE RESOLVE NO. 19

DATE	SEQ. NO.	JOURNAL PAGE	SENATE ACTION
04/13/83	10	0650	FIRST READING -- COMMITTEE REPORTS
04/26/83	11	0810	RES -- CS06
06/01/83	12	1160	FIN -- CS06
06/20/83	13	1387	RLS -- OTHER03
			TAKEN UP IMMEDIATELY
06/20/83	14	1395	SECOND READING
06/20/83	15	1395	FIN CS ADOPTED BY UNAN CONSENT
06/20/83	16	1395	ADVANCED TO 3RD READING BY UNAN CONSENT
06/20/83	17	1395	THIRD READING
06/20/83	18	1396	PASSED BY DIV 18-00-02

SB 309: (Original)	SB 309: (Senate Resources Committee)	SB 309: (Senate Rules Committee)	SB 309: (House Special Committee on Oil & Gas)
For the purpose of determining the value of the state's share of royalty gas, taken in-value and sold pursuant to a long-term contract, the Department of Natural Resources would be required to use the long-term contract price unless it could show, by clear and convincing evidence, that the contract price was unreasonably low at the time the contract was entered into. The bill would apply to all leases issued before and after the effective date of the act and would also apply to all types of gas sale contracts.	Within 90 days of the written request of a lessee, the Commissioner of the Department of Natural Resources would enter into an agreement with the lessee to value the state's share of in-value royalty gas at the contract price, unless the Commissioner made a finding, based on clear and convincing evidence, that the price was unreasonably low and the reduction in royalties would not be offset by benefits to consumers. This version of the bill would only apply to arm's length contracts between lessees and non-profit electric cooperatives or municipal electric utilities. The bill would also allow in-kind gas sales at less than market value and would apply only to contracts entered into after the effective date of the act.	Expanded the operative effect of SB 309 (Resources) to local regulated electric and gas utilities and added a procedure for establishing the royalty value of gas in arm's length contracts for the sale of gas from Prudhoe Bay reservoirs, via pipeline, for export from the state. For Prudhoe Bay gas, the Department of Natural Resources Commissioner could enter into an agreement to use the contract price to value in-value royalty gas provided the Commissioner makes a written finding that the contract price would assure maximum benefit to the people of Alaska.	Deleted the section dealing with Prudhoe Bay gas. The Committee also deleted the requirement that any decision by the DNR Commissioner not to use the contract price (for arm's length contracts between lessees and gas or electric utilities) must be based on clear and convincing evidence. The Committee added a new requirement that a gas utility, if it owned a gas pipeline, must agree to common carrier status under Alaska statutes, in order to obtain the benefits provided in the bill.

042386/457a-ltrs/le

CHRONOLOGY OF

ROYALTY GAS DISPUTE

(As of April 23, 1986)

1960	-	State leases with ARCO, Shell and Chevron (or their predecessors-in-interest) (DL-1)
1962	-	Beluga Unit Agreement
1965	-	Chugach signs contract with ARCO, Shell and Chevron for Beluga gas.
1968	-	Chugach's Beluga generating plant begins operation.
1973	-	Chugach signs new contracts with ARCO, Shell and Chevron for Beluga gas.
Dec. 1982	-	Alaska Pipeline signs gas contracts with Marathon and Shell.
March 18, 1985	-	DNR notice to lessees asserting "market value" for royalty gas.
Late April 1985	-	ARCO, Shell & Chevron file litigation against state over the royalty gas revaluation. (ARCO and Chevron named Chugach as a co-defendant)
May 1985	-	SB 309 and other bills introduced to tie royalty gas valuation to long-term contract price.
Feb. 19, 1986	-	Agreement between Chugach and state on Senate Resource Committee Substitute for SB 309; tentative settlement of litigation based on passage of this bill.
March 1986	-	Amended SB 309 passes out of Senate Rules Committee and Senate.
April 17, 1986	-	Amended SB 309 (Oil & Gas) passes out of House Special Committee on Oil & Gas.

042386/456-ltrs/le

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

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

OFFICE OF THE COMMISSIONER

April 24, 1986

The Honorable Richard Shultz
Co-Chair, House Resources Committee
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Representative Shultz:

Following up on my letter to you earlier this week on HCS CSSB 309 (O & G), I am writing to provide more information about an amendment that the Department supports and recommends to the Committee (see attachment).

The purpose of the bill, which we strongly endorse, is to provide a greater measure of certainty in royalty gas pricing for Alaska consumers. The benefits of the new policy embodied in the bill will be shared by a large number of Alaskans. We recognize that uncertainty in long-term pricing of royalty gas can cause difficulty in planning for Alaska utilities and their customers, both in financing for projects and in rate stability.

The attached amendment will help provide the certainty that we believe Alaska consumers deserve. In the specific situations enumerated (i.e., arms length sales to regulated utilities) we believe the presumption should be that the Commissioner will accept the contract price unless there is a clear and convincing reason not to do so.

Please contact me if you have questions about this language. I hope to be present at your hearing tomorrow morning, and I appreciate your attention to the bill.

Sincerely,

Esther C. Wunnicke
Commissioner

cc: Committee members

Attachments

10-J9LH

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

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

OFFICE OF THE COMMISSIONER

April 22, 1986

The Honorable Richard Shultz
Co-Chair, House Resources Committee
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Representative Shultz:

I am writing with regard to HCS CSSB 309 (Oil and Gas), relating to royalty gas contracts.

The Department strongly supports the bill as it has come to the Committee. After many months of negotiations and discussions about the consumer impact of our statutorily-derived royalty gas policy, we agreed to support a bill providing a preference for gas consumers in Alaska. This benefit will affect up to 270,000 gas and electric customers in Alaska and in future years if gas production occurs elsewhere in the state, we can expect even broader benefits from use of the state's royalty gas.

We remain opposed to the original version of SB 309 for a number of reasons. The original bill would have had broad constitutionally questionable impacts, and would not have protected the interests of the state or consumers.

However, we are aware that some members of the House, including some Committee members, are interested in amending HCS CSSB 309 (Oil and Gas) to affect a broader range of gas producers in Alaska. Even though I continue to believe that this issue should be considered and discussed in another piece of legislation than this "consumer bill," I am attaching possible language that protects the state's interests and could be adopted if the Committee wishes to address the broader issues of royalty gas valuation.

10-J9LH

Attachment 1 is language (similar to the Senate-passed bill) to provide a mechanism for establishing the value of royalty gas that could be transported through a proposed gas pipeline from the North Slope. Proponents of the North Slope gasline have indicated that it would be difficult, if not impossible, to achieve financing for the project without the ability to obtain certainty about the price of the state's royalty gas. We recognize the desirability of a major North Slope gas marketing project, and drafted language for the Senate Rules Committee that would assist in financing a gasline project. While I would prefer to see this issue addressed in another bill, I believe that the attached language drafted by our attorneys would protect the interests of the state and could be added to HCS CSSB 309 (Oil and Gas).

Attachment 2 is broader language to establish a general framework for setting the value of royalty gas for any use other than those specific consumer uses covered by the proposed Sec. (aa) under Sec. 2 of this bill. This provision would apply to a North Slope gasline or any other user. Again, although I would prefer to see this issue addressed in another bill, I believe that the language would protect the interests of the state and could be added to HCS CSSB 309 (Oil and Gas).

Both proposals, in Attachments 1 and 2, also would require an amendment to Sec. 5 of the bill to provide that (bb) of the bill is not retroactive but applies only to gas production sold under a contract entered into on or after the effective date of the act.

An amendment that we recommend is to reinstate language that appeared in the Senate Resources and Senate Rules versions of the bill regarding the standard for the commissioner's decision to reject use of an arms'-length contract price between a lessee and a gas or electric utility. We recommend that you adopt the amendment on Attachment 3.
Please contact me if you have any comments or questions. My staff will be present at your Friday hearing on the bill.

Sincerely,

Esther C. Wunnicke
Commissioner

cc: Committee members
Dr. Joyce Murphy, Chugach Electric

Attachments

Attachment 1

Possible amendment of CS for SB 309 (Oil and Gas) which would add a new version of (bb):

AS 38.05.180 is amended by adding a new subsection to read:

(bb) In the event of a contract for the sale of gas from Alaska North Slope gas leases by means of delivery of the gas through a pipeline for export out of the state, the commissioner may enter into an agreement with the lessee to use the price for the gas established in the gas sales contract as the value of the state's royalty share of gas production sold by the lessee under the gas sales contract if the commissioner makes a written finding that the contract price assures the receipt of maximum benefits to the people of the state in return for the state's gas resources. In order to invoke this subsection, a lessee must make its written request no later than 90 days after the first delivery of gas under the gas sales contract. The commissioner shall then act on the request in writing within 120 days. The agreement between the lessee and the commissioner may be for a lesser period of time than that covered by the lessee's gas sales contract, and may provide for a periodic review of the royalty value term by the commissioner. The lessee shall have the burden of providing all information necessary for the commissioner to make an informed decision, and shall provide clear and convincing evidence that the value of the gas is reflected by the gas sales contract price rather than being attributed to transportation, marketing, manufacturing, or other profit or cost centers. In this subsection

(1) "Alaska North Slope gas leases" includes any gas lease issued by the state under this section that lies in whole or in part north of 68 degrees north latitude;

(2) "gas sales contract" includes, in addition to its ordinary meaning, a written agreement for the intracompany tranfer of gas; and

(3) "price for the gas established in the gas sales contract" includes tax reimbursement amounts, deliverability and other charges, and other forms of consideration received by the lessee under the gas sales contract.

Possible amendment of CS for SB 309 (Oil and Gas) which would add a new version of (bb):

AS 38.05.180 is amended by adding a new subsection to read:

(bb) In the event of a contract for the sale of gas from a gas lease issued under this section that does not qualify under subsection (aa), the commissioner may enter into an agreement with the lessee to use the price for the gas established in the gas sales contract as the value of the state's royalty share of gas production sold by the lessee under the gas sales contract if the commissioner makes a written finding that the contract price assures the receipt of maximum benefits to the people of the state in return for the state's gas resources. In order to invoke this subsection, a lessee must make its written request no later than 90 days after the first delivery of gas under the gas sales contract. The commissioner shall then act on the request in writing within 120 days. The agreement between the lessee and the commissioner may be for a lesser period of time than that covered by the lessee's gas sales contract, and may provide for a periodic review of the royalty value term by the commissioner. The lessee shall have the burden of providing all information necessary for the commissioner to make an informed decision, and shall provide clear and convincing evidence that the value of the gas is reflected by the gas sales contract price rather than being attributed to transportation, marketing, manufacturing, or other profit or cost centers. In this subsection

(1) "gas sales contract" includes, in addition to its ordinary meaning, a written agreement for the intracompany tranfer of gas; and

(2) "price for the gas established in the gas sales contract" includes tax reimbursement amounts, deliverability and other charges, and other forms of consideration received by the lessee under the gas sales contract.

Attachment 3

At p. 1, line 28, after "finding", insert:

based on clear and convincing evidence

COOK INLET ROYALTY GAS VALUATION:
An Overview

A Presentation to the
Senate Resources Committee
by:

Esther C. Wunnicke, Commissioner
Alaska Department of Natural Resources

Kay Brown, Director
Division of Oil and Gas
Alaska Department of Natural Resources

Bill Van Dyke, Petroleum Manager
Division of Oil and Gas
Alaska Department of Natural Resources

Mark Worcester, Assistant Attorney General
Alaska Department of Law

February 10, 1986

ATTACHMENT 1

2/5/86

COOK INLET GAS SUMMARY

Lease interpretation: Under the terms of its oil and gas lease contracts with the oil companies, the state is entitled to royalty payments determined by the higher of the price received by an oil company under its sales contract, or the value of the gas at the time of production. This means that the price received under a long-term gas sales contract does not control royalty valuation in those instances where inflation and market forces have caused the current value of the gas to be higher than the contract price.

DNR policy:

(1) As land manager for the citizens of the entire state, it is DNR's responsibility to obtain fair value for the state's oil and gas resources by collecting the full royalties to which the state is entitled under its oil and gas leases.

(2) DNR should not selectively abdicate its responsibility to enforce the royalty terms of the Cook Inlet gas leases just because utility companies have agreed as part of their gas purchase contracts to reimburse the oil companies for royalty collections made by the state. Any consumer subsidy should be the result of an affirmative, direct subsidy by the legislature as part of a comprehensive energy policy.

(3) DNR should not divert from uniform enforcement of the oil and gas leases, since such action could, in addition to directly reducing revenues from any leases from which royalties are not fully collected, also indirectly cause a much larger reduction in state revenues by impairing the state's ability to enforce the royalty provisions of the North Slope leases.

The potential consumer impact result from actions by Chugach, not the state. The risk that gas values might escalate to values in excess of the long-term gas sales price was a circumstance foreseen by the parties to those sales contracts. This is demonstrated by the fact that the contracts between the oil company lessees and Chugach Electric Association, Inc. (Chugach) specifically assign to Chugach the risk of any rise in royalty obligations. The state was not a party to those sales contracts. The contract price, the absence of an adequate price escalator or price reopener, and the assignment to Chugach of the risk of increased royalty obligations were all conditions established by contract between Chugach and the lessees without state participation.

Existing law provides an adequate mechanism for long-term royalty certainty: DNR is sympathetic to the desirability of long-term certainty in royalty matters. However, new statutory authorities are not necessary in order to provide such certainty. Royalty certainty can be attained by negotiation of long-term in kind gas sales contracts which parallel the contracts between the state's

lessees and their gas purchasers. This would allow an opportunity for DNR, the royalty board, and the legislature to evaluate the adequacy of the royalty over the life of the contract. This is preferable to being locked into a long-term royalty value set by prices established by lessees without any notice to or participation from the state.

Litigation: Last March DNR notified the Cook Inlet lessees of its determination to enforce the leases. The notices asserted that the most recent (December 1982) major contracts from the Kenai and Beluga River fields (the "APL II contracts") established the current value. These contracts had a base contract price of $2.05 per mcf in 1985. The state subsequently indicated its readiness to accept a lower royalty value if presented with evidence that the current value of gas in Cook Inlet is less than the price established under the APL II contracts. Union, Marathon, ARCO, Chevron and Shell responded to the notices by suing the state.

Recent Cook Inlet Gas Sales Contracts:

Date of Contract	Purchaser	Field	Starting Base Price
1982	APL (Enstar)	Beluga	$2.32
1982	APL (Enstar)	Kenai, Beaver Creek or McArthur River	$2.32
1983	Chugach	Cannery Loop	$1.80
1984	APL (Enstar)	Lewis River	$1.80
1985	Tesoro	Kenai, Beaver Creek or McArthur River	$2.01

Settlements achieved: In the last two months of 1985 DNR's royalty enforcement actions achieved significant success. Settlements relating to gas royalties due on production from the Kenai Field, and involving Marathon, Union, Alaska Pipeline Company (Enstar), CIRI, the U.S. Department of the Interior and the state, yielded the state about $4 million in retroactive royalties, and will bring in excess of $6.5 million per year more than the amounts which would have been paid under the lessees' prior reporting practices (including those increases attributable to the state's 90% interest in federal onshore royalties). Under the lessees' theory, the royalties would have been variously between $0.21 and $0.61 per mcf; under the settlement, the lessees will pay $1.95 per mcf during 1986. The $1.95 is squarely within the gas values established by recent Cook Inlet gas sales contracts, as well as the values established by Enstar's pending rates ($2.1854 for Schedule C purchasers - "Large Commercial Service", and from $1.6480 to $2.0158 for sales to power plants). The settlements confirm the soundness of the royalty enforcement action taken last spring.

Remaining disputes: The major remaining dispute relates to the Beluga River field, the primary source of gas for Chugach.

Settlement negotiations during the last six months have failed to produce any resolution. Options explored have included underlifting the state's royalty share, thus delaying the royalty into the future; an in kind sale to Enstar or Chugach; and an in value settlement. The lessees (ARCO, Chevron and Shell) assert that they should not be required to contribute any monies to any settlement, since their sales contract with Chugach requires Chugach to reimburse the lessees for any additional royalty amount the state collects. Chugach, in turn, has been unwilling to agree to an acceptable value, and has indicated that it will seek legislative relief. Recently, the state made a formal offer to its lessees to settle the dispute for $1.50 per mcf. This offer was rejected, but settlement efforts and discussions continue.

Consumer impact. Chugach estimates that a royalty rate of $2.05 per mcf on state leases would increase retail consumer rates only about 2.38%, assuming the lessees were successful in asserting that their contracts with Chugach permitted them to pass the royalty burden on to Chugach, and further assuming that the APUC permitted Chugach to pass the burden on to its consumers. DNR estimates that a $2.05 royalty would increase state revenues by about $2.8 million per year. Under the $1.50 per mcf settlement offer, the increased royalty income would fall to about $2 million per year, and the magnitude of retail consumer impact would be correspondingly reduced to less than 2%. (A two per cent increase on a monthly bill of $30 would be only $0.60).

ATTACHMENT 2

2/5/86

COOK INLET GAS ROYALTY SETTLEMENTS
(State leases and State share of federal royalties)

Lessee	Scope of Settlement	Retro-active Payment (millions)	Current Monthly Value Under Settlement (per Mcf)	Estimated Additional Royalties per year (millions)
Phillips	North Cook Inlet Field gas sold as LNG in Japan	$36.3	$2.32	$12.00
Marathon	Kenai field gas sold as LNG in Japan	$ 4.3	$2.32	$ 0.75
Union and Marathon	All of Union's Kenai field gas disposition (including the following: urea/ammonia plant, rental gas, Enstar), plus Marathon's dispostions to Enstar under Enstar's 1975 contract	$ 4.1	$1.95	6.90
	Total	$44.7		$19.65

2/5/86

COOK INLET GAS ROYALTY CHRONOLOGY

Month	Year	Description of Event
March	1964	Foster v. Atlantic Refining Company, 329 F.2d 485 (5th Cir. 1964) holds that long-term contract price does not control royalty valuation when market value rises, even if this is burdensome on the lessee.
May	1965	Chugach Electric Association, Inc. enters into 20 year contracts with ARCO, Chevron and Shell for Beluga River gas, with an initial price of 15.2 cents per mcf, subject to a volume limit.
January	1973	Chugach renegotiates its 1965 contracts, extending the term to 1998 (unless the new, higher volume limit is reached earlier). The 1986 base price under those contracts is about 21 cents per mcf.
November	1982	Chugach obtains supplemental gas deliveries under the 1973 contract at a base price of $1.48 per Mmbtu (approximately equivalent to $1.48 per mcf).
December	1982	Alaska Pipeline Company (Enstar) signs contracts for gas deliveries from Beluga River (with Shell) and Kenai (with Marathon) at a price of $2.32 per mcf, with annual adjustments based upon fuel price fluctuations (the "APL-II" contracts). This is the first totally new contract for Beluga River gas subsequent to the 1973 Chugach contract under which there were any deliveries.
March	1984	Piney Woods County Life School v. Shell Oil Company, 726 F.2d 225 (5th Cir. 1984), reh. den. 750 F.2d 69, cert. den. 105 S.Ct. 1868 (1985) reaffirms the soundness and continued validity of the rule in Foster, above.
May	1984	The state and Phillips settle their dispute concerning the valuation of Cook Inlet gas from state leases which is sold as LNG in Japan, using a formula which initially yields a royalty of $2.40 per mcf.
May	1984	The federal government informs Union that virtually all gas royalties from the Kenai field, including gas sold under below-current-market, long-term contracts with Enstar, must be valued in accordance with the price under the APL-II contracts.
November	1984	DNR determines, in consultation with the Department of Law, to enforce the Cook Inlet lease terms requiring payment of gas royalty on the basis of current value.

February	1985	U.S. District Judge Fitzgerald rules that Marathon must pay royalties on Kenai Field gas sold as LNG in Japan based upon the Japan sales price, less costs of transportation. Marathon calculates the netback value under the order to be about $3.00 per mcf, while the federal government calculates the value to be about $3.60 per mcf. The accounting remains in dispute in District Court, while the District Court's February 1985 decision is under appeal to the Ninth Circuit.
March	1985	By written notice, DNR informs its Cook Inlet lessees of its determination to enforce the royalty requirements of the leases.
May/June	1985	All Cook Inlet gas producers file separate lawsuits seeking judicial declaration of their royalty obligations under the leases.
July	1985	The state and Marathon settle their dispute concerning the royalty value of Kenai Field gas sold as LNG in Japan in accordance with the terms of the May 1984 Phillips settlement.
November	1985	The state, federal government and CIRI (all royalty owners in the Kenai field) settle most royalty issues for production from the Kenai field. Most significantly, royalty on gas used in Union's urea and ammonia plant and used to promote greater oil production from the Swanson River oil field, is set at $1.85 per mcf for 1985 and $1.95 per mcf for 1986, with annual adjustments thereafter based upon fluctuations in fuel oil prices.
November	1985	The Secretary of the Interior issues a definitive order holding that Cook Inlet gas sold by Union and Marathon to Enstar must be valued for royalty purposes according to current market values.
December	1985	The state, federal government and CIRI enter into a settlement agreement on the value of the royalty on Kenai gas sold to Enstar under long-term contracts. Under this settlement, the royalty owners receive $1.85 per mcf for the part of 1985 at issue, and will receive $1.95 per mcf for 1986 production, with annual adjustment thereafter based upon fluctuations in the oil prices.
January	1986	The state offers to the producers to settle the dispute concerning the royalty value of gas sold to Chugach. This $1.50 per mcf offer is rejected by the producers, but settlement discussions continue.

ALASKA DEPARTMENT OF NATURAL RESOURCES - DIVISION OF OIL AND GAS
SUMMARY STATISTICS
COOK INLET GAS PRICE DISPUTE
AVERAGE MONTHLY SALES VOLUMES - JULY 1984 THROUGH JUNE 1985

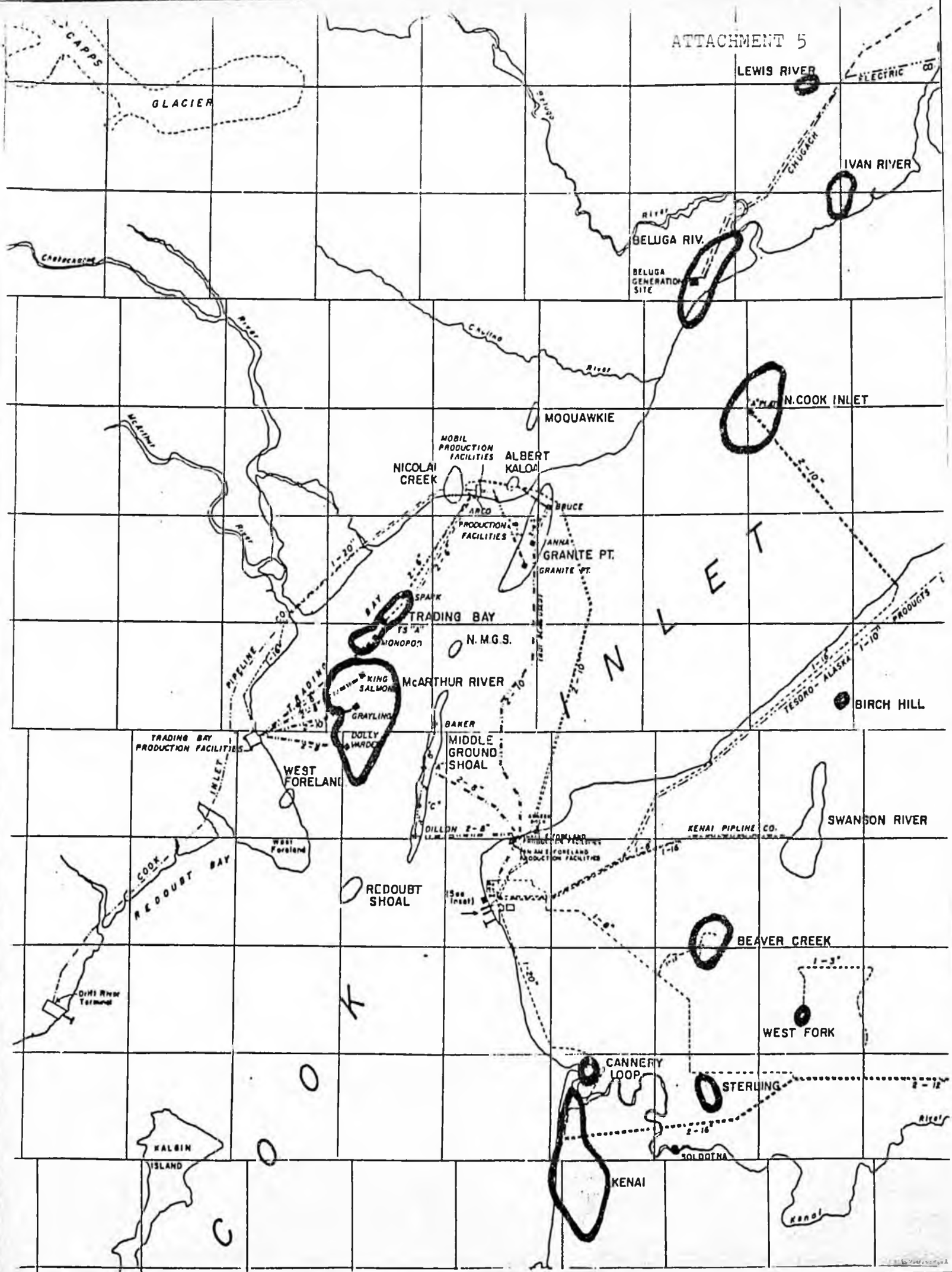
Date:1/14/86

FIELD Producers (% of field owned)	PURCHASER	% of FIELD on sale by sale basis	SALES VOLUMES (MCF) 1/	EFFECTIVE ROYALTY INTEREST	ROYALTY VOLUME (MCF)	VALUE REPORTED FOR ROYALTIES 2/	PRODUCER/ PURCHASER BASE CONTRACT VALUE 2/ 7/	EFFECTIVE DATE	EXPIRATION DATE	
BELUGA RIVER FIELD										
CHEVRON (33.33%)	ENSTAR	2.11%	37,790	0.07555	2,855	$1.8000	$2.0300 9/	12/20/82	10/1999	
ARCO (33.33%)	ENSTAR	2.11%	37,790	0.07555	2,855	$1.8000	$2.0300 9/	12/20/82	10/1999	
SHELL (33.33%)	ENSTAR	2.11%	37,790	0.07555	2,855	$1.8000	$2.0300 9/	12/20/82	10/1999	
AGEA (100.00%)W-214-35	ENSTAR	0.45%	8,122	0.07555	614	$1.8000	$2.0300 9/	12/20/82	10/1999	
SUB TOTAL		6.77%	121,492		9,179					
CHEVRON (33.33%)	CHUGACH	28.70%	515,065	0.07555	38,913	$0.2103	$0.2103	5/14/65	1/1998	3/
ARCO (33.33%)	CHUGACH	28.70%	515,065	0.07555	38,913	$0.2103	$0.2103			
SHELL (33.33%)	CHUGACH	28.70%	515,065	0.07555	38,913	$0.2103	$0.2103			
AGEA (100.00%)W-214-35	CHUGACH	7.13%	127,863	0.07555	9,660	$0.2103	$0.2103			
SUB TOTAL		93.23%	1,673,058		126,400					
TOTAL BELUGA RIVER FIELD		100.00%	1,794,550		135,578					
KENAI FIELD										
UNION (50%)	APL-ANCHORAGE	10.28%	845,622	0.020688	17,494	$1.9500 8/	$0.6220 6/	5/13/60	12/92	3/
UNION (50%)	APL-CHEV NIK	0.19%	15,888	0.020688	329	$1.9500 8/	$0.6220			
UNION (50%)	UNION-CHEV	0.19%	15,518	0.020688	321	$1.9500 8/	$0.6220	2/5/81	INDEFINITE	
UNION (50%)	CITY OF KENAI	0.25%	20,590	0.020688	426	$0.3000	$0.3000	5/17/66	6/1986	
UNION (50%)	RENTAL GAS	4.50%	370,334	0.020688	7,661	$1.9500 8/	$0.0700	1/17/66	1/1995	3/
UNION (50%)	ADDITIONAL RENTAL	2.37%	194,981	0.020688	4,034	$1.9500 8/	$0.3800			
UNION (50%)	UNION CHEMICAL	40.73%	3,352,041	0.020688	69,347	$1.9500 8/	$0.6130	11/1/77	1998	
TOTAL UNION SHARE		58.51%	4,814,973		99,612					
MARATHON (50%)	APL-I	14.38%	1,183,535	0.020688	24,485	$1.9500 8/	$0.6220 6/		12/1992	3/
MARATHON (50%)	APL-II	4.48%	368,603	0.020688	7,626	$2.0550	$2.0800 9/	12/16/82	12/1997	3/
MARATHON (50%)	APL-NIKISKI	0.19%	15,888	0.020688	329	$2.0550 4/	$0.6220			
MARATHON (50%)	CITY OF KENAI	0.25%	20,599	0.020688	426	$2.0550 4/	$0.3000		6/1986	
MARATHON (50%)	RENTAL GAS	4.50%	370,242	0.020688	7,660	$0.2100	$0.2100		1/1995	3/
MARATHON (50%)	ADDITIONAL RENTAL	2.36%	194,450	0.020688	4,023	$0.3800	$0.3800			
MARATHON (50%)	TOKYO UTILITIES	15.32%	1,261,073	0.020688	26,089	$2.2795	$4.7590 5/		6/1/89	
TOTAL MARATHON SHARE		41.49%	3,414,390		70,637					
TOTAL KENAI FIELD		100.00%	8,229,363		170,249					
STERLING FIELD										
UNION (50%)	PENINSULA GREENHOUSE	50.00%	736	0.015546	11	$0.4000	$0.4000	10/27/61		
MARATHON (50%)	PENINSULA GREENHOUSE	50.00%	736	0.015546	11	$2.0550 4/	$0.4000			
TOTAL STERLING FIELD		100.00%	1,472		23					
MCARTHUR RIVER FIELD										
UNION/MARATHON (50% each)		0.47%	1,671	0.125	209	0.000	0.000			
UNION/MARATHON (50% each)	RENTAL GAS	1.40%	5,260	0.125	658	0.000	0.210			
UNION/MARATHON (50% each)	UNION CHEMICAL	87.56%	311,215	0.125	38,902	0.000	0.613			
UNION/MARATHON (50% each)		9.39%	33,375	0.125	4,172	0.000	0.000			
UNION/MARATHON (50% each)		1.10%	3,910	0.125	489	0.000	0.000			
TOTAL MCARTHUR RIVER FIELD		100.00%	355,431		44,429					
TRADING BAY FIELD										
Marathon 48.66%		48.66%	580	0.125	73	0.000	0.000			
Union 48.66%		48.66%	580	0.125	73	0.000	0.000			
Superior 1.34%		1.34%	16	0.125	2	0.000	0.000			
Texaco 1.34%		1.34%	16	0.125	2	0.000	0.000			
TOTAL TRADING BAY FIELD		100.00%	1,192		149					

1/ ANNUAL VOLUME DIVIDED BY 12 MONTHS EQUAL AVERAGE MONTHLY VOLUME.
2/ ROYALTY AND CONTRACT VALUES ARE THE MOST CURRENT IN EFFECT AS OF JANUARY 1986. PRODUCTION AND HAVE NOT BEEN ADJUSTED FOR BTU CONTENT.
3/ QUANTITY TERM COULD OPERATE TO EXTEND OR SHORTEN THE CONTRACT PERIOD.
4/ PRICE REPORTED BY MARATHON IS BEING PAID UNDER PROTEST.
5/ CONTRACT PRICE IS A GROSS PRICE BEFORE TRANSPORTATION COSTS.
6/ CONTRACT PRICE TO GO TO $0.27 MCF DURING 1986.
7/ BASE CONTRACT PRICE DOES NOT INCLUDE LESSEE TAX OBLIGATIONS PAID BY THE PURCHASER.
8/ VALUE AGREED TO BY SETTLEMENT.
9/ SPECIAL DELIVERABILITY CHARGE OF $0.35/MCF MAY ALSO BE EFFECTIVE.

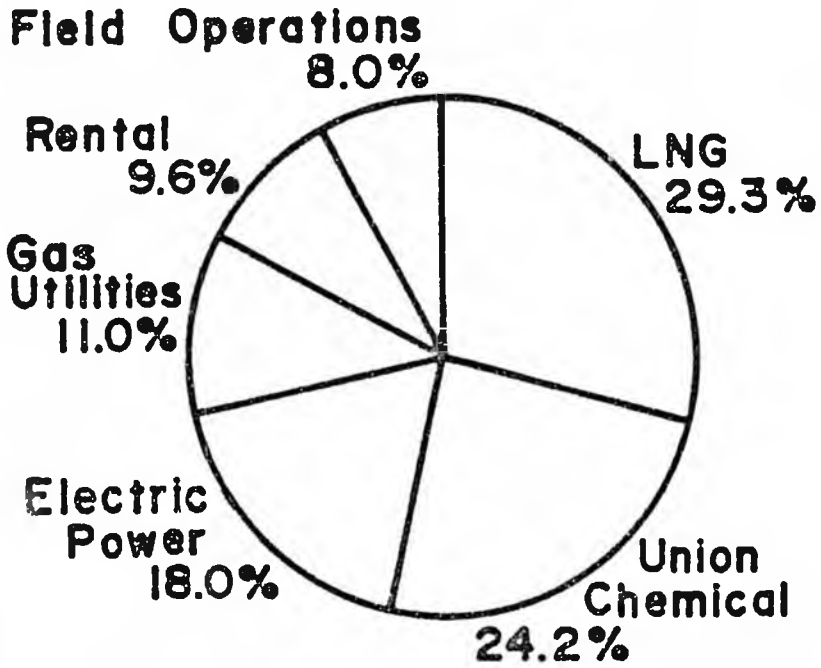
ATTACHMENT 4

ATTACHMENT 5

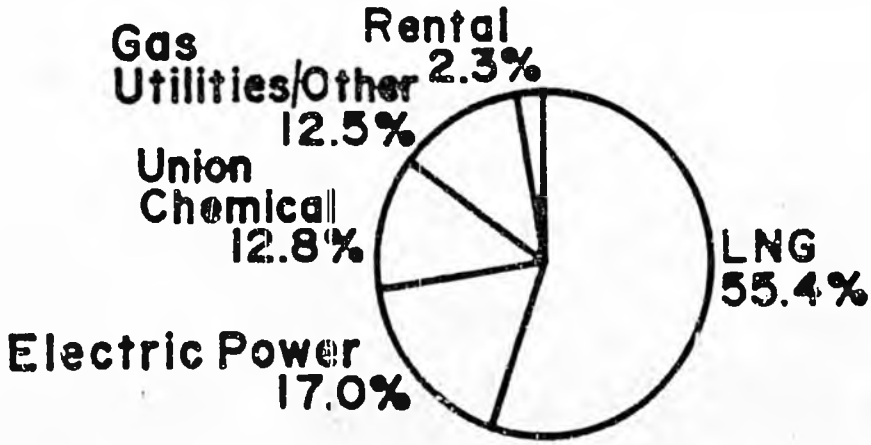


COOK INLET

Total Sales

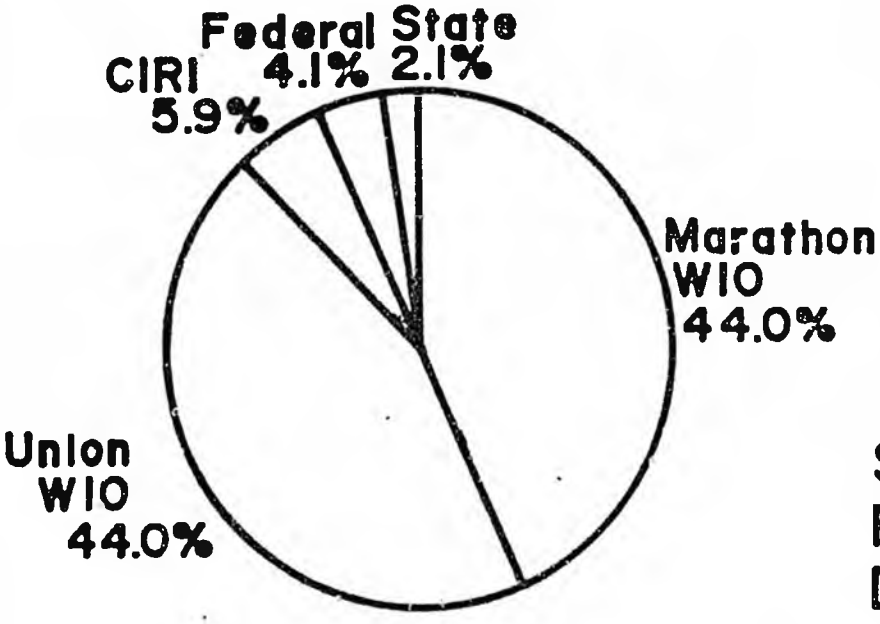


State Royalty Disposition

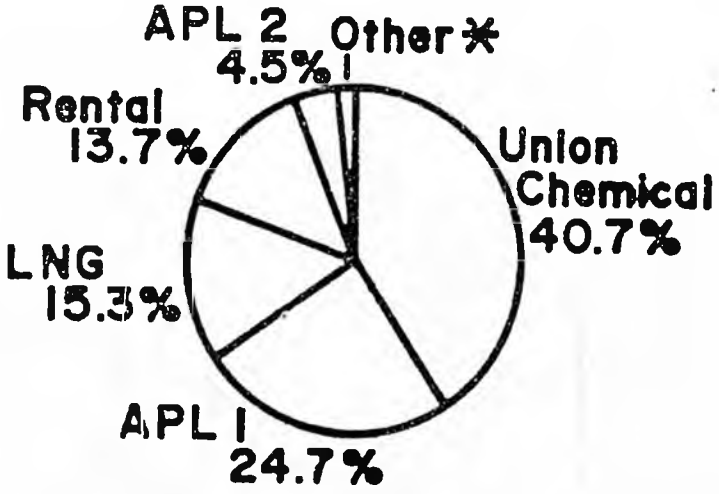


KENAI FIELD

Royalty And Working Interest Ownership



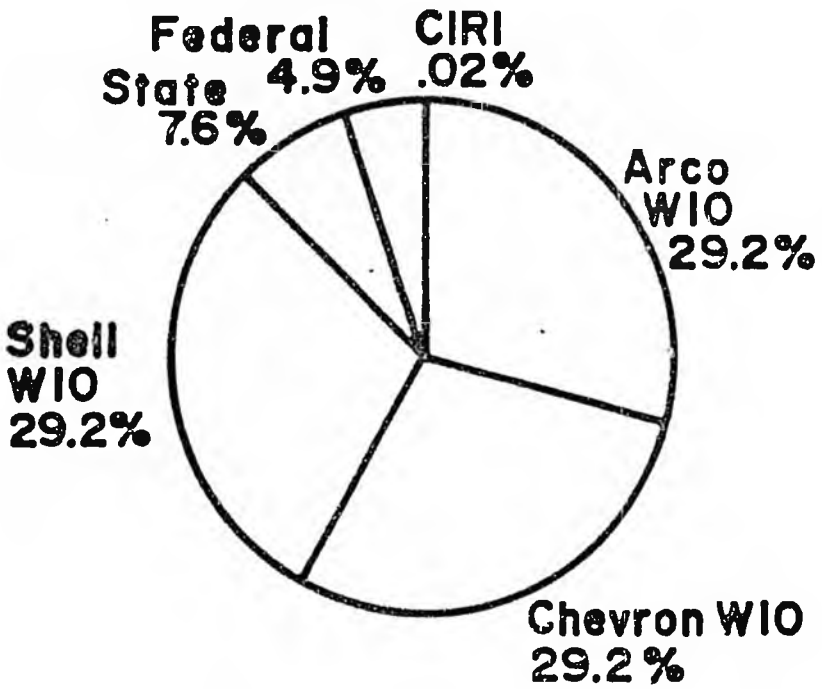
State Royalty Disposition



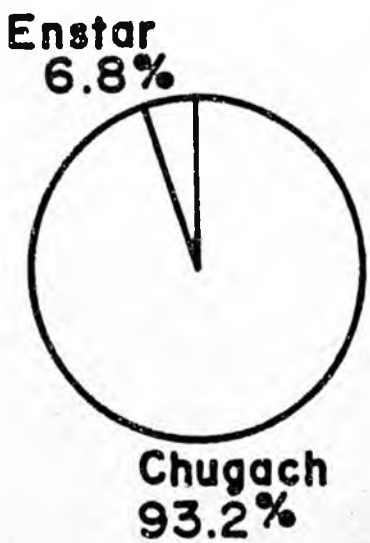
* AFL-Nikiski 0.4%
Union-Chevron Exchange 0.2%
City Of Kenai 0.5%

BELUGA FIELD

Royalty And Working Interest Ownership



State Royalty Disposition



COOK INLET GAS PRODUCTION
(For 1984)

	Total MMCF/Month	State Royalty MMCF/Month
Beluga River Field		
For: Chugach	1673	125
Enstar	121	9
Total	1794	134
Kenai Field		
For: APL 1	2029	42
APL 2	369	8
APL Nikiski	31	1
APL Kenai	41	1
Union Chevron Ex	16	1
Rental gas	741	15
Rental gas extra	389	8
Ammonia-Urea	3352	67
LNG	1261	25
Total	8229	168
McArthur River Field		
For: Rental gas and ammonia-urea	355	44
Beaver Creek Field		
For: APL 2	789	0
Lewis River Field		
For: APL 2	153	19
North Cook Inlet Field		
For: LNG	3932	491
GRAND TOTAL	15,250	856