

ALASKA LEGISLATURE COMMITTEE FILES 1995-1996 8672

9010 SENATE RESOURCES

507

Table 4.

Research Associates 2495

**Spring 1995 Production Forecast for 1995-2010 (Alaska Dept. of Revenue)**  
(000 bbls)

000 Barrels per day.

| Year                  | Field <sup>1</sup> | Prudhoe <sup>1</sup> | Kuparuk          | Lisburne      | Pr. McIntyre   | Endicott       | Milne Pt. <sup>2</sup> | Niobrara      | W. Sak         | Other <sup>3</sup> | Total                       |
|-----------------------|--------------------|----------------------|------------------|---------------|----------------|----------------|------------------------|---------------|----------------|--------------------|-----------------------------|
| 1995                  |                    | 1,007                | 304              | 18            | 112            | 95             | 20                     | 14            |                |                    | 1,570 (000 bpd)             |
| 1996                  |                    | 913                  | 293              | 15            | 111            | 91             | 30                     | 27            |                |                    | 1,501 *                     |
| 1997                  |                    | 880                  | 290              | 13            | 106            | 90             | 32                     | 24            |                |                    | 1,435 *                     |
| 1998                  |                    | 857                  | 290              | 12            | 103            | 83             | 35                     | 21            |                | 7                  | 1,418 *                     |
| 1999                  |                    | 835                  | 287              | 10            | 97             | 76             | 40                     | 20            |                | 14                 | 1,376 *                     |
| 2000                  |                    | 808                  | 288              | 9             | 89             | 70             | 40                     | 18            | 12             | 14                 | 1,342 *                     |
| 2001                  |                    | 796                  | 283              | 8             | 75             | 64             | 35                     | 16            | 12             | 15                 | 1,304 *                     |
| 2002                  |                    | 769                  | 275              | 7             | 68             | 58             | 30                     | 14            | 12             | 12                 | 1,245 *                     |
| 2003                  |                    | 740                  | 267              | 6             | 60             | 52             | 27                     | 12            | 19             | 10                 | 1,193 *                     |
| 2004                  |                    | 713                  | 258              | 6             | 53             | 47             | 24                     | 11            | 25             | 10                 | 1,147 *                     |
| 2005                  |                    | 685                  | 249              | 5             | 47             | 43             | 21                     | 9             | 37             | 9                  | 1,105 *                     |
| 2006                  |                    | 646                  | 223              | 4             | 41             | 38             | 18                     | 8             | 30             | 9                  | 1,027 *                     |
| 2007                  |                    | 607                  | 198              | 4             | 37             | 35             | 16                     | 7             | 62             | 9                  | 975 *                       |
| 2008                  |                    | 570                  | 177              | 3             | 32             | 31             | 13                     | 6             | 74             | 10                 | 914 *                       |
| 2009                  |                    | 535                  | 157              | 3             | 28             | 28             | 12                     | 5             | 74             | 61                 | 927 *                       |
| 2010                  |                    | 501                  | 141              | 3             | 25             | 26             | 11                     | 4             | 70             | 60                 | 844 *                       |
| <b>Total Barrels:</b> |                    | <b>4,330,725</b>     | <b>1,453,430</b> | <b>45,970</b> | <b>791,645</b> | <b>338,355</b> | <b>166,805</b>         | <b>70,040</b> | <b>148,135</b> | <b>105,120</b>     | <b>7,874,085 (789 Bbls)</b> |

<sup>1</sup> Includes all NGL's, N. Prudhoe, W. Beach<sup>2</sup> Includes Schrader Duffs<sup>3</sup> North Star, Cascade

Source: Alaska Dept. of Revenue, Spring 1995 (Non-Case Forecast ("Non-Case Simulated (34 Production)"))

★ 1975 Serving Alaska for 20 years 1995 ★



# Resource Development Council for Alaska, Inc.

121 West Firewood Lane, Suite 250, Anchorage, Alaska 99503-28  
Phone 907/276-0700 Fax 276-349

**EXECUTIVE DIRECTOR**  
Betty L. Orr

**MEMBER EXECUTIVE COMMITTEE**  
David J. Parish, President  
Frank Rasmussen, Vice President  
Scott L. Thomson, Vice President  
Lyle Van Bergen, Secretary  
Alan Brigham, Treasurer  
Jacob Adams  
Cynthia Bailey  
Dennis G. Bush  
Dale M. Campbell  
James L. Child  
John Flanagan  
Mona Frey  
Paul S. Giambrini  
Lyle L. Gross  
Roger C. Hanson  
Carl M. Smith  
Jerome M. Sells  
John Svingen  
William A. Thomas  
John L. West  
James D. West

**DIRECTORS**

John Adams  
Vera A. Anderson  
Shirley B. Anderson  
Ernest Boland  
Richard F. Barnes  
Mary Baggett  
William C. Barrow  
A. J. "Bud" Binstock  
Max L. Boland  
James E. Cameron  
Thomas Cook  
Marilyn Crockett  
Lory Danks  
James C. Day  
James V. Deas  
Paul P. Deane  
Douglas S. Edwards  
Scott Galloway  
And Hal  
John L. Harbo  
Robert S. Harford, Jr.  
Joseph R. Hart  
Karen J. Harstad  
William L. Hester  
David W. Hughes  
Jim Johnson  
John P. Jones  
John A. Lanning  
Paul Lashford  
Shirley Lewis  
Dore A. Lindsey  
Robert M. Lonscher  
Carl M. Mares  
Howard McMillan  
W. Raymond Mackinnon  
Clarence "Bobby" Miller  
E. M. "Bud" Nelson  
John H. Norman  
Arthur O'Brien  
James Parsons  
Kathleen E. Pappas  
Kathleen R. Potts  
Stephen W. Rasmussen  
John A. L. Rasmussen  
Carl R. Rasmussen  
High Schmitt  
George A. Smith  
Thos. J. Stone  
Harriet "Honey" Stanger  
H. B. Swan  
Murray S. Stone  
David S. Thompson  
Gary B. Thorsen  
Doug W. West  
J. C. Wingard  
George P. Walsh

**HONORARY DIRECTORS**

Paul R. Anderson  
William R. Wood  
**AS OFFICIAL MEMBERS**  
George A. Boland  
Barbara F. Mulrow  
Congressman Don Young  
Governor Tony Knowles

## Testimony of Resource Development Council on HB 207

### An Act relating to the reduction of royalties reserved to the state to encourage production of oil and gas from marginal fields Senate Resources Committee April 21, 1995

Good afternoon. My name is Carl Portman, Communications Director of the Resource Development Council for Alaska, Inc. On behalf of RDC, thank you for the opportunity to testify on HB 207.

RDC is a proponent of a strong oil and gas industry and has worked to advance incentives that will encourage the industry to explore for new oil fields in Alaska and to bring into production existing reserves. Oil revenues account for 65 percent of state revenues and one in every three jobs in Alaska. As oil production and revenues decline, so will the number of Alaska jobs supported by petroleum revenues.

Sustaining industry investments in Alaska projects is in the best interests of this state. Half of the oil production projected for 2000 and beyond is based on investments yet to be made. As a result, the outlook for future production and revenues could be worse than current projections if investments are made elsewhere.

Alaska is at a competitive disadvantage in attracting capital investments because of high transportation, exploration and development costs, long lead times, crude oil characteristics that discount North Slope oil compared to other crudes and a state revenue structure that takes a bigger share of profits. Moreover, the opportunities that do exist on the North Slope consist of marginal new oil fields or marginal projects within existing fields. In this global environment, companies are becoming increasingly selective in choosing which projects to pursue. Projects that are funded are those offering the highest returns against the lowest risks.

What we need is a strategy to overcome these disadvantages, to make Alaska more competitive in the world market so that more dollars are invested here. In this emerging era of marginal oil field development, the strategy must be based on the team concept. It is imperative that the oil industry and the State of Alaska work

|                      |      |          |
|----------------------|------|----------|
| Post or Fax Note     | 3671 | 4/21/95  |
| To: (S) Resources    |      | Amch. TC |
| Attn: Jim Linnell    |      |          |
| From: Alaska Council |      |          |

**Page 2/RDC comments on HB 207**

together as a team to overcome the challenges and capture the potential for new investments, revenues and jobs.

HB 207, the royalty adjustment legislation, will encourage teamwork and is a step toward making our collective share of oil revenues grow. Flexibility in setting royalty terms for marginal fields will help attract investment capital and maximize long-term benefits to the state. HB 207 is a tool that the State can use to enhance the competitiveness of projects whose funding might otherwise go abroad.

The legislation before you is also an important hedge industry needs against the risk of low oil prices. Low prices is a risk the industry cannot effectively manage alone. As you know, Alaska production is especially vulnerable to low prices due to the current structure of state taxes and royalties. HB 207, however, would help to minimize the industry's exposure to low prices and enhance prospects for making development more viable.

Flexibility in royalty terms would encourage the state and the industry to work together to change the economic equation for marginal fields. And by working together to identify win-win solutions, we can all gain, and in the process, bring on new oil fields, extend the life of existing fields and build a stronger economic base for the future.

Working together to reach shared goals is more important than ever because so much of Alaska's future production will come from marginal fields -- accumulations that would be developed if they were in the lower-cost and lower-risk environment of the Lower 48. HB 207, however, is a step in the right direction. It sends a clear signal that Alaska aims to be competitive in the world market to attract the investments necessary to develop its oil and gas potential. It provides the flexibility needed in working with investors on a case-by-case basis to make new development a reality.

RDC strongly supports this legislation. Thank you for the opportunity to comment.

THE FOLLOWING PAGES  
WERE TREATED AS A UNIT  
IN THE ORIGINAL FILE

HB 207 BRIEFING PAPER

FOR SENATE RESOURCES COMMITTEE

APRIL 1995

## CS FOR HB 207(FIN)AM QUESTIONS & ANSWERS

### A. Purpose

#### 1. What, generally, does the bill accomplish?

This legislation amends current law to give the Commissioner of the Department of Natural Resources (DNR) authority to grant royalty reduction for fields that have been delineated, but not produced. The current law allows the commissioner to grant royalty reduction to prolong the economic life of a field or to reestablish shut-in production. The bill requires that the applicant make a clear and convincing showing that any reduction meets certain requirements and is in the best interests of the state. As part of the application the commissioner shall require the applicant to provide financial and technical data (which may be kept confidential at the request of the applicant) to assure that the requirements are met and that a royalty reduction is warranted. If the commissioner determines that a third-party analysis of the submitted data is necessary, then he may require that the applicant pay for this analysis. This bill also provides that if relevant factors change in the future, then the commissioner may raise the royalties that were previously reduced. The commissioner must condition royalties if oil price changes.

- These reductions may be applied only if one of the three "trigger events" is met:
- Fields that are delineated, but not previously produced, to allow production that would not otherwise be economically feasible.
- Oil and gas fields whose economic life may be prolonged in light of increasing costs in the later stages of production.
- Reestablishing commercial production of shut-in oil or gas that would not otherwise be economically feasible.

Before approving any royalty reduction, the commissioner must issue written findings assuring compliance with the requirements of this section and that the best interests of the state are preserved. The legislation also requires the commissioner to give notice of his preliminary findings and determination to the legislature and public, and allow for comment before adopting final findings and determination. The current committee substitute also states that the commissioner shall offer to provide the LB&A committee a review of the preliminary findings and determination.

#### 2. Why is a change in the law necessary?

A change is necessary for three reasons. First, a change will help to make Alaska more competitive on a worldwide basis for oil companies' investment dollars. The legislation would give the commissioner greater flexibility than exists under current law and authority to reduce the royalty rate on fields that have been delineated, but have not previously produced oil or gas. Second, it would change the economic standard for a reduction for a mature field to a

point-forward or incremental analysis from a historical investment analysis which is not relevant to a decision whether to abandon or continue producing a field. Third, it would clarify the authority to reduce royalty under AS 38.05.180 (j) & (p).

## B. Standards

1. The "best interest" standard seems vague. Should the legislature define the criteria that must be considered in making a best interest decision? Should the legislature maintain the requirement in existing law that the commissioner must find that the "state has obtained the maximum economic return that is compatible with allowing a reasonable rate of return for the lessee"?

Before talking about further defining the best interest standard, there already is a clear limit on the commissioner's authority. The current statute permits the commissioner to grant royalty reduction only if one of two trigger events is met. As discussed above, the legislation would add a third trigger event -- a delineated field that would not otherwise be economically feasible to produce. Only if that showing is met, which must be met by clear and convincing evidence, is the commissioner authorized to even consider whether he should grant royalty relief.

If the commissioner makes a finding that one of the trigger events has been met, then he must decide whether the reduction would be in the best interest of the state before a reduction would be granted. This standard, or a similar standard, is used throughout the statutes without explicit criteria set forth. For example, AS 38.05.180(p) gives the commissioner authority to unitize oil and gas leases if he determines it is necessary to "secure the public interest."

Importantly, DNR has already discussed the best interest standard in connection with Conoco's royalty reduction application. In a published decision document, then Commissioner Heinze noted that the "public interest finding (does) not simply weigh cash gains and losses to the state government" although he determined that lost revenues to the state government would be approximately four times greater than the sum of additional royalties to the state government. The commissioner considered: (1) the effect on the total royalties that would be paid; (2) the additional projected recovery of oil; (3) the ability of the project to render a positive cash flow; (4) the desirability of encouraging further investment that has a direct benefit to the state; (5) the effect of additional production on TAPS throughput; and (6) the benefits of additional employment. At a minimum, the commissioner would consider these factors in making any decision.

The legislature, of course, remains free to put sideboards or restraints on the commissioner's discretion, but any sideboard or restraint could effectively restrain the commissioner's ability to craft practical relief for a given field or reservoir. The current version of the bill requires the commissioner to change the royalty rate if the price of oil changes.

Finally, DNR opposed an amendment to reinstate the "maximum possible economic return to the state" standard. DNR believes that the economic standard set forth in the trigger events is adequate. Moreover, the maximum economic standard is an impossible standard to define, let alone meet.

2. Why does the legislation change the standard for royalty reduction for mature producing fields?

The legislation actually clarifies the confusing old standard of reasonable rate of return on total investment. The old standard is unworkable for fields in the later stages of production. For these fields, the analysis should be based on expected future costs and future revenues. Past profitability has little to do with the decision to produce or abandon a field today or tomorrow. Abandonment decisions are based on a point-forward analysis, not historical performance.

3. Why does the legislation change the standard of persuasion from "clear" to "clear and convincing"?

The "clear and convincing" standard is a term of art in the law which has been defined by the courts and has an accepted definition. A "clear" standard has not been so embraced. This led to a dispute between DNR and Conoco & Oxy in their application for royalty reduction. The issue was pending before the superior court, but had not been decided, when the parties settled. The change was made in hopes of avoiding litigation.

4. The legislation is non-specific about when and how the royalty could increase. Shouldn't it be more specific?

This provision is basically the same as existing law. Specifying when and how the royalty must increase would take away flexibility. Presumably, the commissioner's decision would provide for an increase if prices increase or costs decrease. However under the governor's bill, there would be flexibility to tailor the terms to the specific facts. The commissioner's final finding or determination would include the terms providing for the increase.

5. What does the term "delineated" mean? Should the term be defined in the statute?

DNR believes that the term "delineated" is a term of art in the industry. Its generally accepted definition is that there is sufficient knowledge of the aerial extent, volume, and productivity of the field to allow a lessee to decide whether to proceed with development and production, including determining costs to develop and produce the field. In other words, delineation is the process by which a resource in a previously discovered accumulation makes the transition to "reserves." Reserves are resources demonstrated with reasonable certainty to be recoverable from a known accumulation under existing economic and operating conditions.

The requisite information varies from field to field and no specific test would suffice for all fields. The information pertinent to making the decision would include drilled wells, seismic data and interpretations, and engineering data on the reservoir's characteristics, including well flow test data of sufficient duration to provide estimates of future development well productivity.

DNR believes that any attempt to specifically define "delineated" would likely create as many problems as it solves.

6. What do the terms "field" and "pool" mean?

The meaning of the term "field" was disputed in the Conoco & Oxy application process. DNR defined the term to include all reservoirs or pools underlying the lease or unit area. "Pool" means an underground reservoir containing a common accumulation of oil or gas. Each zone of a general structure which is completely separated from any other zone in the structure is covered by the term "pool." The terms "pool" and "field" mean the same thing when only one underground reservoir is involved, but "field" - unlike "pool" - may relate to two or more pools. To prevent future disputes, and to increase flexibility, the bill references both "field" and "pool."

7. Can the royalty reduction apply to a single pool on a given lease, as compared to all production from the lease?

The legislation would give the commissioner that discretion. If there had been production from one pool in a field, but not another pool, the commissioner would have authority to consider a royalty reduction only for some or all of the second pool if it had been delineated. Future discoveries or developments on the lease would not be automatically granted a reduction.

On leases that have been developed, such as the Kuparuk-West Sak situation, DNR wants the latitude to consider royalty reductions for the West Sak reservoir, while retaining the original royalty rate for the deeper Kuparuk reservoir.

8. Would the royalty reduction be granted for the entire field or unit area?

The reduction, if granted, would be granted on a lease by lease basis. The lease or unit agreement establishes the royalty rate, and it is the lease or unit agreement that needs to be amended if the royalty rate is to be changed. Of course, the reduction could apply to all leases within the unit area.

9. Would the bill allow the Commissioner to reduce the royalty rate at the state's largest fields, including Prudhoe Bay?

No. The new trigger event in the bill would not allow a royalty reduction for a field like Prudhoe Bay. Both gas and oil have been produced and sold from that field. Consequently, it could not qualify under the new trigger event of a delineated, but not produced field. Simply put, a reduction is not necessary to get the field developed. At some point in the distant future when the field is in steep decline, Prudhoe Bay may become eligible for a reduction under one of the other two trigger events contained in the current royalty reduction statute.

10. What does the term "reasonable rate of return" mean in the current legislation?

DNR recommends dropping the term. This term led to serious disagreements between an applicant and DNR. DNR felt obliged to adopt an objective standard which could be applied consistently regardless of the vagaries of an individual company's financial planning standards. Recognizing that neither the state's oil and gas leases nor statutes guaranteed a company a specific rate of return, or any return at all, Commissioner Heinze adopted a standard – the return on a 90 day Treasury bill – which provided a positive real rate of return, but did not provide an excessive profit at the expense of the state's royalty share. Other potential rates considered by DNR included: (1) the individual company's cost of capital plus a marginal profit; (2) a public utility type rate of return; (3) the economic yardstick used by DOE to determine if a field is commercially developable; (4) the long-term bond yield; and (5) the rate allowed by DOR in determining reasonable shipping rates for severance tax purposes. As noted previously, once a field is developed (i.e., major investments sunk) any revenue in excess of operating costs is sufficient to keep the field in production.

### C. Appealability & Confidentiality

1. The non-appealability clause seems unusual. Why is it in the bill?

The clause has two purposes: The first is to make clear that the statute does not confer on a lessee a right or entitlement to a royalty reduction. Even if the lessee makes a showing that the lessee could not economically produce the field, there is no duty on behalf of the commissioner to grant royalty relief. DNR makes a business judgment whether the state would rather have production on a reduced royalty basis or take back the leases and attempt to relet them. Moreover, the commissioner may have to consider other factors, such as the effect on the bidding process and on the environment, in determining whether a royalty reduction should be granted.

There is some federal law on the subject of royalty reductions on federal leases. Under federal law the Secretary of Interior has authority to reduce a lease's royalty rate under certain circumstances. But federal law holds that:

[There are] no circumstances which require BLM to reduce royalty. Under the statute, no entitlement to such a reduction can ever arise. BLM

remains free to accept the economic consequences of denying royalty relief, which may vary from case to case. ... The discretionary authority conferred by (the federal royalty reduction statute) enables BLM to exercise prudent business judgment to accept the alternative that best protects the economic interest of the United States as owner of the mineral resources.

Peabody Coal Co., 93 IBLA 317, 326 (1986) (emphasis added).

Given that there is no entitlement or no right to a royalty reduction, the second purpose is to preclude expensive, time consuming litigation, which can have no basis, by the applicant whose application has been denied. The intent of the provision is to preclude the applicant from appealing. The courts have rejected an argument that there is a constitutionally guaranteed minimum right of judicial review where the "administrative activity ... involves the grant or denial of a privilege which the state government is free to allow or withhold in its discretion ...." Cooper, State Administrative Law 677 (1965). The Department of Law believes that the commissioner's determination regarding a royalty reduction application would fall into that category and thus the court would likely give effect to a provision precluding judicial review.

The general rule, according to Professor Davis, one of the foremost authorities on administrative law, is that:

[I]f a statute unequivocally precludes judicial review of an agency action, and judicial review is sought on any basis other than a claimed violation of a constitutional right, the Court will give statute effect.... When the scope and effect of an explicit statutory limit on judicial review is less clear, however, and the Court perceives a significant risk of unfairness if the statutory limit is given broad effect, the Court sometimes strains to interpret the limit narrowly.

Davis, Administrative Law, §17.8 at 155. The court could read into the finality provision an implied exception permitting review of constitutional questions, questions regarding the jurisdiction of the agency and the regularity of its procedure, questions affecting the existence of property rights, questions involving bad faith, or questions regarding fraud. Cooper, supra at 679.

The Alaska Supreme Court has stated that a "legislative statement of finality is one which we will honor to the extent that it accords with constitutional guarantees." K & L Distributors, Inc. v. Murkowski, 486 P.2d 351, 357 (Alaska 1971). It is likely that the court will attempt to whittle down any finality language to size to fit the court's sense of fundamental fairness. In other words, a statement of finality will not prevent the court from reviewing the decision to assure compliance with the due process clause under the Alaska constitution. Nevertheless, a finality provision will mean that any review of a royalty reduction decision will

be much more limited than the broad review of an agency decision required by the Alaska Administrative Procedure Act. For example, the court would not review each factual finding to see that it is correct, or even that it is supported by substantial evidence. The court would only examine the commissioner's decision to determine whether it has "passed beyond the lowest limit of the permitted zone of reasonableness to become capricious, arbitrary or confiscatory." *Id.* at 358. Given this, we believe that it is less likely that a disgruntled lessee would appeal and, therefore, more likely needless court expense would be saved.

2. Should the commissioner's decision be subject to legislative review?

The administration does not object to some type of legislative oversight. The administration believes that the legislature could request a briefing even without a specific provision in the bill. The administration notes that at least one company has opposed a proposed amendment which would have provided for a confidential briefing by the commissioner of the legislature.

3. Why does the bill contain confidentiality provisions?

The confidentiality provision in the bill is no different than existing law. The purpose of this provision is to protect a company's competitiveness relative to other companies. Obviously, a company which has spent millions of dollars to acquire geological, geophysical, and engineering information regarding a potential oil field does not want that information revealed to other companies. Furthermore, releasing financial information about the company would reveal the company's underlying economic philosophy regarding exploration and development and, thus, disadvantage the company with respect to its competitors. The confidentiality provision actually promotes the disclosure of complete and frank information to the state. Given industry's testimony at the hearings, it is likely that without a confidentiality provision for new fields, no company would apply for royalty relief and the benefits of the bill would be lost. Nevertheless, the bill allows the company to disclose its information to the public if it desires.

#### D. Miscellaneous

1. Why does the legislation delete the provision in former law that the commissioner shall adopt regulations?

Such a provision is unnecessary and would delay the implementation of any new program. Under current law, the commissioner already has the authority to adopt regulations necessary to carry out the purposes of the Alaska Land Act. AS 38.05.020(b)(1). There are already existing regulations which define the procedure for submitting an application for reduction under AS 38.05.180(j). 11AAC 83.185. DNR would plan to amend those regulations to deal with the proposed changes in the statute. DNR, however, does not want to be required to

implement regulations because that could delay implementation of any new statutory changes. The current law allows the commissioner to adopt regulations if needed.

2. Do you have any concerns that the legislation will undermine the competitive bidding process?

The commissioner will have to consider this issue in determining whether a reduction is in the state's best interest. Certainly, if the royalty rate is the bid variable this is a very real concern. In general, the closer the reductions to the time of the bid, the greater the concern. That is one of the reasons why the former law provided for a two year production requirement. That requirement, however, proved unworkable and the legislature dispensed with that requirement in 1990 to allow the commissioner more flexibility.

The proposed amendment tries to balance the need to protect the bidding process with the need to get marginal fields timely developed. For example, a reduction cannot take place until the lessee at least does delineation work. In other words, the commissioner could not grant a reduction the day after the lease sale. More importantly, the commissioner cannot grant a reduction unless the lessee makes a clear and convincing showing that absent relief the field would not otherwise be economically feasible. In making that determination and deciding whether granting relief would be in the state's best interest, the commissioner will have to examine whether other potential lessees would develop or produce the field without royalty relief.

The Alaska Supreme Court has recognized a competitively bid government contract can be amended under certain circumstances without jeopardizing the competitive bid process. Kenai Lumber Co., Inc. v. LeResche, 646 P.2d 215, 220-22 (Alaska 1982). Importantly, every state oil and gas lease contains a royalty reduction so all competitive bidders were on notice that the royalty could be reduced under appropriate conditions.

4. Is it legally required that the permanent fund be held harmless?

Probably not, but a concern has been raised. Article IX, Section 15, provides that: "At least twenty-five per cent of all mineral lease rentals, royalties, royalty sale proceeds ... received by the state shall be placed in a permanent fund." The Department of Law believes that the most likely interpretation of the constitutional provision is the permanent fund gets 25% of whatever the state gets and if the state gets a lesser or greater royalty for that matter, the permanent fund gets 25% of that amount.

An argument can be made that the provision means the permanent fund gets 25% of the original royalty rate specified in the lease and the legislature or the commissioner cannot change the amount, at least for the permanent fund. The Department of Law does not believe that such an argument would be persuasive to a court. There have been statutory and lease provisions providing for royalty reduction in one form or another since statehood. These

provisions were in effect at the time the permanent fund provision took effect and no special provision was enacted to keep the permanent fund whole in that instance. Consequently, we believe the permanent fund takes its 25% share subject to the possibility that the royalty share may be reduced. In short, the permanent fund gets at least 25% of whatever the state receives.

A good example would be the administration of the former royalty reduction statute (which still applies today on some of the older leases). That statute provides for reduction of the royalty rate to 5% on a lease where a discovery is made. In that case, the permanent fund has not been held harmless or kept whole. The permanent fund gets 25% of the reduced rate, no more or no less.

The current committee substitute deletes the permanent fund hold harmless provisions which were in the bill as originally introduced. Regardless of whether the bill contains hold harmless provisions, the administration supports a floor for any reduction that does not exceed 75% of the applicable royalty rate.

## **HB 207 Briefing Paper for Senate Resources Committee**

1. **Former and Current Versions of the Royalty Reduction Statute**
2. **Former and Current Versions of the Unitization Statute**
3. **Royalty Reduction Regulations**
4. **Former & Current Royalty Reduction Lease Provisions**
5. **Commissioner Heinze's Decision on Conoco's Application for Royalty Reduction**
6. **Article re Federal Legislation to Provide Royalty Relief for New Production Off Alaska**

FL 1

VERSIONS OF THE  
ROYALTY REDUCTION STATUTE

1959 Statute

SLA 1959, Chapter 169, Article VIII, § 2  
Leasing of Mineral Lands

Sec. 2. No person, association, or corporation, except as herein provided, shall take or hold coal leases or permits during the life of such lease on Alaska lands....The Commissioner, for the purpose of encouraging the greatest ultimate recovery of coal, oil, gas, oil shale, phosphate, sodium, potassium, and sulphur, and in the interest of conservation of natural resources, is authorized, after public hearing, to waive, suspend, or reduce the rental, or minimum royalty, or reduce the royalty on an entire leasehold, or on any tract or portion thereof segregated for royalty purposes, whenever in his judgment it is necessary to do so in order to promote development, or whenever in his judgment the leases cannot be successfully operated under the terms provided therein. In the event the Commissioner, in the interest of conservation, shall direct or shall assent to the suspension of operations and production under any lease granted, any payment of acreage rental or of minimum royalty prescribed by such lease likewise may be suspended during such period of suspension of operations and production; and the term of such lease shall be extended by adding any such suspension period thereto.

1978 Statute

SLA 1978, Chapter 155, Section 1

AS 38.05.180 (j) To prolong the economic life of an oil and gas field, the commissioner shall adopt regulations for all bidding methods to allow reduction of royalty on leases within the field to compensate for increasing costs in the later stages of production decline. The commissioner may not grant a reduction of royalty until two years' initial production from the field has occurred and each lessee requesting the reduction has made a clear showing that the revenue from all hydrocarbons produced from the field is insufficient to produce a reasonable rate of return with respect to that lessee's total investment in the field.

1990 Statute

SLA 1990, Chapter 124, Section 1

AS 38.05.180 (j) To prolong the economic life of an oil and gas field or to reestablish commercial production of shut-in oil or gas that would not otherwise be economically feasible, the commissioner shall adopt regulations to allow reduction of royalty on leases. The commissioner may not grant a reduction of royalty unless the lessee requesting the reduction makes a clear showing that the revenue from the lessee's share of all hydrocarbons produced from the field is and is likely to continue to be insufficient to produce a reasonable rate of return with respect to the lessee's total investment in the field. The commissioner may condition a royalty reduction granted under this subsection in any way necessary to protect the state's interest including restoration of the state's royalty share in the event of an increase in the price of oil or gas. Before approving a royalty reduction, the commissioner shall make a written finding that the state has obtained the maximum possible economic return that is compatible with allowing a reasonable rate of economic return for the lessee, and send copies of the finding to all members of the legislature.

VERSIONS OF THE  
UNITIZATION STATUTE

1960 Statute

SLA 1960, Chapter 61, Section 18

(Formerly AS 38.05.180 (m)) For the purpose of more properly conserving the natural resources of any oil or gas pool, field, or like area, or any part thereof (whether or not any part of said oil or gas pool, field, or like area is then subject to any cooperative or unit plan of development or operation), lessees thereof and their representatives may unite with each other, or jointly or separately with others, in collectively adopting or operating under a cooperative or unit plan of development or operation of such pool, field, or like area, or any part thereof, whenever determined and certified by the Commissioner to be necessary or advisable in the public interest. The Commissioner is thereunto authorized, in his discretion, with the consent of the holders of leases involved, to establish, alter, change, or revoke drilling, producing, rental, minimum royalty, and royalty requirements of such leases and to make such regulations with reference to such leases, with like consent on the part of the lessees, in connection with the institution and operation of any such cooperative or unit plan as he may determine necessary or proper to secure the proper protection of the public interest. The Commissioner may provide that oil and gas leases issued under this subsection shall contain a provision requiring the lessee to operate under such a reasonable cooperative or unit plan, and he may prescribe such a plan under which such a lessee shall operate, which shall adequately protect all parties in interest, including Alaska.

1978 Statute

SLA 1978, Chapter 155, Section 1

AS 38.05.180 (p) To conserve the natural resources of all or a part of an oil or gas pool, field or like area, the lessees and their representatives may unite with each other, or jointly or separately with others, in collectively adopting or operating under a cooperative or a unit plan of development or operation of the pool, field, or like area, or a part of it, when determined and certified by the commissioner to be necessary or advisable in the public interest. The commissioner may, with the consent of the holders of leases involved, establish, change, or revoke drilling, producing, and royalty requirements of the leases and adopt regulations with reference to the leases, with like consent on the part of the lessees, in connection with the institution and operation of a cooperative or unit plan as he determines necessary or proper to secure the proper protection of the public interest. The commissioner may require oil and gas leases issued under this section to contain a provision requiring the lessee to operate under a reasonable cooperative or unit plan, and he may prescribe a plan under which the lessee must operate. The plan must adequately protect all parties in interest, including the state.

11 AAC 83.183. **SLIDING SCALE ROYALTY.** If the commissioner selects a method of bidding which sets a royalty reserved to the state, either fixed or as the bid variable, based on a sliding scale, the sliding scale will be determined, according to a method chosen at the commissioner's discretion which will be based on volume of production or other factors. The method chosen by the commissioner will consider the prolongation of the economic life of the oil and gas reservoir or reservoirs underlying the sale area or lease to which the sliding scale is to be applied. (Eff. 11/9/79, Register 72)

Authority: AS 20.05.010  
AS 20.05.100

11 AAC 83.185. **ROYALTY REDUCTION.** (a) An application for a reduction of royalty on leases under AS 20.05.180(g) must comply with 11 AAC 88.105 and

- (1) state all the facts entitling the applicant to relief,
  - (2) state location and status of all past and present activities on the lease,
  - (3) include a detailed report of all production during the six months preceding the filing of the application,
  - (4) contain a detailed statement covering the entire life of the lease showing all expenses and costs of operating the lease, including all royalties and overriding royalties and all income from all produced minerals from the lease; and
  - (5) include an agreement by the applicant to defray the cost of publishing a notice as provided by (b) of this section.
- (b) Upon receipt of an application complying with (a) of this section, the commissioner will cause to be published a notice of public hearing as required on the application. The notice will
- (1) state the time and place of hearing,
  - (2) describe the land involved, and
  - (3) state the name of the applicant and the nature of the relief applied for

(c) The notice will be published at least once a week for at least two consecutive weeks in advance of the hearing date, which must be at least 15 days after the last date of publication, in at least one newspaper of general circulation in the vicinity of the principal office of the department, and must be posted at the principal office for the same period.

(d) At the time and place specified in the published notice, the commissioner will hear evidence offered by the applicant and any other interested party.

(c) Within a reasonable time following the hearing or any continuation of it, the commissioner will make written findings together with his determination as to the relief that should be granted.

(f) The commissioner will give notice of the findings and determination to the leasee and to any other person who has filed a written request for it. The action taken is effective on the date specified in the notice. (Eff. 9/5/74, Register 81; am. 7/23/79, Register 71)

Authority: AS 20.05.010  
AS 20.05.100  
AS 20.05.180

11 AAC 83.190. **EXTENSION BY COMMITMENT TO AN APPROVED UNIT.** If, on or before the expiration date of the primary term of a lease, the lease is committed to a unit agreement approved by the state, the lease will be extended for as long as it remains subject to the unit agreement. (Eff. 7/23/79, Register 71)

Authority: AS 20.05.010

Article 2. Net Profit Share Listing

| Section | Description  |
|---------|--|
| 201     | Payments   |
| 202     | Extraordinary production revenue or lease                            |
| 203     | Development amount and production revenue amount - by ground         |
| 204     | Net profit share fee   |
| 205     | Advertising costs  |
| 206     | Production revenue amount  |
| 207     | Development amount   |
| 208     | Net profit percent amount  |
| 209     | Estimate from minerals   |
| 210     | Development costs  |
| 211     | Production revenue   |
| 212     | Unitization  |
| 213     | Valuation of oil or gas  |
| 214     | Lease price  |
| 215     | Precedent sales  |
| 216     | Change of methods for determining reasonable costs of transportation |
| 217     | Calculation of reasonable costs of transportation                    |

Editor's notes - The former Article 2, relating to oil and gas lease discovery and 11 AAC 83.200, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218, 11 AAC 83.219, 11 AAC 83.220, was repealed with effect, commencing 11 AAC 83.200, 11 AAC 83.201, 11 AAC 83.202, 11 AAC 83.203, 11 AAC 83.204, 11 AAC 83.205, 11 AAC 83.206, 11 AAC 83.207, 11 AAC 83.208, 11 AAC 83.209, 11 AAC 83.210, 11 AAC 83.211, 11 AAC 83.212, 11 AAC 83.213, 11 AAC 83.214, 11 AAC 83.215, 11 AAC 83.216, 11 AAC 83.217, 11 AAC 83.218,

(4) a description of the service rendered by the lessee prior to the request;

(5) a description of the proposed change; and

(6) a statement of the reasons for the proposed change.

(c) The commissioner of natural resources or his authorized representative will act on each completed request as soon as practicable. (E.R. 3/3/74, Register 49)

Authority: AS 28.05.020(a); AS 28.25.040; AS 28.25.050(a); AS 28.25.010; AS 28.25.020

**11 AAC 80.035. ADMINISTRATIVE DETERMINATION FOR TEMPORARY OR EMERGENCY SERVICE OR TEMPORARY OR EMERGENCY ABANDONMENT, REDUCTION OR IMPAIRMENT OF SERVICE.** (a) The commissioner of natural resources, or his authorized representative, will disapprove a request for authorization for temporary or emergency rendering of service or a request for the temporary or emergency abandonment, reduction or impairment of service under AS 28.25.040 only after determining that

(1) the disapproval will promote state interests and goals and will have no adverse effect upon the interstate character of commercial activities which outweighs the public benefit; and

(2) the disapproval will not illegally interfere with an area of regulation pre-empted by federal statute or regulation.

(b) The commissioner of natural resources, or his authorized representative, will exercise the authority conferred upon him by AS 28.25.040 to require temporary or emergency rendering of service or temporary or emergency abandonment, reduction or impairment of service only after determining that

(1) the requirements will promote state interests and goals and will have no adverse effect upon the interstate character of commercial activities which outweighs the public benefit; and

(2) the requirement will not illegally interfere with an area of regulation pre-empted by federal statute or regulation.

(c) In making determinations required in subsections (a) and (b) of this section, the commissioner of natural resources or his authorized representative will investigate and consider all relevant facts and will make written findings which specify

(1) the state interests to be advanced by disapproving the request or by imposing the requirement and the degree to which the state interests will be advanced;

(2) the nature and degree of any adverse effect created on interstate commerce by disapproving the request or by imposing the requirement; and

(3) the nature and degree of the effect of disapproving the request or of imposing the requirement upon areas of federal regulation. (E.R. 3/3/74, Register 49)

Authority: AS 28.05.020(a); AS 28.25.050(a); AS 28.25.010; AS 28.25.030(a)

**11 AAC 80.045. FIELD GATHERING LINES EXEMPT.** Field gathering lines are exempt from the requirement of obtaining a right-of-way lease under AS 28.25 (E.R. 3/3/74, Register 49)

Authority: AS 28.05.020(a); AS 28.25.020(a)

**11 AAC 80.055. FIELD GATHERING LINES DEFINED.** "Field gathering lines" means pipe and associated facilities, including separators, test equipment, pumps, treaters and tanks, used in the transfer of gas or oil from a well or other facility used in the production of gas or oil to a point where there is either a custody transfer of the gas or oil or where the gas or oil enters a common carrier pipeline, whichever first occurs. (E.R. 3/3/74, Register 49)

Authority: AS 28.05.020(a); AS 28.25.020(a)

**CHAPTER 82. MINERAL LEASING PROCEDURE**

**Article**

1. Availability of Land 11 AAC 82.100 - 11 AAC 82.110
2. Qualifications 11 AAC 82.200 - 11 AAC 82.205
3. Acreage Limitations 11 AAC 82.300 - 11 AAC 82.340
4. Competitive Bidding 11 AAC 82.400 - 11 AAC 82.475
5. Miscellaneous Provisions 11 AAC 82.500 - 11 AAC 82.540
6. Miscellaneous Leasing Procedures 11 AAC 82.600 - 11 AAC 82.675
7. Royalty Provisions 11 AAC 82.700 - 11 AAC 82.715
8. Records and Reports 11 AAC 82.800 - 11 AAC 82.815

**Editor's note.** - The mineral leasing regulations in 11 AAC 82, 11 AAC 83, 11 AAC 84, 11 AAC 85 and 11 AAC 86, effective September 5, 1974, and distributed to Alaska Administrative Register 81, constitute a comprehensive reorganization

and revision of this material, and thus the history line at the end of each section does not reflect the history of the provision before September 5, 1974, and the section numbering may or may not be related to the numbering before that date.

**ROYALTY REDUCTION PROVISION**  
State of Alaska Department of Natural Resources  
Competitive Oil & Gas Lease Forms

DL-1

Rental or minimum royalty may be waived, suspended, or reduced, or royalty may be reduced on all of said land or any tract or portion thereof segregated for royalty purposes if Lessor finds that such relief is necessary for the purpose of encouraging the greatest ultimate recovery of oil or gas and is in the interest of conservation of natural resources and either that such relief is necessary in order to promote development or that the lease cannot be successfully operated under the terms provided herein.

**DNEM-A revised 8/27/79**

After two years' initial production from the field in which the leased area is located has occurred, the State may reduce Lessee's obligations to pay royalty on all of the leased area or on any tract or portion thereof segregated for royalty purposes upon (1) request by Lessee and (2) a clear showing by Lessee that the revenue from all oil, gas and associated substances produced from the field is insufficient to produce a reasonable rate of return with respect to Lessee's total investment in the field.

**DNEM-1-79-A revised 11/5/79**

After two (2) years' initial production from the field in which the leased area is located has occurred, the State, in its discretion, may reduce Lessee's obligations to pay royalty on all of the leased area or on any tract or portion thereof segregated for royalty purposes upon (1) request by Lessee, (2) a clear showing by Lessee that the revenue from all oil, gas and associated substances produced from the field is insufficient to produce a reasonable rate of return with respect to Lessee's total investment in the field, and (3) a clear showing by Lessee that a reduction in royalty will increase total production from the field.

**DNEM-4-81 revised 6/23/81**

After initial production for two years from the field in which the leased or unit area is located has occurred, the State, in its discretion, may reduce Lessee's obligations to pay royalty on all of the leased area or on any tract or portion thereof segregated for royalty purposes upon (1) request by Lessee, (2) a clear showing by Lessee that the revenue from all oil, gas and associated substances produced from the field is insufficient to produce a reasonable rate of return with respect to the Lessee's total investment in the field, and (3) a clear showing by the Lessee that a reduction in royalty will increase total production from the field.

**DNR 10-4037 revised 9/90**

Lessee may request a reduction of royalty in accordance with the applicable statutes and regulations in effect on the date of application for the reduction.<sup>1</sup>

---

<sup>1</sup>This version was revised August, 1993 in lease form DOO 9200AS for Sale 75 to reflect the joint leases between the State and the Arctic Slope Regional Corporation. (No reduction of royalty payable to ASRC shall be effected without ASRC's approval and, likewise, no reduction of royalty payable to the State shall be effected without the State's approval.)

DL-1

Date:

**12. REDUCTION OF ROYALTY RATES FOR DISCOVERY.** If Lessee shall drill on said land and make the first discovery of oil or gas in commercial quantities in any geological structure, the royalty rate under this lease shall, instead of the rates prescribed in Paragraph 11, be five per cent for a period of ten years following the date of such discovery, and thereafter the royalty rates shall be those prescribed in Paragraph 11. If this lease is committed to a unit agreement approved or prescribed by Lessor as provided in the regulations, the five per cent royalty rate shall apply to all, but only, the production allocated to this lease under such agreement.

**13. REDUCTION OF RENTAL AND ROYALTY.** Rental or minimum royalty may be waived, suspended, or reduced, or royalty may be reduced on all of said land or any tract or portion thereof segregated for royalty purposes if Lessor finds that such relief is necessary for the purpose of encouraging the greatest ultimate recovery of oil or gas and is in the interest of conservation of natural resources and either that such relief is necessary in order to promote development or that the lease cannot be successfully operated under the terms provided herein.

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

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

Revised 8/27/79

6. If such oil, gas or associated substances are sold away from the leased or unit area, the volume weighted average price for oil of like grade and gravity, gas of like kind and quality or associated substances of like kind and quality received by other producers in the same field or area from the purchasers thereof less the volume weighted average cost to those other producers of transportation away from the leased or unit area to the point of delivery.

E. Minimum Value Determinations. The State may determine which of the methods contained in paragraph III.D.1. through 6. above shall be used to establish the value of royalty oil and gas, and associated substances, for purposes of computing royalties payable under this lease. Each such determination shall be made only after Lessee has been given notice and a reasonable opportunity to be heard.

F. Reduction of Royalty. After two years' initial production from the field in which the leased area is located has occurred, the State may reduce Lessee's obligations to pay royalty on all of the leased area or on any tract or portion thereof segregated for royalty purposes upon (1) request by Lessee and (2) a clear showing by Lessee that the revenue from all oil, gas and associated substances produced from the field is insufficient to produce a reasonable rate of return with respect to Lessee's total investment in the field.

G. Payments. All payments to the State under this lease shall be made payable to the State in the manner directed by the State, and shall be tendered to the State at Department of Natural Resources, 323 East Fourth Avenue, Anchorage, Alaska 99501, or to any depository designated by the State with at least sixty (60) days' notice to Lessee.

#### IV. LEASE OPERATIONS.

##### A. Plan of Operations.

1. No lease operations other than surface reconnaissance may be undertaken by Lessee, its agents or assigns, on the leased area, except in conformity with a plan of operations approved by the State. Lessee shall file four (4) copies of application for approval of its proposed plan of operations to the State.

2. The application shall set forth a detailed proposed plan of operations, including but not limited to statements and maps or drawings setting forth each of the following:

MEM-1-79-17 (NPS)  
REVISED November 3, 1979

9. **REDUCTION OF ROYALTY.** After two (2) years' initial production from the field in which the leased area is located has occurred, the State, in its discretion, may reduce Lessee's obligations to pay royalty on oil of the leased area or on any tract or portion thereof segregated for royalty purposes upon (1) request by Lessee, (2) a clear showing by Lessee that the revenue from all oil, gas and associated substances produced from the field is insufficient to produce a reasonable rate of return with respect to Lessee's total investment in the field, and (3) a clear showing by Lessee that a reduction in royalty will increase total production from the field.

10. **ROYALTY IN VALUE.** Unless the State elects to receive all or a portion of its royalty in kind as provided in Paragraph 12 below, Lessee shall pay to the State the value of all royalty oil, gas and associated substances as determined under Paragraph 11 below. 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 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 payments shall be accompanied by copies of run tickets or such other information relating to valuation of 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.

11. **VALUE.** (a) For purposes of computing royalties due under this lease, the value of royalty oil, gas or associated substances shall not be less than the highest of:

- (1) the field price actually received by Lessee for such oil, gas or associated substances;
- (2) Lessee's posted price in the field for such oil, gas or associated substances;
- (3) the volume weighted average field price actually received by other producers in the same field or area for oil of like grade and gravity, gas of like kind and quality or associated substances of like kind and quality at the time such oil, gas or associated substances are removed from the leased or unit area or such gas is delivered to an extraction plant if such a plant is located on 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 oil of like grade and gravity, gas of like kind and quality or associated substances of like kind and quality at the time such oil, gas or associated substances are removed from the leased or unit area or such gas is delivered to an extraction plant if such a plant is located on the leased or unit area.

(b) If oil, gas or associated substances are sold away from the leased or unit area, the term "field price" in subparagraph (a) above shall be the actual price for such oil, gas or 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.

(c) **Minimum Value Determinations.** The State may establish minimum values for purposes of computing royalties on oil, gas or 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 oil, gas or associated substances under this lease may not necessarily equal the price of such oil, gas or associated substances.

12. **ROYALTY IN KIND.** (a) At the State's option, which may be exercised from time to time upon not less than six (6) months' notice to Lessee, Lessee shall deliver all or a portion of the State's royalty oil, gas or associated substances produced from the leased area in kind. Delivery shall be on the leased area or at a place mutually agreed to by the State and Lessee, and shall be to the State or to any individual, firm or corporation designated by the State.

(b) Royalty oil, gas or associated substances delivered in kind shall be delivered in good and merchantable condition and be of pipeline quality, and shall be free and clear of all lease expenses (and any portion of such expenses which are 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.

(c) After having given notice of its intention to take, or after having taken, its royalty oil, gas or associated substances in kind, the State, at its option and upon six (6) months' notice to Lessee, may elect to receive a different portion or none of its royalty in kind. If, under federal regulations, the Lessor's taking of royalty oil, gas or associated substances in value creates a supplier-purchaser relationship, Lessee hereby waives its right to continue to receive royalty oil, gas or associated substances under such a relationship, and further agrees that it will require any purchasers of the royalty oil, gas or associated substances to likewise waive any such rights.

(d) Lessee shall furnish storage for royalty oil and natural gas liquids produced from the leased or unit area to the same extent that Lessee provides storage for Lessee's share of oil and natural gas liquids. Lessee shall not be liable for the loss or destruction of stored royalty oil and natural gas liquids from causes beyond Lessee's reasonable control.

13. **RECORDS.** Lessee shall keep and have in its possession books and records showing the development and production (including records of development and production expenses) and disposition of all oil, gas and associated substances produced from the leased area. Lessee shall permit the State or its agents to examine such books and records at all reasonable times. Such books and records of development and production must employ methods and techniques that will ensure the most accurate figures reasonably available without requiring Lessee to provide separate tags and/or meters for each well. Lessee shall use standard and consistent accounting procedures which are common to the industry.

14. **APPORTIONMENT OF ROYALTY FROM APPROVED UNIT.** The landowner's royalty share of the unit production allocated to each acreatory 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 expenses and free of any lien for it. Under this provision, the State's 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.

15. **PAYMENTS.** All payments to the State under this lease shall be made payable to the State in the manner directed by the State, and shall be rendered to the State at

DEPARTMENT OF NATURAL RESOURCES  
373 EAST FOURTH AVENUE  
ANCHORAGE, ALASKA 99501

or to any depository designated by the State with at least sixty (60) days' notice to Lessee.

16. **PLAN OF OPERATIONS.** (a) No lease operations other than surface reconnaissance may be undertaken by Lessee, its agents or assigns, on the leased area, except in conformity with a plan of operations approved by the State. Lessee shall file with the State four (4) copies of its application for approval of its proposed plan of operations.

(b) The application shall set forth a detailed proposed plan of operations, including, but not limited to, statements and maps or drawings setting forth each of the following: (1) the sequence and schedule of the operations proposed to be conducted on the leased area; (2) projected use requirements associated with the proposed operations, including, but not limited to, the location and design of well sites, material sites, water courses, buildings, roads, utilities, pipelines and all other facilities necessary for exploration, development and production of the leased area; (3) plans for restoration of the leased area upon the completion of operations or phases thereof; and (4) a description of operating procedures designed to prevent or minimize adverse impacts upon other natural resources and other uses of the leased area and adjacent areas.

NMEM-4-81. (Royalty)  
Revised June 23, 1981

37. REDUCTION OF ROYALTY. After initial production for two years from the field in which the leased or unit area is located has occurred, the State, in its discretion, may reduce the Lessee's obligations to pay royalty on all of the leased area or on any tract or portion of the leased area segregated for royalty purposes upon (1) request by the Lessee, (2) a clear showing by the Lessee that the revenue from all oil, gas, and associated substances produced from the field is insufficient to produce a reasonable rate of return with respect to the Lessee's total investment in the field, and (3) a clear showing by the Lessee that a reduction in royalty will increase total production from the field.

IN WITNESS WHEREOF the parties have executed this lease effective as of the \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_

LESSEE

STATE OF ALASKA

By:

Title:

THE UNITED STATES OF AMERICA )  
STATE OF ALASKA ) ss.

Acknowledgement of Lessor

This certifies that on the \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_, before me, a notary public in and for the State of Alaska, duly commissioned and sworn, personally appeared \_\_\_\_\_ to me known to be the person who executed the foregoing lease on behalf of the State of Alaska, who, after being duly sworn according to law, stated to me under oath that he or she has authority pursuant to law to execute the foregoing lease on behalf of the State of Alaska, acting through the Department of Natural Resources, and that he or she executed the same freely and voluntarily as the act and deed of the State of Alaska and for the Department of Natural Resources.

WITNESS my hand and official seal.

Notary Public in and for Alaska  
My commission expires \_\_\_\_\_

F

INSERT NOTARY ACKNOWLEDGEMENT OF LESSEE'S SIGNATURE HERE.

(3) the lessee's posted price in the field or area for the oil, gas, or associated substances;

or

(4) the volume-weighted average of the three highest posted prices in the same field or area of the other producers in the same field or area for oil of like grade and gravity, gas of like kind and quality, or associated substances of like kind and quality at the time the oil, gas, or associated substances are sold or removed from the leased or unit area or the gas is delivered to an extraction plant if that plant is located on the leased or unit area; if there are less than three prices posted by other producers, the volume-weighted average will be calculated using the lesser number of prices posted by other producers in the field or area.

(b) If oil, gas, or associated substances are sold away from the leased or unit area, the term "field price" in subparagraph (a) above will be the cash value of all consideration received by the lessee or other producer from the purchaser of the oil, gas, or associated substances, less the reasonable costs of transportation away from the leased or unit area to the point of sale. The "reasonable costs of transportation" are as defined in 11 AAC 83.228 and 11 AAC 83.229 as those regulations exist on the effective date of this lease.

(c) In the event the lessee does not sell in an arm's-length transaction the oil, gas, or associated substances, the term "field price" in subparagraphs (a) and (b) above will mean the price the lessee would expect to receive for the oil, gas, or associated substances if the lessee did sell the oil, gas, or associated substances in an arm's-length transaction, minus reasonable costs of transportation away from the leased or unit area to the point of sale or other disposition. The lessee must determine this price in a consistent and logical manner using information available to the lessee and report that price to the state.

(d) The state may establish minimum values for the purposes of computing royalties on oil, gas, or associated substances obtained from this lease, with consideration being given to the price actually received by the 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 the lessee and/or other producers from sales occurring away from the leased area, and/or to other relevant matters. In establishing minimum values, the state may use, but is not limited to, the methodology for determining "prevailing value" as defined in 11 AAC 83.227. Each minimum value determination will be made only after the 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 oil, gas, or associated substances under this lease may not necessarily equal, and may exceed, the price of the oil, gas, or associated substances.

**37. ROYALTY IN VALUE.** Except to the extent that the state elects to receive all or a portion of its royalty in kind as provided in Paragraph 38 below, the lessee shall pay to the state that value of all royalty oil, gas, and associated substances as determined under Paragraph 36 above. Royalty paid in value will be free and clear of all lease expenses (and any portion of those expenses that is incurred away from the leased area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering, saltwater disposal, and preparing the oil, gas, or associated substances for transportation off the leased area. All royalty that may become payable in money to the State of Alaska must 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. The amount of all royalty in value payments which are not paid when due under this lease or which are subsequently determined to be due as the result of a redetermination will bear interest from the date the obligation accrued, until it is paid in full, at a variable annual rate equal to 1.25 percent plus the prime rate as announced from time to time by the Bank of America, San Francisco, California. Royalty payments must be accompanied by such information relating to valuation of royalty as the state may require which may include, but is not limited to, run tickets, evidence of sales, shipments, and amounts of gross oil, gas, and associated substances produced.

**38. ROYALTY IN KIND.** (a) At the state's option, which may be exercised from time to time upon not less than 90 days' notice to the lessee, the lessee shall deliver all or a portion of the state's royalty oil, gas, or associated substances produced from the leased area in kind. Delivery will be on the leased area, unit area, or at a place mutually agreed to by the state and the lessee, and must be delivered to the State of Alaska or to any individual, firm, or corporation designated by the state.

(b) Royalty oil, gas, or associated substances delivered in kind must be delivered in good and merchantable condition, of pipeline quality, and free and clear of all lease expenses (and any portion of those expenses incurred away from the leased area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering, saltwater disposal, and preparing the oil, gas, or associated substances for transportation off the leased area.

(c) After having given notice of its intention to take, or after having taken its royalty oil, gas, or associated substances in kind, the state, at its option and upon 90 days' notice to the lessee, may elect to receive a different portion or none of its royalty in kind. If, under federal regulations, the taking of royalty oil, gas, or associated substances in value by the state creates a supplier-purchaser relationship, the lessee hereby waives its right to continue to receive royalty oil, gas, or associated substances under that relationship, and further agrees that it will require any purchasers of the royalty oil, gas, or associated substances likewise to waive any supplier-purchaser rights.

(d) The lessee shall furnish storage for royalty oil, gas and associated substances produced from the leased or unit area to the same extent that the lessee provides storage for the lessee's share of oil, gas and associated substances. The lessee shall not be liable for the loss or destruction of stored royalty oil, gas and associated substances from causes beyond the lessee's ability to control.

(e) If a state royalty purchaser refuses or for any reason fails to take delivery of oil, gas, or associated substances, or in an emergency, and with as much notice to the lessee as is practical or reasonable under the circumstances, the state may elect without penalty to underlift for up to six months all or a portion of the state's royalty on oil, gas, or associated substances produced from the leased or unit area and taken in kind. The state's right to underlift is limited to the portion of royalty oil, gas, or associated substances that the royalty purchaser refused or failed to take delivery of, or the portion necessary to meet the emergency condition. Underlifted oil, gas, or associated substances may be recovered by the state at a daily rate not to exceed 10 percent of its royalty interest share of daily production at the time of the underlift recovery.

**39. REDUCTION OF ROYALTY.** Lessee may request a reduction of royalty in accordance with the applicable statutes and regulations in effect on the date of application for the reduction.



DECISION OF THE COMMISSIONER  
ON CONOCO'S APPLICATION FOR ROYALTY REDUCTION

Conoco, Inc. submitted an application to the State of Alaska Department of Natural Resources (DNR). That application requested that the State's royalty share of oil and gas produced from the Kuparuk River formation underlying five Milne Point leases be reduced from twenty percent to five percent.

Conoco's application was analyzed by the staff of the Division of Oil and Gas. Mark Myers, Petroleum Geologist, conducted a public hearing on the application, then prepared a Recommended Decision on Conoco's application. The Recommended Decision was accompanied by, and incorporated by reference, an economic analysis of the application prepared by Edward Phillips, Petroleum Economist (retired).

Normally, the Commissioner of the DNR would act on a recommended decision without further input from Conoco. However, Conoco requested and was granted thirty days in which to comment on the Recommended Decision. Conoco's comments consisted of fifty-one pages of text and twenty pages of affidavits, all of which have now been reviewed by this Commissioner.

As Commissioner, I hereby adopt the Recommended Decision as the final decision of DNR, subject to the additional findings and conclusions set forth in the remainder of this Final Decision.

In this Final Decision I do not undertake to address every alleged fact and argument raised by Conoco in its final comments. The bulk of Conoco's final comments simply state alleged facts and arguments which the hearing officer found inaccurate, unsupported,

or unpersuasive in his Recommended Decision, and which I, too, find inaccurate, unsupported, and unpersuasive. However, portions of Conoco's final comments suggest basic misunderstandings which may be cleared up by a few short words here.

First, the Milne Point Unit Agreement is not an agreement between the State of Alaska and Conoco. It is an agreement between all parties owning a working interest or overriding royalty interest in any lease within the Milne Point Unit. The State of Alaska is not a party to the Unit Agreement; rather, it simply approved the Agreement, subject to certain non-negotiable conditions. Conoco's allegation that paragraphs 1 (Enabling Act and Regulations), 14 (Royalty Settlement), and 18(h) (8) (Reduction of Royalty) of the Unit Agreement were the result of intricate negotiations between the State of Alaska and Conoco is not supported by the record. Nor is Conoco's allegation of linkage between paragraph 14 (increasing the royalty rate from 12.5 percent to 20 percent) and paragraph 18(h) (8) (limiting the availability of royalty reduction).

Second, pursuant to paragraph 14 of the Milne Point Unit Agreement, only five of the leases within the Milne Point Unit are burdened with a twenty percent royalty rate.<sup>†</sup> The remaining leases within the Unit have a 12.5% royalty rate. But paragraph 18(h) (8) of the Milne Point Unit Agreement, by its terms, applies equally to all applications for royalty reduction, whether the royalty rate of the subject leases is 12.5 percent or 20 percent. If there was the

---

<sup>†</sup> These five leases would have expired for failure to drill but for the State's approval of the Milne Point Unit Agreement.

linkage between paragraphs 14 and 13(h)(8) which Conoco suggests, then I would expect paragraph 13(h)(8) to set forth two sets of criteria for royalty reduction, one applicable to leases with a 12.5 percent royalty rate, and another for leases with a 20% royalty rate.

Third, while the Milne Point Unit Agreement may be the only unit agreement which provides for a royalty rate of twenty percent, numerous oil and gas leases issued during the time period in which the Milne Point Unit Agreement was approved also provide for a twenty percent royalty rate. No special provision was made by statute, regulation, agreement, or lease to treat differently applications for royalty reduction on leases bearing a twenty percent royalty rate from applications for royalty reduction on leases bearing a 12.5 percent royalty rate.

Fourth, even if paragraph 13(h)(8) of the Milne Point Unit Agreement governed Conoco's application (AS 38.05.180(j) and (p) having no force or effect), paragraph 13(h)(8): (a) makes relief discretionary, and (b) requires a clear showing by Conoco that the revenue from all oil and gas produced from the field is insufficient to produce a reasonable rate of return on Conoco's total investment in the field. Following the reasoning set forth in the Recommended Decision, I find that: (a) it would be an abuse of my discretion to grant the royalty reduction requested because it is not in the public interest, and (b) Conoco has failed to make

a clear showing that its revenue from the field is insufficient to produce a reasonable rate of return on its total investment in the field.

Fifth, AS 38.05.180(j) is not being applied retroactively. It was incorporated by reference in the Milne Point Unit Agreement. It is being applied to an application submitted after the statute's effective date. And it did not materially and adversely impact Conoco such as to constitute an impairment of contract.

Sixth, footnote 15 of Conoco's comments indicates that the Recommended Decision used as a reasonable rate of return "current T-Bill rates, which are ... 2.4% in real terms." In fact, the Recommended Decision used as a reasonable rate of return the average of the Treasury Bill rates for the life of the Milne Point Unit (1980-1989), which average rate approximates six percent per annum in real terms.

Seventh, when Conoco submitted an application for royalty reduction in 1985, it requested relief under AS 38.05.180(p). AS 38.05.180(p) does not require two years production before relief can be granted. However, Conoco's application was also burdened by the requirements of paragraph 18(h)(6) of the Milne Point Unit Agreement. That paragraph requires two years of production before royalty reduction can be granted. Conoco had not produced for two years from the Milne Point Unit until February 1990. Therefore, if for no other reason, Conoco's 1985 application had to be denied because Conoco had not then produced for two years.

Eighth, public utility law and oil and gas law can be distinguished on grounds other than the costs of capital for utilities and oil and gas producers. A public utility often has a single profit center; if its economic return is insufficient, its entire operation may cease. For that reason, public utility law seeks to guarantee a return adequate to assure continuing services from what is often the sole source for those services. Conversely, the major oil producers, including Conoco, have multiple profit centers. Should Conoco fail to obtain what it considers to be an adequate return on a single profit center--such as the Milne Point Unit--Conoco's other more-profitable ventures virtually assure Conoco's continued existence. But even if Conoco failed to survive, the public's supply of oil and gas is not dependent on a single producer. Therefore, neither this State's oil and gas leases nor the royalty reduction statutes need guarantee an oil producer a specific rate of return, or any return at all. I find that no guarantee of a rate of return was intended by the legislative or executive branches of this State's government.

In addition to clarifying the foregoing matters, I hereby supplement the Recommended Decision's public interest finding. Contrary to the assertions of Conoco, the public interest finding did not simply weigh cash gains and losses to the state government. The Recommended Decision determined that lost revenues to the state government would be approximately four times greater than the sum of additional royalties to the state government plus the total

value of the increase in production assured by royalty reduction.<sup>1</sup> The Recommended Decision also gave weight to additional, though speculative, production which may result from the royalty reduction. However, the Recommended Decision did not specifically or fully address certain feasible benefits of royalty reduction, probably due to their speculative and minute nature. These benefits include the following:

First, if future seismic acquisition and interpretation supports Conoco's current geologic mapping, and the State reduces its royalty to five percent, Conoco will drill two additional production wells which, based on Conoco's expectations, would produce approximately 3 million additional barrels of oil (chance factor times estimated reserves in the two largest fault blocks). This places the maximum possible additional benefit produced by the royalty reduction at 4.2 million barrels (3 million barrels of new

---

<sup>1</sup> The Recommended Decision, at page 13, states:

Assuming first that the average wellhead value for oil produced from the Kuparuk Formation is \$12 per barrel and the State's royalty is reduced from 20% to 5%, the State will lose \$64,000,000 in royalties on oil produced during the next twenty-two years, and gain \$720,000 in royalties on oil produced twenty-two to twenty-five years from now. Total recovery of additional production under a reduced royalty rate is estimated to be 1.2 million barrels of oil valued at \$14,400,000.

Assuming that the average wellhead value is \$22 per barrel and the State's royalty is reduced from 20% to 5%, the State will lose \$109,000,000 in royalties on oil produced during the next twenty-two years, and gain \$1,220,000 in royalties on oil produced twenty-two to twenty-five years from now. The total incremental volume of oil that would be achieved through a reduction in this case would be valued at \$26,400,000.

reserves plus 1.2 million barrels due to three extra years of production). The royalty value to the State of the speculative additional 3 million barrels of oil at a \$22 per barrel well head value is approximately \$3.2 million. Consequently, if royalty reduction was granted, the State would forego \$109 million in royalties to gain up to \$4.5 million in royalties from additional production.

Second, royalty reduction is virtually certain to increase production by 1.2 million barrels, and may increase it by an additional 3 million barrels. The Trans-Alaska Pipeline transports 2 million barrel per day. One million, two-hundred thousand barrels would fill the line for 19.4 hours. Three million barrels would fill the line for 15 hours. The sum of the two volumes would fill the line for just 30.4 hours.

Third, additional production from the Milne Point Unit could mean additional jobs. Based on Conoco's statement that it may be able to increase production in the event of a royalty reduction by drilling two additional wells, I estimate that no more than thirty additional workers would be employed for a period no greater than one month.

In weighing the costs and benefits of royalty reduction, foregone royalties, additional royalties, and additional production can be quantified, at least in a relative sense. Assigning dollar values to pipeline fill and additional jobs is more difficult. Yet clearly these benefits are insufficient to overcome the phenomenal costs of granting the royalty reduction requested by Conoco.

Therefore, even after considering benefits not quantified or expressly addressed in the Recommended Decision, I conclude that it is not in the public interest to grant the royalty reduction requested by Conoco.

Subject to the foregoing, the Recommended Decision on Conoco's application for royalty reduction for the Milne Point Unit is hereby adopted as the Final Decision of the Department of Natural Resources.

STATE OF ALASKA, DEPARTMENT OF  
NATURAL RESOURCES

Dated: \_\_\_\_\_

4/21/91



Harold C. Heinze, Commissioner

RECOMMENDED DECISION OF THE COMMISSIONER OF  
NATURAL RESOURCES REGARDING THE CONOCO  
APPLICATION FOR ROYALTY REDUCTION ON ADL 47433,  
47434, 47437, 47438, AND 28231 (KUPARUK  
PARTICIPATING AREA: MILNE POINT UNIT).

12/28/90

Finding and Recommendation

Conoco has applied for a reduction of its royalty from 20 percent to five percent on Kuparuk Formation oil produced from the Milne Point Unit. Given the short history of the field, the information provided in Conoco's application and its public comments on the application fail to: (1) provide a clear showing that its revenue over time will not allow for a reasonable rate of return; (2) demonstrate with any certainty that the requested reduction will significantly prolong the life of the field; or (3) demonstrate that the requested reduction would secure the proper protection of the public interest.

A clear showing of a failure to achieve a pre-determined rate of return over time requires accurate forecasting of oil prices over nearly two decades, as well as a clearer understanding of the potential total production from Milne Point, both with and without royalty reduction, than is currently available. The difficulty of reliably quantifying the latter is demonstrated by Conoco's reported decision to proceed shortly with Schrader Bluff production with the goal of ultimately tripling average daily production from the unit. On its face, it is difficult to argue the need for royalty relief at this time for a field which pays no severance tax, and for which the economics will be dramatically altered in the very near future by the operator's decision to pursue development of these shallow oil sands.

You have the discretion to approve a royalty reduction when it is determined to be in the state's best interest. However, our analysis of the potential benefits which may be gained years hence from the forbearance of substantial state royalties for the next twenty years or so, does not

appear to support such a finding in Conoco's case. For the reasons discussed more fully both below in the accompanying confidential Appendix I, I recommend that you deny Conoco's application on these bases.

The department's analysis of Conoco's application clearly illustrates the need for a policy that limits royalty relief to those instances where sufficient objective factual data, including production revenues and development expenses, are available to establish that the reduction of the state's royalty share will both prolong production and result in benefits which are demonstrably in the state's interest. In addition to maintaining a continuous, though reduced, royalty stream, those benefits could include continued employment, additional capital investments in wells and production facilities (to increase the total recovery of oil from the field) and other factors.

Although Conoco's application fails to make a clear showing of its inability to achieve a reasonable rate of return over time or of being in the state's best interest, our review of its application did point out several concerns common to any application for royalty reduction under the existing statutes. These include defining "reasonable rate of return" consistently and objectively for royalty reduction purposes, and structuring any reduction so as to be effective in achieving the desired results without unduly diminishing the state's royalty interest.

Based upon our analysis and using Conoco's application as an example, I recommend an alternative approach from that advocated by Conoco for setting a reasonable rate of return, and provide documentation to support the use of such a standard for evaluating future applications. If you agree with the use of the rate of return test which is suggested, I recommend that the division prepare appropriate draft regulations and notice them for public comment and hearing so that future applicants who may be affected have the opportunity to comment on the draft regulations.

## I. Background and Introduction

Conoco Inc. has applied for a reduction of the State of Alaska's royalty interest in oil and gas production from the Kuparuk River Participating Area of the Milne Point Unit. In its application, Conoco requests that the State's royalty interest in its production from the Kuparuk Formation only, underlying ADLs 47433, 47434, 47437, 47438, and 28231, be reduced from 20% to 5%. Conoco has not requested a royalty reduction for production from the Schrader Bluff Formation, which lies above the Kuparuk Formation throughout much of the Milne Point Unit.

Conoco submitted its formal application for royalty reduction in February 1990. However, the application was not determined to be substantially complete until July 1990. As provided for under 11 AAC 83.185, a public hearing on the application was conducted by the department on August 28, 1990. Conoco continued to submit documents in support of its application through October 9, 1990. Conoco's application has been evaluated under, alternatively, AS 38.05.180(p), AS 38.05.180(j), as it existed at the time the Milne Point Unit Agreement was executed and at the time Conoco's application was submitted, and AS 38.05.180(j), as amended in 1990 by HB 128, effective September 12, 1990.

Two key terms used in these statutes need to be clearly defined in order to make a royalty reduction determination. These terms are discussed in Parts II, III, and IV. Part III defines "field," as used in the royalty reduction context. Part IV analyzes what constitutes a "reasonable rate of return." Part V specifies why a decision to grant royalty relief is discretionary, not mandatory. Parts VI, VII, and VIII address each of the three statutory provisions listed above, as they apply to Conoco's application. Part IX refutes Conoco's assertion that Paragraph 18(h)(8) of the Milne Point Unit Agreement controls disposition of its application for a royalty reduction. Finally, this document concludes with a brief summary of this finding and recommendation.

This document is accompanied by Appendix I, an economic analysis of rates of return, the cost of capital, Conoco's confidential financial data, and the costs to the state of a royalty reduction as proposed by Conoco in this instance. Appendix I was prepared by Ed Phillips, Petroleum Economist (retired) for the Division of

Oil and Gas. Although Appendix I supports the conclusions reached herein, it cannot be part of the public record of this recommended decision. It must remain confidential due to its extensive references to Conoco's proprietary information and data which are entitled to confidentiality under state statutes.

## II. Definitions

Two key terms used in the statutes need to be clearly defined in order to make a royalty reduction determination. These terms are reasonable rate of return, and field. Since these terms lack statutory definitions for the purposes of royalty reduction, and since no previous requests for royalty reduction have been granted, these terms are examined with respect to this application. In its August 27, 1990 supplemental brief Conoco attempted to define the terms reasonable rate of return and field and presented arguments why the department should be bound by the definitions in its review of Conoco's application. The following two sections will explain why, in my opinion, Conoco's proposed definitions are inappropriate and must be rejected. Additionally, these sections will provide alternative definitions of these terms and demonstrate why these definitions are appropriate for royalty reduction analyses.

## III. Definition of a Field

AS 38.05.180(j), before and after amendment by H.B. 128, and paragraph 18(h)(8) of the Milne Point Unit Agreement restrict royalty relief to instances in which the "field" would not otherwise produce a reasonable rate of return. AS 38.05.180(j) before amendment also requires that the relief prolong "field" life. AS 38.05.180(j) after amendment by H.B. 128 requires that either the relief be necessary to prolong "field" life or restore shut-in production. Neither the royalty reduction statutes or the Unit Agreement define "field."

Conoco, in its supplemental brief submitted on August 27, 1990, stated its belief that, for the purpose of royalty reduction, the Milne Point leases contain two separate oil fields, the Kuparuk River and Schrader Bluff "Fields." It based its argument on the fact that the two oil pools are vertically separated, have different reservoir properties, and will require

different production techniques. Additionally, Conoco's brief states that the definition it offers is identical to the definition of "field" used in Texas oil and gas law. Conoco's argument for considering the Schrader Bluff and Kuparuk River oil pools as separate fields is summarized by the following statement: "Geologically distinct fields will also be economically distinct, and therefore of little utility in assessing the economics of each other." (Supplemental Brief of Conoco and Oxy USA Inc. p.25).

To support its interpretation of the definition of "field" Conoco referenced *Wotton v. Bush*, 261 P.2d 256 (Cal. 1953), in which for the purpose of well spacing requirements, an administrative officer of the California Division of Oil and Gas testified that "a field has come to be considered as that expanded area from the region of initial production to the limits of productivity in all lateral directions; and that within a given field there was no structural connection or drainage to or from other fields." It should also be noted that unlike Milne Point, the fields in the *Wotton* case were geographically (laterally) separated and not at different depths on the same leases. The *Wotton* case dealt with the issue of well spacing requirements. Appropriate well spacing is ideally determined by internal reservoir properties including porosity, permeability, heterogeneity, viscosity of oil, reservoir thickness, reservoir pressure, fluid contacts, and other factors. These properties are certainly unique to each pool and/or reservoir and often vary within the same pool or reservoir. A definition of "field" that is applicable for determining production rates, well spacing, participating areas, internal company development plans, tax credit for enhanced oil recovery, etc. may not be applicable or even appropriate to royalty reduction. This is the case with the definition proposed by Conoco.

Conoco argues that its definition is consistent with that used by industry. However, this argument is not persuasive since there is no consistent use of the term "field" within industry. For example, the Kuparuk River Formation within the Kuparuk River Oil Field consists of two separate reservoir intervals, the A and C sands of different geologic age (Valanginian vs. Hauterivian). Additionally, the sands are vertically separated by a major regional unconformity, were deposited in different

depositional settings, and have very different reservoir properties. In spite of these different properties neither industry nor the State differentiates these producing intervals when they refer to the Kuparuk River Oil Field.

For the purpose of royalty reduction, the department must define "field" in a matter that: (1) is consistent with the intent of the royalty reduction statutes, regulations, and, to the extent feasible, the Milne Point Unit Agreement; (2) is founded on accepted geologic and engineering principles; (3) can be applied impartially to all applicants for royalty reduction; and (4) will generally result in reproducible results when applied by different qualified petroleum geologists.

A royalty reduction application under AS 38.05.180(j) must comply with 11 AAC 83.185, which requires the application to:

... (2) state location and status of all past and present activities on the lease; (3) include a detailed report of all production during the six months preceding the filing of the application; (4) contain a detailed statement covering the entire life of the lease showing all expenses and costs of operating the lease, including all royalties and overriding royalties and all income from all produced minerals from the lease;

(Emphasis added). This regulation evidences the department's interpretation of "field" as clearly referring to all reservoirs underlying the lease.

This interpretation is consistent with earlier comments in a October 9, 1984 letter to Conoco from Division of Oil and Gas Director Kay Brown in which she stated, "the division has no statutory definition of 'field'..." and listed three possible geologic definitions of "field." "Field may refer (1) to a common source of supply, pool, or reservoir; (2) to multiple reservoirs vertically separated; or (3) to multiple, partially overlapping individual reservoirs...."

Further support for the department's interpretation of "field" comes from the definition of "field" used by another state regulatory agency, the Alaska Oil and Gas Conservation Commission (AOGCC). While AOGCC's

definition of "field" does not govern an application for royalty reduction, it is indicative of a definition accepted by industry in some settings. For the AOGCC, "field" is defined by AS 31.05.170(5), which states:

"field" means a general area which is underlain or appears to be underlain by at least one pool, and includes the underground reservoir containing oil and gas; and the words "pool" and "field" mean the same thing when only one underground reservoir is involved, but "field" unlike "pool" may relate to two or more pools...

For the purpose of royalty reduction requests, the department defines "field" as encompassing the lateral limits of productivity of all reservoirs or pools within the Milne Point Unit regardless of vertical stratification of reservoirs or pools underlying a lease or leases. This definition meets the standards set out earlier: (1) is consistent with the intent of the royalty reduction statutes, regulations, and to the extent feasible, the Milne Point Unit agreement; (2) is founded on accepted geologic and engineering principles; (3) can be applied impartially to all applicants for royalty reduction; and (4) will generally result in reproducible results when applied by different qualified petroleum geologists.

This definition allows the department to consider all the relevant information with regard to royalty reduction. Commonality of production and transportation facilities and well bores, as well as shared information and economy of scale provided by having multiple stacked reservoirs under a single lease are important factors in the development of an oil field. Not only do multiple stacked reservoirs have lower development costs, but their development also entails lower risk wells. For example, wells can be plugged back and produced from the shallower horizon, if the deeper horizon is not produced due to faulting, lack of net pay, well bore damage, depletion or other factors. The department's definition of "field" is similar to that used by AOGCC in that it considers multiple vertically separated pools or reservoirs underlying the same lease or leases a single "field."

Utilizing a definition that encompasses all reservoirs or pools within the Milne Point Unit also helps minimize the incentive for the operator and lessees to manipulate production and/or costs from individual reservoirs within the Unit for the purposes of affecting royalty reduction applications.

Note that the department's definition does not prohibit the commissioner from granting selective relief to individual pools or reservoirs, or even individual leases. In this case, the ability to do so is clearly stated by the Milne Point Unit Agreement and not prohibited by statute.

#### IV. Definition of Reasonable Rate of Return

Similarly, regardless of whether one is guided by State law or the Milne Point Unit Agreement, there is the potential for serious disagreement between the applicant and the department regarding what constitutes "a reasonable rate of return" for the purpose of evaluating a royalty reduction request. Without providing objective standards, both AS 38.05.180(j) and the Milne Point Unit Agreement leave it up to the commissioner to define a reasonable rate of return for royalty reduction purposes. Against this backdrop, the department has an obligation to adopt a standard that is objective and which may be applied consistently without regard to the vagaries of the financial planning standards of individual companies. Furthermore, the standard should provide a positive real rate of return (more than inflation), yet not allow for excessive profit at the expense of the state's royalty share.

Conoco has argued in its August 27, 1990 supplemental brief and in testimony at the public hearing, that, at a minimum, a reasonable rate of return, for royalty reduction, should be defined as the cost of capital to the company plus a marginal profit. There are obvious problems with this standard. First of all, such a standard would vary widely from company to company. Of the eight major North Slope producers examined, Conoco had the highest cost of capital at a nominal rate of 12.75%. Based upon information available to the department, other North Slope producers' cost of capital ranged from a low of 9.26% (Oxy) to a high of 10.26% (ARCO). Additionally, proprietary financial data of this sort are generally

not directly available to the public, rates are difficult to monitor over time, and many projects are internally financed by the companies.

Thus, defining a reasonable rate of return standard as the individual firm's cost of capital is not acceptable since it treats every firm differently. Such a standard would provide a different level of relief based upon the company, regardless of the field. To protect the state's interest, royalty relief should be based on the economics of the field and not on a company's real or perceived internal financial characteristics. Further, the standard should be impartially applicable to all lessees. A reasonable rate of return that is independent of the particular company financing involved should be adopted to avoid possible manipulation of in-house economics simply for royalty reduction purposes.

In its August 27, 1990 supplemental brief, Conoco cites a number of public utilities law cases in support of its proposed definition of rate of return. These cases are intended to demonstrate examples where the most strict standard for a reasonable rate of return is the cost of capital. However, for royalty reduction purposes, these are invalid analogs. A public utility is granted a rather generous (but capped) rate of return since it is regulated and at the same time must compete with unregulated firms in the capital market. Also, a public utility does not have an opportunity to make large profits in other settings, as does a large, privately owned integrated oil company such as Conoco. Neither Conoco's prices nor its costs are regulated by a public agency therefore, Conoco has no regulated limits on its potential profitability.

It is the potential for large profits that allows Conoco, or any other oil and gas lessee for that matter, to take the risks inherent in wildcat exploration and oil field development. This provides a freedom of operation not granted to a public utility. It is therefore only proper that a more conservative standard for rate of return be applied to Conoco, and other lessees, in determining whether, and to what extent, a reduction in the state's royalty share of production is appropriate. When all the arguments are stripped away, the stated purposes of the royalty reduction statutes are to prolong the economic life of the field and protect the public interest, not

to guarantee the state's lessees a minimum rate of return on every field which they choose to develop.

Standards other than those suggested by Conoco are available to define a reasonable rate of return. For example, the economic yardstick used by the United States Geologic Survey and the U.S. Department of Energy in recent studies has been an after-tax rate of return of 8%. Referring to the development of North Slope reserves in *Economics and the National Oil and Gas Assessment, The Case of Onshore Northern Alaska* (In press Attanasi, Bird, and Mast) the authors state "Fields were considered commercially developable if a discounted cash flow analysis showed that an after-tax return of 8 percent could be achieved. At the time of the assessment, the 8 percent hurdle rate was being used by the U.S. Department of Energy's Energy Information Administration in the national energy base case forecasts (Jon Rasmussen, Energy Information Administration, oral communication)."

Another potential yardstick for defining a reasonable rate of return is the standard used by the State of Alaska Department of Revenue (DOR) in determining reasonable shipping rates for North Slope crude for the purpose of calculating severance tax obligations. Shippers are allowed the Gross National Product deflator (GNPd) plus two percentage points return to capital as allowable expenses (profits). For the 1980-1989 period, the GNPd fell short of the 90 day Treasury bill rate by 4.4 percentage points. Otherwise stated, DOR has allowed, as a reasonable rate of return, a rate which is, on average, 2.4 percentage points less than the 90 day Treasury bill rate.

The standard which I recommend the department choose to define a "reasonable rate of return" for the purposes of this application is the rate of return for a 90 day Treasury Bill. The basis for this recommendation is more fully set out in the text of Appendix 1. For the period of 1980-1989 the real rate of return for the 90 day bill was approximately six percent. This standard compares favorably with other potential standards examined by the department.

V. Discretionary Nature of Royalty Reduction

A well established rule of interpretation specifies that "may" refers to discretionary action, while "shall" dictates mandatory action. Similarly, "may not" constitutes a mandatory prohibition.

AS 38.05.180(p) states the commissioner "may ... change ... royalty requirements ...." Paragraph 18(h)(8) of the Milne Point Unit Agreement provides that the State "may reduce Lessee's obligation to pay royalty ...." Thus, both AS 38.05.180(p) and paragraph 18(h)(8) of the Milne Point Unit Agreement permit royalty reductions, but they do not mandate royalty reductions, except where a denial of a royalty reduction would be arbitrary or unreasonable.

AS 38.05.180(j), both before and after amendment by HB 128, mandates promulgation of regulations governing applications for royalty reduction: "the commissioner shall adopt regulations ...." However, the regulations are "to allow reduction of royalty ...." The word "allow," like "may," is permissive, not mandatory. AS 38.05.180(j), both before and after amendment by HB 128, then uses mandatory language to specify one instance in which royalty reduction is not allowed: "The commissioner may not grant a reduction of royalty" unless the applicant has made a clear showing that its revenue from the field is insufficient to produce a reasonable rate of return on its total investment in the field. In short, while AS 38.05.180(j) contains some compulsory directives, it also permits denial of an application where not unreasonable or arbitrary to do so.

VI. Evaluation of Application Under AS 38.05.180(p)

AS 38.05.180(p) states:

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

of the pool, field or like area, or a part of it, when determined and certified by the commissioner to be necessary or advisable in the public interest. The commissioner may, with the consent of the holders of leases involved, establish, change, or revoke drilling, producing, and royalty requirements of the leases and adopt regulations with reference to the leases, with like consent on the part of the lessees, in connection with the institution and operation of a cooperative or unit plan as the commissioner determines necessary or proper to secure the proper protection of the public interest.

(Emphasis added).

Conoco's application, as initially submitted, represented that the Milne Point Unit Kuparuk Formation had an expected field life of twenty-five years, three years of which have almost elapsed. The original application did not indicate that the field life would be lengthened, or more oil produced, should Conoco be granted the royalty relief requested. Subsequently, Conoco amended its application, to clarify that if the State reduced its royalty to 5%, Conoco would produce 1.2 million barrels more than it would otherwise produce in the three years following the first twenty-five years of production.

In evaluating Conoco's application, the department must determine whether the public interest would best be served by the State's receipt of a 20% royalty over a remaining field life of twenty-two years, or by the State's receipt of a 5% royalty over a remaining field life of twenty-five years and the production of an additional 1.2 million barrels of oil twenty-two to twenty-five years from now. This determination cannot be made without reference to the wellhead value of Milne Point oil.

It is impossible to accurately calculate the wellhead value of production occurring over the next twenty-two to twenty-five years. The impossibility of the task is exemplified by the wide range of values for oil produced from the Kuparuk Formation in the Milne Point Unit in 1990 alone, when the reported wellhead value tripled between July and September. However, the department is able to model the effects in a gross sense by selecting a low estimated average value and a high estimated average value, then calculating the costs and benefits of granting the requested royalty reduction should values approaching either of these extremes prove accurate.

In this analysis, the department selected a low average wellhead value of \$12 per barrel and a high average wellhead value of \$22. These wellhead values were chosen to represent possible average wellhead values for the entire life of the field. These wellhead values roughly correspond with United States West Coast average prices of \$20 and \$30 per barrel, respectively.

Assuming first that the average wellhead value for oil produced from the Kuparuk Formation is \$12 per barrel and the State's royalty is reduced from 20% to 5%, the State will lose \$64,000,000 in royalties on oil produced during the next twenty-two years, and gain \$720,000 in royalties on oil produced twenty-two to twenty-five years from now. Total recovery of additional production under a reduced royalty rate is estimated to be 1.2 million barrels of oil valued at \$14,400,000.

Assuming that the average wellhead value is \$22 per barrel and the State's royalty is reduced from 20% to 5%, the State will lose \$109,000,000 in royalties on oil produced during the next twenty-two years, and gain \$1,220,000 in royalties on oil produced twenty-two to twenty-five years from now. The total incremental volume of oil that would be achieved through a reduction in this case would be valued at \$26,400,000.

Under both scenarios the cost of the royalty reduction to the State is roughly four times the combined value of the benefits, including the state's royalty share. These analyses were conducted in constant 1989 dollars. Obviously, had they been done in present value terms, the disparity between costs and benefits would have been even greater.

But there are other benefits which may be obtained by reducing the royalty rate to 5%. By letters dated May 16 and October 9, 1990, Conoco committed to expand its 3-D seismic program, and, dependent on the outcome of the seismic program, possibly drill two additional wells to evaluate three regions of the Kuparuk Formation within the Milne Point Field. These wells would be targeted to delineate the resource potential of several small fault blocks and/or the down-dip limit of the field. Conoco first termed the magnitude of reserve additions attributable to these operations as "totally speculative." Subsequently, Conoco

provided reserve estimates for one of the three regions and risk factors for all three regions. Based on the relatively low reserve estimate, coupled with the risk factor, the conditional nature of the commitment to drill, and ownership interests of other parties in the reserves, the department concludes that the potential incremental benefits of royalty reduction are insufficient to tip the scales in favor of granting the reduction requested.

Based on the extraordinary value of lost royalties, the modest benefit of a 1.2 million barrel increase in production, and the highly speculative benefits of Conoco's commitment to additional exploration and development activities, it is extremely difficult to make a finding that granting the royalty reduction which Conoco requests is either necessary or proper to secure the proper protection of the public interest.

VII. Evaluation of Application Under AS 38.05.180(j), Prior to Amendment By HB 128 in 1990

AS 38.05.180(j), as it existed at the time the Milne Point Unit Agreement was executed and at the time Conoco's application was submitted, stated:

**AS 38.05.180(j) "To prolong the economic life of an oil and gas field, the commissioner shall adopt regulations for all bidding methods to allow reduction of royalty on leases within the field to compensate for increasing costs in the later stages of production decline. The commissioner may not grant a reduction of royalty until two years' initial production from the field has occurred and each lessee requesting the reduction has made a clear showing that the revenue from all hydrocarbons produced from the field is insufficient to produce a reasonable rate of return with respect to that lessee's total investment in the field."**

(Emphasis added).

As with AS 38.05.180(p), relief under AS 38.05.180(j) is discretionary. However, the department should not exercise its discretion in favor of royalty reduction unless the reduction is in the public interest. For the reasons discussed in Part VI, above, granting the royalty reduction as requested by Conoco is not in the public interest.

To qualify for relief under AS 38.05.180(j), an applicant must establish that the relief requested: (1) follows two years initial production from the field; (2) will prolong the economic life of the field; (3) will compensate for increasing costs in the later stages of production decline; and (4) is necessary to produce a reasonable rate of return on the applicant's total investment in the field.

Conoco submitted its application for royalty reduction immediately following two years of cumulative production from the Kuparuk Formation of the Milne Point field; therefore, the requirement of two years initial production from the field has been met. However, Conoco has not established that the requested royalty reduction will significantly prolong the economic life of the field. While the field life might be extended by three years, more than twenty years in the future, the number of years added is not relevant--the number of additional barrels recovered is. Conoco's unconditional commitment to increased production is limited to 1.2 million barrels. This volume represents less than 2% of the estimated production for the Kuparuk Formation, and an even lesser percentage of estimated production for the Milne Point field. Given the cost to the State of the royalty reduction requested, the amount of potential new production 20+ years hence is almost inconsequential in both absolute and relative terms.

Having failed the second part of a four part test for royalty reduction under AS 38.05.180(j), it is unnecessary to examine elements three and four. However, brief mention of the two remaining elements is appropriate. AS 38.05.180(j) restricts royalty reduction to instances in which it will compensate for increasing costs in the later stages of production decline. First, the department has received no information that would indicate the Milne Point field is in the later stages of production decline. To the contrary, Conoco has announced plans to develop the Schrader Bluff Formation within the Milne Point with the ultimate goal of at least doubling production. Second, the department interprets this requirement as limiting the amount of relief which may be granted to that amount necessary to offset the increase in costs. It is impossible to ascertain whether royalty relief granted after three years of production in a field with an estimated field life of twenty-five to twenty-eight years would compensate for, and be commensurate with, increasing costs in the later stages of production decline. Given the volatility of future oil prices and the remoteness of late-stage costs, the

department should not conclude that this standard would be met by granting the requested royalty reduction at this time.

Finally, AS 38.05.180(j) requires the applicant to make a clear showing that the revenue generated by the field is insufficient to produce a reasonable rate of return on the total investment in the field. A clear showing requires evidence which is precise, explicit, and which directly establishes the point. It is very difficult, if not impossible, to provide such evidence here, since the Milne Point field is in the very early stages of production. Use of estimated value, production, and cost data for the remaining twenty-two to twenty-five year life of the field adds a high level of uncertainty to determining the long-term validity of any purported "need" for Conoco's royalty reduction. Particularly disturbing is the unreliability inherent in estimating the value of oil to be produced over the next twenty-two to twenty-five years. As mentioned earlier, this unreliability is dramatically underscored by the tripling of reported wellhead values from the Milne Point Unit between July and September 1990.

Estimating revenue from future production is further complicated by a lack of knowledge regarding the potential volume and value of future production from other pools in the Milne Point field, such as the Schrader Bluff Formation, as well as by price and technology sensitive enhanced oil recovery techniques which may significantly increase total production from all reservoirs or pools within the Milne Point field.

On the other hand, since much of the major field facility development has already occurred, the cost estimates for the remaining field life are easier to approximate. According to the data submitted by Conoco on June 13, 1990, about 87% of the capital investment in field facilities has been completed, leaving only relatively minor capital investment expenses to be estimated. This, however, does not include the costs associated with Schrader Bluff development and production.

In short, the department may reasonably conclude it impossible to make a clear showing that the revenue generated by the Milne Point field over its entire life will be insufficient to produce a reasonable rate of return on the total investment in the field when but a small fraction of the minimum estimated field life has transpired.

In conclusion, Conoco's application should not be granted as requested under AS 38.05.180(j) (as it existed before amended by HB 128). Conoco has not established that reducing the royalty rate on the Kuparuk Formation from 20% to 5% would significantly prolong the life of the Milne Point field. A minimal extension of the field at a very high cost to the State is not in the public interest. Furthermore, the uncertainties inherent in estimating revenue and costs for the next twenty-two to twenty-five years allow the commissioner to conclude that Conoco cannot adequately show either the magnitude of increasing costs in the later stages of production decline or total field life rate of return.

**VIII. Evaluation of Application Under AS 38.05.180(j), As Amended  
By HB 128 in 1990**

AS 38.05.180(j) was amended by HB 128, effective September 12, 1990. It now reads:

To prolong the economic life of an oil and gas field or to reestablish commercial production of shut-in oil or gas that would not otherwise be economically feasible, the commissioner shall adopt regulations to allow reduction of royalty on leases. The commissioner may not grant a reduction of royalty unless the lessee requesting the reduction makes a clear showing that the revenue from the lessee's share of all hydrocarbons produced from the field is and is likely to continue to be insufficient to produce a reasonable rate of return with respect to the lessee's total investment in the field. The commissioner may condition a royalty reduction granted under this subsection in any way to protect the state's interest, including restoration of the state's royalty share in the event of an increase in the price of oil or gas. Before approving a royalty reduction, the commissioner shall make a written finding that the state has obtained the maximum possible economic return that is compatible with allowing a reasonable rate of economic return for the lessee, and send copies of the finding to all members of the legislature.

(Emphasis added).

As with AS 38.05.180(p), and AS 38.05.180(j) prior to its amendment by HB 128, relief under the amended standard is discretionary. The department, however, should not exercise its discretion in favor of royalty reduction unless the reduction is demonstrated to be in the public interest. For the reasons discussed in Part VI, above, granting royalty reduction as requested by Conoco, in this instance is not in the public interest.

Under AS 38.05.180(j) as amended by HB 128, royalty relief cannot be granted unless it will either prolong the economic life of an oil and gas field or reestablish commercial production of shut-in oil or gas that would not otherwise be economically feasible. The royalty reduction requested by Conoco will not substantially prolong the economic life of the Kuparuk Formation or Milne Point field for the reasons discussed in Part VII, above. Nor is the Kuparuk Formation shut-in as it was for several months before Conoco submitted its application. Therefore, Conoco's application fails these alternative requirements of AS 38.05.180(j), as amended by HB 128.

As 38.05.180(j), as amended, also retains the requirement of a clear showing that revenue from the field is insufficient to produce a reasonable rate of return on total field investment. The department's analysis of this requirement is the same under both the former AS 38.05.180(j) and its current amended version. (See Part VII, above).

The 1990 amendment to AS 38.05.180(j) specifies that an application for royalty reduction cannot be approved unless the commissioner makes a written finding that the State has obtained the maximum possible economic return that is compatible with allowing a reasonable rate of economic return for the applicant. Due to volatile oil prices, risks inherent in oil and gas production, and uncertain future costs, the department cannot find that the State will obtain its maximum possible economic return without providing for the recapture of foregone royalties in the event a lessee ultimately achieves more than a predetermined reasonable rate of return. However, in this instance the department need not craft a limited or conditional royalty relief, since the royalty relief requested is inappropriate for other reasons, as discussed above.

IX. Milne Point Unit Agreement, Paragraph 18(h)(8)

Conoco argues in its August 27, 1990 supplemental brief that paragraph 18(h)(8) of the Milne Point Unit Agreement governs its application for royalty reduction; and that AS 38.05.180 (p) and (j) apply only to the extent that they are not inconsistent with the unit agreement. Paragraph 18(h)(8) states:

Reduction of Royalty. After two years' initial production from the field in which the leased area is located has occurred, the State may reduce Lessee's obligations to pay royalty on all of the leased area or on any tract or portion thereof segregated for royalty purposes upon (1) request by Lessee and (2) a clear showing by Lessee that the revenue from all oil, gas and associated substances produced from the field is insufficient to produce a reasonable rate of return with respect to Lessee's total investment in the field.

Conoco's argument that paragraph 18(h)(8) prevails where inconsistent with AS 38.05.180(p) or (j) appears to be based on an incomplete reading of paragraph 1 of the Unit Agreement, which states:

The Alaska Land Act ... and all valid and pertinent oil and gas statutes and regulations including the oil and gas operating statutes and regulations in effect as of the effective date hereof or hereafter issued thereunder governing drilling and producing operations, not inconsistent with the terms hereof or the laws of the State of Alaska are hereby accepted and made a part of this agreement.

(Emphasis added). Conoco chooses to ignore that all statutes not inconsistent with the laws of the State of Alaska are incorporated by reference in the Unit Agreement. Since the statutes are the laws of the State of Alaska, they cannot be inconsistent with the laws of the State of Alaska (except to the extent that one or more statutes are contrary to the United States or Alaska constitution). Therefore, AS 38.05180(j) and (p) are incorporated by reference in the Unit Agreement, and are thus every bit as much a part of the Unit Agreement as is paragraph 18(h)(8).

In any case, a state agency is without authority to enter into an agreement in conflict with applicable statutes. Thus, even without an explicit incorporation of

Alaska's statutes by reference in Paragraph I of the Milne Point Unit Agreement, the statutes control when in conflict with the Unit Agreement.

X. Summary

In this instance, I have recommended that the requested royalty reduction should be denied under AS 38.05.180(p), (j), and (j), as amended by H.B. 128 since the department concludes that Conoco has failed to demonstrate:

- (1) that granting the requested royalty relief will be in the public interest;
- (2) that reducing the royalty from 20% to 5% will significantly prolong the economic life of the field; and
- (3) a clear showing that its revenue from oil, gas, and associated substances produced from the field is insufficient to produce a reasonable rate of return with respect to Conoco's total investment in the field.

The statutes and regulations do not discuss the quantity or quality of data needed to demonstrate a clear showing (though, obviously, "clear showing" is a high standard) that Conoco's revenue from the field is insufficient to produce a reasonable rate of return with respect to its total investment in the field. Similarly, the statutes and regulations do not list precisely the quantity or quality of data needed to demonstrate that the economic life of the field will be significantly prolonged by a royalty reduction. These determinations must be made by the commissioner based on the discretionary power granted by the statutes, department regulations, and the Milne Point Unit Agreement. However, it becomes apparent that, especially in the case of a field such as Milne Point, with only a few years of production history, determining the long term profitability of the field with any certainty is virtually impossible.

In order to thoroughly evaluate Conoco's application, an extensive financial, economic, and technical analysis was completed by the department. While I recommend that the department deny the application, this analysis provides a groundwork for evaluating future royalty reduction requests since this was the first request completely processed by the department.

Even though it is recommended that Conoco's application for a royalty reduction to 5% be denied, the division felt obligated to carefully analyze the data submitted to determine if an alternative approach for royalty reduction could be developed which would meet the statutory requirements. Among the possibilities examined were a sliding scale royalty based on wellhead value, short term relief, relief down to a floor of 12.5% and combinations of these three methodologies. These limited and/or conditional alternatives to a complete denial were determined to be unacceptable since in all cases examined, even ignoring Conoco's failure to make a clear showing, the estimated return to the state and public was substantially less than the estimated revenue lost by the state in forgone royalty. Therefore, even a limited or conditional royalty does not appear to be in the public interest at this time.

# Mozambique gas field marked for development

Mozambique's state owned Empresa Nacional de Hidrocarbonetos de Moçambique (ENH) and South Africa's Sasol Ltd., Johannesburg, plan a \$700-\$850 million joint field development project.

Pande gas field in Mozambique, which lies 20 km inland and 600 km northeast of Maputo, will be developed to supply gas by pipeline to markets in the Johannesburg area.

A Sasol official said Argentine company Pluspetrol SA has been brought in as operator of field development. A pipeline company also is being sought to join in the project with a minority interest in the field.

Pipeline companies have been approached by ENH and Sasol, which expect to select a partner in September. ENH and Sasol expect to begin development as soon as the pipeline partner is chosen.

Pande field interests have not been settled, although ENH and Sasol will almost certainly be major shareholders under a production sharing agreement.

## Pande field

Pande field was discovered by Gulf Oil Corp. in 1961, but development was hampered by Mozambique's unstable political situation, said project financial adviser Morgan Grenfell & Co. Ltd., London.

The bank said ENH began appraisal of the field in 1989 and concluded in 1991 that field development was viable. An agreement with Sasol in Feb-

ruary 1992 was said to be key because Mozambique's gas market is small.

"While Sasol is likely to invest in the upstream field development," said the bank, "its most important role will be to offtake most of the gas under a long term take or pay contract, develop the local market, and build the distribution system."

Eleven wells drilled so far have proven Pande field reserves to be about 1.7 tcf of gas. The gas is said to be dry, high in methane content with no sulfur. Sasol said further appraisal drilling is planned, with the intent to confirm more reserves before development proceeds.

Morgan Grenfell said reserves discovered to date are expected to support projected market demand for at least 20 years.

## Gas pipeline

The ENH-Sasol combine plans to lay a 905 km pipeline from Pande field to Secunda, 100 km east of Johannesburg. About two thirds of the line will be in Mozambique and the rest in South Africa.

Morgan Grenfell said the proposed pipeline route is via the Ressano Garcia/Komatipoort border crossing, with a spur line to Durban and offtakes to Nelspruit, Ngodwana, Bethal, and Pretoria and a lateral line to Maputo.

Two spur line options are being considered: a 605 km line from Ressano Garcia to Durban via Maputo and a 540 km line from Badplaas in the Transvaal to Durban with a separate

spur to Maputo.

Capital cost of the pipeline is estimated at \$400-500 million, including compressors. Line diameters will range from 16 to 24 in.

Design, procurement, construction, and commissioning of the system are expected to take about 28 months.

## Energy markets

Morgan Grenfell estimates South Africa's total primary energy demand is 84 million metric tons/year of oil equivalent. Coal is estimated to provide 80% and is used to produce electricity, gasoline, diesel fuel, and fuel gas.

The Johannesburg area is said to hold 45% of South Africa's urban population and 45% of the country's industrial capacity.

"The South African energy market expects significant growth rates in coming years, and consumers are eager to investigate the use of gas," Morgan Grenfell said.

"Detailed market surveys conducted recently by Sasol suggest a penetrable market for gas of 64 bcf/year, mostly in the paper, metals, mineral processing, and chemicals sectors."

The bank said 76% of potential gas customers currently use coal, with gas derived from coal the second largest energy source.

Total gas use in the Maputo area is predicted to reach 19 bcf/year by 2010, with nearly 15 bcf/year being required for power generation and the remainder for industry.

# Deepwater royalty relief to get Clinton support

The Clinton administration is preparing to support U.S. legislation that would provide royalty relief for new deepwater production and any production off Alaska.

Bill White, deputy secretary of the Department of Energy, told the Senate energy committee the administration will support a bill the panel has approved but then qualified that support.

White explained the administration could not support the deepwater—more than 200 m—relief bill and a separate proposal for a \$5/bbl tax credit for deepwater production. The administration will study the latter measure and report back to Congress soon.

White, who sits on a White House task force studying energy issues, said

the bill "makes sense," but to approve deepwater relief, which would grant a royalty holiday until operators recover their cost of developing otherwise uneconomic fields, and a \$5 credit might be "overkill."

Sen. Bennett Johnston (D-La.), energy committee chairman, argued the two proposals are not mutually exclusive because the legislation would not apply to projects that were otherwise economic to develop. Johnston said he soon will press for action on the bill by the full Senate.

Thomas H. Neel, CNG Producing Co. chief executive officer, told the committee. "This is an innovative approach which would provide the economic incentive to develop already discovered domestic hydrocarbons.

"It would be particularly important

to companies like CNG, the large independents which are becoming so important in the gulf but do not have financial resources of the majors."

## Other issues

The energy committee bill also would order the Minerals Management Service not to revise the present area-wide leasing system in the central and western Gulf of Mexico. MMS is renewing possible changes to its leasing approach.

And the bill has a provision to amend the 1990 Oil Pollution Act so its oil spill insurance requirements would apply only to offshore facilities and allow MMS to mandate less than the \$150 million of insurance required in the original bill.

Assistant Interior Sec. Robert Arm-

THE PRECEDING PAGES  
WERE TREATED AS A UNIT  
IN THE ORIGINAL FILE

TONY KNOWLES  
GOVERNOR



STATE OF ALASKA  
OFFICE OF THE GOVERNOR  
JUNEAU

HB 207  
PO Box 110001  
Juneau, Alaska 99811-0001  
(907) 465-3500  
Fax (907) 465-3532

February 27, 1995

The Honorable Gail Phillips  
Speaker of the House  
Alaska State Legislature  
State Capitol  
Juneau, AK 99801-1182

Dear Speaker Phillips:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill relating to the reduction of royalties reserved to the state to encourage otherwise uneconomic production of oil and gas from marginal fields and to prolong the production life of declining fields.

The bill would change existing royalty reduction provisions to grant the commissioner of the Department of Natural Resources greater discretion to provide royalty relief to lessees when necessary and clarify the commissioner's authority to grant such relief under various provisions in AS 38.05.180.

The proposed changes will require the lessee to make a clear and convincing showing that a royalty reduction is necessary and is in the best interest of the state. The commissioner may condition granting of a royalty reduction in any way necessary to protect the state's best interests, such as increasing the state's royalty share if the price of oil or gas rises.

Finally, the bill maintains the royalty contributions to the permanent fund so that the fund would never receive a royalty less than that provided under existing statutes.

I urge your favorable action on this bill.

Sincerely,

A handwritten signature in dark ink, appearing to read "Tony Knowles".

Tony Knowles  
Governor

## CS FOR HB 207(FIN)AM QUESTIONS & ANSWERS

### A. Purpose

#### 1. What, generally, does the bill accomplish?

This legislation amends current law to give the Commissioner of the Department of Natural Resources (DNR) authority to grant royalty reduction for fields that have been delineated, but not produced. The current law allows the commissioner to grant royalty reduction to prolong the economic life of a field or to reestablish shut-in production. The bill requires that the applicant make a clear and convincing showing that any reduction meets certain requirements and is in the best interests of the state. As part of the application the commissioner shall require the applicant to provide financial and technical data (which may be kept confidential at the request of the applicant) to assure that the requirements are met and that a royalty reduction is warranted. If the commissioner determines that a third-party analysis of the submitted data is necessary, then he may require that the applicant pay for this analysis. This bill also provides that if relevant factors change in the future, then the commissioner may raise the royalties that were previously reduced. The commissioner must condition royalties if oil price changes.

- These reductions may be applied only if one of the three "trigger events" is met:
- Fields that are delineated, but not previously produced, to allow production that would not otherwise be economically feasible.
- Oil and gas fields whose economic life may be prolonged in light of increasing costs in the later stages of production.
- Reestablishing commercial production of shut-in oil or gas that would not otherwise be economically feasible.

Before approving any royalty reduction, the commissioner must issue written findings assuring compliance with the requirements of this section and that the best interests of the state are preserved. The legislation also requires the commissioner to give notice of his preliminary findings and determination to the legislature and public, and allow for comment before adopting final findings and determination. The current committee substitute also states that the commissioner shall offer to provide the LB&A committee a review of the preliminary findings and determination.

#### 2. Why is a change in the law necessary?

A change is necessary for three reasons. First, a change will help to make Alaska more competitive on a worldwide basis for oil companies' investment dollars. The legislation would give the commissioner greater flexibility than exists under current law and authority to reduce the royalty rate on fields that have been delineated, but have not previously produced oil or gas. Second, it would change the economic standard for a reduction for a mature field to a

point-forward or incremental analysis from a historical investment analysis which is not relevant to a decision whether to abandon or continue producing a field. Third, it would clarify the authority to reduce royalty under AS 38.05.180 (j) & (p).

## B. Standards

1. The "best interest" standard seems vague. Should the legislature define the criteria that must be considered in making a best interest decision? Should the legislature maintain the requirement in existing law that the commissioner must find that the "state has obtained the maximum economic return that is compatible with allowing a reasonable rate of return for the lessee"?

Before talking about further defining the best interest standard, there already is a clear limit on the commissioner's authority. The current statute permits the commissioner to grant royalty reduction only if one of two trigger events is met. As discussed above, the legislation would add a third trigger event -- a delineated field that would not otherwise be economically feasible to produce. Only if that showing is met, which must be met by clear and convincing evidence, is the commissioner authorized to even consider whether he should grant royalty relief.

If the commissioner makes a finding that one of the trigger events has been met, then he must decide whether the reduction would be in the best interest of the state before a reduction would be granted. This standard, or a similar standard, is used throughout the statutes without explicit criteria set forth. For example, AS 38.05.180(p) gives the commissioner authority to unitize oil and gas leases if he determines it is necessary to "secure the public interest."

Importantly, DNR has already discussed the best interest standard in connection with Conoco's royalty reduction application. In a published decision document, then Commissioner Heinze noted that the "public interest finding (does) not simply weigh cash gains and losses to the state government" although he determined that lost revenues to the state government would be approximately four times greater than the sum of additional royalties to the state government. The commissioner considered: (1) the effect on the total royalties that would be paid; (2) the additional projected recovery of oil; (3) the ability of the project to render a positive cash flow; (4) the desirability of encouraging further investment that has a direct benefit to the state; (5) the effect of additional production on TAPS throughput; and (6) the benefits of additional employment. At a minimum, the commissioner would consider these factors in making any decision.

The legislature, of course, remains free to put sideboards or restraints on the commissioner's discretion, but any sideboard or restraint could effectively restrain the commissioner's ability to craft practical relief for a given field or reservoir. The current version of the bill requires the commissioner to change the royalty rate if the price of oil changes.

Finally, DNR opposed an amendment to reinstate the "maximum possible economic return to the state" standard. DNR believes that the economic standard set forth in the trigger events is adequate. Moreover, the maximum economic standard is an impossible standard to define, let alone meet.

2. Why does the legislation change the standard for royalty reduction for mature producing fields?

The legislation actually clarifies the confusing old standard of reasonable rate of return on total investment. The old standard is unworkable for fields in the later stages of production. For these fields, the analysis should be based on expected future costs and future revenues. Past profitability has little to do with the decision to produce or abandon a field today or tomorrow. Abandonment decisions are based on a point-forward analysis, not historical performance.

3. Why does the legislation change the standard of persuasion from "clear" to "clear and convincing"?

The "clear and convincing" standard is a term of art in the law which has been defined by the courts and has an accepted definition. A "clear" standard has not been so embraced. This led to a dispute between DNR and Conoco & Oxy in their application for royalty reduction. The issue was pending before the superior court, but had not been decided, when the parties settled. The change was made in hopes of avoiding litigation.

4. The legislation is non-specific about when and how the royalty could increase. Shouldn't it be more specific?

This provision is basically the same as existing law. Specifying when and how the royalty must increase would take away flexibility. Presumably, the commissioner's decision would provide for an increase if prices increase or costs decrease. However, under the governor's bill, there would be flexibility to tailor the terms to the specific facts. The commissioner's final finding or determination would include the terms providing for the increase.

5. What does the term "delineated" mean? Should the term be defined in the statute?

DNR believes that the term "delineated" is a term of art in the industry. Its generally accepted definition is that there is sufficient knowledge of the aerial extent, volume, and productivity of the field to allow a lessee to decide whether to proceed with development and production, including determining costs to develop and produce the field. In other words, delineation is the process by which a resource in a previously discovered accumulation makes the transition to "reserves." Reserves are resources demonstrated with reasonable certainty to be recoverable from a known accumulation under existing economic and operating conditions.

The requisite information varies from field to field and no specific test would suffice for all fields. The information pertinent to making the decision would include drilled wells, seismic data and interpretations, and engineering data on the reservoir's characteristics, including well flow test data of sufficient duration to provide estimates of future development well productivity.

DNR believes that any attempt to specifically define "delineated" would likely create as many problems as it solves.

6. What do the terms "field" and "pool" mean?

The meaning of the term "field" was disputed in the Conoco & Oxy application process. DNR defined the term to include all reservoirs or pools underlying the lease or unit area. "Pool" means an underground reservoir containing a common accumulation of oil or gas. Each zone of a general structure which is completely separated from any other zone in the structure is covered by the term "pool." The terms "pool" and "field" mean the same thing when only one underground reservoir is involved, but "field" - unlike "pool" - may relate to two or more pools. To prevent future disputes, and to increase flexibility, the bill references both "field" and "pool."

7. Can the royalty reduction apply to a single pool on a given lease, as compared to all production from the lease?

The legislation would give the commissioner that discretion. If there had been production from one pool in a field, but not another pool, the commissioner would have authority to consider a royalty reduction only for some or all of the second pool if it had been delineated. Future discoveries or developments on the lease would not be automatically granted a reduction.

On leases that have been developed, such as the Kuparuk-West Sak situation, DNR wants the latitude to consider royalty reductions for the West Sak reservoir, while retaining the original royalty rate for the deeper Kuparuk reservoir.

8. Would the royalty reduction be granted for the entire field or unit area?

The reduction, if granted, would be granted on a lease by lease basis. The lease or unit agreement establishes the royalty rate, and it is the lease or unit agreement that needs to be amended if the royalty rate is to be changed. Of course, the reduction could apply to all leases within the unit area.

9. Would the bill allow the Commissioner to reduce the royalty rate at the state's largest fields, including Prudhoe Bay?

No. The new trigger event in the bill would not allow a royalty reduction for a field like Prudhoe Bay. Both gas and oil have been produced and sold from that field. Consequently, it could not qualify under the new trigger event of a delineated, but not produced field. Simply put, a reduction is not necessary to get the field developed. At some point in the distant future when the field is in steep decline, Prudhoe Bay may become eligible for a reduction under one of the other two trigger events contained in the current royalty reduction statute.

10. What does the term "reasonable rate of return" mean in the current legislation?

DNR recommends dropping the term. This term led to serious disagreements between an applicant and DNR. DNR felt obliged to adopt an objective standard which could be applied consistently regardless of the vagaries of an individual company's financial planning standards. Recognizing that neither the state's oil and gas leases nor statutes guaranteed a company a specific rate of return, or any return at all, Commissioner Heinze adopted a standard – the return on a 90 day Treasury bill – which provided a positive real rate of return, but did not provide an excessive profit at the expense of the state's royalty share. Other potential rates considered by DNR included: (1) the individual company's cost of capital plus a marginal profit; (2) a public utility type rate of return; (3) the economic yardstick used by DOE to determine if a field is commercially developable; (4) the long-term bond yield; and (5) the rate allowed by DOR in determining reasonable shipping rates for severance tax purposes. As noted previously, once a field is developed (i.e., major investments sunk) any revenue in excess of operating costs is sufficient to keep the field in production.

### C. Appealability & Confidentiality

1. The non-appealability clause seems unusual. Why is it in the bill?

The clause has two purposes: The first is to make clear that the statute does not confer on a lessee a right or entitlement to a royalty reduction. Even if the lessee makes a showing that the lessee could not economically produce the field, there is no duty on behalf of the commissioner to grant royalty relief. DNR makes a business judgment whether the state would rather have production on a reduced royalty basis or take back the leases and attempt to relet them. Moreover, the commissioner may have to consider other factors, such as the effect on the bidding process and on the environment, in determining whether a royalty reduction should be granted.

There is some federal law on the subject of royalty reductions on federal leases. Under federal law the Secretary of Interior has authority to reduce a lease's royalty rate under certain circumstances. But federal law holds that:

[There are] no circumstances which require BLM to reduce royalty. Under the statute, no entitlement to such a reduction can ever arise. BLM

remains free to accept the economic consequences of denying royalty relief, which may vary from case to case. ... The discretionary authority conferred by (the federal royalty reduction statute) enables BLM to exercise prudent business judgment to accept the alternative that best protects the economic interest of the United States as owner of the mineral resources.

Peabody Coal Co., 93 IBLA 317, 326 (1986) (emphasis added).

Given that there is no entitlement or no right to a royalty reduction, the second purpose is to preclude expensive, time consuming litigation, which can have no basis, by the applicant whose application has been denied. The intent of the provision is to preclude the applicant from appealing. The courts have rejected an argument that there is a constitutionally guaranteed minimum right of judicial review where the "administrative activity ... involves the grant or denial of a privilege which the state government is free to allow or withhold in its discretion ...." Cooper, State Administrative Law 677 (1965). The Department of Law believes that the commissioner's determination regarding a royalty reduction application would fall into that category and thus the court would likely give effect to a provision precluding judicial review.

The general rule, according to Professor Davis, one of the foremost authorities on administrative law, is that:

[I]f a statute unequivocally precludes judicial review of an agency action, and judicial review is sought on any basis other than a claimed violation of a constitutional right, the Court will give statute effect... When the scope and effect of an explicit statutory limit on judicial review is less clear, however, and the Court perceives a significant risk of unfairness if the statutory limit is given broad effect, the Court sometimes strains to interpret the limit narrowly.

Davis, Administrative Law, §17.8 at 155. The court could read into the finality provision an implied exception permitting review of constitutional questions, questions regarding the jurisdiction of the agency and the regularity of its procedure, questions affecting the existence of property rights, questions involving bad faith, or questions regarding fraud. Cooper, supra at 679.

The Alaska Supreme Court has stated that a "legislative statement of finality is one which we will honor to the extent that it accords with constitutional guarantees." K & L Distributors, Inc. v. Murkowski, 486 P.2d 351, 357 (Alaska 1971). It is likely that the court will attempt to whittle down any finality language to size to fit the court's sense of fundamental fairness. In other words, a statement of finality will not prevent the court from reviewing the decision to assure compliance with the due process clause under the Alaska constitution. Nevertheless, a finality provision will mean that any review of a royalty reduction decision will

be much more limited than the broad review of an agency decision required by the Alaska Administrative Procedure Act. For example, the court would not review each factual finding to see that it is correct, or even that it is supported by substantial evidence. The court would only examine the commissioner's decision to determine whether it has "passed beyond the lowest limit of the permitted zone of reasonableness to become capricious, arbitrary or confiscatory." *Id.* at 358. Given this, we believe that it is less likely that a disgruntled lessee would appeal and, therefore, more likely needless court expense would be saved.

2. Should the commissioner's decision be subject to legislative review?

The administration does not object to some type of legislative oversight. The administration believes that the legislature could request a briefing even without a specific provision in the bill. The administration notes that at least one company has opposed a proposed amendment which would have provided for a confidential briefing by the commissioner of the legislature.

3. Why does the bill contain confidentiality provisions?

The confidentiality provision in the bill is no different than existing law. The purpose of this provision is to protect a company's competitiveness relative to other companies. Obviously, a company which has spent millions of dollars to acquire geological, geophysical, and engineering information regarding a potential oil field does not want that information revealed to other companies. Furthermore, releasing financial information about the company would reveal the company's underlying economic philosophy regarding exploration and development and, thus, disadvantage the company with respect to its competitors. The confidentiality provision actually promotes the disclosure of complete and frank information to the state. Given industry's testimony at the hearings, it is likely that without a confidentiality provision for new fields, no company would apply for royalty relief and the benefits of the bill would be lost. Nevertheless, the bill allows the company to disclose its information to the public if it desires.

**D. Miscellaneous**

1. Why does the legislation delete the provision in former law that the commissioner shall adopt regulations?

Such a provision is unnecessary and would delay the implementation of any new program. Under current law, the commissioner already has the authority to adopt regulations necessary to carry out the purposes of the Alaska Land Act. AS 38.05.020(b)(1). There are already existing regulations which define the procedure for submitting an application for reduction under AS 38.05.180(j). 11AAC 83.185. DNR would plan to amend those regulations to deal with the proposed changes in the statute. DNR, however, does not want to be required to

implement regulations because that could delay implementation of any new statutory changes. The current law allows the commissioner to adopt regulations if needed.

2. Do you have any concerns that the legislation will undermine the competitive bidding process?

The commissioner will have to consider this issue in determining whether a reduction is in the state's best interest. Certainly, if the royalty rate is the bid variable this is a very real concern. In general, the closer the reductions to the time of the bid, the greater the concern. That is one of the reasons why the former law provided for a two year production requirement. That requirement, however, proved unworkable and the legislature dispensed with that requirement in 1990 to allow the commissioner more flexibility.

The proposed amendment tries to balance the need to protect the bidding process with the need to get marginal fields timely developed. For example, a reduction cannot take place until the lessee at least does delineation work. In other words, the commissioner could not grant a reduction the day after the lease sale. More importantly, the commissioner cannot grant a reduction unless the lessee makes a clear and convincing showing that absent relief the field would not otherwise be economically feasible. In making that determination and deciding whether granting relief would be in the state's best interest, the commissioner will have to examine whether other potential lessees would develop or produce the field without royalty relief.

The Alaska Supreme Court has recognized a competitively bid government contract can be amended under certain circumstances without jeopardizing the competitive bid process. Kenai Lumber Co., Inc. v. LeResche, 646 P.2d 215, 220-22 (Alaska 1982). Importantly, every state oil and gas lease contains a royalty reduction so all competitive bidders were on notice that the royalty could be reduced under appropriate conditions.

4. Is it legally required that the permanent fund be held harmless?

Probably not, but a concern has been raised. Article IX, Section 15, provides that: "At least twenty-five per cent of all mineral lease rentals, royalties, royalty sale proceeds ... **received by the state** shall be placed in a permanent fund." The Department of Law believes that the most likely interpretation of the constitutional provision is the permanent fund gets 25% of whatever the state gets and if the state gets a lesser or greater royalty for that matter, the permanent fund gets 25% of that amount.

An argument can be made that the provision means the permanent fund gets 25% of the original royalty rate specified in the lease and the legislature or the commissioner cannot change the amount, at least for the permanent fund. The Department of Law does not believe that such an argument would be persuasive to a court. There have been statutory and lease provisions providing for royalty reduction in one form or another since statehood. These

provisions were in effect at the time the permanent fund provision took effect and no special provision was enacted to keep the permanent fund whole in that instance. Consequently, we believe the permanent fund takes its 25% share subject to the possibility that the royalty share may be reduced. In short, the permanent fund gets at least 25% of whatever the state receives.

A good example would be the administration of the former royalty reduction statute (which still applies today on some of the older leases). That statute provides for reduction of the royalty rate to 5% on a lease where a discovery is made. In that case, the permanent fund has not been held harmless or kept whole. The permanent fund gets 25% of the reduced rate, no more or no less.

The current committee substitute deletes the permanent fund hold harmless provisions which were in the bill as originally introduced. Regardless of whether the bill contains hold harmless provisions, the administration supports a floor for any reduction that does not exceed 75% of the applicable royalty rate.

**HB**

**208**

# FISCAL NOTE

No. 1  
 Bill Version: CSHB 208 (FSH)  
 (H) Publish Date: 4/3/95

**STATE OF ALASKA**  
**1995 LEGISLATIVE SESSION**

Revision Date: \_\_\_\_\_  
 Title: Seafood Processing Standards  
 Sponsor: Representative Moses  
 Requestor: H(FSH)

Department Affected: Environmental Conservation  
 BRU: Environmental Health  
 Component: Seafood Sanitation Inspection

COMPONENT SERIAL NO. 1936

**Expenditures/Revenues:**

(Thousands of Dollars)

| OPERATING EXPENDITURES | FY 96      | FY 97      | FY 98      | FY 99      | FY 00      | FY 01      |
|------------------------|------------|------------|------------|------------|------------|------------|
| PERSONAL SERVICES      | 00         | 00         | 00         | 00         | 00         | 00         |
| TRAVEL                 | 00         | 00         | 00         | 00         | 00         | 00         |
| CONTRACTUAL            | 00         | 00         | 00         | 00         | 00         | 00         |
| SUPPLIES               | 00         | 00         | 00         | 00         | 00         | 00         |
| EQUIPMENT              | 00         | 00         | 00         | 00         | 00         | 00         |
| LAND & STRUCTURES      | 00         | 00         | 00         | 00         | 00         | 00         |
| GRANTS/CLAIMS          | 00         | 00         | 00         | 00         | 00         | 00         |
| MISCELLANEOUS          | 00         | 00         | 00         | 00         | 00         | 00         |
| <b>TOTAL OPERATING</b> | <b>0.0</b> | <b>0.0</b> | <b>0.0</b> | <b>0.0</b> | <b>0.0</b> | <b>0.0</b> |

|                      |    |    |    |    |    |    |
|----------------------|----|----|----|----|----|----|
| CAPITAL EXPENDITURES | 00 | 00 | 00 | 00 | 00 | 00 |
|----------------------|----|----|----|----|----|----|

|                    |    |    |    |    |    |    |
|--------------------|----|----|----|----|----|----|
| CHANGE IN REVENUES | 00 | 00 | 00 | 00 | 00 | 00 |
|--------------------|----|----|----|----|----|----|

**FUND SOURCE**

|                          |            |            |            |            |            |            |
|--------------------------|------------|------------|------------|------------|------------|------------|
| 1002 Federal Receipts    | 00         | 00         | 00         | 00         | 00         | 00         |
| 1005 State Funds         | 00         | 00         | 00         | 00         | 00         | 00         |
| 1008 GF                  | 00         | 00         | 00         | 00         | 00         | 00         |
| 1009 GF Program Receipts | 00         | 00         | 00         | 00         | 00         | 00         |
| 1009 GF MDTA             | 00         | 00         | 00         | 00         | 00         | 00         |
| Other                    | 00         | 00         | 00         | 00         | 00         | 00         |
| <b>TOTAL</b>             | <b>0.0</b> | <b>0.0</b> | <b>0.0</b> | <b>0.0</b> | <b>0.0</b> | <b>0.0</b> |

Estimate of any current year (FY95) cost: \$ 0.0

**POSITIONS**

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

**ANALYSIS** (Attach a separate page if necessary.)

The intent of the bill is to substitute a federally required Hazardous Analysis Critical Control Point (HACCP) plan for the statutorily required Plan of Operation so that processors need only develop a single plan which could be submitted to both the federal Food & Drug Administration and the State.

Prepared by: Larry Jones  
 Division: Director, Division of Administrative Services

Phone: 465-1010  
 Date: 3/21/95

Approved by Commissioner: Larry Jones  
 Agency: Department of Environmental Conservation

Date: 3/21/95

PREPARED TO PROVIDE ALL DIS-  
**COMMITTEE COPY** tribution

FIVE OFFICE  
 office

STATE OF ALASKA

TONY KNOWLES, GOVERNOR

DEPARTMENT OF COMMERCE AND  
ECONOMIC DEVELOPMENT

DIVISION OF ECONOMIC DEVELOPMENT

March 3, 1985

P.O. BOX 110804  
JUNEAU, ALASKA 99811-0804  
PHONE: (907) 485-3017

The Honorable Carl Moses  
House of Representatives  
State Capitol  
Juneau, AK 99801-1182

Dear Representative Moses:

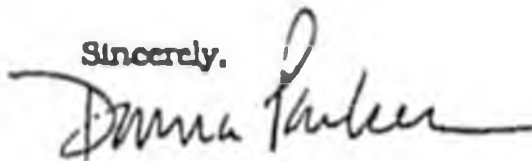
The Department of Commerce and Economic Development strongly supports your efforts to harmonize State and federal seafood safety regulations in your proposed House Bill 208.

This legislation seeks to have State regulations mirror new federally-mandated seafood inspection regulations as well as international regulations. This will improve the ability of the Alaska seafood industry to successfully compete in the domestic and international marketplace.

The bill requires that Alaska seafood inspection regulations be consistent with the Hazard Analysis at Critical Control Points (HAACP) inspection regulations recently promulgated by FDA. HAACP regulations were developed by FDA to standardize and improve seafood safety regulations. Similar regulatory development has occurred in the EU. By harmonizing Alaska seafood safety regulations with those in the global marketplace, Alaska seafood processors can better market products across state lines and international boundaries.

Please call on this office for any further assistance we can offer in support of this proposed legislation.

Sincerely,



Donna Parker  
Fisheries Specialist



March 21, 1995

BY FAX COMMUNICATION TO:

Cheryl Sutton, Staff Fisheries Specialist  
Office of Representative Carl E. Moses  
Fax No. 907-465-3445

Dear Ms. Sutton,

We are writing to express our strong support for House Bill No. 208, now before the State of Alaska Legislature, House of Representatives.

We feel that this Bill is of vital importance to the seafood industry, not only to protect its integrity, but also to ensure that only the safest products produced by the Alaska seafood industry are offered for sale to the public. It is important that future quality assurance programs followed by the Alaska seafood industry be consistent with the Hazard Analysis Critical Control Points (HACCP) regulations being proposed by the federal Food and Drug Administration. House Bill No. 208 accomplishes this objective.

Sincerely,  
UNISEA, INC.



Joe Frazier  
Director of Quality Assurance

cc: Mr. Rick Lauber, Pacific Seafood Processors Assn.-Juneau  
Mr. Roger DeCamp, Nation Food Processors Assn.-Seattle  
Mr. L. John Iani-UniSea



## Dutch Harbor Seafoods, Ltd.

15110 Northeast 90th Street  
P.O. Box 97049  
Redmond, Washington 98073-9749  
(206) 881-8181 FAX (206) 882-1660

MAR 22 1995

March 22, 1995

BY FAX COMMUNICATION TO:

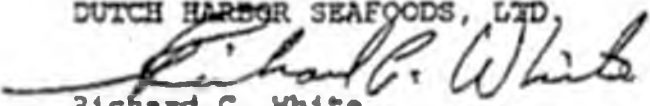
Cheryl Sutton, Staff Fisheries Specialist  
Office of Representative Carl E. Moses  
Fax No. 907-465-3445

Dear Ms. Sutton,

On behalf of Dutch Harbor Seafoods, Ltd., I want to express our full support for House Bill No. 208, which has been introduced in the State of Alaska House of Representatives.

I feel that this Bill is extremely important to the seafood industry. The public demands, and deserves, assurance that safe seafood products will be the only products coming from our industry. House Bill No. 208 ensures that all processors, large and small, will implement quality control/quality assurance programs that meet this demand. It is equally important that future quality assurance programs followed by the Alaska seafood industry be consistent with the Hazard Analysis Critical Control Points (HACCP) regulations being proposed by the federal Food and Drug Administration. House Bill No. 208 accomplishes this objective as well.

Sincerely,  
DUTCH HARBOR SEAFOODS, LTD.

  
Richard C. White  
President

cc: Mr. Rick Lauber, Pacific Seafood Processors Assn.-Juneau  
Mr. Roger DeCamp, Nation Food Processors Assn.-Seattle  
Mr. L. John Iani-UniSea



## SEAFOOD PRODUCERS COLD STORAGE, INC.

PRODUCERS, PROCESSORS & MARKETERS OF PREMIUM QUALITY SEAFOODS

DATE: 3/22/95

TO: Carl Moses, Representative

ATTN:

FROM: Tim Northrop, Plant Manager

MESSAGE: Representative Moses,

We support House Bill 208. It is important to us that we not have to react to two different sets of regulations covering the same situation in our industry. If you need anything from us, please contact us.

**OCEAN BEAUTY**  
SEAFOODS, INC.

March 21, 1995

VIA FAX

The Honorable Carl Moses  
Alaska House of Representatives  
Capital Building, Room 204  
Juneau, Alaska

Re: HOUSE BILL 208

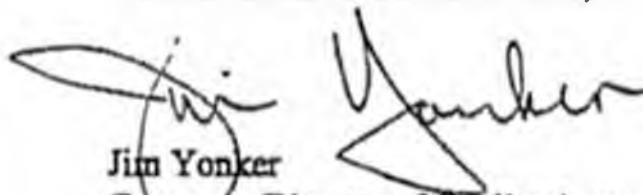
Dear Representative Moses:

Please be advised that Ocean Beauty Seafoods, Inc. supports your bill requesting a change in the current ADEC statutes to incorporate the Food and Drug Administration's "Seafood Safety" HACCP proposal.

You and your fellow representatives should be commended for your efforts to harmonize the regulations that affect Alaska's seafood products on an international, national, and state level. Your efforts in HB 208 will allow for a safe food product produced in Alaska to compete in all markets.

Very truly yours,

OCEAN BEAUTY SEAFOODS, INC.



Jim Yonker  
Corporate Director of Quality Assurance  
and Government Relations

JY:mal

cc: William Terhar, Executive V.P. & C.O.O.

Regional Specialties

Eyak

Select Provisions

**Eyak Packing Company**  
 Cannery Direct Mail Order  
 Smoked & Canned Alaska Salmon of Finest Quality

MAR 22 1995

MARCH 22, 1995

To/ Representative Moses

Eyak Packing was established in 1983 -  
 We are 100% ALASKAN owned and we employ  
 ALASKANS - we support House Bill NO. 208 100%  
 and THANK you for your efforts.

Sincerely,

Gerald Masolini  
 Gerald MASOLINI  
 Owner/Manager  
 Eyak Packing Co.



329-333 Katlian Street

Sitka, Alaska 99838



3/22/95

Representative Carl E. Moses  
Alaska State Legislature

Dear Carl:

Unfortunately, we will be unable to attend or partake in the teleconference hearing today. The Sitka Sound Seine Sac Roe Herring Fishery is rapidly approaching.

We do however, want to go on record and state that Sitka Sound Seafoods, Inc. both endorses and supports House Bill No. 208. Please contact us if you need any additional support in writing.

Sincerely,

Harold K. Thompson  
President, SSS

Gail B. Stromme  
SSS Government Compliance

(907) 747-6662  
TELEFAX (907) 747-6268  
Telex 090-45-391 SEEAFOOD SICA

FRESH AND FROZEN SALMON, COD, BLACK COD, HALIBUT, ROCK FISH, CRAB, HERRING

4

MAR 22 1995



# ALASKA PACIFIC SEAFOODS

DIVISION OF NORTH PACIFIC PROCESSORS, INC.  
HOME OFFICE: 2200 EASTLAKE AVE. EAST • SEATTLE, WASHINGTON 98102 • (206) 724-9900

P.O. BOX 31178 • SEATTLE, WASHINGTON 98103-1178

PROCESSING PLANT: 677 DRYLAND AVE. • KODIAK, ALASKA 99587 • (907) 485-3241

March 22, 1995

Representative Carl E. Moses, Chair  
House Rules Committee

State of Alaska

The seafood industry has been under inspection for many years, whereas the fish industry has not. Whether or not in the fishing industry have a perceptual or factual problem as it relates to our food items and disease, the consumer needs to have greater confidence in our products.

As a processor of Alaska Seafoods, it is our duty to see our state Representatives guiding the fishing industry on a path which will help market our fish in future times.

Sincerely,

John Saville  
Plant Manager

JS/sjn

*Processors of Quality Alaskan Seafoods*



*East Point*  
seafood company

420 MARINE WAY • P.O. BOX 1637  
KODIAK, ALASKA 99615  
TELEPHONE: (907) 486-5799  
FACSIMILE: (907) 486-4079

March 22, 1995

MAR 22 1995

Cheryl Sutton c/o Carl Moses  
House of Representatives, Alaska State Legislature  
State Capitol  
Juneau AK 99801-1182

Re: HB 208

Dear Ms. Sutton:

I would like you to know that East Point Seafoods fully supports the above-mentioned bill.

It will allow the seafood processors of Alaska to operate under one set of rules that will insure all seafood produced within the state will be safe and wholesome.

Sincerely

Charles L. Jensen  
Manager, Gov't Relations/Quality Assurance



# Ocean Beauty Seafoods, Inc.

ST. ELIAS DIVISION

PO. BOX 548 • CORDOVA, ALASKA 99574 • (907) 424-7171 • FAX (907) 424-5514  
PO. BOX 70739 • SEATTLE, WASHINGTON 98107 • (206) 285-6800 • FAX (206) 281-0820

March 30, 1995

Representative Carl Moses  
State Capitol  
Juneau, Alaska  
99901-1132

Rep. Carl Moses:

This letter is an acknowledgment of support of H.B. 208 as it is currently written. This Bill will bring HACCP regulations in line for A.D.E.C., F.D.A., and the E.U.. It is good to see the state recognize the needs for more simple, rather than more complex regulations. This will help in keeping costs down, lead to less duplication of effort, and ensure that product will not be rejected based on technicalities. This Bill has wide support from the industry.

Hap Symmonds  
CBSI- St. Elias Division

Ken Roennidt  
North Pacific Processors

Bill Gilbert  
Silverlining Seafoods

Sylvia Lange  
Cannery Row

Gerald Masolini  
Eyak Packing

Roger Stiles  
Great Pacific Seafoods

**KODIAK FISH COMPANY**

F/V Alliance F/V Provider  
P. O. Box 469  
Kodiak, Alaska 99615-0469



April 23, 1995

The Honorable Loren Leman  
Chairman  
Senate Resources Committee  
Alaska State Legislature

Subject: HB 208 - Relating to plans of operation for seafood processing facilities.

Dear Senator Leman:

I wish to urge the Senate Resources committee to expedite passage of this bill. Its purpose is to eliminate duplication of rulemaking between the State of Alaska and the Food and Drug Administration - both sets of rules are designed to produce the same result. Without this bill, all seafood processing businesses in the State - including small ones such as ours - will be faced with development of two different and highly complex plans. By placing HACCP regulations in State regulation, everyone's job is eased. State and federal regulators are using the same standard, industry has a single set of regulations and is producing one plan. In addition, HACCP regulations being finalized by FDA have undergone an exhaustive period of public comment, agency review and industry scrutiny.

HB 208 may be the only piece of legislation dealt with this session which is a no brainer. It costs nothing, saves industry money and results in no loss of consumer protection. It has received wide support from all segments of the industry and is also supported by the Department of Environmental Conservation.

Thank you for the opportunity to comment. I wished to testify at tomorrow's hearing but have a prior commitment. I hope these remarks which I am faxing to your office will be received and reviewed in a timely manner.

Sincerely,

A handwritten signature in cursive script that reads "Teressa Kandianis".

TERESSA M. KANDIANIS  
Vice President

PHONE 907-486-6002  
FAX 907-486-2617

DIVISION OF LEGAL SERVICES  
LEGISLATIVE AFFAIRS AGENCY  
STATE OF ALASKA

(907) 465-3867 or 465-2450  
FAX (907) 465-2029  
Mail Stop 3101

130 Seward Street, Suite 409  
Juneau, Alaska 99801-2105

MEMORANDUM

February 15, 1995

**SUBJECT:** Summary of certain statutes relating to the wholesomeness of food products (Work Order No. 9-LS01581C)

**TO:** Representative Carl Moses  
Attn: Cheryl Sutton

**FROM:** George Utermohle *GU*  
Legislative Counsel

This memorandum summarizes certain statutes governing the wholesomeness of food products.

AS 03.05.011 sets out the authority of the commissioner of environmental conservation to issue orders, regulations, permits, quarantines, and embargoes relating to labeling of meat, seafood, and poultry; examination and inspection of meat, fish, and poultry advertised for sale; enforcement of quality assurance plans; inspection for pests and infested food products; cooperation with federal and state agencies; regulation of fur farming; and monitoring of aquatic farms and aquatic farm products.

AS 03.05.020 sets out the duties of the commissioner of environmental conservation in regard to inspection of food animals, fish, and poultry; prohibiting the transportation and sale of food products that do not meet state standards; regulating the labeling and production of milk and milk products; establishing an inspection program for reindeer; designating points of entry for livestock and poultry into the state; and establishing a schedule of fees for services provided by the state veterinarian.

AS 03.05.025 provides that a person may not operate a seafood processing establishment or vessel without a seafood processing permit and an approved plan of operation.

AS 03.05.026 provides that the Alaska Seafood Marketing Institute may design an "inspection" seal and a "premium quality" seal. The commissioner of environmental conservation shall authorize the use of the seals by seafood processors who meet requirements established by the commissioner.

AS 03.05.035 prohibits the mislabeling of frozen foods. Meat, fish, or poultry that have been frozen must be labeled as frozen food and may not be sold or represented as fresh food. The commissioner of environmental conservation shall adopt regulations for the labeling of frozen

Representative Carl Moses  
February 15, 1995  
Page 2

meat, fish, and poultry and for the inspection of meat, fish, and poultry to determine whether they had been frozen.

AS 03.05.040 provides that the commissioner of natural resources and the commissioner of environmental conservation may, as appropriate, enter a storehouse, warehouse, cold storage plant, packing house, slaughterhouse, retail store, or other place to inspect agricultural, fisheries, or aquatic farm products.

AS 03.05.050 provides that the commissioner of natural resources or the commissioner of environmental conservation, as appropriate, may declare an agricultural or fisheries product that violates provisions of AS 03.05, or regulations adopted under AS 03.05, to be a public nuisance injurious to the public interest. Such products may not be moved and are subject to the directions of the appropriate commissioner.

AS 03.05.090 provides that a person who violates AS 03.05 or a regulation, order, quarantine, or permit issued under AS 03.05 is guilty of a class A misdemeanor.

AS 17.20.020 establishes what is adulterated food.

AS 17.20.040 establishes when food is mislabeled.

AS 17.20.050 provides that the commissioner of environmental conservation may issue permits governing the manufacture, processing, or packing of a class of food, if such permits are necessary to protect the public health from food contaminated with microorganisms that cannot be identified as a dangerous food product after the product enters commerce.

AS 17.20.060 provides that the commissioner of environmental conservation may suspend a permit issued under AS 17.20.050, if the commissioner finds that the terms of the permit are being violated. The commissioner may reinstate the permit if the terms of the permit have been satisfied.

AS 17.20.070 provides that the commissioner of environmental conservation may inspect a factory or establishment that holds a permit under AS 17.20.050.

AS 17.20.180 provides that the Department of Environmental Conservation and the Department of Health and Social Services may adopt regulations as necessary to enforce the Alaska Food, Drug and Cosmetic Act (AS 17.20).

AS 17.20.200 provides that the commissioner of environmental conservation shall have free access to a factory, warehouse, or establishment where foods are manufactured, processed, packed, or held for introduction into commerce in order to inspect the facility for compliance with AS 17.20 and to collect samples for examination.

Representative Carl Moses  
February 15, 1995  
Page 3

AS 17.20.230 provides that the commissioner of environmental conservation may place an embargo on food that the commissioner has probable cause to believe is adulterated or so misbranded as to be fraudulent or dangerous.

AS 17.20.240 provides that the commissioner of environmental conservation shall petition the superior court for a libel for condemnation of food embargoed under AS 17.20.230.

AS 17.20.250 provides that the commissioner of environmental conservation shall destroy an embargoed food product after the superior court enters a decree under AS 17.20.240.

AS 17.20.260 provides that food subject to an embargo and to a decree of the superior court may be returned to a person for relabeling or further processing if the adulteration or the mislabeling can be cured by relabeling or further processing. The person who claims the food for relabeling or further processing shall pay the costs of the commissioner of environmental conservation to supervise the relabeling or further processing and shall post sufficient bond to assure that the food is brought into compliance with AS 17.20.

AS 17.20.270 provides that commissioner of environmental conservation shall immediately destroy, condemn, or render unsalable as human food any meat, seafood, poultry, vegetable, fruit, or other perishable article in any room, building, vehicle, or other structure that is unsound or contains a filthy, decomposed, or putrid substance or a substance that may be poisonous or hazardous to the public health.

AS 17.20.280 provides that the commissioner of environmental conservation may apply to the superior court for an injunction to prevent certain acts prohibited under AS 17.20.290.

AS 44.46.020 sets out the duties of the Department of Environmental Conservation including the adoption of regulations for the prevention and control of public nuisances, regulation of sanitation and sanitary practices in the interest of public health, and standards of cleanliness and sanitation in connection with the construction, operation, and maintenance of a camp, cannery, food handling establishment, food manufacturing establishment, and other establishments where lack of sanitation may create a condition that causes disease.

AS 46.03.100 - 46.03.120 provides for the issuance, modification, or termination of a permit for the disposal of waste material or waste water.

If I may be of further assistance, please advise.

GU:glc  
95-145 glc

**DIVISION OF LEGAL SERVICES  
LEGISLATIVE AFFAIRS AGENCY  
STATE OF ALASKA**

(907) 465-3867 or 465-2450  
FAX (907) 465-2029  
Mail Stop 3101

130 Seward Street, Suite 409  
Juneau, Alaska 99801-2105

**MEMORANDUM**

April 6, 1995

**SUBJECT:** Sectional Summary of CSHB 208(FSH); An Act relating to seafood processing permits and hazard analysis critical control point plans; and relating to seafood processing plans of operation and quality assurance plans.

**TO:** Representative Carl Moses  
Attn: Cheryl Sutton

**FROM:** George Utermohle *GU*  
Legislative Counsel

This memorandum is a sectional summary of CSHB 208(FSH), an Act relating to seafood processing permits and hazard analysis critical control point plans, and relating to seafood processing plans of operation and quality assurance plans.

As a preliminary matter, note that a sectional summary of a bill is not an authoritative interpretation of the bill. The bill itself is the best statement of its contents.

Section 1 of the bill amends AS 03.05.011(a)(8) to allow the commissioner of environmental conservation to enforce hazard analysis critical control point programs for seafood processing.

Section 2 of the bill amends AS 03.25.025(a) to eliminate the requirement that a seafood processing plan of operation be incorporated into the seafood processing permit and be renewed annually.

Section 3 of the bill repeals and reenacts AS 03.05.025(b) in order to provide that a seafood processing establishment or vessel must have a plan of operation that has been approved by the Department of Environmental Conservation, unless the establishment or vessel is engaged in the production of a fresh or frozen seafood product. Once the plan of operation is approved by the department, the plan does not need to be reviewed again until there is a change in the operation of the establishment or vessel or the product produced or the process conducted at the establishment or vessel that necessitates a change in the plan.

**Sectional Analysis**

Representative Carl Moses

April 6, 1995

Page 2

Section 4 of the bill repeals and reenacts AS 03.05.025(b) in order to provide that a seafood processing establishment or vessel must have an written hazard analysis critical control point control plan

Section 5 of the bill grants a temporary exemption from the provisions added by secs. 2 and 3 of this bill in order to provide a smooth transition for the implementation of this bill.

Section 6 of the bill provides that secs. 1 and 4 of the bill take effect on the effective date of regulations adopted by the federal Food and Drug Administration that establish procedures for processing of fish and fishery products in accordance with hazard analysis critical control point principles.

GU:imb:klb

95-158.lmb

# SENATE COMMITTEE REPORT

DATE: 4/11/95

FURTHER:

DATE TURNED INTO OFFICE: 4-24-95

Resources Committee considered CS FOR HOUSE BILL NO. 208(FSH)

Seafood processing permits and hazard analysis critical control point plans; relating to seafood processing plans of operation and quality assurance plans; efd.

and recommends:

- be replaced with \_\_\_\_\_ CS \_\_\_\_\_ (\_\_\_\_\_)
- adopt previous \_\_\_\_\_ CS \_\_\_\_\_ (\_\_\_\_\_)
- attached amendment(s)
- adopt Letter of Intent by \_\_\_\_\_ Committee
- further referral to the \_\_\_\_\_ Committee

Senate Bill:

- same title
  - new title
- House Bill:
- same title
  - technical change
  - new: SCR° \_\_\_\_\_

| SIGNING DO/PASS             | DP | OTHER RECOMMENDATIONS | NR | DNP | AM |
|-----------------------------|----|-----------------------|----|-----|----|
| <i>Rick Halford</i>         | ✓  |                       |    |     |    |
| <i>Dave</i>                 | ✓  |                       |    |     |    |
| <i>Miss L. Taylor</i>       | ✓  |                       |    |     |    |
|                             |    |                       |    |     |    |
|                             |    |                       |    |     |    |
| CHAIR: <i>Laura A. Swan</i> | ✓  |                       |    |     |    |

**NEW FISCAL NOTE(S):**

Department                      Date    Zero    Fiscal

| Department | Date | Zero | Fiscal |
|------------|------|------|--------|
|            |      |      |        |
|            |      |      |        |
|            |      |      |        |
|            |      |      |        |
|            |      |      |        |

**PREVIOUS FISCAL NOTE(S):\***

Department                      Date    Zero    Fiscal

| Department | Date | Zero | Fiscal |
|------------|------|------|--------|
| DEC        | 4/3  | ✓    |        |
|            |      |      |        |
|            |      |      |        |
|            |      |      |        |
|            |      |      |        |

APPROPRIATION -- no fiscal note

\*include fiscal notes accompanying Governor's bill

# Alaska State Legislature

## Representative Carl E. Moses

CHAIRMAN  
HOUSE RULES COMMITTEE

VICE CHAIRMAN  
HOUSE SPECIAL COMMITTEE ON FISHERIES

MEMBER  
HOUSE SPECIAL COMMITTEE ON  
ECONOMIC DEVELOPMENT

COMMITTEE ON COMMITTEES

FINANCE SUBCOMMITTEES  
TRANSPORTATION AND PUBLIC FACILITIES  
FISH & GAME



**SESSION:**  
STATE CAPITOL BUILDING #204  
JUPITER, ALASKA 99501-1182  
PHONE (907) 485-4451  
FAX (907) 485-3445

**INTERIM:**  
718 W 6TH AVE #830  
ANCHORAGE, ALASKA 99501-2133  
PHONE (907) 258-8187  
FAX (907) 258-3488

### TESTIMONY

House Bill 208

Senate Resources - April 24, 1995

Mr. Chairman and members of the committee, my name is Cheryl Sutton, aide to Representative Carl Moses and I will be testifying on his behalf today.

House Bill 208 seeks to harmonize the state regulations for plans of operation of seafood processing facilities with federally mandated FDA regulations. The new program involves state-of-the-art inspection technology called Hazard Analysis Critical Control Point or HACCP. The HACCP program was first developed by Pillsbury for use by the NASA space program. At present, FDA is moving forward in consultation with the seafood industry in their rule-making process.

HACCP takes a proactive approach to food safety by adopting preventive measures to avoid food safety hazards. The program establishes critical control points throughout the process where a hazard could occur. It then monitors these control points to provide for safe product development. Other systems respond *after the fact*. They generally examine or test product *after* they are finished. It becomes much more difficult to correct a problem *after the fact* rather than by monitoring the process through each control point and responding to make corrections before the product is completed.

House Bill 208 will replace the current plan of operation required by DEC with a HACCP plan which will mirror the federal rule. The current requirements for a plan of operation will remain in place until the federal rule is adopted. In addition to providing a better program for food safety, the HACCP program will provide a single standard utilized worldwide for commerce.

House Bill 208 is supported by the Alaska seafood industry and the Department of Environmental Conservation. It has a zero fiscal note.

Janice Adair, DEC Director of Environmental Health, is on line in Anchorage. Also, Kit Ballentine, Program Coordinator for Environmental Health is here in Juneau. In addition, we have several seafood industry members who would like to lend their support to the bill.

I have been contacted by seafood industry folks ranging from fishermen to moms and pops to large processors of Alaska seafood and have had unanimous support for this bill. Representative Moses would respectfully request your support and passage from committee. This bill provides a forward look for the seafood industry and the state. It will improve the quality of seafood safety in production resulting in safe Alaska seafood products in the world market. Thank you.