

ALASKA LEGISLATURE COMMITTEE FILES 1995-1996 8672

8983 SENATE RESOURCES

1 (3) The Department of Law has testified that any waiver of BP Exploration  
2 (Alaska) Inc.'s commitment to perform under the sanction schedule would have to be done  
3 "reasonably and not arbitrarily," and Commissioner Shively has testified "I have no intention  
4 of waiving that. I mean that's a very important part of the arrangement, and I mean, I think  
5 that if we cannot get this project going, then we need to reassess those leases and get them  
6 back out onto the public market."

7 (4) In response to the question of how would the administration, or a court if  
8 the need should arise, measure compliance given the number of disclaimers and qualifiers, and  
9 the lack of any specific performance measures in the agreement, Commissioner Shively has  
10 testified "I think we have stated this before. What we are asking BP to do, and what they  
11 have committed to do, I do not believe is enforceable by law."

#### 12 ARTICLE 13. POLICY IMPLICATIONS OF THE PASSAGE OF SB 318.

13 (1) As to where the state ultimately ends up if, as a matter of precedent, it has  
14 to negotiate against itself in other instances to encourage its existing lessees to honor the terms  
15 of their competitively bid contracts, Commissioner Shively has testified "[A]ny of these things  
16 puts the state in a difficult position. We've, on the other hand, there have been provisions that  
17 allow the state to modify lease terms in the law and in the lease since Statehood. This is not  
18 a new concept. I was actually just reading an article the other day about the recent leases or  
19 arrangements that were made between the Venezuelan government and a number of private  
20 companies, and one of the conclusions of that article was that the first thing the companies  
21 were going to do down there was go back in and renegotiate their terms. And so, it does put  
22 the government in a difficult position. It's why I think in things like this and also like heavy  
23 oil, we need to do some economic and other analyses, which we did. But I think in this day  
24 and age this is part of how the government manages its resources. But it is not new. We've  
25 made changes to the leases before. We have not made changes in this particular way, but we  
26 have done these before, and once you start down that road, which we started down years ago,  
27 yes, the state does put itself in a difficult position, but not an impossible position."

28 (2) In response to the question of how the commissioner can test whether, and  
29 to what extent the state must give up public resources to promote the development of the  
30 state's resources, if, as here, there are no standards and no rules, Commissioner Shively has  
31 testified "When you make these decisions, it's like anything else, you have to use your best

1 judge it. I happen to believe that one of the problems with government is that we try to set  
2 all of these sorts of rules and guidelines, and it's what makes government unworkable. What  
3 you need is people that can make judgments, that can look at difficult situations, assess the  
4 information, and say this is a good idea or a bad idea. I see nothing wrong with that. I think  
5 that's better government, but this idea that we have now that if you just have enough rules and  
6 enough regulations, everything is going to be perfect is nuts. I mean, even the bidding  
7 process doesn't necessarily guarantee the state that you get your full value for your resources.  
8 You get the most somebody wants to pay for it. That may or may not be full value."

9 \* Sec. 2. ADDITIONAL FINDINGS AND POLICY. Based upon the findings of facts ~~set~~  
10 out above, the legislature finds:

11 (1) the production of oil and gas from state land is a matter of statewide  
12 interest and effect because it is the principal source of revenue to the state and provides  
13 important job opportunities for the people of the state;

14 (2) BP Exploration (Alaska) Inc. holds certain state oil and gas leases in the  
15 Northstar Unit that include net profit share provisions;

16 (3) BP Exploration (Alaska) Inc. has refused to develop the Northstar Unit  
17 leases unless the leases are amended to eliminate the net profit share provisions;

18 (4) unless the net profit share provisions of the Northstar Unit are amended,  
19 production of oil and gas from the unit is highly unlikely to begin before the year 2002;

20 (5) because of the development account provisions of the net profit share  
21 leases, the later that these leases are developed, the less "net profits" the state receives;

22 (6) if the net profit share provisions of the Northstar Unit leases are amended,  
23 full production of oil and gas from the unit may begin as early as the year 1999;

24 (7) amending the net profit share provisions of the Northstar Unit leases to  
25 provide for a supplemental royalty, instead of a share of net profits, will provide economic  
26 benefits of oil and gas production to the people of the state by encouraging production from  
27 the Northstar Unit earlier than it might otherwise occur under the terms of the Northstar Unit  
28 Agreement and the unit's approved Plan of Development;

29 (8) the development of the unit and the associated construction of unit facilities  
30 within the state will provide additional revenue to the state and increased job opportunities;

31 (9) the expedited development of the unit may result in increased state revenue

1 from future oil and gas lease sales;

2 (10) the expedited development of the unit may result in technological  
3 breakthroughs and other cost savings that may make other development opportunities in the  
4 state economically feasible;

5 (11) notwithstanding the anticipated benefits that may result from the  
6 amendment of the Northstar Unit's net profit share lease terms, the legislature reaffirms that  
7 it is the policy of the state to enforce the competitively bid terms of its oil and gas leases and  
8 that the commissioner of natural resources should assure that the state's oil and gas resources  
9 are being diligently and timely developed;

10 (12) the public's confidence that the terms of the state's oil and gas leases are  
11 being fairly and uniformly administered must be maintained;

12 (13) it is important to assure that there is no appearance of favoritism in the  
13 state's administration of its oil and leases; and therefore

14 (14) except as provided under sec. 3 of this Act, the commissioner of natural  
15 resources is directed not to negotiate the amendment of the competitively bid terms of any  
16 state oil and gas lease without prior explicit authorization by the legislature through the  
17 passage of a general act granting the authority to do so.

18 \* Sec. 3. (a) The State of Alaska and BP Exploration (Alaska) Inc. are parties to the  
19 following leases in the Northstar Unit:

20 (1) ADL 312798, effective February 1, 1980;

21 (2) ADL 312799, effective February 1, 1980;

22 (3) ADL 312808, effective February 1, 1980;

23 (4) ADL 312809, effective February 1, 1980; and

24 (5) ADL 355001, effective August 1, 1983.

25 (b) The commissioner of natural resources may amend the Northstar Unit leases  
26 described in (a) of this section as set out below:

27 **AMENDMENT TO THE NORTHSTAR UNIT LEASES**

28 **BETWEEN THE STATE OF ALASKA AND**

29 **BP EXPLORATION (ALASKA) INC.**

30 The State of Alaska ("State") and BP Exploration (Alaska) Inc.  
31 ("BPXA") are parties to the following leases in the Northstar Unit: ADL

1 312798, effective February 1, 1980; ADL 312799, effective February 1, 1980;  
2 ADL 312808, effective February 1, 1980; and ADL 312809, effective  
3 February 1, 1980 (collectively the "1980 Leases"); as well as ADL 355001,  
4 effective August 1, 1983 (the "1983 Lease"). The parties agree to amend the  
5 1980 Leases and the 1983 Lease as set forth in this amendment to the Northstar  
6 Unit leases.

#### 7 1980 Leases

8 (1) Paragraph 6(b) is replaced in its entirety as follows:

9 (b) Annual rental paid in advance is a credit on the royalty or  
10 supplemental royalty due under this lease for that year.

11 (2) Paragraph 7 is replaced in its entirety as follows:

12 7. SUPPLEMENTAL ROYALTY. (a) In addition to the  
13 royalty paid and computed under paragraphs 8, 10, and 11 below,  
14 Lessee shall pay to the State a supplemental royalty ("supplemental  
15 royalty"). Lessee shall pay the supplemental royalty, if owed, upon the  
16 same production volume for which royalty is paid ("production  
17 volume"). The supplemental royalty payment for a given month equals  
18 the supplemental royalty value times the supplemental royalty  
19 percentage rate ("percentage rate") times the production volume for that  
20 month. The percentage rate shall be calculated monthly by reference  
21 to: (1) an ANS West Coast spot price ("spot price"); and (2) a  
22 supplemental royalty trigger price ("trigger price"). If the spot price is  
23 equal to or less than the trigger price, then the percentage rate equals  
24 zero. If the spot price is greater than the trigger price, then the  
25 percentage rate equals [the spot price per barrel minus the trigger price  
26 per barrel] times 1.5 percent per dollar per barrel. The percentage rate  
27 may never exceed 7.5 percent.

28 (b) The spot price is the price per barrel calculated in Article  
29 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement  
30 Agreement ("ANS Agreement"), dated December 31, 1991, between the  
31 State and ANS, for the crude oil referred to as "ANS (USWC)" in the

1           ANS Agreement. The trigger price is \$17.35 per barrel through  
2           April 30, 1997. On May 1, 1997, and each May 1 thereafter, the  
3           trigger price shall be adjusted by an inflation factor equal to fifty  
4           percent of the "inflation rate" defined as the Producer Price Index for  
5           Industrial Commodities ("PPI") for December of the previous year, as  
6           reported by April 30 of the current year, divided by the PPI for  
7           December of 1995, as reported by April 30, 1996. The supplemental  
8           royalty value for oil, gas, natural gas liquids and associated substances  
9           is defined in paragraphs 10 and 11 below. Exhibit B is a sample  
10          calculation to demonstrate the method of calculating supplemental  
11          royalty for oil.

12          (3) Paragraph 9 is replaced in its entirety as follows:

13                 9. REDUCTION OF ROYALTY. Except as provided in  
14                 paragraph 7 above, Lessee shall not be entitled to any reduction of  
15                 royalty paid under paragraph 8 above or supplemental royalty paid  
16                 under paragraph 7 above based on any current or future agreement,  
17                 State statute, or State regulation.

18          (4) Paragraph 10 is replaced in its entirety as follows:

19                 10. ROYALTY IN VALUE. Unless the State elects to receive  
20                 all or a portion of its royalty or supplemental royalty in kind as  
21                 provided in paragraph 12 below, Lessee shall pay to the State the value  
22                 of all royalty and supplemental royalty oil, gas and associated  
23                 substances as determined under paragraph 11 below. Royalty and  
24                 supplemental royalty paid in value shall be free and clear of all lease  
25                 expenses (and any portion of such expenses which is incurred away  
26                 from the leased area), including, but not limited to, expenses for  
27                 separation, cleaning, dehydration, gathering, saltwater disposal, and  
28                 preparing the oil, gas or associated substances for transportation off the  
29                 leased area. All royalty and supplemental royalty that may become  
30                 payable in money to the State shall be paid on or before the last day of  
31                 the calendar month following the month in which the oil, gas or

1 associated substances are produced. Royalty and supplemental royalty  
2 payments shall be accompanied by copies of run tickets or such other  
3 information relating to valuation of royalty and supplemental royalty as  
4 the State may require, which may include, but is not limited to,  
5 evidence of sales, shipments, and amounts of gross oil, gas and  
6 associated substances produced.

7 (5) Paragraph 11 is replaced in its entirety as follows:

8 11. VALUE. For purposes of computing supplemental royalty  
9 due under this lease, the value of supplemental royalty oil, gas, natural  
10 gas liquids and associated substances shall be the value used in  
11 computing royalty on said substances.

12 (a) To compute the value of oil for royalty and supplemental  
13 royalty purposes, this lease shall be deemed an "ANS Lease" under the  
14 terms of the ANS Agreement, irrespective of any provision(s) of such  
15 agreement which would otherwise exclude this lease therefrom.

16 (b) To compute the value of gas and natural gas liquids for  
17 royalty and supplemental royalty purposes, this lease shall be deemed  
18 a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation  
19 Settlement Agreement between BPXA and the State dated as of April 1,  
20 1995, irrespective of any provision(s) of such agreement which would  
21 otherwise exclude this lease therefrom.

22 (c) To compute the value of associated substances (which shall  
23 be deemed to exclude oil, gas, and natural gas liquids) for royalty and  
24 supplemental royalty purposes, the value of such associated substances  
25 shall not be less than the highest of:

26 (1) the field price actually received by Lessee for such  
27 associated substances;

28 (2) Lessee's posted price in the field for such associated  
29 substances;

30 (3) the volume weighted average field price actually  
31 received by other producers in the same field or area for associated

1 substances of like kind and quality at the time such associated  
2 substances are removed from the leased or unit area; or

3 (4) the volume weighted average posted price in the  
4 field of other producers in the same field or area for associated  
5 substances of like kind and quality at the time such associated  
6 substances are removed from the leased or unit area.

7 If associated substances are sold away from the leased or unit  
8 area, the term "field price" above shall be the actual price for such  
9 associated substances received from the purchaser thereof less the actual  
10 cost of transportation away from the leased or unit area to the point of  
11 delivery.

12 Minimum Value Determinations. The State may establish  
13 minimum values for purposes of computing royalties on associated  
14 substances obtained from this lease, with consideration being given to  
15 the price actually received by Lessee, to the price or prices paid in the  
16 same field or area for production of like quality, to posted prices, to  
17 prices received by Lessee and/or other producers from sales occurring  
18 away from the leased area, and to other relevant matters. Each such  
19 determination will be made only after Lessee has been given notice and  
20 a reasonable opportunity to be heard. Under this provision, it is  
21 expressly agreed that the minimum value of royalty associated  
22 substances under this lease may not necessarily equal the price of such  
23 associated substances.

24 (6) The following provision shall be added to the end of paragraph 12:

25 (c) Supplemental royalty under paragraph 7 above may be taken  
26 in kind under the same terms and conditions as royalty may be taken  
27 in kind under this paragraph 12.

28 (7) Paragraph 14 is replaced in its entirety as follows:

29 14. APPORTIONMENT OF ROYALTY FROM APPROVED  
30 UNIT. The landowner's royalty and supplemental royalty share of the  
31 unit production allocated to each separately owned tract shall be

1           regarded as royalty to be distributed to and among, or the proceeds of  
2           it paid to, the landowners, free and clear of all unit expense and free of  
3           any lien for it. Under this provision, the State's royalty and  
4           supplemental royalty share of any unit production allocated to the  
5           leased area shall be regarded as royalty to be distributed to, or the  
6           proceeds of it paid to, the State, free and clear of all unit expenses (and  
7           any portion of such expenses which is incurred away from the unit  
8           area), including, but not limited to, expenses for separation, cleaning,  
9           dehydration, gathering, saltwater disposal, and preparing oil, gas or  
10          associated substances for transportation off the unit area, and free of  
11          any lien for it.

12          (8) Paragraph 28 (c) is added as follows:

13                 (c) Notwithstanding any other provisions of this lease, the  
14                 Northstar Unit Agreement, State statute, or State regulation, this lease  
15                 shall terminate automatically without notice, an opportunity to be heard,  
16                 or judicial proceeding, if the Lessee fails to comply with the sanction  
17                 schedule set forth in Exhibit C ("sanction schedule"), attached and  
18                 incorporated by reference. Automatic termination shall occur whether  
19                 or not there is a well on the leased area capable of producing oil or gas  
20                 in paying quantities, the lease is committed to a unit agreement, or the  
21                 Lessee is drilling or conducting reworking operations, on the date  
22                 performance under the schedule is due. Furthermore, upon termination  
23                 BPXA shall promptly file of record appropriate lease relinquishments.  
24                 The automatic termination shall occur at 11:59 P.M., Alaska Time, on  
25                 the day performance of the obligation under the sanction schedule is  
26                 due.

27          (9) Paragraph 32 is replaced in its entirety as follows:

28                 32. FORCE MAJEURE. If the State determines that Lessee has  
29                 been prevented, after diligent efforts made in good faith, from  
30                 complying with any express or implied promise, term, condition or  
31                 covenant of this lease (other than the obligation to provide project

1 sanction within twelve (12) months of the passage by the legislature of  
2 an Act authorizing an Amendment to the Northstar Unit leases for the  
3 project), from conducting drilling operations, or from producing or  
4 marketing oil or gas from the leased area, by reason of war, riots, acts  
5 of God, unusually severe weather, or any other cause beyond Lessee's  
6 reasonable ability to foresee or control (including delays caused by  
7 judicial decision or lack thereof or inability to obtain local, State, or  
8 federal permits or environmental impact statements), whether similar to  
9 those enumerated or not, Lessee's obligation to comply with such  
10 provision shall be suspended, but not voided, and Lessee shall not be  
11 liable for damages for failure to comply therewith. If Lessee's  
12 obligations to conduct drilling or reworking operations are suspended  
13 under this paragraph and the continuation of such operations without  
14 suspension would have had the effect of preventing the expiration or  
15 termination of this lease, this lease shall not terminate during the period  
16 which the obligation to perform such operations is suspended. Nothing  
17 in this paragraph shall be construed to suspend the obligation to pay  
18 rentals, or to suspend the obligation to pay royalties, supplemental  
19 royalties or other production payments from operations on the lease area  
20 which are not suspended or from operations which are not affected by  
21 any such suspension, to the State.

22 (10) Paragraph 41 is replaced in its entirety as follows:

23 41. FABRICATION OF PRODUCTION AND PROCESSING  
24 MODULES WITHIN ALASKA AND EMPLOYMENT OF ALASKAN  
25 RESIDENTS. Lessee agrees to utilize on-site production and  
26 processing modules for development of the Northstar oil field, and  
27 agrees to fabricate those modules within Alaska. The State of Alaska  
28 will not be responsible for contributing to any capital expenditures  
29 required to prepare, develop or operate any sites or facilities necessary  
30 for the fabrication, transportation or installation of the Northstar Unit  
31 production and processing modules. All expenses associated with the

1 design, fabrication, transportation and installation of production and  
 2 processing modules required for the development of the Northstar oil  
 3 field will be the sole responsibility of BP Exploration (Alaska) Inc. and  
 4 its contractors.

5 Lessee shall comply with all valid federal, State and local laws  
 6 in hiring Alaska residents and contractors and shall not discriminate  
 7 against Alaska residents or contractors. Within the constraints of law,  
 8 Lessee shall employ Alaska residents and contractors to the extent they  
 9 are available and qualified. Subject to the foregoing:

10 Lessee voluntarily agrees to hire residents of Alaska. Lessee  
 11 shall advertise for available positions locally and use Alaska job service  
 12 organizations to notify the Alaskan public. For work in connection with  
 13 this lease, Lessee shall <sup>purchase materials and services from</sup> contract with Alaska firms <sup>Alaska vendors, suppliers and consultants and</sup> and fabricate  
 14 the modules for on-site production and processing facilities in Alaska.  
 15 Lessee shall require its contractors to employ and train, when necessary,  
 16 residents of Alaska. Lessee shall submit annually to the Director,  
 17 Division of Oil and Gas, for transmission to the President of the Senate  
 18 and the Speaker of the House of Representatives, a report that details  
 19 the specific measures Lessee and its contractors and subcontractors have  
 20 taken or are planning to take to recruit qualified Alaska residents for  
 21 available jobs, describes on-the-job training opportunities, and describes  
 22 Lessee's efforts to hire Alaska firms for work in connection with this  
 23 lease. Lessee shall furnish the Department of Labor, for transmission  
 24 to the President of the Senate and the Speaker of the House of  
 25 Representatives, a quarterly report regarding the employment of Alaska  
 26 residents on the lease area in compliance with regulations by the  
 27 Department of Labor. The report must also include statistical data  
 28 concerning the number of resident personnel hired within the past year  
 29 for this lease.

#### 30 1983 Lease

31 (1) Paragraph 4(f) and paragraph 34(7) are deleted and replaced in their

1 entirety with the following paragraph 4(f):

2 (f) FORCE MAJEURE. If the State determines that lessee has  
3 been prevented, after diligent efforts made in good faith, from  
4 complying with any express or implied promise, term, condition or  
5 covenant of this lease (other than the obligation to provide project  
6 sanction within twelve (12) months of the passage by the legislature of  
7 an Act authorizing an Amendment to the Northstar Unit leases for the  
8 project), from conducting drilling operations, or from producing or  
9 marketing oil or gas from the leased area, by reason of war, riots, acts  
10 of God, unusually severe weather, or any other cause beyond lessee's  
11 reasonable ability to foresee or control (including delays caused by  
12 judicial decision or lack thereof or inability to obtain local, State, or  
13 federal permits or environmental impact statements), whether similar to  
14 those enumerated or not, lessee's obligation to comply with such  
15 provision shall be suspended, but not voided, and lessee shall not be  
16 liable for damages for failure to comply therewith. If lessee's  
17 obligations to conduct drilling or reworking operations are suspended  
18 under this paragraph and the continuation of such operations without  
19 suspension would have had the effect of preventing the expiration or  
20 termination of this lease, this lease shall not terminate during the period  
21 which the obligation to perform such operations is suspended. Nothing  
22 in this paragraph shall be construed to suspend the obligation to pay  
23 rentals, or to suspend the obligation to pay royalties, supplemental  
24 royalties or other production payments from operations on the lease area  
25 which are not suspended or from operations which are not affected by  
26 any such suspension, to the State.

27 (2) Paragraph 5(b) is replaced in its entirety as follows:

28 (b) Annual rental paid in advance is a credit on the royalty or  
29 supplemental royalty due under this lease for that year.

30 (3) Paragraph 7 is replaced in its entirety as follows:

31 7. APPORTIONMENT OF ROYALTY FROM APPROVED

1 UNIT. The State's royalty and supplemental royalty share of the unit  
2 production allocated to each separately owned tract must be regarded  
3 as royalty to be distributed to or among, or the proceeds of it paid to,  
4 the State, free and clear of all unit expenses and free of any lien for  
5 them. Under this provision, the State's royalty and supplemental royalty  
6 share of any unit production allocated to the leased area will be  
7 regarded as royalty to be distributed to, or the proceeds of it paid to, the  
8 State, free and clear of all unit expenses (and any portion of those  
9 expenses incurred away from the unit area), including, but not limited  
10 to, expenses for separating, cleaning, dehydration, gathering, saltwater  
11 disposal, and preparing oil, gas, or associated substances for  
12 transportation off the unit area, and free of any lien for them.

13 (4) A new paragraph 20(c) is added as follows:

14 (c) Notwithstanding any other provisions of this lease, the  
15 Northstar Unit Agreement, State statute, or State regulation, this lease  
16 shall terminate automatically without notice, an opportunity to be heard,  
17 or judicial proceeding, if the lessee fails to comply with the sanction  
18 schedule set forth in Exhibit C ("sanction schedule"), attached and  
19 incorporated by reference. Automatic termination shall occur whether  
20 or not there is a well on the leased area capable of producing oil or gas  
21 in paying quantities, the lease is committed to a unit agreement, or the  
22 lessee is drilling or conducting reworking operations, on the date  
23 performance under the schedule is due. Furthermore, upon termination  
24 BPXA shall promptly file of record appropriate lease relinquishments.  
25 The automatic termination shall occur at 11:59 P.M., Alaska Time, on  
26 the day performance of an obligation under the sanction schedule is  
27 due.

28 (5) Paragraph 31 is replaced in its entirety as follows:

29 31. FABRICATION OF PRODUCTION AND PROCESSING  
30 MODULES WITHIN ALASKA AND EMPLOYMENT OF ALASKAN  
31 RESIDENTS. Lessee agrees to utilize on-site production and

1 processing modules for development of the Northstar oil field, and  
2 agrees to fabricate those modules within Alaska. ~~The State of Alaska~~  
3 will not be responsible for contributing to any capital expenditures  
4 required to prepare, develop or operate any sites or facilities necessary  
5 for the fabrication, transportation or installation of the Northstar Unit  
6 production and processing modules. All expenses associated with the  
7 design, fabrication, transportation and installation of production and  
8 processing modules required for the development of the Northstar oil  
9 field will be the sole responsibility of BP Exploration (Alaska) Inc. and  
10 its contractors.

11 Lessee shall comply with all valid federal, State and local laws  
12 in hiring Alaska residents and contractors and shall not discriminate  
13 against Alaska residents or contractors. Within the constraints of law,  
14 Lessee shall employ Alaska residents and contractors to the extent they  
15 are available and qualified. Subject to the foregoing:

16 Lessee voluntarily agrees to hire residents of Alaska. Lessee  
17 shall advertise for available positions locally and use Alaska job service  
18 organizations to notify the Alaskan public. For work in connection with  
19 this lease, Lessee shall contract with Alaska firms and fabricate the  
20 modules for on-site production and processing facilities in Alaska.  
21 Lessee shall require its contractors to employ and train, when necessary,  
22 residents of Alaska. Lessee shall submit annually to the Director,  
23 Division of Oil and Gas, for transmission to the President of the Senate  
24 and the Speaker of the House of Representatives, a report that details  
25 the specific measures Lessee and its contractors and subcontractors have  
26 taken or are planning to take to recruit qualified Alaska residents for  
27 available jobs, describes on-the-job training opportunities, and describes  
28 Lessee's efforts to hire Alaska firms for work in connection with this  
29 lease. Lessee shall furnish the Department of Labor, for transmission  
30 to the President of the Senate and the Speaker of the House of  
31 Representatives, a quarterly report regarding the employment of Alaska

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residents on the lease area in compliance with regulations by the Department of Labor. The report must also include statistical data concerning the number of resident personnel hired within the past year for this lease.

(6) Paragraph 35 is replaced in its entirety as follows:

35. ROYALTY ON PRODUCTION. Except for oil, gas, and associated substances used on the leased area for development and production or unavoidably lost, the lessee shall pay to the State as a royalty 20 percent in amount or value of the oil, gas, and associated substances saved, removed, or sold from the leased area and of the gas used on the leased area for extraction of natural gasoline or other products from the leased area.

(7) Paragraph 36 is replaced in its entirety as follows:

36. VALUE. For purposes of computing supplemental royalty due under this lease, the value of supplemental royalty oil, gas, natural gas liquids, and associated substances shall be the value used in computing royalty on said substances.

(a) To compute the value of oil for royalty and supplemental royalty purposes, this lease shall be deemed an "ANS Lease" under the terms of the ANS Agreement, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(b) To compute value of gas and natural gas liquids for royalty and supplemental royalty purposes, this lease shall be deemed a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation Settlement Agreement between BPXA and the State dated as of April 1, 1995, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(c) To compute the value of associated substances (which shall be deemed to exclude oil, gas, and natural gas liquids) for royalty and supplemental royalty purposes, the value of such associated substances shall not be less than the highest of:

1 (1) the field price actually received by lessee for such  
2 associated substances;

3 (2) Lessee's posted price in the field for such associated  
4 substances;

5 (3) the volume weighted average field price actually  
6 received by other producers in the same field or area for associated  
7 substances of like kind and quality at the time such associated  
8 substances are removed from the leased or unit area; or

9 (4) the volume weighted average posted price in the  
10 field of other producers in the same field or area for associated  
11 substances of like kind and quality at the time such associated  
12 substances are removed from the leased or unit area.

13 If associated substances are sold away from the leased or unit  
14 area, the term "field price" above shall be the actual price for such  
15 associated substances received from the purchaser thereof less the actual  
16 cost of transportation away from the leased or unit area to the point of  
17 delivery.

18 Minimum Value Determination: The State may establish  
19 minimum values for purposes of computing royalties on associated  
20 substances obtained from this lease, with consideration being given to  
21 the price actually received by lessee, to the price or prices paid in the  
22 same field or area for production of like quality, to posted prices, to  
23 prices received by lessee and/or other producers from sales occurring  
24 away from the leased area, and to other relevant matters. Each such  
25 determination will be made only after lessee has been given notice and  
26 a reasonable opportunity to be heard. Under this provision, it is  
27 expressly agreed that the minimum value of royalty associated  
28 substances under this lease may not necessarily equal the price of such  
29 associated substances.

30 (8) Paragraph 37 is replaced in its entirety as follows:

31 37. ROYALTY IN VALUE. Unless the State elects to receive

1 all or a portion of its royalty or supplemental royalty in kind as  
2 provided in paragraph 38, lessee shall pay to the State the value of all  
3 royalty and supplemental royalty oil, gas and associated substances as  
4 determined under paragraph 36. Royalty and supplemental royalty paid  
5 in value shall be free and clear of all lease expenses (and any portion  
6 of such expenses which is incurred away from the leased area),  
7 including, but not limited to, expenses for separation, cleaning,  
8 dehydration, gathering, saltwater disposal, and preparing the oil, gas or  
9 associated substances for transportation off the leased area. All royalty  
10 and supplemental royalty that may become payable in money to the  
11 State shall be paid on or before the last day of the calendar month  
12 following the month in which the oil, gas or associated substances are  
13 produced. Royalty and supplemental royalty payments shall be  
14 accompanied by copies of run tickets or such other information relating  
15 to valuation of royalty and supplemental royalty as the State may  
16 require, which may include, but is not limited to, evidence of sales,  
17 shipments, and amounts of gross oil, gas and associated substances  
18 produced.

19 (9) The following provisions shall be added to the end of paragraph 38:

20 (f) Supplemental royalty under this lease may be taken in kind  
21 under the same terms and conditions as royalty may be taken in kind  
22 under this paragraph 38.

23 (10) Paragraph 39 is replaced in its entirety as follows:

24 39. REDUCTION OF ROYALTY. Except as provided in  
25 paragraph 40 below, lessee shall not be entitled to any reduction of  
26 royalty paid under paragraph 35 above or supplemental royalty paid  
27 under paragraph 40 below based on any current or future agreement,  
28 State statute, or State regulation.

29 (11) Paragraph 40 is replaced in its entirety as follows:

30 40. SUPPLEMENTAL ROYALTY. (a) In addition to the  
31 royalty paid and computed under paragraphs 35, 36, 37 above, lessee

1 shall pay to the State a supplemental royalty ("supplemental royalty").  
2 Lessee shall pay the supplemental royalty, if owed, upon the same  
3 production volume for which royalty is paid ("production volume").  
4 The supplemental royalty payment for a given month equals the  
5 supplemental royalty value times the supplemental royalty percentage  
6 rate ("percentage rate") times the production volume for that month.  
7 The percentage rate shall be calculated monthly by reference to: (1) an  
8 ANS West Coast spot price ("spot price"); and (2) a supplemental  
9 royalty trigger price ("trigger price"). If the spot price is equal to or  
10 less than the trigger price, then the percentage rate equals zero. If the  
11 spot price is greater than the trigger price, then the percentage rate  
12 equals [the spot price per barrel minus the trigger price per barrel] times  
13 1.5 percent per dollar per barrel. The percentage rate may never exceed  
14 7.5 percent.

15 (b) The spot price is the price per barrel calculated in Article  
16 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement  
17 Agreement ("ANS Agreement"), dated December 31, 1991, between the  
18 State and BP Exploration (Alaska) Inc. for the crude oil referred to as  
19 "ANS (USWC)" in the ANS Agreement. The trigger price is \$17.35  
20 per barrel through April 30, 1997. On May 1, 1997, and each May 1  
21 thereafter, the trigger price shall be adjusted by an inflation factor equal  
22 to fifty percent of the "inflation rate" defined as the Producer Price  
23 Index for Industrial Commodities ("PPI") for December of the previous  
24 year, as reported by April 30 of the current year, divided by the PPI for  
25 December of 1995, as reported by April 30, 1996. The supplemental  
26 royalty value for oil, gas, natural gas liquids and associated substances  
27 is defined in paragraphs 36 and 37 above. Exhibit B is a sample  
28 calculation to demonstrate the method of calculating supplemental  
29 royalty for oil.

30 These amendments do not affect: (1) any future agreements which may  
31 be reached for the handling of outside substances as that term is used in the

1 Northstar Unit Agreement effective January 24, 1990, or (2) the current  
 2 valuation methodology for royalty for any other Alaska Net Profit Share leases  
 3 between the State and BP Exploration (Alaska) Inc. or any affiliates or any  
 4 future agreements which may be reached regarding a future valuation  
 5 methodology for Alaska Net Profit Share leases. These amendments take effect  
 6 on the first day following delivery of a letter from the commissioner of the  
 7 Department of Natural Resources to the Revisor of Statutes, with copies to the  
 8 President of the Senate and the Speaker of the House of Representatives,  
 9 confirming that BP Exploration (Alaska) Inc. or its parent entity has made an  
 10 irrevocable commitment of full funding (project sanction) to develop the North  
 11 Star Oil Field. This amendment is dated for reference purposes as of \_\_\_\_\_  
 12 \_\_\_\_\_ (Date).

13 LESSEE: LESSOR:  
 14 BP EXPLORATION (ALASKA), INC. STATE OF ALASKA  
 15 \_\_\_\_\_  
 16 \_\_\_\_\_, Vice President \_\_\_\_\_, Commissioner  
 17 Department of Natural Resources

18 STATE OF ALASKA )  
 19 ) ss.  
 20 Third Judicial District )  
 21 On \_\_\_\_\_, 1996, before me appeared \_\_\_\_\_,  
 22 Commissioner, State of Alaska, Department of Natural Resources, and who  
 23 executed this lease and acknowledged voluntarily signing it on behalf of the  
 24 State of Alaska, as lessor.

25 \_\_\_\_\_  
 26 Notary Public in and for the State of Alaska  
 27 My Commission expires: \_\_\_\_\_  
 28 STATE OF ALASKA )  
 29 ) ss.  
 30 Third Judicial District )  
 31 On \_\_\_\_\_, 1996, before me appeared \_\_\_\_\_

1 Vice President of BP Exploration (Alaska), Inc. and who executed this lease  
 2 and acknowledged voluntarily signing it on behalf of the BP Exploration  
 3 (Alaska), Inc. as lessee.

4 \_\_\_\_\_  
 5 Notary Public in and for the State of Alaska

6 My Commission expires: \_\_\_\_\_

7 Exhibit B

8 Calculation of the Supplemental Royalty Payment for Oil

9 (1) The calculation of the ANS West Coast spot price is derived  
 10 from Platt's "Oilgram Price Report" Spot Crude Price Assessments:

11 Platt's Reported Daily

12 Assessment (\$/barrel)

13 Date	14 ANSWC Low	15 ANSWC High	16 ANSWC Daily Average	17 ANSWC Daily Average (After Rounding) <sup>1</sup>
18 01/02/96	\$17.97	\$18.06	\$18.015	\$18.02
19 01/03/96	\$17.94	\$18.03	\$17.985	\$17.98
20 01/04/96	\$17.96	\$18.03	\$17.995	\$18.00
21 01/05/96	\$18.60	\$18.64	\$18.620	\$18.62
22 01/09/96	\$18.23	\$18.29	\$18.260	\$18.26
23 01/10/96	\$17.99	\$18.05	\$18.020	\$18.02
24 01/11/96	\$17.10	\$17.17	\$18.135	\$17.14
25 01/12/96	\$16.64	\$16.71	\$18.675	\$16.68
26 01/15/96	\$16.75	\$16.83	\$16.690	\$16.79
27 01/16/96	\$16.60	\$16.66	\$16.730	\$16.63
28 01/17/96	\$16.91	\$16.97	\$16.940	\$16.94
29 01/18/96	\$17.46	\$17.54	\$17.500	\$17.50
	\$17.28	\$17.37	\$17.325	\$17.32
	\$17.02	\$17.08	\$17.050	\$17.05

1 \_\_\_\_\_  
 2 All source and calculated numbers shall be rounded as required in the ANS  
 3 Agreement.

1	01/23/96	\$17.10	\$17.16	\$17.150	\$17.13
2	01/24/96	\$17.35	\$17.41	\$17.380	\$17.38
3	01/25/96	\$16.76	\$16.81	\$17.785	\$16.78
4	01/26/96	\$16.43	\$16.53	\$17.480	\$16.48
5	01/29/96	\$16.16	\$16.24	\$16.200	\$16.20
6	01/30/96	\$16.30	\$16.38	\$16.340	\$16.34
7	01/31/96	\$16.46	\$16.56	\$16.510	\$16.51

8 Monthly Average calculated from ANSWC Daily

9 Average (After Rounding) = \$17.2271 per barrel

10 ANS West Coast spot price for the January 1996

11 month of production = \$17.23 per barrel

12 (2) The inflation factor shall be calculated as follows: Assume  
13 that by April 30, 1996, the U.S. Department of Labor reports a PPI for  
14 December 1995 as 126.2. Assume that by April 30, 1998, the PPI for  
15 December 1997 is 134.2. The inflation factor for 1998 is calculated according  
16 to the following formula:

17 Inflation Factor for May 1, 1998, through April 30, 1999

18 = [(PPI December of the previous year ÷ PPI December 1995) - 1] x 0.5

19 = [(134.2 ÷ 126.2) - 1] x 0.5 = 0.0317 = 3.17 percent

20 (3) The trigger price for May 1, 1998, through April 30, 1999,  
21 is calculated by adjusting \$17.35 per barrel by the inflation factor as follows:

22 Trigger price for the current year = \$17.35 per barrel x (1 + inflation factor)

23 = \$17.35 per barrel x (1 + 3.17 percent)

24 = \$17.35 x 1.0317

25 = \$17.90 per barrel

26 (4) Assuming the current month ANSWC spot price is \$21.40,  
27 the supplemental royalty percentage rate is calculated as:

28 Supplemental royalty percentage rate = (ANSWC spot price - trigger price for the  
29 current year) x (1.5 percent per dollar per barrel)

30 = (\$21.40 per barrel - \$17.90 per barrel) x 1.5 percent per dollar per barrel

31 = (21.40 - 17.90) x 0.015

1 = 0.05250 = 5.25 percent

2 (5) The calculation of the supplemental royalty payment for the  
3 current month is the product of the production volume times the royalty value  
4 and the supplemental royalty percentage rate. Assume that 1,550,000 barrels  
5 of oil were produced in the Northstar unit in the current month and that the  
6 royalty value is \$17.71. The supplemental royalty is:

7 Supplemental royalty payment = production volume x royalty value x supplemental  
8 royalty percentage rate

9 = 1,550,000 barrels x \$17.71 per barrel x 5.25 percent

10 = \$1,441,151.25

### 11 EXHIBIT C

#### 12 SANCTION SCHEDULE

13 The Northstar Development Project ("the Project") is described in the  
14 document titled "Northstar Development Project, Conceptual Engineering  
15 Report" dated February 1996. BPXA shall comply with the following sanction  
16 schedule for the Project and shall provide satisfactory evidence of compliance  
17 within fifteen (15) days of the date performance is due under the schedule:

18 BPXA shall receive Project sanction within twelve (12) months after  
19 passage by the legislature of an Act approving the Amendment to the Northstar  
20 Unit Leases for the Project. "Project sanction" means approval in writing by  
21 the highest appropriate authority in BPXA or its parent entity necessary for the  
22 total amount of expenditures required for the Project. Satisfactory evidence of  
23 receipt of sanction shall be tendered to the State in the form of the sanctioning  
24 entity's documents approving the expenditure of funds for the Project. Project  
25 sanction by BPXA or its parent entity shall be irrevocable. If project sanction  
26 is withdrawn for any reason whatsoever, BPXA shall notify the State within  
27 three working days by letter from an authorized officer and BPXA shall be  
28 deemed to have failed to comply with this schedule.

29 (c) Notwithstanding any other provision of law, the "Amendment to the Northstar Unit  
30 Leases Between the State of Alaska and BP Exploration (Alaska) Inc." as described in (b) of  
31 this section, if voluntarily agreed to by the commissioner of natural resources and BP

- 1 Exploration (Alaska) Inc., is approved and ratified.
- 2 \* Sec. 4. This Act takes effect on the first day following delivery of a letter from the
- 3 commissioner of natural resources to the revisor of statutes, with copies to the president of the
- 4 senate and the speaker of the house of representatives, confirming that BP Exploration
- 5 (Alaska) Inc. or its parent entity has made an irrevocable commitment of full funding
- 6 (projection sanction) to develop the Northstar Oil Field.



E. M. Luttrell  
Vice President  
Exploration, Alaska

**BP EXPLORATION**

BP Exploration (Alaska) Inc  
600 East Benson Boulevard  
P.O. Box 198812  
Anchorage, Alaska 99519-8812  
(907) 564-4892

April 18, 1996

Senator Loren Leman  
Alaska State Legislature  
State Capitol (MS 3100)  
Juneau, Alaska 99801-1182

Subject: BP position on the CS for Senate Bill 318

Dear Senator Leman:

BP has reached a negotiated agreement with the State of Alaska to amend the Northstar unit leases. The Legislature has been asked to consider and ratify that agreement. Ratification will lead to the early development of Northstar to the mutual benefit of both Alaska and BP.

The CS (Committee Substitute) has altered the agreement, attempting to reopen the negotiation. All of the areas of the original agreement which have been amended in the CS version are areas which were carefully discussed and negotiated to arrive at a balanced agreement. Both we and the DNR have sought to explain to your committee the reason for these conclusions. BP will not reopen the negotiations and can not agree to the changes.

To be clear, BP and its contractors have heard the concern of the Legislature over local hire and we reaffirm our public commitment to maximize the job opportunities for Alaskans and Alaskan contractors represented by Northstar development.

Sincerely,



Eric M. Luttrell

EML/dd

cc: President Drue Pearce  
Speaker Gail Phillips  
Commissioner John Shively

State of Alaska  
 Department of Natural Resources  
*Division of Oil and Gas - Director's Office*

3601 C Street, Suite 1380, Anchorage, Alaska 99503  
 Phone 907-269-8784 Fax 907-562-3852

*Fax transmittal*



To: Lenston Loren Loren

Fax Number: 907-465-3810

From: Ken Boyd

Date & Time: 4/23/96 10:05 am

Number of Pages (including cover sheet): 27

Comments:

TONY KNOWLES, GOVERNOR

## DEPARTMENT OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

3601 C STREET, SUITE 1380  
ANCHORAGE, ALASKA 99503-5848  
PHONE: (907) 762-2549

April 23, 1996

The Honorable Loren Leman  
Chairman, Senate Resources Committee  
Alaska State Legislature  
State Capitol Building, Room 113  
Juneau, Alaska 99801-1182  
MAIL STOP 3100

Dear Senator Leman:

The Division believes that the "so-called" findings of fact in Section 1 of CS for SB 318 (RES.) should be dropped. The findings are replete with opinion rather than facts, and for the most part add little to the debate. If the committee is intent on leaving them in the bill, the Division has drafted suggested changes. The Division believes that the findings are unsatisfactory in two principal areas. For the most part, the Division's suggestions are directed at these two areas.

First, the findings unfairly suggest that the Division's extension of the NSU and the approval of the revised three-year plan of development (POD) in 1995 was somehow out of the ordinary and was not designed to encourage early exploration and development. In essence by allowing the unit to continue in effect, the Division continued two leases that would have otherwise expired. Also the Division did not take the drastic step of ordering production from the certified wells on the other three leases. The decision was consistent with over twenty previous decisions, which the Division has identified after just a perusal of in-house records, that have extended leases without mandating production.

To illustrate the findings' skewed approach, let us examine the 1990 decision by Director Eason, now the committee's advisor, to approve the NSU. The findings claim that the POD which Director Eason approved was "designed to encourage expedited evaluation and development" of the NSU. Initially, the Division notes that there has been no testimony supporting this opinion. While the Division does not necessarily disagree with the statement, it does disagree with the implication that the 1990 decision was designed to encourage expedited evaluation and development, but the 1995 was not. In 1990, four of the five leases were due to expire. Instead of approving the unit, the Division could have caused the one lease without a certified well to automatically revert back to the state and it could have ordered the three leases with certified wells into production. It could have competitively rebid the one lease and, if the others were not placed into production, it could have terminated them and released them. The Division did not. There is no evidence that it consulted the DOL about these possibilities. It was unnecessary, just as it was unnecessary in 1995, because as

The Honorable Loren Leman

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April 23, 1996

a matter of consistent policy since at least 1977, the Division has believed that it is better to work with the current lessees to get a mutually acceptable POD that hopefully encourages early exploration and production rather than require the return of leases or force production.

In 1990, the Division settled for a POD that, while giving the state some fee obligation payments, did not even require the drilling of one well. There was no requirement that Amerada Hess drive down development costs. There was no requirement that Amerada Hess be in production before the 5 year term ended. (For your information, there was nothing unique about the five year term as suggested by the findings.) Indeed, the POD contemplated a further extension if during the five-year term Amerada Hess could show the field was economic. Although the intent of the POD might have been expedited exploration and development, the POD did not deliver it. At the end of the term, Amerada Hess had drilled only one more well, had a development plan that was totally uneconomic, and had not produced a drop of oil. The current three-year POD at least provides for project sanction by the end of the three-year plan.

The extension of leases by putting them into units could be argued to violate the competitive bid process. The leases were bid for a set primary term. What the state wants is production. If the current lessee has not delivered, why not take the leases back? The consistent answer is that if the current lessee and the Division can agree to a POD, the Division believes that the state is better off than trying to take the leases back. In all situations, the POD is negotiated with the Division typically wanting more, sooner; and the lessee wanting less, later. Ultimately, the Division's goal has been to obtain development as soon as reasonably possible. Rentals or payments in lieu of drilling obligations provide minimal revenue in comparison to what the state receives if a lease is put into production.

If the Senate is critical of the 1995 decision, then it should be critical of all these past decisions. This lease extension issue has been previously visited by the legislature when it considered whether the Division should have authority to form exploratory units. Previous legislatures did not take this authority away from the Division. If the Senate believes that the Division should not have the authority, then it should mandate a change in that policy by changing the law. The Division suspects that there would be a cry of anguish from industry for virtually every company drilling wells in Alaska has at one time or another asked the Division to extend leases by putting them into exploratory units or deferring the contraction of leases from a unit. The result would not be partnering or trying to get reasonable exploration and development. It would be slavish attention to the competitive bidding process.

The second principal objection is the slant of the findings on the economic issues. Initially, the findings overstate the likely economic benefits the Division believes could be obtained if the leases were relet. Next, in comparing the benefits of supplemental royalty against the net profit share, the findings emphasize the effects of the upside cases while ignoring the downside cases. Finally, the findings improperly focus on whether the deal is a "good" deal or an "OK" deal. When was the last time anyone of us can say we got a "good" deal. If the Division were to say that the state got a good

The Honorable Loren Leman

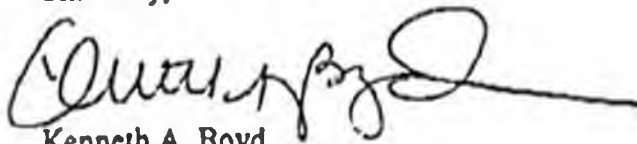
3

April 23, 1996

deal, doesn't that imply that BP got a bad deal? In most negotiations, each party will give up things that it would rather not. The Division's position is that even without any Alaska Hire, this deal would be a reasonable deal for the state, no more or no less. If BP honors its commitment to Alaska Hire, and the fabrication industry in this state is able to expand and become competitive on a world wide basis, then the deal could be characterized as a good deal or maybe even a great deal.

Again, the Division believes that the committee should drop the findings in Section 1 altogether. If the committee chooses to do otherwise, then the Division has enclosed its proposed amendments.

Sincerely,



Kenneth A. Boyd  
Director

Enclosures

**MEMORANDUM**  
DEPARTMENT OF NATURAL RESOURCESState of Alaska  
DIVISION OF OIL AND GASTO: Patrick Coughlin  
Deputy Director/Petroleum Investments  
Manager

DATE: April 23, 1996

TELEPHONE NO: 269-8812

FROM: Mike Kotowski ~~MDK~~  
Units ManagerSUBJECT: Unit Decisions  
Extending Leases

Per your request, attached is a list of units and unit expansions approved by the DNR which extended leases beyond their primary term. The list includes the date of application for the unit agreement or unit expansion, the date the application was approved, the date the unit terminated (if terminated), and the director of the Division of Oil and Gas or commissioner of the DNR approving the application.

Attachment

Unit	Operator	Date of Application	Date of Approval	Date of Termination	Director	Commissioner
Astoch	Conoco	7/30/90	11/16/90	10/8/92	James E. Eason	Glenn Olds
Budoni	BP	11/18/84	3/13/86			Mary Fetherford, Dep. Co.
Big Flyer	ARCO	8/24/84	8/21/90	4/8/91	James E. Eason	Rod Swape
Deck Island	Esxon to BP	2/3/78	8/21/78			Fred Bonema, Dep. Co.
Falls Creek	Chevron to ARCO	8/30/88	12/21/80		Leo Petersen, Acting Dir, DOI	Rosecoe E. Bell
Gaydyr Bay	Conoco	4/28/78	10/23/78	10/1/82		R. LaFresche
Hemi Springs	ARCO	11/14/83	1/17/84	10/1/82	Key Brown	Eather Winnicko
Jensen Island	AMCO to Amerade Hess	8/27/82	12/18/82	8/8/84	James E. Eason	Glenn Olds
Kavik	ARCO	8/27/72	3/23/73			Charles F. Herbert
Kukpik	ARCO	4/10/82	8/10/82		James E. Eason	Glenn Olds
Mine Point	Conoco	4/27/78	10/29/78			R. LaFresche
MPU Expansion	Conoco	10/23/91	3/2/92		James E. Eason	Harold G. Heliza
Nicola Creek	Texaco	3/11/84	3/15/88			Thomas Kelley
North Fort	Chevron	5/4/85	5/25/85			Rosecoe E. Bell
Northstar	Amerade Hess to BP	10/12/88	1/24/90		James E. Eason	Lennie Gorsuch
Point Thomson	Esxon	10/21/78	8/1/77		J.P. Green, DNEM	R. LaFresche
Point Thomson Expansion	Esxon	1/13/84	3/28/84		Key Brown	Eather Winnicko
Prudhoe Bay/Niakak*	BP/AMCO	10/27/86	2/25/87		James E. Eason	Judith Brady
Prudhoe Bay/Pt. McIntyre*	BP/ARCO	10/27/86	2/25/87		James E. Eason	Judith Brady
	* Involved deferral of PBU contract for 4 leases					
Thesis Island	Esxon	11/13/82	2/12/93	5/15/82	James E. Eason	Glenn Olds
W McArthur River	Stewart Petroleum	4/18/80	7/27/80		James E. Eason	Rod Swape

Amendment to Page 1, Line 13, Paragraph 1

Replace with...

(1) The net profit share provision of four of the five state leases now included in the Northstar Unit was the competitively bid variable when the leases were originally offered for lease. The leases were offered with a fixed per acre cash bonus and a fixed royalty of 20 percent, and bidders were asked to submit sealed competitive bids based upon the percentage of net profits that the bidder would share with the state. According to the Department of Natural Resources, the average of the winning net profit share bids for these leases was "about 89 percent." As to the fifth state lease, the net profit share and royalty were fixed by the Department of Natural Resources at 40 percent and 12 1/2 percent, respectively, and the competitively bid variable was the amount of bonus offered by the bidders.

Amendment to Page 2, Line 30, Paragraph 1

Replace with...

(1) [ FOLLOWING LENGTHY NEGOTIATIONS BETWEEN THE AMERADA HESS CO., THE DEPARTMENT OF NATURAL RESOURCES, AND THE MINERALS MANAGEMENT SERVICE,] Instead of attempting to take back the four leases which were due to expire so that they could be competitively released, then Director Eason of the Department of Natural Resources along with [AND] the Minerals Management Service approved formation of the Northstar Unit and its initial

Plan of Development, thereby extending the ten-year primary term of the leases committed to the unit. The Department of Natural Resources' action in approving this exploratory unit which effectively extended all four state leases beyond their primary term (and effectively precluding competitively releasing them) without any certainty of production was consistent with the department's actions on a multitude of units including: Prudhoe Bay/Niakuk deferral, Prudhoe Bay/Point McIntyre deferral, Milne Point formation, Milne Point Expansion, Duck Island, Point Thomson, Point Thomson Expansion, Thetis Island, Heml Springs, Big River, Astoch, Badami, Kuuknik, Northstar formation, Northfork, Nicolai Creek, Kavik, Jones Island, Falls Creek, West McAurthur River, and Gwydyr Bay. There has been no evidence that the Department of Natural Resources sought the Department of Law's advice in connection with his 1990 decision about taking back the leases without certified wells and forcing the leases with certified wells into production.

Amendment to Page 3, Line 4, Paragraph 2

Replace with...

(2) The term of the Northstar Unit was [LIMITED INITIALLY TO] five years [HOWEVER.] from January 24, 1990, until January 23, 1995. [AND THE PLAN OF DEVELOPMENT REQUIRED BY THE DEPARTMENT OF NATURAL RESOURCES PROVIDED SPECIFIC AND DETAILED CONDITIONS DESIGNED TO ENCOURAGE EXPEDITED EVALUATION AND DEVELOPMENT OF THE FIELD.]

Amendment to Page 3, Line 20, Paragraph 4

Replace with...

(4) Amerada Hess Co. and its partners made the scheduled "in lieu of drilling" payments for the first three years of the five-year Plan of Development period, with payments totaling \$5 million. Amerada Hess Co. then elected to drill the Amerada Hess Co. Northstar No. 3 Well in 1994, extinguishing its remaining financial obligations to the state under the terms of the Plan of Development for the Northstar Unit. Amerada Hess Co. and its partners also timely complied fully with each of the other conditions set out by the Department of Natural Resources in its approval of the initial Plan of Development. The Plan of Development had succeeded in getting only one well drilled, no production, and an inefficient development plan in the five year term.

Amendment to Page 3, Line 27, Paragraph 5

Replace with...

(5) Following the drilling of the Amerada Hess Co. Northstar Unit No. 3 Well earlier in 1994, Amerada Hess Co. met with representatives of the Department of Natural Resources and the Minerals Management Service in June 1994, to inform the agencies of its decision not to proceed with development of the Northstar Unit. Amerada

Hess Co. stated that the development costs for the Northstar Unit leases would exceed \$1.4 billion. Assuming that the state could get them back, the leases had little value, and would most likely be released for a nominal bonus bid.

Amendment to Page 4, Line 19, Paragraph 9

Replace with...

(9) Amerada Hess Co. and Shell began efforts to sell their respective interests in the Northstar Unit leases, [SOMETIME DURING 1994.] Neither the exact timing nor the details of Amerada Hess Co.'s and Shell's efforts to market the leases are a matter of public record.

Amendment to Page 4, Line 22, Paragraph 10

Replace with...

(10) Amerada Hess Co. and Shell subsequently sold their interests in the Northstar leases to BP Exploration (Alaska) Inc. early in 1995. BP Exploration (Alaska) Inc. has characterized the terms of its purchase of the Northstar Unit lease interests as a "competitive process." However, BP Exploration (Alaska) Inc. has declined to make public the terms of its purchase or the identity of its competitors for the purchase of Amerada Hess Co.'s and Shell's interest in the Northstar Unit leases, citing a confidentiality agreement between the parties that prohibits its doing so. The state played no role in the offering or selling of Amerada Hess Co.'s and Shell's interest in the

Northstar Unit leases to BP Exploration (Alaska) Inc. Lessee commonly sell interests in leases without the state's involvement other than approving assignments resulting from sale. [NOR WAS IT OFFERED THE OPPORTUNITY TO COMPETE FOR THE LEASES.]

Amendment to Page 4-5, Line 31, Paragraph 11

Replace with...

(11) In its purchase of the Northstar Unit leases from Amerada Hess Co. and its partners, BP Exploration (Alaska) Inc. acquired [INHERITED] the net profit share development accounts for those leases. The amount of accrued costs in the Northstar Unit net profit share development accounts has been estimated by BP Exploration (Alaska) Inc. [DEPARTMENT OF NATURAL RESOURCES] to be \$262,000,000. Under the terms of the leases and the Department of Natural Resources' regulations, although BP Exploration (Alaska) Inc. did not actually spend the \$262,000,000 in the development accounts, it would be entitled to recover those costs, plus its actual future costs of development, with interest, before it would be obligated to pay the state a share of net profits from the development of the Northstar Unit leases.

Amendment to Page 5, Line 29, Paragraph 2

Replace with...

(2) Effective January 19, 1995, then Director Eason [THE DNR] approved assignment of the state Northstar Unit leases to BP Exploration (Alaska) Inc. as had been requested earlier, and on January 20, 1995, both then Director Eason of the Department of Natural Resources and the Minerals Management Service approved BP Exploration (Alaska) Inc. as the successor operator of the Northstar Unit:

Amendment to Page 6, Line 9, Paragraph 4

Replace with...

(4) The following day, on January 24, 1995, then Director Eason of the Department of Natural Resources approved BP Exploration (Alaska) Inc.'s request for a 90 day extension to submit a new plan of development because, according to Director Eason, it was "in everyone's best interest to allow BP additional time to conclude its acquisition and to formulate a new plan of development," Mr. Eason has not explained why he took this action, instead of simply disapproving the plan and letting the unit terminate. There is no evidence that Director Eason consulted the Department of Law regarding whether he could have used this authority to grant the extension and approve the Plan of Development to leverage earlier production. [AND] On January 24, 1995, the Minerals Management Service also

approved BP Exploration (Alaska) Inc.'s request for an extension to file a more detailed Plan of Development until April 30, 1995.

Amendment to Page 6, Line 12, Paragraph 5

Replace with...

(5) On March 30, 1995, BP Exploration (Alaska) Inc. submitted a revised and more comprehensive Plan of Development and a request to extend the Northstar Unit Agreement for a three-year term coincident with its revised Plan of Development. Importantly, the revised plan included sanction within the last year. The plan included the following specific activities: 1) Data gathering and project development, including environmental data gathering and studies, promulgation of marine mammal incidental take regulations, and a cooperative agreement with the Alaska Eskimo Whaling Commission; 2) 3-D seismic acquisition, including the appropriate government permits and seismic processing, pipeline and facility engineering and reservoir descriptions; 3) Project sanction including project construction permits, integrated 3-D seismic and reservoir descriptions, permit approvals, and, finally, sanction by BP Exploration (Alaska) Inc.'s headquarters. The revised Plan of Development added the steps required by BP Exploration (Alaska) Inc. to take the Northstar development to project sanction. The estimated cost of these activities was \$12,000,000. In the two year plan the estimated cost was \$10,000,000.

Amendment to Page 6, Line 15, Paragraph 6

Replace with...

(6) [IT IS UNCLEAR FROM THE RECORD WHY] [T]The term of the second Plan of Development was increased from the originally proposed two-year to a three-year term, because of increased commitments by BP Exploration (Alaska) Inc. [THUS EXTENDING THE TIME DURING WHICH THE DEPARTMENT OF NATURAL RESOURCES CANNOT MOVE TO FORCE PRODUCTION FROM THE NORTHSTAR UNIT LEASES.]

(7) On May 1, 1995, the Minerals Management Service approved the revised plan concluding that the "new schedule of activities are deemed necessary to bring the unit into production."

Amendment to Page 6, Line 19, Paragraph 7

Replace with...

[(7)] (8) On June 2, 1995, the Department of Natural Resources "conditionally" approved BP Exploration (Alaska) Inc.'s revised three-year Plan of Development. Director Boyd approved the plan because, in his judgment, it was a reasonable one that allowed the new operator, BP Exploration (Alaska) Inc., adequate time to interpret the existing geological, geophysical and engineering data,

shoot what he considered important 3-D seismic data, begin work on development options, define the scope of reservoir/conceptual engineering, and submit permits  
is the ultimate goal of getting Internal BP Exploration (Alaska) Inc. sanction in  
the fourth quarter of 1997. The plan was tailored to the shortest deadlines that an  
operator could reasonably be expected to meet. The plan explicitly stated that  
sanction would "depend on economic competitiveness of the project compared to  
other BP Exploration (Alaska) Inc. projects worldwide, the business climate (oil  
price, etc.), and the status of the external permitting processes." It also noted that  
the risks included "[d]evelopment and production economics."

Amendment to Page 6, Line 21, Paragraph 8

Replace with...

[(8)] (2)....

Amendment to Page 7, Line 22, Paragraph 4

Replace with...

(4) Based upon testimony by both Commissioner Shively and BP  
Exploration (Alaska) Inc.'s Mr. Morgan, it is clear that even had HB 207 been amended

to include explicit authority for the commissioner to reduce the state's net profit share under the same circumstances as the commissioner was ultimately authorized to reduce the state's royalty share under the terms of HB 207, to encourage production that otherwise would not be economically feasible, the commissioner could not have done so in this instance because production from the Northstar Unit is forecasted to [WOUT.D] be economic without amendments to the net profit share provision.

Amendment to Page 8, Line 7, Paragraph 2

Replace with...

(2) Both the Department of Natural Resources and BP Exploration (Alaska) Inc. have testified that BP Exploration (Alaska) Inc.'s development of the Northstar Unit leases under the original lease terms would be economic under the most likely scenario. According to BP Exploration (Alaska) Inc.'s President, Mr. Morgan, "[W]e have never argued that the development of Northstar could not be profitable under the terms including the net profit arrangements. In profitability in terms of return on capital, this would be possible. This is not a marginal oil field."

Amendment to Page 8, Line 25, Paragraph 5

Replace with...

(5) Based upon Bp Exploration (Alaska) Inc.'s own analysis development of the Northstar project under a supplemental royalty as proposed "would have

approximately \$485 million (in inflation-adjusted dollars) and a full project rate of return (ROR) of around 21%” forecasting price volatility in the future.

Amendment to Page 9, Line 29, Paragraph 1

Replace with...

(1) The [DEPARTMENT OF NATURAL RESOURCES'] decision by the commissioner of the Department of Natural Resources to offer the Northstar leases with the net profit share as the competitive bid variable in 1979 [REPRESENTED A CONSCIOUS] resulted in a trade-off of larger immediate bonus payments for the speculative potential to receive a share of the lessees' net profits from the development of any field subsequently discovered. Since oil and gas exploration is inherently risky, with commercial discoveries occurring far less frequently than dry holes, the commissioner's [DEPARTMENT OF NATURAL RESOURCES'] bid strategy entailed risk sharing with the lessees. Compared to other bidding terms available to the commissioner [DEPARTMENT OF NATURAL RESOURCES], the selection of net profit share terms allowed successful bidders to obtain the leases for less cash than would otherwise have been required. The then director of the Division of Minerals and Energy Management Thomas Cook thought that using a net profit share method was a bad idea because it “promotes unrealistically high bids [and there is nothing to constrain a bid whose cost is a promise and whose associated obligations are limited.” Director Cook has stated that the net profit share method, unlike the cash

bonus bid method, does not require "careful evaluation on the part of the bidder, and history shows that tracts with high bonus bids receive timely exploration and expeditious development of exploration yields a commercial discovery."

Amendment to Page 10, Line 7, Paragraph 2

Replace with...

(2) Director Cook has also stated that: "In using net-profit share as the bid variable in 1979, the state sacrificed hundreds of millions of dollars in lease bonuses it could have gotten with cash bonus bidding." Interpolating [BASED UPON ITS REVIEW OF THE BONUS] revenue received for the federal leases within the Northstar Unit, which was leased with a 16 2/3 percent sliding scale royalty and the bonus as the bid variable, and making many speculative assumptions, the Department of Natural Resources [ESTIMATES] has guessed that the state's Northstar Unit leases could have brought \$268,406,052, as opposed to the \$15,469,000 actually received, had the leases been offered with a 12 1/2 percent royalty, no net-profit share and with the bonus as the bid variable.

Amendment to Page 10, Line 13, Paragraph 3

Replace with...

(3) Assuming the Department of Natural Resources' guesstimate [ESTIMATE] of bonuses is correct and based upon the annual realized rate of returns reported by the Alaska Permanent Fund Corporation in its 1995 report, the balance of the 50 percent of the \$268,406,052 that would have been deposited to the permanent fund would have been \$704,588,494 at year-end 1995.

Amendment to Page 10, Line 18, Paragraph 4

Replace with...

(4) Director Cook has said that the "state cannot recapture the past [lost bonus bids] by cancelling and re-offering the leases at another date." He believes that the "best course of action the state can take is to cut its losses from past mistakes by dropping the net-profits terms from Northstar leases and getting on with development." He further stated that the "days of large cash bonuses are gone." A 1993 United States Department of Energy study concluded that the "net profit share provisions of the state leases had a very significant burden to the economic viability of the INSU."

Amendment to Page 10, Line 18, Paragraph 4 (5)

Replace with...

[(4)] (5) The Department of Natural Resources has provided estimates of the expected mean value to a bidder of the Northstar Unit leases. [ OF THE BONUS REVENUES THAT THE STATE WOULD RECEIVE TODAY.] [I] If the Northstar Unit leases were returned to the state for reoffering in a competitive sale with bonus as the bid variable, with royalty set at 12 1/2 percent or 20 percent, with no net profit share and with estimated recoverable reserves, capital and operating costs as estimated in its economic modeling of the agreement with BP Exploration (Alaska) Inc., the estimated expected mean value would represent the most a bidder would bid. This bidder would have to have made the same economic assumptions about the Northstar Unit leases as were used by BP Exploration (Alaska) Inc. For a 12 1/2 percent royalty and at discount rates of 10 percent and 15 percent, the Department of Natural Resources estimates that the expected mean value to a bidder [OF ANTICIPATED BONUSES] would be between zero and \$225,000,000 [AND] or \$130,000,000, respectively. For a 20 percent royalty and at discount rates of 10 percent and 15 percent, the Department of Natural Resources estimates the expected mean value to a bidder [OF ANTICIPATED BONUSES] would be between zero and \$182,000,000 [AND] or \$98,000,000, respectively. If a prospective bidder thought that the Northstar Unit leases could be developed for not less than the \$1,400,000,000 predicted by Amerada Hess Co., the bidder would not likely bid at the sale. Based on this assessment of the potential competition for a re-offering sale of the Northstar Unit leases, the Department of Natural Resources expects the bids to be very small at any royalty rate.

(6) The initial assumption, in the analysis is Paragraph (5) above, i.e., that the Northstar Unit leases would be returned to the state to be re-offered in a single competitive lease sale, would not likely occur. At the end of the current Plan of Development in April 1998, only two of the Northstar Unit leases would be returned to the state. The other three leases are held by wells certified capable of producing in paying quantities. Moreover, both of the federal leases are subject to a suspension of their primary term so that termination of the unit may not trigger termination of the federal leases. One of these leases is also held by a certified well. These circumstances underscore the fact that the Northstar Unit leases would be available for lease at different times. It is very unlikely that the Northstar Unit leases could ever be sold as a single property. The Department of Natural Resources believes this would further reduce the expected mean value to the bidders because of the added risk of fragmented ownership.

Amendment to Page 11, Line 1, Paragraph 1

Replace with...

(1) Notwithstanding the acknowledged forecasted profitability of developing the Northstar field under its existing lease terms, BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified that BP Exploration (Alaska) Inc. will not develop the Northstar Unit leases unless the State of Alaska agrees to eliminate the net profit share provisions of the leases.

Amendment to Page 11, Line 12, Paragraph 4

Replace with...

(4) The Department of Natural Resources has testified that there is an implied covenant for lessees of Alaska's oil and gas leases to diligently explore and develop their leases. The Department of Natural Resources also has testified, however, that since the department has approved a three-year Plan of Development for the Northstar Unit leases that does not explicitly require development of the field, it believes that so long as BP Exploration (Alaska) Inc. meets the requirements of that plan, it would be seen as fulfilling its obligation to develop, and cannot be forced to proceed with production during the term of the current plan which does not expire until ~~[JUNE]~~ April 30, 1998.

Amendment to Page 11, Line 25, Paragraph 6

Replace with...

(6) The Department of Natural Resources has testified that if the department had not approved a further three-year extension for the Northstar Unit in June 1995, the ~~two~~ leases within the unit that did not have wells upon them certified to be capable of production in paying quantities would have reverted to the state, becoming available for releasing. Under the lease provisions and the regulations, the department could then have given notice to BP Exploration (Alaska) Inc. to begin production from

[THESE] the three leases that did have wells certified as capable of production in paying quantities within a reasonable time to do so, that could not have been less than six months. The department has never previously given such a notice to any lessee and there could be litigation over what constitutes "reasonable time" on the North Slope to put a well into production. Furthermore, the leases provide that the leases with certified wells can not be terminated without "an appropriate judicial proceeding."

Amendment to Page 12, Line 8, Paragraph 8

Replace with...

(8) The Department of Natural Resources' approval of the second Plan of Development, and the resulting three-year extension, effectively eliminated any short term leverage the department might have had otherwise to expedite BP Exploration (Alaska) Inc.'s development of the Northstar Unit leases without amendment of the leases. The Department of Natural Resources' approval was consistent with the Department of Natural Resources' approval of virtually every other Plan of Development in the recent past.

Amendment to Page 12, Line 12, Paragraph 9

Replace with...

(9) Both the Department of Natural Resources and the Department of Law have testified that the Department of Natural Resources did not consult with the Department of Law regarding whether the state might have any legal basis for moving earlier than 1998 to force production under the lease terms. [GIVEN THE UNIQUE FACTS IN THE CASE.] The Department of Natural Resources saw nothing unique about this case which would justified consulting the Department of Law.

Amendment to Page 12, Line 23, Paragraph 2

Replace with...

(2) As its principal reason for proceeding with the negotiations to amend the leases, the Department of Natural Resources cited its desire to assure that production begins earlier than it otherwise would under the timeline estimated by the Department of Revenue. The Department of Natural Resources maintains that, if the legislature does not pass SB 318. [THE EARLIEST THAT] the department could [NOW] not force BP Exploration (Alaska) Inc. to develop the field [WOULD BE 2002] until after the expiration of the current Plan of Development.

Amendment to Page 17, Line 7, Paragraph 1

Replace with...

(1) Based upon the Department of Natural Resources' analyses, the negotiated amendments to the Northstar Unit leases may or may not [WILL] reduce

expected state revenue from the development of the Northstar Unit. [HOWEVER,] [T]  
The Department of Natural Resources cannot precisely define the state's future revenue losses or gains because of the numerous assumptions about the future.

Commissioner Shively noted that "the only thing we know about all these numbers (the DNR's economic modeling of the effects of amending the NSU leases), is since they are projections, is that they are wrong, we just don't know how wrong."

Amendment to Page 17, Line 14, Paragraph 2

Replace with...

(2) The Department of Natural Resources' Mr. Coughlin has testified regarding potential state revenue loss that "[i]f you look at it as if they (BP Exploration (Alaska) Inc.) would go ahead and develop it because it's, they say, an economic field, the state loses, in essence, \$48 million by trading a net profit share for the supplemental royalty." On the other hand, if full production does not begin until after 2002, the state could lose money if the amendments are not accepted.

Amendment to Page 17, Line 18, Paragraph 3

Replace with...

(3) The Department of Natural Resources' representative has testified that its evaluation of the economic consequences to the state of amending the Northstar Unit

leases to remove the net profit provisions is based upon the assumption that the "mean" recoverable oil reserves from the Northstar Unit are likely to be 130,000,000 barrels, and that there is a [10] 90 percent probability that recoverable reserves will be greater than 105,000,000 barrels and a 90 percent probability that recoverable reserves will be less than 160,000,000 barrels.

Amendment to Page 18, Line 4, Paragraph 6

Replace with...

(6) The Department of Natural Resources' petroleum economist, Mr. Kevin Banks, who was responsible for evaluating the economic effects of the Northstar Unit lease amendments, has testified that the negotiated agreement is an "okay" deal rather than a "good" deal for the state. In response to the question of why he characterized the deal as "okay" rather than "good", Mr. Banks, testified "I think it has to do with the fact that the net profit share has considerable up-side for the state. If there's any change in the economics of the field that improves, if prices are considerably higher, for example, or if production is any higher. As some of the materials we sent over to you earlier would indicate, the net profit share really pours in. By the same token, it's exactly the problem that BP has with it: that for any increase in the "benefits" that might be associated with the higher production rates or higher prices, or some other economic feature, the state gets all of it, virtually all of it. And it has a fairly serious impact on the economics and the incentives for incremental kinds of projects for the company. And that's why I say it's "okay". There is a high side to this that I think we can't ignore." On

the other hand, Mr. Banks has provided the committee with information that under low side cases the net profit share would pay nothing while the supplemental royalty would still pay something, and the longer the project is delayed the more likely a supplemental royalty would pay more than a net profit share.

**SB**

**318**

**(File 2)**



# Alaska State Legislature

## Senate Resources Committee

State Capitol  
Juneau AK 99801

Official Business

Memo

TO: All Legislators  
FROM: Senator Loren Leman, Chairman *Loren Leman*  
DATE: April 18, 1996  
RE: Committee Substitute for Senate Bill 318: Northstar Lease Amendment

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Attached is a sectional analysis and copy of the Senate Resources Committee Substitute for SB 318 for your use.

## Sectional Analysis of CSSB (RES) for SB 318

### Section 1.

Section 1 has been redrafted and expanded into two sections, both of which are "findings". The new Section 1 consists of 13 separate Articles comprised of "Findings of Fact". The finding of facts section is based upon testimony before the Senate Resources Committee, and upon documents submitted for the record by the Department of Law, the Department of Natural Resources and BP Exploration (Alaska) Inc.

### Section 2.

Section 2, which previously consisted of a listing of the Northstar Unit leases, and provided legislative ratification of the commissioner of Natural Resources' March 22, 1996 agreement with BPXA to amend the leases, now instead contains "Additional Facts and Policy". This section reflects the legislature's articulation and balancing of the state's interests related to ratifying the negotiated amendments to the Northstar Unit leases. It also reaffirms that it is the general policy of the state to enforce the competitively bid terms of its oil and gas leases, and confirms the legislature's intent that the state's oil and gas resources be diligently and timely developed. Finally, Section 2 also provides policy direction to the commissioner that, with the exception of the negotiated amendment authorized under Sec. 3 of the CSSB 318, he is not to renegotiate the competitively bid terms of any state oil and gas lease without prior explicit authorization by the legislature through the passage of a general act granting the authority to do so.

### Section 3.

Section 3, was previously the effective date cite, providing for an immediate effective date. The section has been redrafted. Subsection (a) lists the state oil and gas leases in the Northstar Unit. Subsection (b) provides that the commissioner may amend the Northstar Unit lease provisions, as amended and incorporated in this subsection. (Note: the remainder of subsection (b) consists of a redrafted agreement and exhibits) Subsection (c) provides that "Notwithstanding any other provision of law, the "Amendment to the Northstar Unit Leases Between the State of Alaska and BP Exploration (Alaska) Inc." as described in (b) of this section, if voluntarily agreed to by the commissioner of natural resources and BP Exploration (Alaska) Inc. is approved and ratified."

The original agreement between BP Exploration (Alaska) Inc. and the State of Alaska has been amended in the following manner:

- The word "First" has been deleted from the title of the agreement and from the preamble to remove any ambiguity as to whether additional amendments to the agreement are authorized.
- Several non-material typographical errors were corrected throughout the body of the agreement.

#### 1980 Leases

- The language of Paragraph 28 (c) in the original agreement has been amended by removing the reference to "project schedule" and "project" and replacing them with "sanction schedule" and "sanction", respectively. This was done to reflect the fact that Exhibit C of the agreement, to which Paragraph 28(c) relates, is actually a sanction schedule, not a project schedule, per se. No action other than sanctioning is scheduled under Exhibit C. In addition, a provision making the project sanction irrevocable has been inserted.
- The last two sentences of Paragraph 28 (c) in the original agreement, which provided that "[t]he State may waive performance of an obligation under the project schedule by prior written consent." and "[t]he performance of any obligation required under the project schedule is subject to the provisions of paragraph 32.", have been deleted. Since the only obligation under the "project schedule" was sanction, retention of the original language would have allowed the parties to waive one of the most crucial benefits of the agreement—BPXA's commitment either to proceed with development or to relinquish its leases within one year—by prior written agreement, and without legislative review.
- The language of Paragraph 32. ("Force Majeure") has been amended to make its terms consistent with the amendment to Paragraph 28 (c) noted above. The amendment carves out a narrow exception to the numerous circumstances which BPXA and the State have agreed would constitute force Majeure events under the agreement. The amendment recognizes each of the force majeure events enumerated by the State and BP Exploration (Alaska) Inc. "(other than the obligation to provide project sanction within twelve (12) months of the passage by the legislature of an Act authorizing an Amendment to the Northstar Unit leases for the project)".

- The language of Paragraph 41, in the original agreement, entitled "Employment of Alaskan Residents", has been replaced in its entirety with a new paragraph 41 entitled "Fabrication of Production and Processing Modules Within Alaska and Employment of Alaskan Residents". The amendment retains the original language which makes clear that BPXA's obligations under the agreement are subject to "the constraints of law" and must be in compliance "with all valid federal, State and local laws in hiring Alaska residents and contractors and shall not discriminate against Alaska residents or contractors." With this disclaimer, however, the requirement to hire Alaskans and to fabricate and install on-site production and processing facilities has been made explicit. These changes were made in response to testimony by the Department of Natural Resources and the Department of Law confirming that the principal non-monetary obligations of BPXA under the terms of the original agreement are unenforceable. The amendment also clarifies that all expenses associated with "the design, fabrication, construction and installation of the production and processing modules required for the development of the Northstar oil field will be the sole responsibility of BP Exploration (Alaska) Inc.

#### 1983 Lease

- The language of Paragraph 4 (f) of the original agreement ("Force Majeure"), has been amended by insertion of the same force majeure language incorporated in the 1980 Leases, as described above.
- The language of Paragraph 20 (c) has been amended to replace the references to "project schedule" and "project" with references to "sanction schedule" and "sanction" to conform with the amendments to the 1980 Leases, as described above.
- The language of Paragraph 3 ("Employment of Alaskan Residents") has been replaced in its entirety with the same language used to amend Paragraph 41 of the 1980 Leases, as noted above.

Rather than authorizing the commissioner of the Department of Natural Resources to amend the Northstar leases as originally contemplated, subsection (c) has been redrafted to provide that "Notwithstanding any other provision of law, the "Amendment to the Northstar Unit Leases Between the State of Alaska and BP Exploration (Alaska) Inc." as described in (b) of this section, if voluntarily agreed to by the commissioner of

natural resources and BP Exploration (Alaska) Inc. is approved and ratified."

#### Section 4.

Section 4 is a new section providing for an effective date. Instead of becoming effective immediately, as originally contemplated by the agreement and the original bill, section 4 provides that "[t]hese amendments take effect on the first day following delivery of a letter from the commissioner of the Department of Natural Resources to the Revisor of Statutes, with copies to the President of the Senate and the Speaker of the House of Representatives, confirming that BP Exploration (Alaska) Inc., or its parent entity has made an irrevocable commitment of full funding (project sanction) to develop the Northstar Oil Field.

—END OF ANALYSIS—

Amendments to Work Draft 9-GS2065\ CS FOR SENATE BILL NO. 318(RES)

Amendment No. 1:

As to whether the promises of local manufacture and assembly of facilities must be binding terms of the Northstar Agreement in order to meet the "statewide significance" test, the DOL has testified "that there needs to be a record made here in the legislature of the State interests that are behind this very narrowly focused piece of legislation. As far as the promises to be binding I think it is enough that there's some good and sound reason for this kind of legislation":

Amendment No. 2:

The DOL has testified that "whether the agreement bears fruit I don't think is as important as the fact that you are doing it in good faith belief that it will happen. I don't know if I can tell you that it has to be binding. That's not a consideration of our opinion. It's merely a fact that there must be some sound reasonable basis for making this legislation as narrow as it is":

Amendment No. 3:

The DOL has testified "we think this transaction has state-wide significance because of the amount of revenue that's involved, the fact the major population center of the railbelt area would be the beneficiary of some of the economic activity connected with the development of the Northstar Unit, that fact that petroleum revenues form such a large percentage of the total revenues to the State. It makes this a very good case for being a matter of state-wide significance":

Amendment No. 4:

As to whether the expenditures (loss of state revenues) under the Northstar Agreement meet the "public purposes" test under Article IX, Section 6, of the Alaska Constitution, the DOL has testified "it's been our opinion in the past that the courts will generally find a public purpose if the legislature declares it to be a public purpose. That's been the reasoning of the courts. From our side, analyzing it even further than that, because we don't like to stop there sometimes being the executive branch. We also analyze it as this mutually of consideration that there has to be some equal exchange in order for there to be a public purpose":

Amendment No. 5:

As to the consideration which the state must receive under the Northstar Agreement, the DOL has testified "there has to be, in order to satisfy the public purpose doctrine, a direct public benefit and not an indirect public benefit—when you're giving up public revenues or foregoing some debt that's owed you by some third party. There has to be a direct public benefit and not an indirect benefit. The direct benefit cannot only flow to the other interest and there appears to be direct public benefit here in connection with the way this agreement is structured":

Amendment No. 6:

As to whether the consideration which the State expects to receive under the Northstar Agreement actually must be received, the DOL has testified "no, I don't think so, not under the public purpose doctrine. The public purpose doctrine is the one legal issue that worries me the least. I think this transaction easily passes the public purpose doctrine test. The courts have been very deferential to legislative determinations of what is in the best interests of the State to expend its money on or to forego its revenues on or to receive additional revenues on. The courts have been very deferential in that regard and I don't see that as being a major factor influencing the validity of this particular transaction":



# Alaska State Legislature


Senate Resources Committee

Official Business

State Capitol  
Juneau AK 99801

Memo

TO: Tam Cook, Director  
Legal Services  
hand delivered

FROM: Annette E. Kreitzer, Aide to   
Senate Resources Committee

DATE: April 14, 1996

RE: CS SB 318: Northstar Lease Agreement

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Please draft the attached as a Senate Resources Committee Substitute for SB 318. The material given is only part of the bill, but because of the volume of typing, I wanted to get something to you to start on. This bill will have to be ready for the committee by 3:00 p.m. Tuesday, April 16.

This CS needs no legal review and should be typed using utmost measures to protect the committee's confidentiality in this request.

Thank you for your assistance. Please call Jim Eason or me at X4907 if you have questions.

Replacement text for Sections 2 and 3 of SB 318:

Sec. 2. (a) The State of Alaska and BP Exploration (Alaska) Inc. are parties to the following leases in the Northstar Unit:

- (1) ADL 312798, effective February 1, 1980;
- (2) ADL 312799, effective February 1, 1980;
- (3) ADL 312808, effective February 1, 1980;
- (4) ADL 312809, effective February 1, 1980; and
- (5) ADL 355001, effective August 1, 1983.

(b) The commissioner of the Department of Natural Resources may amend the Northstar Unit leases described in (a) of this section as set forth below:

(NOTE TO DRAFTERS: Insert the entire document entitled "Revisions to Agreement" here.)

(c) Notwithstanding any other provision of law, the "Amendment to the Northstar Unit Leases Between the State of Alaska and BP Exploration (Alaska) Inc." as described in (b) of this section, if voluntarily agreed to by the commissioner of the Department of Natural Resources and BP Exploration (Alaska) Inc., is approved and ratified.

Sec. 3. This Act takes effect [IMMEDIATELY UNDER AS 01.10.070(C)] on the first day following delivery of a letter from the commissioner of the Department of Natural Resources to the Reviser of Statutes, with copies to the President of the Senate and the Speaker of the House of Representatives, confirming that BP Exploration (Alaska) Inc. or its parent entity has made an irrevocable commitment of full funding (project sanction) to develop the Northstar Oil Field.

## "Revisions to Agreement"

### [FIRST] AMENDMENT TO THE NORTHSTAR UNIT LEASES BETWEEN THE STATE OF ALASKA AND BP EXPLORATION (ALASKA) INC.

The State of Alaska ("State") and BP Exploration (Alaska) Inc. ("BPXA") are parties to the following leases in the Northstar Unit: ADL 312798, effective February 1, 1980; ADL 312799, effective February 1, 1980; ADL 312808, effective February 1, 1980; and ADL 312809, effective February 1, 1980 (collectively the "1980 Leases"); as well as ADL 355001, effective August 1, 1983 (the "1983 Lease"). The parties agree to amend the 1980 Leases and the 1983 Lease as set forth in this first amendment to the Northstar Unit leases.

#### 1980 Leases

1) Paragraph 6(b) is replaced in its entirety as follows:

(b) Annual rental paid in advance is a credit on the royalty or supplemental royalty due under this lease for that year.

2) Paragraph 7 is replaced in its entirety as follows:

7. SUPPLEMENTAL ROYALTY. (a) In addition to the royalty paid and computed under paragraphs 8, 10, and 11 below, Lessee shall pay to the State a supplemental royalty ("supplemental royalty"). Lessee shall pay the supplemental royalty, if owed, upon the same production volume for which royalty is paid ("production volume"). The supplemental royalty payment for a given month equals the supplemental royalty value times the supplemental royalty percentage rate ("percentage rate") times the production volume for that month. The percentage rate shall be calculated monthly by reference to: (1) an ANS West Coast spot price ("spot price"); and (2) a supplemental royalty trigger price ("trigger price"). If the spot price is equal to or less than the trigger price, then the percentage rate equals zero. If the spot price is greater than the trigger price, then the percentage rate equals [the spot price per barrel minus the

trigger price per barrel times 1.5 per cent per dollar per barrel. The percentage rate may never exceed 7.5 per cent.

(b) The spot price is the price per barrel calculated in Article 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement Agreement ("ANS Agreement"), dated December 31, 1991, between the State and BPXA, for the crude oil referred to as "ANS (USWC)" in the ANS Agreement. The trigger price is \$17.35 per barrel through April 30, 1997. On May 1, 1997, and each May 1 thereafter, the trigger price shall be adjusted by an inflation factor equal to fifty percent of the "inflation rate" defined as the Producer Price Index for Industrial Commodities ("PPI") for December of the previous year, as reported by April 30 of the current year, divided by the PPI for December of 1995, as reported by April 30, 1996. The supplemental royalty value for oil, gas, natural gas liquids and associated substances is defined in paragraphs 10 and 11 below. Exhibit B is a sample calculation to demonstrate the method of calculating supplemental royalty for oil.

3) Paragraph 9 is replaced in its entirety as follows:

9. REDUCTION OF ROYALTY. Except as provided in paragraph 7 above, Lessee shall not be entitled to any reduction of royalty paid under paragraph 8 above or supplemental royalty paid under paragraph 7 above based on any current or future agreement, State statute, or State regulation.

4) Paragraph 10 is replaced in its entirety as follows:

10. ROYALTY IN VALUE. Unless the State elects to receive all or a portion of its royalty or supplemental royalty in kind as provided in paragraph 12 below, Lessee shall pay to the State the value of all royalty and supplemental royalty oil, gas and associated substances as determined under paragraph 11 below. Royalty and supplemental royalty paid in value shall be free and clear of all lease expenses (and any portion of such expenses which is incurred away from the leased area), including, but not limited to, expenses for separation, cleaning, dehydration, gathering, saltwater disposal, and preparing the oil, gas or associated substances for transportation off the leased area. All royalty and supplemental royalty that may become payable in money to the State shall be paid on or before the last day of the calendar month following the month in which the oil, gas or associated substances are produced. Royalty and supplemental royalty payments shall be accompanied by copies of run tickets or such other information relating to valuation of royalty and supplemental royalty as the State may require, which may include, but is not limited to, evidence of sales, shipments, and amounts of gross oil, gas and associated substances produced.

5) Paragraph 11 is replaced in its entirety as follows:

11. VALUE. For purposes of computing supplemental royalty due under this lease, the value of supplemental royalty oil, gas, natural gas liquids and associated substances shall be the value used in computing royalty on said substances.

(a) To compute the value of oil for royalty and supplemental royalty purposes, this lease shall be deemed an "ANS Lease" under the terms of the ANS Agreement, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(b) To compute the value of gas and natural gas liquids for royalty and supplemental royalty purposes, this lease shall be deemed a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation Settlement Agreement between BPXA and the State dated as of April 1, 1995, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(c) To compute the value of associated substances (which shall be deemed to exclude oil, gas, and natural gas liquids) for royalty and supplemental royalty purposes, the value of such associated substances shall not be less than the highest of:

(1) the field price actually received by <sup>Y</sup> ~~the~~ Lessee for such associated substances;

(2) Lessee's posted price in the field for such associated substances;

(3) the volume weighted average field price actually received by other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area; or

(4) the volume weighted average posted price in the field of other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area.

If associated substances are sold away from the leased or unit area, the term "field price" above shall be the actual price for such associated substances received from the purchaser thereof less the actual cost of transportation away from the leased or unit area to the point of delivery.

Minimum Value Determinations. The State may establish minimum values for purposes of computing royalties on associated substances obtained from this lease, with consideration being given to the price actually received by Lessee, to the price or prices paid in the same field or area for production of like quality, to posted prices, to prices received by Lessee and/or other producers from

sales occurring away from the leased area, and to other relevant matters. Each such determination will be made only after Lessee has been given notice and a reasonable opportunity to be heard. Under this provision, it is expressly agreed that the minimum value of royalty associated substances under this lease may not necessarily equal the price of such associated substances.

6) The following provision shall be added to the end of paragraph 12:

(e) Supplemental royalty under paragraph 7 above may be taken in kind under the same terms and conditions as royalty may be taken in kind under this paragraph 12.

7) Paragraph 14 is replaced in its entirety as follows:

14. APPORTIONMENT OF ROYALTY FROM APPROVED UNIT. The landowner's royalty and supplemental royalty share of the unit production allocated to each separately owned tract shall be regarded as royalty to be distributed to and among, or the proceeds of it paid to, the landowners, free and clear of all unit expense and free of any lien for it. Under this provision, the State's royalty and supplemental royalty share of any unit production allocated to the leased area shall be regarded as royalty to be distributed to, or the proceeds of it paid to, the State, free and clear of all unit expenses (and any portion of such expenses which is incurred away from the unit area), including, but not limited to, expenses for separation, cleaning, dehydration, gathering, saltwater disposal, and preparing oil, gas or associated substances for transportation off the unit area, and free of any lien for it.

8) Paragraph 28 (c) is added as follows:

(c) Notwithstanding any other provisions of this lease, the Northstar Unit Agreement, State statute, or State regulation, this lease shall terminate automatically without notice, an opportunity to be heard, or judicial proceeding, if the Lessee fails to comply with the ["sanction schedule"] set forth in Exhibit C ["project schedule"], attached and incorporated by reference. Automatic termination shall occur whether or not there is a well on the leased area capable of producing oil or gas in paying quantities, the lease is committed to a unit agreement, or the Lessee is drilling or conducting reworking operations, on the date performance under the schedule is due. Furthermore, upon termination BPXA shall promptly file of record appropriate lease relinquishments. The automatic termination shall occur at 11:59 P.M., Alaska Time, on the day performance of an obligation under the project schedule is due. ["The State may waive performance of an obligation required under the project schedule by prior written consent. The performance of any obligation

required under the project schedule is subject to the provisions of paragraph 32.]

Sec typed insert  
to Paragraph 32

- 9) Paragraph 32 is replaced in its entirety as follows:

32. FORCE MAJEURE. If the State determines that Lessee has been prevented, after diligent efforts made in good faith, from complying with any express or implied promise, term, condition or covenant of this lease, from conducting drilling operations, or from producing or marketing oil or gas from the leased area, by reason of war, riots, acts of God, unusually severe weather, or any other cause beyond Lessee's reasonable ability to foresee or control (including delays caused by judicial decision or lack thereof or inability to obtain local, State, or federal permits or environmental impact statements), whether similar to those enumerated or not, Lessee's obligation to comply with such provision shall be suspended, but not voided, and Lessee shall not be liable for damages for failure to comply therewith. If Lessee's obligations to conduct drilling or reworking operations are suspended under this paragraph and the continuation of such operations without suspension would have had the effect of preventing the expiration or termination of this lease, this lease shall not terminate during the period which the obligation to perform such operations is suspended. Nothing in this paragraph shall be construed to suspend the obligation to pay rentals, or to suspend the obligation to pay royalties, supplemental royalties or other production payments from operations on the lease area which are not suspended or from operations which are not affected by any such suspension, to the State.

- 10) Paragraph 41 is replaced in its entirety as follows:

Sec insert to Paragraph 41

OK → § 41. [EMPLOYMENT OF ALASKAN RESIDENTS. Lessee shall comply with all valid federal, State and local laws in hiring Alaska residents and contractors and shall not discriminate against Alaska residents or contractors. Within the constraints of law, Lessee shall employ Alaska residents and contractors to the extent they are available and qualified. Subject to the foregoing:

Lessee voluntarily agrees to adopt a program to hire residents of Alaska. Lessee shall advertise for available positions locally and use Alaska job service organizations to notify the Alaskan public. For work in connection with this lease, Lessee shall use best efforts to contract with Alaska firms and fabricate modules in Alaska, whenever feasible. Lessee shall encourage its contractors to employ and train, when necessary, residents of Alaska. In determining feasibility, Lessee shall consider commercial, health, safety, and environmental conditions and requirements to ensure maintenance of Lessee's operational standards. Lessee shall submit annually to the Director, Division of Oil and Gas, for transmission to the Department of

Insert to "Force Majeure Language" of Paragraph 32. of the 1980 leases and replacement Paragraph 4(f) to Paragraphs 4(f) and 34(7) of the 1983 lease

(other than the obligation to provide project sanction within twelve (12) months of the passage by the legislature of an Act authorizing an Amendment to the Northstar Unit leases for the project)

Insert to replace text of "Paragraph 41." of the 1980 leases (pages 4-5) and "Paragraph 31" of the 1983 lease as provided in the First Amendment to the Northstar Unit Leases Between the State of Alaska and BP Exploration (Alaska) Inc.:

FABRICATION OF PRODUCTION AND PROCESSING MODULES WITHIN ALASKA AND EMPLOYMENT OF ALASKAN RESIDENTS . Lessee agrees to utilize on-site production and processing modules for development of the Northstar oil field, and agrees to fabricate those modules within Alaska. The State of Alaska will not be responsible for contributing to any capital expenditures required to prepare, develop or operate any sites or facilities necessary for the fabrication, transportation or installation of the Northstar Unit production and processing modules. All expenses associated with the design, fabrication, transportation and installation of production and processing modules required for the development of the Northstar oil field will be the sole responsibility of BP Exploration (Alaska) Inc. and its contractors.

Lessee shall comply with all valid federal, State and local laws in hiring Alaska residents and contractors and shall not discriminate against Alaska residents or contractors. Within the constraints of law, Lessee shall employ Alaska residents to the extent they are available and qualified. Subject to the foregoing:

Lessee voluntarily agrees [TO ADOPT A PROGRAM] to hire residents of Alaska. Lessee shall advertise for available positions locally and use Alaska job service organizations to notify the Alaska public. For work in connection with this lease, Lessee shall [USE BEST EFFORTS] contract with Alaska firms and fabricate the modules for on-site production and processing facilities in Alaska [WHENEVER FEASIBLE]. Lessee shall [ENCOURAGE] require its contractors to employ and train, when necessary, residents of Alaska. [IN DETERMINING FEASIBILITY, LESSEE SHALL CONSIDER COMMERCIAL, HEALTH, SAFETY, AND ENVIRONMENTAL CONDITIONS AND REQUIREMENTS TO ENSURE MAINTENANCE OF LESSEE'S OPERATIONAL STANDARDS.] Lessee shall submit annually to the Director, Division of Oil and Gas, for transmission to the [DEPARTMENT OF LABOR] President of the Senate and the Speaker of the House of Representatives, a report that details the specific measures Lessee and its

contractors and subcontractors have taken or are planning to take to recruit qualified Alaska residents for available jobs, describes on-the-job training opportunities, and describes Lessee's efforts to hire Alaska firms for work in connection [TO] with this lease. Lessee shall furnish the Department of Labor, for transmission to the President of the Senate and the Speaker of the House of Representatives, a quarterly report regarding the employment of Alaska residents on the lease[D] area in compliance with regulations by the [COMMISSIONER] Department of Labor. The report must also include statistical data concerning the number of resident personnel hired within the past year for this lease.

Labor, a report that details the specific measures Lessee and its contractors and subcontractors have taken or are planning to take to recruit qualified Alaska residents for available jobs, describes on-the-job training opportunities, and describes Lessee's efforts to hire Alaska firms for work in connection to this lease. Lessee shall furnish the Department of Labor a quarterly report regarding the employment of Alaska residents on the leased area in compliance with regulations by the Commissioner of Labor. The report must also include statistical data concerning the number of resident personnel hired within the past year for this lease.]

1983 Lease

*See typed Insert  
to Paragraph (f)*

- 1) Paragraph 4(f) and paragraph 34(7) are deleted and replaced in their entirety with the following paragraph 4(f):

(f) FORCE MAJEURE. If the state determines that lessee has been prevented, after diligent efforts made in good faith, from complying with any express or implied promise, term, condition or covenant of this lease, from conducting drilling operations, or from producing or marketing oil or gas from the leased area, by reason of war, riots, acts of God, unusually severe weather, or any other cause beyond lessee's reasonable ability to foresee or control (including delays caused by judicial decision or lack thereof or inability to obtain local, state, or federal permits or environmental impact statements), whether similar to those enumerated or not, lessee's obligation to comply with such provision shall be suspended, but not voided, and lessee shall not be liable for damages for failure to comply therewith. If lessee's obligations to conduct drilling or reworking operations are suspended under this paragraph and the continuation of such operations without suspension would have had the effect of preventing the expiration or termination of this lease this lease shall not terminate during the period which the obligation to perform such operations is suspended. Nothing in this paragraph shall be construed to suspend the obligation to pay rentals, or to suspend the obligation to pay royalties, supplemental royalties or other production payments from operations on the lease area which are not suspended or from operations which are not affected by any such suspension, to the state.

- 2) Paragraph 5(b) is replaced in its entirety as follows:

(b) Annual rental paid in advance is a credit on the royalty or supplemental royalty due under this lease for that year.

- 3) Paragraph 7 is replaced in its entirety as follows:

7. APPORTIONMENT OF ROYALTY FROM APPROVED UNIT. The state's royalty and supplemental royalty share of the unit production allocated to each separately owned tract must be regarded as royalty to be distributed to or among, or the proceeds of it paid to, the state, free and clear of all unit expenses and free of any lien for them. Under this provision, the state's royalty and supplemental royalty share of any unit production allocated to the leased area will be regarded as royalty to be distributed to, or the proceeds of it paid to, the state, free and clear of all unit expenses (and any portion of those expenses incurred away from the unit area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering, saltwater disposal, and preparing oil, gas, or associated substances for transportation off the unit area, and free of any lien for them.

("Sanction ~~Section~~ Schedule")

- 4) A new paragraph 20(c) is added as follows:

Sanction

(c) Notwithstanding any other provisions of this lease, the Northstar Unit Agreement, state statute, or state regulation, this lease shall terminate automatically without notice, an opportunity to be heard, or judicial proceeding, if the lessee fails to comply with the [project] schedule set forth in Exhibit C ["project schedule"], attached and incorporated by reference. Automatic termination shall occur whether or not there is a well on the leased area capable of producing oil or gas in paying quantities, the lease is committed to a unit agreement, or the lessee is drilling or conducting reworking operations, on the date performance under the schedule is due. Furthermore, upon termination BPXA shall promptly file of record appropriate lease relinquishments. The automatic termination shall occur at 11:59 P.M., Alaska Time, on the day performance of an obligation under the project schedule is due. The state may waive performance of an obligation required under the project schedule by prior written consent. The performance of any obligation required under the project schedule is subject to the provisions of paragraph 4(f).

- 5) Paragraph 31 is replaced in its entirety as follows:

See Insert to Replace Paragraph 31.

31. [EMPLOYMENT OF ALASKAN RESIDENTS. Lessee shall comply with all valid federal, state and local laws in hiring Alaska residents and contractors and shall not discriminate against Alaska residents or contractors. Within the constraints of law, lessee shall employ Alaska residents and contractors to the extent they are available and qualified. Subject to the foregoing:

Lessee voluntarily agrees to adopt a program to hire residents of Alaska. Lessee shall advertise for available positions locally and use Alaska job

service organizations to notify the Alaskan public. For work in connection with this lease, lessee shall use best efforts to contract with Alaska firms and fabricate modules in Alaska, whenever feasible. Lessee shall encourage its contractors to employ and train, when necessary, residents of Alaska. In determining feasibility, lessee shall consider commercial, health, safety, and environmental conditions and requirements to ensure maintenance of lessee's operational standards. Lessee shall submit annually to the Director, Division of Oil and Gas, for transmission to the Department of Labor, a report that details the specific measures lessee and its contractors and subcontractors have taken or are planning to take to recruit qualified Alaska residents for available jobs, describes on-the-job training opportunities, and describes lessee's efforts to hire Alaska firms for work in connection to this lease. Lessee shall furnish the Department of Labor a quarterly report regarding the employment of Alaska residents on the leased area in compliance with regulations by the Commissioner of Labor. The report must also include statistical data concerning the number of resident personnel hired within the past year for this lease.]

- 6) Paragraph 35 is replaced in its entirety as follows:

35. ROYALTY ON PRODUCTION. Except for oil, gas, and associated substances used on the leased area for development and production or unavoidably lost, the lessee shall pay to the state as a royalty 20 percent in amount or value of the oil, gas, and associated substances saved, removed, or sold from the leased area and of the gas used on the leased area for extraction of natural gasoline or other products from the leased area.

- 7) Paragraph 36 is replaced in its entirety as follows:

36. VALUE. For purposes of computing supplemental royalty due under this lease, the value of supplemental royalty oil, gas, natural gas liquids, and associated substances shall be the value used in computing royalty on said substances.

(a) To compute the value of oil for royalty and supplemental royalty purposes, this lease shall be deemed an "ANS Lease" under the terms of the ANS Agreement, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(b) To compute value of gas and natural gas liquids for royalty and supplemental royalty purposes, this lease shall be deemed a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation Settlement Agreement between BPXA and the State dated as of April 1, 1995, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(c) To compute the value of associated substances (which shall be deemed to exclude oil, gas, and natural gas liquids) for royalty and supplemental royalty purposes, the value of such associated substances shall not be less than the highest of:

(1) the field price actually received by lessee for such associated substances;

(2) Lessee's posted price in the field for such associated substances;

(3) the volume weighted average field price actually received by other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area; or

(4) the volume weighted average posted price in the field of other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area.

If associated substances are sold away from the leased or unit area, the term "field price" above shall be the actual price for such associated substances received from the purchaser thereof less the actual cost of transportation away from the leased or unit area to the point of delivery.

**Minimum Value Determinations.** The state may establish minimum values for purposes of computing royalties on associated substances obtained from this lease, with consideration being given to the price actually received by lessee, to the price or prices paid in the same field or area for production of like quality, to posted prices, to prices received by lessee and/or other producers from sales occurring away from the leased area, and to other relevant matters. Each such determination will be made only after lessee has been given notice and a reasonable opportunity to be heard. Under this provision, it is expressly agreed that the minimum value of royalty associated substances under this lease may not necessarily equal the price of such associated substances.

8) Paragraph 37 is replaced in its entirety as follows:

**37. ROYALTY IN VALUE.** Unless the state elects to receive all or a portion of its royalty or supplemental royalty in kind as provided in paragraph 38, lessee shall pay to the state the value of all royalty and supplemental royalty oil, gas and associated substances as determined under paragraph 36. Royalty and supplemental royalty paid in value shall be free and clear of all lease expenses (and any portion of such expenses which is incurred away from the leased area), including, but not limited to, expenses for separation, cleaning

dehydration, gathering, saltwater disposal, and preparing the oil, gas or associated substances for transportation off the leased area. All royalty and supplemental royalty that may become payable in money to the state shall be paid on or before the last day of the calendar month following the month in which the oil, gas or associated substances are produced. Royalty and supplemental royalty payments shall be accompanied by copies of run tickets or such other information relating to valuation of royalty and supplemental royalty as the state may require, which may include, but is not limited to, evidence of sales, shipments, and amounts of gross oil, gas and associated substances produced.

9) The following provision shall be added to the end of paragraph 38:

(f) Supplemental royalty under this lease may be taken in kind under the same terms and conditions as royalty may be taken in kind under this paragraph 38.

10) Paragraph 39 is replaced in its entirety as follows:

39. REDUCTION OF ROYALTY. Except as provided in paragraph 40 below, lessee shall not be entitled to any reduction of royalty paid under paragraph 35 above or supplemental royalty paid under paragraph 40 below based on any current or future agreement, state statute, or state regulation.

11) Paragraph 40 is replaced in its entirety as follows:

40. SUPPLEMENTAL ROYALTY. (a) In addition to the royalty paid and computed under paragraph 35, 36, 37 above, lessee shall pay to the state a supplemental royalty ("supplemental royalty"). Lessee shall pay the supplemental royalty, if owed, upon the same production volume for which royalty is paid ("production volume"). The supplemental royalty payment for a given month equals the supplemental royalty value times the supplemental royalty percentage rate ("percentage rate") times the production volume for that month. The percentage rate shall be calculated monthly by reference to: (1) an ANS West Coast spot price ("spot price"); and (2) a supplemental royalty trigger price ("trigger price"). If the spot price is equal to or less than the trigger price, then the percentage rate equals zero. If the spot price is greater than the trigger price, then the percentage rate equals [the spot price per barrel minus the trigger price per barrel] times 1.5 per cent per dollar per barrel. The percentage rate may never exceed 7.5 per cent.

(b) The spot price is the price per barrel calculated in Article 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement Agreement ("ANS Agreement"), dated December 31, 1991, between the State and BPXA, for the crude oil referred to

as "ANS (USWC)" in the ANS Agreement. The trigger price is \$17.35 per barrel through April 30, 1997. On May 1, 1997, and each May 1 thereafter, the trigger price shall be adjusted by an inflation factor equal to fifty percent of the "inflation rate" defined as the Producer Price Index for Industrial Commodities ("PPI") for December of the previous year, as reported by April 30 of the current year, divided by the PPI for December of 1995, as reported by April 30, 1996. The supplemental royalty value for oil, gas, natural gas liquids and associated substances is defined in paragraphs 36 and 37 above. Exhibit B is a sample calculation to demonstrate the method of calculating supplemental royalty for oil.

These amendments do not affect: (1) any future agreements which may be reached for the handling of outside substances as that term is used in the Northstar Unit Agreement effective January 24, 1990 or (2) the current valuation methodology for royalty for any other Alaska Net Profit Share leases between the State and BPXA or any affiliates or any future agreements which may be reached regarding a future valuation methodology for Alaska Net Profit Share leases. <sup>See</sup> These amendments take effect when and if an Act(s) substantially similar to the act, attached as Exhibit D and <sup>incorporated by reference, takes effect.</sup> <sup>incorporated by reference, takes effect.</sup> <sup>entitled</sup> <sup>"OFF. DATE"</sup> <sup>for language</sup> <sup>to replace the</sup> <sup>text deleted here</sup> This amendment is dated for reference purposes as of March 22, 1996.

LESSEE:

BP EXPLORATION (ALASKA), INC.

  
\_\_\_\_\_  
E. M. Luttrell, Vice President

LESSOR:

STATE OF ALASKA

  
\_\_\_\_\_  
John T. Shively, Commissioner  
Department of Natural Resources

**"Eff. Date" insert to page 11 of "Amendment to ...."**

These amendments take effect on the first day following delivery of a letter from the commissioner of the Department of Natural Resources to the Reviser of Statutes, with copies to the President of the Senate and the Speaker of the House of Representatives, confirming that BP Exploration (Alaska) Inc. or its parent entity has made an irrevocable commitment of full funding (project sanction) to develop the Northstar Oil Field.

STATE OF ALASKA )  
 ) ss.  
Third Judicial District )

On March 22, 1996, before me appeared John T. Shively, Commissioner, State of Alaska, Department of Natural Resources, and who executed this lease and acknowledged voluntarily signing it on behalf of the State of Alaska, as lessor.

*Dianne A. Pitts*  
Notary Public in and for the State of Alaska  
My Commission Expires: 1/16/99



STATE OF ALASKA )  
 ) ss.  
Third Judicial District )

On March 22, 1996, before me appeared E. M. Lutrell, Vice President of BP Exploration (Alaska), Inc., and who executed this lease and acknowledged voluntarily signing it on behalf of the BP Exploration (Alaska), Inc., as lessee.

*Dianne A. Pitts*  
Notary Public in and for the State of Alaska  
My Commission Expires: 1/16/99



Exhibit B  
Calculation of the Supplemental Royalty Payment for Oil

1) The calculation of the ANS West Coast spot price is derived from Platt's 'Oilgram Price Report' Spot Crude Price Assessments:

Date	Platt's Reported Daily Assessment (\$/barrel)		ANSWC Daily Average	ANSWC Daily Average (After Rounding) <sup>1</sup>
	ANSWC Low	ANSWC High		
01/02/96	\$17.97	\$18.06	\$18.015	\$18.02
01/03/96	\$17.94	\$18.03	\$17.985	\$17.98
01/04/96	\$17.96	\$18.03	\$17.995	\$18.00
01/05/96	\$18.60	\$18.64	\$18.620	\$18.62
01/09/96	\$18.23	\$18.29	\$18.260	\$18.26
01/10/96	\$17.99	\$18.05	\$18.020	\$18.02
01/11/96	\$17.10	\$17.17	\$18.135	\$17.14
01/12/96	\$16.64	\$16.71	\$18.675	\$16.68
01/15/96	\$16.75	\$16.83	\$16.690	\$16.79
01/16/96	\$16.60	\$16.66	\$16.730	\$16.63
01/17/96	\$16.91	\$16.97	\$16.940	\$16.94
01/18/96	\$17.46	\$17.54	\$17.500	\$17.50
01/19/96	\$17.28	\$17.37	\$17.325	\$17.32
01/22/96	\$17.02	\$17.08	\$17.050	\$17.05
01/23/96	\$17.10	\$17.16	\$17.150	\$17.13
01/24/96	\$17.35	\$17.41	\$17.380	\$17.38
01/25/96	\$16.76	\$16.81	\$17.785	\$16.78
01/26/96	\$16.43	\$16.53	\$17.480	\$16.48
01/29/96	\$16.16	\$16.24	\$16.200	\$16.20
01/30/96	\$16.30	\$16.38	\$16.340	\$16.34
01/31/96	\$16.46	\$16.56	\$16.510	\$16.51

Monthly Average calculated from ANSWC Daily Average (After Rounding) = \$17.2271 per barrel

ANS West Coast spot once for the January 1996 month of production = \$17.23 per barrel

2) The inflation factor shall be calculated as follows: Assume that by April 30, 1996, the U.S. Department of Labor reports a PPI for December 1995 as 126.2. Assume that by April 30, 1998, the PPI for December 1997 is 134.2. The inflation factor for 1998 is calculated according to the following formula:

<sup>1</sup> All source and calculated numbers shall be rounded as required in the ANS Agreement.

Inflation Factor for May 1, 1998 through April 30, 1999  

$$= [(PPI \text{ December of the previous year} + PPI \text{ December 1995}) - 1] \times 0.5$$

$$= [(134.2 - 126.2) - 1] \times 0.5 = 0.0317 = 3.17 \text{ percent}$$

3) The trigger price for May 1, 1998 through April 30, 1999 is calculated by adjusting \$17.35 per barrel by the inflation factor as follows:

$$\begin{aligned} \text{Trigger price for the current year} &= \$17.35 \text{ per barrel} \times (1 + \text{inflation factor}) \\ &= \$17.35 \text{ per barrel} \times (1 + 3.17 \text{ percent}) \\ &= \$17.35 \times 1.0317 \\ &= \$17.90 \text{ per barrel} \end{aligned}$$

4) Assuming the current month ANSWC spot price is \$21.40, the supplemental royalty percentage rate is calculated as:

$$\begin{aligned} \text{Supplemental royalty percentage rate} &= (\text{ANSWC spot price} - \text{trigger price for the current year}) \\ &\quad \times (1.5 \text{ percent per dollar per barrel}) \\ &= (\$21.40 \text{ per barrel} - \$17.90 \text{ per barrel}) \times 1.5 \text{ percent per dollar per barrel} \\ &= (21.40 - 17.90) \times 0.015 \\ &= 0.05250 = 5.25 \text{ percent} \end{aligned}$$

5) The calculation of the supplemental royalty payment for the current month is the product of the production volume times the royalty value and the supplemental royalty percentage rate. Assume that 1,550,000 barrels of oil were produced in the Northstar unit in the current month and that the royalty value is \$17.71. The supplemental royalty is:

$$\begin{aligned} \text{Supplemental royalty payment} &= \text{production volume} \times \text{royalty value} \times \text{supplemental royalty} \\ &\quad \text{percentage rate} \\ &= 1,550,000 \text{ barrels} \times \$17.71 \text{ per barrel} \times 5.25 \text{ percent} \\ &= \$1,441,151.25 \end{aligned}$$

EXHIBIT C C SANCTION  
[PROJECT] SCHEDULE

The Northstar Development Project ("the Project") is described in the document titled "Northstar Development Project, Conceptual Engineering Report" dated February 1996. BPXA shall comply with the following sanction schedule for the Project and shall provide satisfactory evidence of compliance within fifteen days of the date performance is due under the schedule:

BPXA shall receive Project sanction within twelve (12) months after passage by the legislature of an Act approving the First Amendments to the Northstar Unit Leases for the Project. "Project sanction" means approval in writing by the highest appropriate authority in BPXA or its parent entity necessary for the total amount of expenditures required for the Project. Satisfactory evidence of receipt of sanction shall be tendered to the State in the form of the sanctioning entity's documents approving the expenditure of funds for the Project. [If Project sanction is withdrawn for any reason whatsoever, BPXA shall notify the State within three working days by letter from an authorized officer and BPXA shall be deemed to have failed to comply with this schedule.] Project sanction by BPXA or its parent entity shall be irrevocable.

# Alaska State Legislature



*During Interim:*

716 West 4th Avenue, Suite 500  
Anchorage, Alaska 99501-2133  
(907) 258-8185  
Fax (907) 258-0226

*During Session:*

State Capitol  
Juneau, Alaska 99801-1182  
(907) 465-4993  
Fax (907) 465-3872

**Drue Pearce**  
*President of the Senate*

March 22, 1996

Honorable Tony Knowles  
Governor of the State of Alaska  
State Capitol  
Juneau, Alaska 99801

Dear ~~Governor Knowles~~ Tony

Your announcement yesterday afternoon that the administration has renegotiated the competitively bid terms of the leases in the Northstar unit has prompted several questions. I would appreciate your clarifying some of the comments which appeared in your press release on the subject. I hope you will also provide timely answers to the following requests for Attorney General's opinions.

You indicated in your press release that "Legislative approval of Northstar is similar to its approval of last year's Tesoro royalty contract, which was negotiated by the executive branch and approved by the legislature." I cannot find any similarity between the established statutory procedures which guide the Commissioner of Natural Resources in the sale of the state's royalty oil and gas and the ad hoc confidential negotiations which preceded the announcement of this deal.

In the case of the royalty contracts, the legislature has provided explicit authority for the commissioner to negotiate sales of royalty oil, subject to the legislature's review and approval. The legislature has provided explicit direction regarding the criteria which the commissioner must consider, and it has established the Royalty Oil and Gas Development Advisory Board (Royalty Board) to promote public review of proposed disposals long before their introduction to the legislature. Thus, the policies were established by the legislature, and the commissioner must make formal findings in compliance with the guidelines set forth in statute, as well as in the Department's and the Royalty Board's regulations.

Page two to Governor Tony Knowles

We had hoped to be able to discuss these questions more thoroughly before you made your public announcement of the deal. In fact, we were willing to avoid public discussion of the terms as we awaited further information, at your request. Instead of further briefings - before or after the press conference - we are now faced with a number of legitimate questions based upon your press release and comments and the news stories of the day.

Therefore, on behalf of the Alaska Legislature, I ask that you provide a written explanation of the similarities - as you see them - between the process you envision for the legislature's review of the deal Commissioner Shively has negotiated and its review of proposed royalty contracts.

I also ask that you provide a written formal Attorney General's Opinion responding to the question of whether the administration has the clear authority to renegotiate the Net Profit Share terms of a state oil and gas lease.

You also apparently said in your press conference that the "Legislation to implement the deal will apply only to the Northstar field and will not open the door for other companies to seek similar breaks." Aside from the obvious questions of equal access to state resources and fairness which these comments invite, they also raise other questions of law.

In light of these concerns, and of your indication that you will be presenting the legislature with proposed legislation, I also ask that you provide a written, formal Attorney General's Opinion regarding the perceived legality of enacting what, by your own description, appears to be "special legislation", which is disallowed under Article II, Section 19, of the Alaska Constitution.

Presuming that the Attorney General disagrees with this view, and concludes that such legislation is permissible, I would also appreciate your reconciling the seemingly inconsistent goals of providing special benefits for one lessee while indicating your nonsupport of legislation that attempts to encourage increased participation by independents and other new companies in the state's oil and gas leasing and development program.

The estimates of the revenue which the state stands to lose as a result of Commissioner Shively's renegotiation of the Northstar lease terms have changed considerably since the commissioner briefed some members of the legislature on the proposal last week. According to the article, the administration's estimate of losses have shrunk from \$60 million to \$4 million since we met last week.

I presume the administration is prepared to document for public review the assumptions behind its revised estimates of revenue losses. Regardless of

Page three to Governor Tony Knowles

the magnitude of the anticipated revenue losses, entering into an agreement under which the state assumes that it will receive less revenue than it is entitled to receive under its competitively bid leases appears tantamount to an appropriation. Therefore, I ask that you also provide a written Attorney General's Opinion on this question as well.

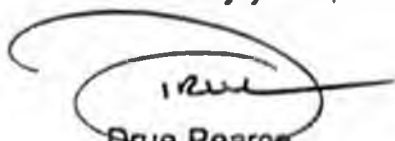
Given the short time remaining for legislative review and my unwillingness to consider any requests to introduce a bill until these questions are answered, I would appreciate expedited responses. I think your answers and the opinions

will result in a focused and expedited debate once the legislature is in possession of a bill.

And, finally, Governor, while I appreciate your sincerity in saying that Alaskans should have a "full and open public discussion on the terms of any new oil development" and your inference that the only opportunity lies in legislative approval, I would remind you of two things. You certainly didn't hold that view when we wanted legislative approval on HB207- related royalty reductions. In fact, you fought us and publicly declared that our request for legislative approval made it clear that YOU wanted Alaska to be "open and ready to do business", while the Republicans in the Senate were anti-development. And, second, you have ample opportunities to hold public hearings in your own right, as is clear in your letter of March 20, 1996, to "Dear Alaskan", announcing public testimony on the domestic violence bills.

Governor, you cannot have it both ways.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Bruce Pearce", enclosed within a large, loopy circular flourish.

Bruce Pearce  
Senate President

cc: Attorney General Bruce Botelho  
Commissioner John Shively, Department of Natural Resources  
Representative Gail Phillips, Speaker of the House



# Alaska State Legislature

## Senate Resources Committee

Official Business

State Capitol  
Juneau AK 99801

TO: Senator Pearce, Vice-Chairman  
Senator Halford  
Senator Frank  
Senator Taylor  
Senator Hoffman  
Senator Lincoln

FROM: Senator Loren Leman, Chairman

DATE: April 11, 1996

RE: SB 318: Northstar Lease Agreement

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A handwritten signature in cursive script that reads "Loren Leman".

As you know, the intent of the Senate Resources hearings on Senate Bill 318 has been to cooperate with the Governor's request for open, public meetings regarding the proposed agreement.

A lot of information has been disseminated, a lot of questions asked to this point. The summary below is intended to focus the committee as we continue deliberations on this issue.

**—Summary of Senate Resources Committee Action on SB 318—**

The committee's efforts to date have been directed toward developing a detailed record of: 1) the events leading up to the administration's renegotiation of the net profit share provisions of the state leases within the Northstar Unit, 2) the basis for the administration's request for legislative approval, 3) the economic and other consequences of the agreement, 4) the assumptions upon which the administration relied in negotiating the agreement, 5) the actual enforceability of the agreement's terms and, finally, 6) the implications of renegotiating the state's competitively bid oil and gas lease terms.

The sequencing of hearing topics and the detailed questions which have been asked of BPXA, the Department of Natural Resources and the Department of Law thus far were designed to elicit a full understanding of how the decision to amend the leases evolved over time and to identify any issues or additional information that the legislature should consider before making its decision. The intent of the specific lines of questions, as well as the order in which they are being asked is to develop a comprehensive record from which written committee findings may be made for the record.

The areas of inquiry upon which findings will be made include the following subjects:

- The Effect of Passage of SB 318
- The State's Net Profit Share and History of the Northstar Leases before Unitization
- Formation of the Northstar Unit and Activities Under the Initial Plan of Development
- BPXA's Succession as NSU Operator and the DNR's Approval of the 2nd Plan of Development for the NSU
- BPXA's Initial Efforts to Amend the Net Profit Share Terms
- The Economics of Developing the NSU Leases Under Their Existing Terms
- BPXA's Refusal to Develop the NSU Leases Unless the Net Profit Share Provisions are Amended
- DNR's and BPXA's Negotiations to Amend the NSU Leases
- Legal Analysis by the Attorney General
- DNR's and BPXA's View of the Legislature's Role in Ratification and Passage of SB 318
- The Effects of the Amendments on the State's Lease Revenues from the Development of the NSU
- Enforceability of the DNR/BPXA Negotiated Agreement
- Policy Implications of the Passage of SB 318

With the exception of the last two issues/topics, the hearings to date, plus the answer to follow-up questions which have been drafted, will have developed most of the relevant record for the committee's review. Draft findings have been written covering all of the testimony and documents which have resulted from the first three hearings. In other words, the record is "up to date." The findings will be revised—hopefully no later than tomorrow evening—to incorporate any relevant materials from the hearing this evening.

It is anticipated that at least one additional hearing may be required to develop the record related to the last two items—enforceability and implications of the decision. Lengthy hearings are not contemplated, but it is important to establish for the record whether most of the non-cash benefits which the administration claims to have secured through its negotiations may be either illusory, non-enforceable or both. Detailed questions regarding the enforceability of the actual provisions of the agreement will be drafted so that the record will reflect the basis for any amendments to strengthen the agreement, should a decision be made to amend the agreement. It is recommended that the final findings, as modified to reflect the record developed in these last two areas of inquiry, be read into the official record of the committee.

The fact finding portion of the hearing is expected to be followed by at least one hearing dedicated to taking public testimony. Following the close of public testimony, there are a number of options available to the committee. These include:

- 1.) Approving as submitted
- 2.) Rejecting
- 3.) Approving an amended bill
- 4.) Other approach combined with # 3.

I will be ready to discuss these options when we have an opportunity to meet.

**DEPARTMENT OF LAW**

**OFFICE OF THE ATTORNEY GENERAL**

March 26, 1996

Honorable Drue Pearce  
Senator  
Alaska State Legislature  
Room 111  
State Capitol  
Juneau, Alaska 99801

Re: Necessity of legislation to implement  
net profit share reduction

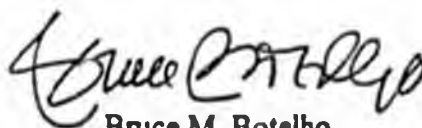
Dear President Pearce:

Enclosed please find a copy of an opinion issued today to Commissioner Shively respecting the Northstar leases.

The opinion confirms advice rendered informally to the commissioner during the course of negotiations and addresses the issues raised in your communication of March 22.

Should you require further analysis, particularly in the event that legislative counsel renders advice inconsistent with this opinion, please do not hesitate to contact me.

Sincerely yours,



Bruce M. Botelho  
Attorney General

BMB:JLB:clh  
Enclosure

TONY KNOWLES, GOVERNOR

PLEASE REPLY TO

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P.O. BOX 110300-DIMOND COURT HOL  
JUNEAU, ALASKA 99811-0300  
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# MEMORANDUM

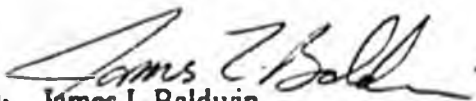
State of Alaska

Department of Law

to: Honorable John T. Shively  
Commissioner  
Department of Natural Resources

DATE: March 26, 1996

FILE NO.: 663-96-0441

  
FROM: James L. Baldwin  
Assistant Attorney General  
Governmental Affairs - Section

TELEPHONE NO.: 465-3600

SUBJECT: Necessity for legislation to  
implement net profit share  
reduction

We were asked whether the Commissioner of Natural Resources has the statutory authority to reduce the net profit share payments required under the Northstar leases held by BP Exploration (Alaska) Inc. After considering that question, we conclude it would be prudent to seek express statutory authority for this action. We also discuss other legal issues that bear on proposed remedial legislation.

## 1. Authority Under Existing Law.

Alaska Statute 38.05.180 is a comprehensive statute which sets out the Commissioner of Natural Resources' authority regarding oil and gas leasing. Section 180 contains express authority in two subsections for the commissioner to modify the royalty provisions of an oil and gas lease. However, neither section 180 nor the Alaska Land Act (AS 38.05) defines the meaning of the term "royalty." To add to the difficulty of statutory construction, section 180 lacks express authority for reduction of a net profit share interest.

The Northstar leases are within the Northstar unit. To implement unitization of a field,

The commissioner may, with the consent of the holders of the leases involved  
... change ... royalty requirements of the leases ...

AS 38.05.180(p); (emphasis added). Section 180(p) provides that a change may be made "in connection with the institution and operation of a cooperative unit plan." The Department of Natural Resources (department) interprets section 180(p) to be applied only at the institution of a unit. For this reason, section 180(p) is not germane to the instant transaction. In any case, section 180(p) was amended during the first session of the Nineteenth Alaska State legislature to provide in part that the commissioner

"may not decrease royalty on leases in connection with a cooperative or unit plan except as provided in (j) of this section.

Sec. 3 , ch. 85, SLA 1995. Section 180 (j) permits the commissioner to

provide for an increase or decrease or otherwise modify royalty, to allow for production that would not otherwise be economically feasible. . . .

Section 180(j) contains intrinsic evidence that the legislature meant only to cover the royalty share in amount or value of production removed from the lease. For example, in section 180(j)(3)(C)(i) and (4)(A) limits are imposed on the commissioner's power to reduce a royalty using the terms "royalty percentage" or "royalty rate." The use of these terms is evidence that the legislature meant section 180 (j) to apply only to a share in the amount or value of production, not to a reduction of a share of the net profit derived from the lease. The foregoing intrinsic evidence of meaning is consistent with your testimony given when section 180(j) was under consideration before enactment by the legislature. You testified, "there was no reference made in [SB 207] to 'net profits leases'. . . . There could be negotiation on the base royalty, but not the net profit portion ." Senate Finance Committee Minutes, SB 207, May 11, 1995 . Senate Bill 207 was never subsequently amended to cover the omission highlighted by the commissioner. Senate Bill 207 was passed by the legislature was signed into law by the governor and became ch. 85, SLA 1995.

There is no commonly understood definition of a net profit share.<sup>1</sup> A net profits interest may be interpreted to be either the equivalent of a royalty which is an interest in land, or it could be considered only a contract right which is severable from an interest in realty. We would be remiss if we did not acknowledge that the department has without discussion, on occasion, interpreted the term "royalty requirements" in section 180 (p) to include a net profit share interest. Similarly, the Minerals Management Service, the federal agency equivalent to the Division of Oil & Gas, has interpreted the term "royalty," in the context of a royalty reduction, to include net profit share payments. See 30 C.F.R. § 203.50. The past administrative interpretations of the department are limited in number and of fairly recent origin. For this reason, we are unable to conclude there has been a contemporaneous construction that a net profit share is included within the meaning of "royalty." For these reasons and the analysis of the relevant provisions discussed above, we believe there is substantial doubt that section 180 prescribes a method for reducing a net profit share interest.

We believe that it would not be prudent to assume that the term "royalty," as used in subsection (p), includes net profit share payments. If that were the case, the commissioner's only statutory authority to reduce the net profit share payments required under the Northstar Unit leases

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<sup>1</sup> See Christy v. Petrol Resources Corp., 691 P.2d 59, 61 (N.M. App. 1984)("net profits interest" has no independent meaning, and nature of the interest must be determined from provisions of the instrument creating it).

is set out in AS 38.05.180(j). For the reasons stated above, we believe that a decision to reduce a net profit share using the authority contained in section 180(j) would be vulnerable to a judicial challenge. Further, under section 180 (j), the commissioner may reduce royalty on unitized leases if the lessee makes a "clear and convincing showing that a modification of royalty meets the requirements of this section and is in the best interests of the state." AS 38.05.180(j)(2). The purpose of subsection (j) is "to allow for production that would not otherwise be economically feasible." You have informed us that the Northstar Unit development does not meet this standard. It would be preferable to seek independent authority for the Northstar net profit share reduction in a way that would bring certainty to the state and the leaseholder while avoiding these difficult legal issues.<sup>2</sup>

## 2. Local or Special Legislation

The department intends to seek the narrowest possible provision to specifically authorize amendments to only the Northstar leases. Consistent with your instructions, we have prepared a bill to accomplish this goal. You ask whether such a bill would violate the Alaska Constitution. The prohibition against local or special legislation provides:

The legislature shall pass no local or special act if a general act can be made applicable. Whether a general act can be made applicable shall be subject to judicial determination.

Alaska Const. Art. II, Sec. 19.

Section 19 has not been recently applied by the Alaska Supreme Court. In 1975, section 19 was applied to invalidate a statute that mandated the creation of an Eagle River-Chugiak Borough. Abrams v. State, 534 P.2d 91 (Alaska 1975). In Abrams, the court recognized that a statute may affect only one of a few areas and yet relate to a matter of statewide concern or common interest.

In 1977, section 19 was again applied to validate a statute authorizing a trade of land between the federal government, the state, and a Native regional corporation. State v. Lewis, 559 P.2d 630 (Alaska 1977), cert. denied, 432 U.S. 901 (1977). The court found that the land trade was unique, but of statewide concern. The Lewis court propounded a test to be used in determining whether a statute violates the special or local prohibition. It was substantially the same as the test used to determine the validity of nonsuspect classifications challenged as violative of equal protection. The state merely had to show a rational basis, a good reason, to justify the special treatment.

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<sup>2</sup> There may be implied authority to amend the net profit share term of an oil and gas lease granted under AS 38.05.180. While that authority may exist, it has never been used to reduce a net profit lease. On a matter of such significance, this transaction should not become the test case.