

ALASKA LEGISLATURE COMMITTEE FILES 1995-1996 8672

9012 SENATE RESOURCES

SENATE COMMITTEE REPORT

DATE: 4/11/95

FURTHER:

DATE TURNED INTO OFFICE: 4-13-95

Resources Committee considered CS FOR HOUSE BILL NO. 239(STA)

"An Act declaring the four spot skimmer dragonfly as the official state insect."

and recommends:

- be replaced with CS _____
- adopt previous CS HB 239 (STA)
- 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 PARS	DP	OTHER RECOMMENDATIONS	SR	DSF	AM
<i>[Signature]</i>					
<i>[Signature]</i>					
<i>[Signature]</i>					
<i>[Signature]</i>					
CHAIR: <i>[Signature]</i>	<input checked="" type="checkbox"/>				

NEW FISCAL NOTE(S):

Department Date Zero Fiscal

PREVIOUS FISCAL NOTE(S):*

Department Date Zero Fiscal

<i>no item</i>	<i>Yes</i>	<input checked="" type="checkbox"/>	

APPROPRIATION -- no fiscal note

*include fiscal notes accompanying Governor's bill

Auntie Mary Nicoll Elementary School
P.O. Box 29
Aniak, Alaska 99557
(907) 675-4487

Dear Legislators and Committee Members:

We want to thank you for the interest you have shown in the Dragonfly project. We have all learned a great deal about insects, passing bills, running elections, and communicating with our Senators and Representatives.

The purpose of this letter is to inform you about the corrected count of the vote. The results are the same but the specific count is slightly altered from the student hand-counted numbers. We transferred the school totals from the notebook to the computer. These are the corrected electronic totals:

Dragonfly	Beet	Mosquito	Butterfly	Total
3914	1477	3035	2872	11298

A list of the schools and the specific vote is also enclosed.

Sincerely,

Ruth Bradford
Ruth Bradford, teacher and DLT coach

Laurence Bradford
Larry Bradford, science teacher

School	Dragonfly	Bee	Mosquito	Butterfly
Akiachak Elem. School, Akiachak	29	4	4	49
Aktuk Memorial School, Kasigluk	13	12	1	19
Akulai School, Akulan	3	7	0	2
Alakanuk School, Alakanuk	16	5	3	9
Allakaket School, Allakaket	11	9	0	6
Ambler School, Ambler	18	15	20	19
Anguin School, Elkm	19	17	15	26
Arctic Village School, Arctic Village	3	9	3	3
Arviq School, Platinum	9	0	1	3
Auntie Mary Nicoll Elem. School, Ariak	44	9	10	17
Aurora Elem. School, Elmendorf AFB	74	11	95	58
Ayagyual Ektneuvial, Bethel	2	1	3	3
Bear Valley School, Anchorage	139	45	145	163
Betuga School, Betuga	0	0	5	3
Bethel Regional High School, Bethel	0	0	12	1
Blackwell School, Anva	14	3	0	5
Bowman Elem. School, Anchorage	112	37	112	65
Bruce Hill School, Port Alice	3	0	1	2
Bruns School, Icy Bay	4	0	0	2
Buckland School, Buckland	7	12	14	5
Campbell Elem. School, Anchorage	125	41	99	95
Chenega Bay Comm. School, Chenega Bc	7	2	11	6
Chester Valley School, Anchorage	14	15	22	32
Chignik Bay School, Chignik Bay	11	2	2	6
Chignik Lagoon School, King Salmon	11	1	0	1
Chig Ivan Blunka School, New Stuyance	19	14	2	0
Cold Bay School, Cold Bay	4	8	4	4
Cooper Landing School, Cooper Landing	14	0	4	0
Craig Elem., Craig	45	11	7	21
Crooked Creek School, Crooked Creek	17	0	2	8
Crow Village Sam School, Chusitbana	9	4	2	2
Cruikshank School, Beaver	3	0	24	0
Cube Cove School, Juneau	13	0	14	1
Danger Bay School, Kodiak	0	3	15	0
Dick R. Klunys Memorial School, Kongigan	12	27	15	61
Eagle School, Eagle	9	5	3	1
Edna Bay School, Edna Bay	2	1	1	7
Ellin Cove School, Ellin Cove	0	2	3	0
Fred Ipswich Elem., Barrow	22	22	8	35
Gastineau Elem., Juneau	16	5	0	6
Gleacher Valley Elem. School, Juneau	13	1	0	2
Gleady Wood Elem., Anchorage	10	15	20	105
Glennallen School, Glennallen	3	3	20	3
Haines Elem. School, Haines	50	15	33	16
Harcoview Elem., Juneau	108	15	23	45
Healy Lake School, Certe Junction	2	2	1	1
Healy School, Healy	51	9	34	31
Robert Bay School, Juneau	1	4	1	2
Mooshan City Schools, Mooshan	26	27	22	25
Mooser Bay School, Mooser Bay	8	0	0	3
Neugwelling School, Neugwelling	22	1	7	6
Nuttman Elem., Anchorage	128	24	88	117
Ny Bay School, Icy Bay	4	0	0	0
Opugig School, Opugig	1	0	4	3

School	Dragonfly	Bee	Mosquito	Butterfly
Jessie Lee School, Anchorage	9	1	7	7
Joan Alexie Memorial School, Almatluck	22	0	19	11
John Fredson School, Venetie	5	7	2	7
Karluk School, Karluk	11	4	0	2
Kayalik Elem., Ne-Aok	18	0	0	0
Ketchikan School, Ketchikan	17	4	1	0
King Cove School, King Cove	24	27	24	24
King Salmon School, King Salmon	3	3	0	1
Kingikmiut School, Wales	12	12	5	22
Kodiak Island Chinik School, Kodiak	10	2	4	2
Kokhanok School, Kokhanok	1	1	1	0
Kotik Schools, Kotik	42	22	12	55
Kotzebue Mid. School, Kotzebue	31	4	2	5
Koyuk Malemute School, Koyuk	8	17	4	5
Lead Elem., Fairbanks	75	11	24	52
Leonard Seppala AH High, Nome	0	0	40	0
Lewis Angapak Memorial School, Tunlituka	13	5	16	23
Main Elem. School, Kodiak	193	36	25	103
Marin L. Olson School, Golovin	19	9	9	8
Mat-Su Alternative School, Wasilla	23	0	55	18
McLaughlin High School, Anchorage	24	3	19	11
McQueen School, Kivalina	5	4	3	5
Meyers Chuck School, Meyers Chuck	9	1	0	1
Miktinguit Elementary, Bethel	44	24	23	43
Minchumina Com. School Lake Minchumina	3	4	1	0
Mosquito Lake School, Haines	7	4	9	4
Mr. Mottet Middle School, Adak	24	1	1	10
Mr. Spurr School, E.A.F.B.	140	32	108	110
Mr. Village Mid. School, Mountain Village	13	1	0	1
Napaaglugmiut School, Noatak	4	7	0	12
Nenana School, Nenana	10	0	22	20
Nikolskaya School, Nikolskaya	43	11	27	12
Nome Elem. School, Nome	94	101	50	121
North Pole Middle School, Fairbanks	47	21	133	29
Northway School, Northway	1	0	2	3
Northwind Cortes School, Yukon Sch. Dist.	2	1	0	3
Purata Valley Elem. School, Anchorage	13	1	0	3
Paul Banks Elem. School, Homer	25	21	8	33
Pelican School, Pelican	27	12	2	9
Pennell School, Eielson A.F.B.	5	2	9	7
Pilot Station School, Pilot Station	32	20	15	30
Plover's Point Schools, St. Mary's	8	3	4	17
Polk Inlet School, Ketchikan	14	1	0	5
Port Lions School, Port Lions	0	0	2	4
Port Protection School, Ketchikan	3	0	0	1
Providence Heights School, Anchorage	19	0	0	0
Pt. Higgins School, Ketchikan	53	17	9	21
Rapocina School, Frazz Creek	14	4	1	11
Richard Johnson Elem. School, Mediasana	14	0	0	0
Rogers Park El. School, Anchorage	117	20	112	65
Sand Point City School, Sand Point	33	14	17	20
Scammon Bay Schools, Scammon Bay	32	4	3	5
Scenic Park Elem. School, Anchorage	60	25	20	120

School	Dragonfly	Bees	Mosquito	Butterfly
Selawik School, Selawik	14	13	3	8
Seldovia School, Seldovia	8	2	1	0
Shishmaref School, Shishmaref	89	12	17	36
Sitka Alternative School, Sitka	0	21	21	0
Skwentna School, Skwentna	0	0	10	2
Smith Cove School, Ketchikan	1	0	0	7
St. Mary's Schools, St. Mary's	46	14	9	10
Sterling Elem. School, Sterling	108	33	60	60
Susan B. English School, Seldovia	23	3	15	1
Sutton Elem. School, Sutton	15	0	9	11
Talkeetna Elem., Talkeetna	18	9	14	22
Tenakee School, Port Alsworth	2	2	8	0
Tannana Middle School, Tannana	0	1	8	16
Taylor Elem., Eielson AFB	32	4	71	21
Telida School, Telida	8	1	0	1
Tenakee Springs School, Tenakee Springs	3	0	2	1
Thome Bay School, Thome Bay	35	14	8	13
Ticasuk Brown Elem. School, Fairbanks	0	1	1	5
Togiak School, Togiak	17	0	10	5
Trapper Creek School, Trapper	10	2	23	10
Tustumena Elem. School, Kaslof	16	5	11	14
Unalakleet Schools, Unalakleet	34	10	23	23
University Park School, Fairbanks	121	17	62	78
Upper Katskag Elem., Katskag	26	0	1	3
Valdez High School, Valdez	15	2	21	1
Valley Park Elem. School, Ketchikan	137	8	11	24
Verstovia Elem. School, Sitka	10	3	2	5
Wade Northway School, Northway	2	3	2	10
Wendler Junior High, Anchorage	84	44	255	56
White Cliff Elem., Ketchikan	18	1	2	3
White Mountain School, White Mountain	17	5	2	7
Willow Elem. School, Willow	39	26	34	30
Wunder Park Elem., Anchorage	120	42	74	145
Zacher Levi Elem. School, Lower Katskag	8	2	20	16
	3914	1477	3035	2872
Total	11298			

House State Affairs Committee Testimony on
HB 239 "An Act Declaring the Dragonfly as the Official State Insect"

Testimony on 3-23-95 from :

Auntie Mary Nicoli Elem. School in Aniak
P.O. Box 29
Aniak AK 99557

Teacher: Ruth Bradford

Students: Rainy Diehl, 8th Grade
Deidre Bush, 8th Grade
Derek Aluia, 7th Grade
Bruck Clift, 7th Grade
Rachael Boelens, 7th Grade
Andrea Gusty, 6th Grade
Dana Diehl, 6th Grade
Melanie Matter, 5th Grade

Thank You very much for this opportunity to testify

*These students will
testify tomorrow 3-23-95
at 8:00 AM
in State Affairs*

COMMENTS MADE BY STUDENTS ABOUT THE ELECTION

Fred Ipalook Elementary, Barrow: The 5th grade surveyed the whole school to get our total vote.

Chiniak School: Our kids are mostly afraid of bumblebees. Dragonflies are common on our beaches.

Blackwell School, Anvik: Thank you for sharing with us.

Campbell Elementary, Anchorage: We enjoyed participating.

Andreafski High School and Elicarvicuar Elementary, St. Mary's: We enjoyed this project. The students in grades 5 and 6 campaigned for the four different insects. They made a presentation to grades Kindergarten through grade four.

Sand Point School, Sandpoint: We had a nice election. 88% of the student body voted. We made slogans: Vote for the humble bee, just remember where your honey comes from!
Vote for someone you know, vote for the mosquito!

Glacier Valley Student Council: We held a school vote. Thank you for making us a part of your project.

Port Protection School: I think the Dragonfly should be the state insect because it has compound eyes to see far and it can fly all sorts of directions and can hover. My personal reason is because it eats small insects like mosquitoes. Mosquitoes bug me a lot. Anthony Dallas.

Beluga School, Beluga: Thank you for letting us participate.

Main Elementary, Kodiak: We had almost 100% participation and our students are very excited to find out the results.

Valdez High School: Thanks for letting u. have input.

Cooper Landing student notes:

I like the dragonfly because they are useful and look neat. Austin

I chose the 4 Spot dragonfly because they eat the nasty bugs and are pretty. Terrin H.

Dragonflies keep the insect population down and they do not hurt people. Jeremy Ellis

Aniak Schools: Comments by the Dragonfly Lobby Team members:

The dragonfly has been around since prehistoric times. They outlived the dinosaurs which shows that Alaska has a history of more than just snow and ice.

by Bruck Clift, 7th grade

The dragonfly is quite unique because it is colorful and larger than most flying insects. Unfortunately there are not enough to destroy all the mosquitoes in rural Alaska!

by Rainy Diehl, 8th grade

I voted for the dragonfly because I don't like mosquitoes. During the summer Alaska is a beautiful place to be. It would be even better with **FEWER MOSQUITOES!**

by Dana Diehl, 6th grade

I fly high, I'm a Four Spot Skimmer Dragonfly,
Watch me soar through the sky,
I represent Alaska, cause I'm an awesome guy.
I'll eat mosquitoes, 'til the day I die.

by Deidre Bush, 8th grade

I like the mosquito but it is a pest,
All it does is bite you.
I like the dragonfly
It eats the pests.
Dragonflies represent Alaska the best.

by Rachael Boelens, 7th grade

The dragonfly is long, slender, and graceful. It eats mosquitoes and was the choice of most Alaskan students. I believe the dragonfly deserves to be our state insect.

by Andrea Gusty, 6th grade

Winter in Alaska is **COLD**. Any insect as big and beautiful as the dragonfly that can survive Alaska's cold deserves to be the state insect.

by Derek Aluia, 7th grade

The committee and I worked hard on this project. We stuffed hundreds of envelopes, counted votes, baked, earned money for postage and the lobby team trip to Juneau. We're not about to stop working until the dragonfly is the official state insect!

by Melanie Matter, 5th grade.

DRAGONFLY LOBBY TEAM
Auntie Mary Nicoli Elementary School
P.O. Box 26
Aniak, AK 99557

Representative Irene Nicholia
State Capital
Juneau, AK 99801-1182

Dear Representative Nicholia:

We are the members of the Dragonfly Lobby Team from Aniak, Alaska. There are eight students on our team, ranging from fifth to eighth grades. Our insect team coach is Ruth Bradford and our science teacher is Larry Bradford. We have worked on this project, along with many other students, since 1992 when we requested nominations, to the present, in our quest for an official state insect for Alaska. As you can see from the enclosed information, we were as busy as mosquitoes, and as determined as dragonflies to work out every detail. Now that the votes are in, we are asking your help in bringing the Four Spot Dragonfly before the State Congress for a vote.

The eight members of our lobby team, coach, and chaperone are planning a trip to Juneau in April or May to lobby for the proposed dragonfly. The members of the team have earned money to pay for the trip and are looking forward to seeing our legislators at work. It is our hope that we could present our proposal to a committee, or watch us it is presented on the floor. We need your help in determining a realistic timeline.

We sincerely appreciate your support.

Sincerely yours;

Ruth Bradford
Ruth Bradford, DLT Coach

Larry Bradford
Larry Bradford, Science Teacher

Melvin Mattes, *Claudia Aluia, Chaperone*, *Dana Diehl*, *Audrea Jesty*,
Bruce Clift, *Derek Aluia*, *Rachael Brooks*,
Deeche Bush, *Rainy Diehl*

enc: Adopt A State Insect
Student comments
cc: Senator Georgeanna Lincoln
Representative Gene Kubina

HEB

265

SENATE COMMITTEE REPORT

First Committee of Referral

DATE: 3/22/96

FURTHER:

DATE TURNED INTO OFFICE: 4-18-96

The Resources Committee considered CS FOR HOUSE BILL NO. 265(FSH)
 Relating to the export of live dungeness crab.

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 title
 - new: SCR# _____

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	NR	DNP	AM
<i>[Signature]</i>		<i>[Signature]</i>			
<i>[Signature]</i>					
<i>[Signature]</i>					
<i>[Signature]</i>	✓				
<i>[Signature]</i>					
CHAIR: <i>[Signature]</i>	✓	CHAIR:			

NEW FISCAL NOTE(S):

Department	Date	Zero	Fiscal

PREVIOUS FISCAL NOTE(S):*

Department	Date	Zero	Fiscal

APPROPRIATION -- no fiscal note

*Include fiscal notes accompanying Governor's bill

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

April 12, 1996

The Honorable Loren Leman
Senator
Senate Resources Committee
Alaska State Legislature
State Capital
Juneau, Alaska 99801-1182

Re: House Bill 265
Export of Dungeness Crab

Dear Senator Leman and Committee members:

This is a response to your request for a copy of the oral testimony on HB 265 presented to the Senate Resources Committee earlier today. The testimony is summarized below:

Last year I sent a letter to Representative Williams indicating that the previous version of this bill might present constitutional difficulties. I do not know how many of you have seen that letter, but I want to make it clear that the department of law's concerns have been greatly reduced both because of changes made in the CS for this bill and because of we have learned that the underlying statute, AS 16.10.240, serves the purpose of making commercial fishing regulations, including size and sex limitations and reporting requirements, enforceable.

It has been called to our attention that the underlying statute generally prohibiting transport of live king, Tanner, and Dungeness crab, except via air freight after prepackaging, helps prevent vessels fishing in isolated areas from retaining undersize or female crab in violation of state regulations. It has also been called to our attention that these enforcement concerns are much less significant in the Dungeness fisheries because they do not generally occur in isolated deep water areas and it is much easier for enforcement officers to board and inspect vessels fishing for Dungeness than for king and Tanner crab. Thus, the underlying statute will continue to serve a compelling purpose even if export of dungeness is allowed. We also note that by prohibiting export by surface transportation during periods in which PSP testing is required, this bill will continue to allow the statute to serve public health purposes.

TONY KNOWLES, GOVERNOR

PLEASE REPLY TO

1031 WEST 4TH AVENUE, SUITE 200
ANCHORAGE, ALASKA 99501-1994
PHONE (907) 269-5100
FAX (907) 276-3697

KEY BANK BUILDING
100 CUSHMAN ST. SUITE 400
FAIRBANKS ALASKA 99701-4679
PHONE (907) 451-2811
FAX (907) 451-2846

P O BOX 110300, DIMOND COURT HOUSE
JUNEAU, ALASKA 99811-0300
PHONE (907) 465-3600
FAX (907) 465-6735

Our previous concern centered on the fact that this bill might undermine public health and safety purposes of the underlying statute, AS 16.10.240, and increase the risk that the statute would be subject to attack under the commerce clause of the U.S. constitution. After reviewing the CS for this bill and discussing the enforcement purposes of the underlying statute with ADF&G staff and F&WP staff we do not believe that this bill would significantly increase the risk of a successful challenge to the underlying statute.

We hope this summary is of assistance to you. We will be happy to provide additional information or clarification if needed.

Sincerely,

BRUCE M. BOTELHO
ATTORNEY GENERAL

By: 

Steven A. Daugherty
Assistant Attorney General

cc: Pat Pourchot
Legislative Director
Office of the Governor

Bruce Botelho
Attorney General

Barbara Ritchie
Deputy Attorney General

Deborah Behr
Assistant Attorney General
Legislation and Regulations Section

FISCAL NOTE

STATE OF ALASKA
1996 LEGISLATIVE SESSION

BILL NO. CS HB265(FSH)

Revision Date: 2/22/96 Dept. Affected: Fish and Game
 Title: Export of dungeness crab BRU: CFMD
 Component: Fisheries Management
 Sponsor: Rep Williams
 Requester: House Fisheries COMPONENT SERIAL NO. 1841

Expenditures/Revenues (Thousands of Dollars)

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

CAPITAL EXPENDITURES	0	0	0	0	0	0
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CHANGE IN REVENUES ()	0	0	0	0	0	0
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FUND SOURCE (Thousands of Dollars)

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

Estimate of any current year (FY96) cost: 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)

Prepared by: Paul Larson Phone: 465-6130
 Division: Commercial Fisheries Management and Development Date: 2/22/96
 Approved by Commissioner: Frank Rue Date: 2/22/96
 Agency: Fish and Game

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FISCAL NOTE

STATE OF ALASKA
1996 LEGISLATIVE SESSION

BILL NO. CSHB 265 (FSH)

Revision Date: 22-Feb-96
 Title: Export of Live Dungeness Crab
 Sponsor: Rep. Williams
 Requestor: Rep. Williams

Department Affected: Environmental Conservation
 BRU: Environmental Health
 Component: Seafood and Sanitation Inspections

COMPONENT SERIAL NO. 1936

Expenditures/Revenues:

(Thousands of Dollars)

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

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
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CHANGE IN REVENUES	0.0	0.0	0.0	0.0	0.0	0.0
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FUND SOURCE

002 Federal Receipts	0.0	0.0	0.0	0.0	0.0	0.0
003 GF Match	0.0	0.0	0.0	0.0	0.0	0.0
004 GF	0.0	0.0	0.0	0.0	0.0	0.0
005 GF/Program Receipt	0.0	0.0	0.0	0.0	0.0	0.0
006 GF/NOTIA	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY 96) 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)

Prepared by Jackie Adam
 Division Director, Division of Environmental Health

Phone: 907-269-7645
 Date: 2/22/96

Approved by Commissioner Lawrence
 Agency Department of Environmental Conservation

Date: 2/22/96

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Legislative Research Agency

Alaska State Legislature



130 Seward Street, Suite 218
Juneau, Alaska 99801-2196

Phone: (907) 463-3991
Fax: (907) 463-3331

March 30, 1995

MEMORANDUM

TO: Representative Bill Williams

FROM: Linda Brooks *LB*
Legislative Analyst

RE: Live Crab Exports to Canada: Reporting Requirements
Research Request 95.171

You posed this question: if Alaska fishermen could deliver live crab to Canadian ports by boat, how would the volume of these sales be recorded? That is, are there reporting requirements that would allow U.S. authorities to know the extent of the trade?

Alaska fishermen who export crab must comply with four state reporting requirements, but the data collected from those reporting requirements would not reveal the volume of live crab being exported to Canada. It appears that information about the amount of Alaska crab exported to Canada could be obtainable from Canadian and U.S. Customs data.

State Reporting Requirements

Alaska fishermen who sold crab directly from their boats to processors in Canadian ports would be classified as "catcher-exporters," and they would have to comply with four state reporting requirements:

- Intent to Operate Application
- Fish tickets
- Processors' annual reports
- Fisheries business license tax return

The fishermen would first file "Intent to Operate" applications with the Alaska Department of Fish and Game (ADF&G). They would also obtain Fisheries Business Licenses from the Alaska Department of Revenue. Fishermen could not begin to export crab until ADF&G approved their Intent to Operate applications. As a condition for approval, fishermen would have to provide

Representative Williams

March 30, 1995

Page 2

ADF&G with proof that they had met the Alaska Department of Revenue's surety bond and fisheries business license tax prepayment requirements.

After fishermen satisfied the Department of Revenue's requirements and obtained approval of their Intent to Operate applications, ADF&G would provide them with fish tickets. Fishermen would have to submit completed fish tickets for their catches to ADF&G before exporting any live crab (5 AAC 39.130). Fishermen would record on the tickets where they caught the crab, the number of pots used, and the number of pounds of crab sold on each ticket.

Fish tickets would be a continuous reporting requirement. Fishermen who directly exported crab would complete a fish ticket for each catch. Fishermen "catcher-exporters" also would face two annual reporting requirements: completion of an Alaska Commercial Operator's Annual Report and a Fisheries Business License Tax return. Both the report and the return would have to be filed by April 1st and would cover all activity from January to December of the preceding year. Fishermen "catcher-exporters" would record on the annual report the amount of crab caught by fishing area and would indicate the price received when sold. Tax forms for the fisheries business license tax would be obtained from the Alaska Department of Revenue, and fishermen "catcher-exporters" would be responsible for paying the tax due.

Nevertheless, while the fishermen "catcher-exporters" would have to comply with the different state reporting requirements, the data collected through these reporting requirements would not reveal the volume of live crab being exported by Alaska fishermen directly into Canadian ports. Fish tickets provide ADF&G with data on the amount of crab being harvested in various areas of the state so that biologists have the information necessary to manage the fishery. The fish tickets would quantify the amount of crab harvested, but they would not indicate the geographical destination of any crab that was exported and sold out-of-state. Likewise, annual processors' reports and business license tax returns would provide no information about the geographical destination of live crab exported from Alaska.

The State of Alaska would have both fiscal and fishery management interests in assuring that fishermen "catcher-exporters" complied with the state reporting requirements. Normally fish processors handle fish tickets, processors' annual reports, and fisheries business license taxes so that fishermen who sell their catches in Alaska are not personally involved in any of these reporting requirements. However, fishermen who act as "catcher-exporters" would be responsible themselves for initiating the reporting processes and complying with all requirements. Some "catcher-exporters" might evade compliance to avoid paying the fisheries business license tax, others might be unaware of the reporting requirements. Failure to submit fish tickets would nonetheless hamper ADF&G's ability to manage the fishery properly. Fish and Wildlife officers from the Alaska Department of Public Safety enforce the ADF&G fish ticket regulations, but fishermen "catcher-exporters" who failed to submit fish tickets would only face a \$1,000 fine for a first offense. In terms of fish tax revenues, the amount lost would depend on the number of "catcher-exporters" who failed to obtain licenses and to pay taxes. The Alaska Department of

Representative Williams

March 30, 1995

Page 3

Revenue enforces tax laws, but the penalty for first-time offenders who failed to obtain a fisheries business license would only be a \$5,000 dollar fine.

U.S. and Canadian Customs Data

U.S. and Canadian Customs data offer the best hope for tracking the volume of live crab exported by Alaska fishermen into Canadian ports. The North American Free Trade Agreement has eliminated the requirement for fishermen to file export declarations, but import data are still kept. Bill Aberle, who works at the Alaska Center for International Business at the University of Alaska, explained that Canada and the United States exchange import data with each other. The United States relies upon Canadian import data to gauge the volume of U.S. exports into Canada. Mr. Aberle said that the Canadians' import data would be detailed enough to track the volume of Alaska dungeness crab received in Canadian ports. Because airports and seaports are tracked separately, it would also be possible to discern the amount of crab arriving by vessel. Mr. Aberle was only unsure of whether or not live crab could be differentiated from other types such as frozen crab.

Furthermore, while Alaska fishermen no longer need to file export declarations with U.S. Customs, they still have to stop en route to Canada at U.S. Customs. At U.S. Customs the fishermen "catcher-exporters" would obtain permits that allow them to conduct trade in foreign ports. Upon their return from Canada, the fishermen again would be required to stop at U.S. Customs. Alaska fishermen re-entering the state would have to file cargo declarations with U.S. Customs. Doug Harmon, port director for the U.S. Customs office in Ketchikan, said that for documentation purposes, they would generally ask fishermen to produce fish tickets for cargo that they might have sold in Canada. Although the Ketchikan U.S. Customs office does not track goods sold in Canada on a regular basis, Mr. Harmon thought that his office might be able to enter into an interagency law enforcement agreement with the Alaska Department of Revenue or the Alaska Department of Public Safety to ensure that fishermen "catcher-exporters" were complying with state reporting requirements for live crab that they sold in Canada. If Alaska officials wished to establish such an agreement, Mr. Harmon said they should contact Mr. Jensen or Mr. Blackmore in the U.S. Customs Enforcement Office in Anchorage.

Finally, in addition to customs data, Alaska fishermen who sold live crab in Prince Rupert would have to obtain permits from the Prince Rupert Fisheries and Oceans Office. A Canadian fisheries official said that each permit would describe the approximate weight of the product, who the product was sold to and its approximate value. The Canadian fisheries official thought his office might be able to share such information with the U.S. National Marine Fisheries Office, if U.S. officials requested information about the amount of Alaska dungeness crab being sold in Prince Rupert.

We hope this information is useful to you. Please do not hesitate to call if you have further questions.

STATE OF ALASKA

TONY KNOWLES, GOVERNOR

**DEPT. OF ENVIRONMENTAL CONSERVATION
DIVISION OF ENVIRONMENTAL HEALTH
DIRECTOR'S OFFICE
555 CORDOVA STREET
ANCHORAGE, ALASKA 99501**

Telephone: (907) 269-7644
Fax: (907) 269-7654

January 23, 1996

The Honorable Bill Williams
House of Representatives
Room 128, Capitol Building
Juneau, Alaska 99801

Dear Representative Williams:

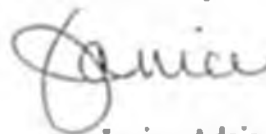
This letter is in response to your request that we provide you with a summary of DEC's recent actions relating to the testing of crab viscera for PSP.

In early October, 1995 our Food Safety Lab compiled the results of the viscera testing that had been conducted over the past 2 years. It was clear that during the winter months in Southeast and the Bering Sea, PSP is not a problem in crab viscera. We took that information to FDA for their concurrence. With it, we were able to suspend the winter PSP testing of crab viscera in these two areas. The testing is still required in and around Kodiak.

I've enclosed a copy of the press releases we issued on this topic. They outline the timelines for which the testing is not required as "winter" varies between the two areas. As you'll note, and I think it's important to point out, we will be doing "spot" monitoring to be sure the PSP levels aren't on the rise. If we find increases, the PSP testing requirement would be reinstated.

Please let me know if you have any questions.

Sincerely,



Janice Adair
Director

1A1a (g) en PSP WILLIAMS

Enclosures

cc: Michele Brown, Acting Commissioner
Shari Kochman, Governor's Legislative Office

DEC NEWS RELEASE

Alaska Department of Environmental Conservation
Environmental Health Division
555 Cordova St. 5th Floor
Anchorage, Alaska 99501
Phone: (907) 260-7601 Fax: 260-7610

November 3, 1995

Contact: Manny Soares or Mike Ostasz, DEC Anchorage

CRAB MONITORING PROGRAM REVISED FOR SOUTHEAST ALASKA

Weekly sampling of Southeast Alaska commercial crab for paralytic shellfish poison (PSP) is no longer required of processors, following review of two years worth of lab data by the Department of Environmental Conservation.

"We can lift this requirement from processors for the time being, and will do periodic testing to ensure the levels remain low," said Janice Adair, Director of DEC's Division of Environmental Health. "If levels go back up, we will likely need to reinstate the weekly monitoring to ensure unsafe product isn't being sold." Adair said that the change applies to the crab fishery between October 1 - March 31.

Widespread testing of crab for PSP was initiated several years ago to meet federal requirements when the toxin was found in the viscera of commercially-caught crab. Testing will continue in other parts of the state where toxin levels remain high.

DEC reviewed the PSP data for crab from Southeast Alaska, for a two year period, to re-evaluate the appropriateness of the fall/winter monitoring requirement. This work by the Palmer Laboratory showed that levels now are and have been well within the action limits, with little or no detectable toxin.

The change in the monitoring program applies to all species of crab caught in Southeast Alaska, and allows the sale of crab with the viscera intact, in live or whole-cooked form.

###

crabPSP11/3/95.rtd

Post-It™ brand fax transmittal memo 7671		# of pages > 1
To	MANNY S.	
Co.	SEA	
Dept.		
Fax #	2A-7510	
From		
Co.		
Phone #		
Addr		

DEC NEWS RE

Alaska Department of Environmental
 Environmental Health Division
 555 Cordova St. 5th Floor
 Anchorage, Alaska 99501
 Phone: (907) 269-7501 Fax: 269-7510

December 26, 1995

Contact: Mike Ostasz shellfish coordinator
 (907) 269-7638 or
 Manny Soares, manager, Seafood program
 (907) 269-7640

REVISED OPILIO TANNER CRAB MONITORING PROGRAM FOR BERING SEA

The Department of Environmental Conservation has announced that, effective immediately, weekly PSP crab sampling of Opilio Tanner crab from the Bering Sea is no longer required by seafood processors for the period of January 15, 1996, until the close of that fishery by the Alaska Department of Fish and Game.

According to Manny Soares, manager of DEC's seafood program, the agency has just completed review of Paralytic Shellfish Poison (PSP) data from a three year period for the Bering Sea crab to re-evaluate the winter monitoring requirement.

Soares said, "Evaluation of the PSP test result data from DEC's Palmer Laboratory for this time period has shown the levels are well within the action limits, with little or no detectable toxin. As a result, we've discontinued the weekly testing requirement but will test periodically to ensure the levels remain low."

The announcement applies to Opilio Tanner crab from the Bering Sea and allows the sale of crab with the viscera intact, live, or whole cooked form.

Don Munhoven
F/V Blue Fin
P. O. BOX 6335
Ketchikan, Ak.
99901
(907-225-5328)

IAR 1 8 199

Attn: Bill Williams.

We are in favor of lifting the ban of shipping live crab only via air freight
in regards to Alaska Statue Sec. 16.10.240.

We know this creates unnecessary hardship on the fishermen and their
markets and only financially benefits the airlines.

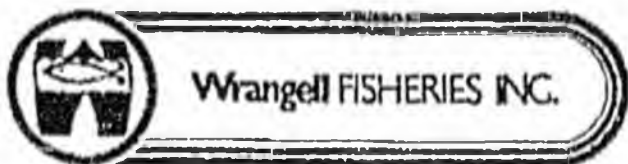
Lifting the ban would allow fishermen to create a better quality product
and would create more jobs.

Thank-you,

Don Munhoven



3-17-95



641 SHAKES STREET, P.O. BOX 908, WRANGELL, ALASKA 99779

TEL. (907) 874-3346 FAX (907) 874-3035

FEBRUARY 23, 1996

Representative Bill Williams
D. Saxman

Dear Sir:

We applaud house bill No. 265 regarding the export of live Dungeness Crab. As we get to gear up for the upcoming season we look forward to seeing this bill become law.

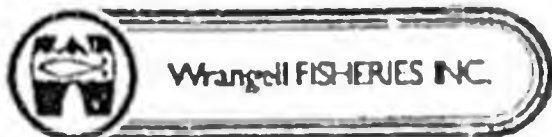
Thanks for your legislation, as it is ridiculous to limit processors by means of the fashion in which to ship their product.

Please let me know at what stage this bill is in, via return fax or call at the above number. All the best

M. Steven Bunness
Assistant Plant Manager

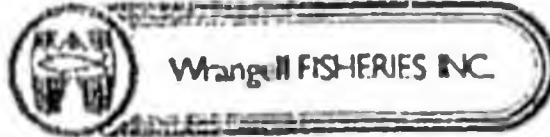
M STEVEN BUNNESS
Assistant Plant Manager

LEVI S. DOW
Plant Manager



641 SHAKES STREET, P.O. BOX 908, WRANGELL, ALASKA, 99779

TEL. (907) 874-3346 FAX (907) 874-3035



641 SHAKES STREET, P.O. BOX 908, WRANGELL, ALASKA, 99779

TEL. (907) 874-3346 FAX (907) 874-3035

HB

325

SENATE COMMITTEE REPORT

First Committee of Referral

DATE: 4/2/96

FURTHER: Finance

DATE TURNED INTO OFFICE: 4-22-96

The Resources Committee considered CS FOR HOUSE BILL NO. 325(FIN) am

Relating to modification of royalty to encourage production from an oil pool containing heavy oil; efd.

and recommends:

- be replaced with SCR CS HB325 (YES)
- 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 title
 - new: SCR^e _____

SIGNING DQ PASS	DP	OTHER RECOMMENDATIONS	NR	DNP	AM
<i>Rich Hatfield</i>		<i>[Signature]</i>			<input checked="" type="checkbox"/>
<i>Abner</i>		<i>Chris I. Tap</i>			<input checked="" type="checkbox"/>
<i>[Signature]</i>		<i>[Signature]</i>			<input checked="" type="checkbox"/>
<i>[Signature]</i>					
CHAIR: <i>David D. Jensen</i>	<input checked="" type="checkbox"/>	CHAIR:			

NEW FISCAL NOTE(S):

Department	Date	Zero	Fiscal

PREVIOUS FISCAL NOTE(S):*

Department	Date	Zero	Fiscal
Revenue	3/1/96	<input checked="" type="checkbox"/>	
INT. OIG	4/2/96		(2200)

*PN 40
C. 1102*

APPROPRIATION -- no fiscal note

*include fiscal notes accompanying Governor's bill

SENATE CS FOR CS FOR HOUSE BILL NO. 325(RES)
 IN THE LEGISLATURE OF THE STATE OF ALASKA
 NINETEENTH LEGISLATURE - SECOND SESSION

BY THE SENATE RESOURCES COMMITTEE

Offered:
 Referred:

Sponsor(s): REPRESENTATIVE GREEN

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to modification of royalty to encourage production from an
 2 oil pool containing heavy oil; and providing for an effective date."

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

4 * Section 1. AS 38.05.180 is amended by adding a new subsection to read:

5 (dd) Notwithstanding any other provision of this section or any provision in
 6 a lease, unit agreement, or other agreement between a lessee and the state that
 7 establishes an obligation to pay royalty on production, royalty is payable at a rate of
 8 two percent, under the conditions and to the extent described in this subsection, for the
 9 production of heavy oil that is removed or sold from a lease or leases located north
 10 of the Umiat baseline, as follows:

11 (1) under this subsection, the reduction in payment of royalty applies

12 (A) only to the portion of the lessee's reported royalty, as may
 13 be later adjusted, before any field cost deduction, as calculated for the month of
 14 production, for the first 450 barrels of daily production of heavy oil from the

1 well, the royalty value of which does not exceed \$15 per barrel as estimated at
2 the lease automatic custody transfer meter at which custody is first transferred
3 into a common carrier pipeline;

4 (B) only if the initial drilling of the well from which the heavy
5 oil is produced began on or after July 1, 1996, and before July 1, 2006; for
6 purposes of this subparagraph, "initial drilling" does not include plug-backs of
7 existing wells, sidetracks from existing wells, multi-lateral or dual completions
8 of existing wells, or sidetracks of redrilled wells;

9 (C) only to heavy oil produced during the first 1,825 days of well
10 operation after the initial production of oil from the well, as reported to the
11 Alaska Oil and Gas Conservation Commission; for purposes of this
12 subparagraph, "initial production" means production following initial drilling;

13 (D) for a well only if the lessee

14 (i) submits with its royalty report for the first month for
15 which the reduction in royalty payment under (A) - (C) of this paragraph
16 is claimed and with subsequent royalty reports for so long as the
17 reduction continues, oil gravity test results performed during the period
18 for which the royalty report is filed demonstrating that the oil tested is
19 heavy oil; the oil gravity test must be in accordance with the standards
20 for measurement and testing set out in the regulations of the Alaska Oil
21 and Gas Conservation Commission; the oil gravity test must be conducted
22 at quarterly intervals except that, for oil that, when tested, has a weighted
23 average of 19 degrees API gravity or greater, the oil gravity test must be
24 conducted not less often than monthly; and

25 (ii) maintains, for a period of at least six years after the
26 last day of the royalty payment reduction authorized by this subsection,
27 records of production that show the actual date that drilling of the well
28 started, the daily production from the well, and the API degree gravity
29 data, and allows the department to inspect the records during regular
30 business hours; and

31 (E) only if the deepest producing perforation of the well from
32 which heavy oil is produced is shallower than 5,000 feet;

1 (2) by taking a reduction in the payment of royalty under this
2 subsection, the lessee waives any right that the lessee might otherwise have under its
3 lease, unit agreement, or other agreement with the state to deduct, against royalty due
4 the state, any field costs associated with the production of the heavy oil for which the
5 reduction is taken;

6 (3) when a reduction in payment of royalty is obtained on the
7 production of heavy oil under this subsection, for a period of 20 years after the last
8 day on which a royalty payment reduction is taken under this subsection, the lessee
9 may not apply for further adjustment of royalty, whether through contract or a
10 provision of law authorizing a royalty modification, on the production of oil from the
11 well for which a reduced royalty was taken under this subsection;

12 (4) for purposes of calculating the first 450 barrels per day of daily
13 production of heavy oil from a well, the production from dual completions and other
14 forms of multiple completions in a well is to be added together and counted as
15 production from a single well;

16 (5) in this subsection,

17 (A) "field costs" includes the lease or unit expenses identified
18 in (f) of this section;

19 (B) "heavy oil" means oil having a weighted average equal to
20 or less than 20 degrees API gravity as the term "API gravity" is defined in
21 AS 43.55.900.

22 • Sec. 2. This Act takes effect immediately under AS 01.10.070(c)



Alaska State Legislature


Senate Resources Committee

Official Business

State Capitol
Juneau AK 99801

MEMO

TO: Legal Services
via fax: X2029 this page only

FROM: Annette Kreitzer, Aide to 
Senate Resources Committee

DATE: April 22, 1996

RE: CS HB 325 : North Slope Heavy Oil Royalty Modification

Please draft a FINAL Resources committee substitute for HB 325 using 9-LS1122Z with the following amendments:

- 1) Page 2, Line 1 following well
INSERT: well, [THAT] the royalty value of which does not exceed \$15 per barrel with value estimated at the Lease Automatic Custody Transfer meter(s) where custody is first transferred into a common carrier pipeline.

9-LS1122VZ
Chenoweth
4/21/96

SENATE CS FOR CS FOR HOUSE BILL NO. 325(RES)
IN THE LEGISLATURE OF THE STATE OF ALASKA
NINETEENTH LEGISLATURE - SECOND SESSION

BY THE SENATE RESOURCES COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE GREEN

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to modification of royalty to encourage production from an
2 oil pool containing heavy oil; and providing for an effective date."

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

4 • Section 1. AS 38.05.180 is amended by adding a new subsection to read:

5 (dd) Notwithstanding any other provision of this section or any provision in
6 a lease, unit agreement, or other agreement between a lessee and the state that
7 establishes an obligation to pay royalty on production, royalty is payable at a rate of
8 two percent, under the conditions and to the extent described in this subsection, for the
9 production of heavy oil that is removed or sold from a lease or leases located north
10 of the Umiat baseline, as follows:

11 (1) under this subsection, the reduction in payment of royalty applies
12 (A) only to the portion of the lessee's reported royalty, as may
13 be later adjusted, before any field cost deduction, as calculated for the month of
14 production, for the first 450 barrels of daily production of heavy oil from the

1 well that does not exceed \$15 per barrel:

2 (B) only if the initial drilling of the well from which the heavy
3 oil is produced began on or after July 1, 1996, and before July 1, 2006; for
4 purposes of this subparagraph, "initial drilling" does not include plug-backs of
5 existing wells, sidetracks from existing wells, multi-lateral or dual completions
6 of existing wells, or sidetracks of redrilled wells;

7 (C) only to heavy oil produced during the first 1,825 days of well
8 operation after the initial production of oil from the well, as reported to the
9 Alaska Oil and Gas Conservation Commission; for purposes of this
10 subparagraph, "initial production" means production following initial drilling;

11 (D) for a well only if the lessee

12 (i) submits with its royalty report for the first month for
13 which the reduction in royalty payment under (A) - (C) of this paragraph
14 is claimed and with subsequent royalty reports for so long as the
15 reduction continues, oil gravity test results performed during the period
16 for which the royalty report is filed demonstrating that the oil tested is
17 heavy oil; the oil gravity test must be in accordance with the standards
18 for measurement and testing set out in the regulations of the Alaska Oil
19 and Gas Conservation Commission; the oil gravity test must be conducted
20 at quarterly intervals except that for oil that, when tested, has a weighted
21 average of 19 degrees API gravity or greater, the oil gravity test must be
22 conducted not less often than monthly; and

23 (ii) maintains, for a period of at least six years after the
24 last day of the royalty payment reduction authorized by this subsection,
25 records of production that show the actual date that drilling of the well
26 started, the daily production from the well, and the API degree gravity
27 data, and allows the department to inspect the records during regular
28 business hours; and

29 (E) only if the deepest producing perforation of the well from
30 which heavy oil is produced is shallower than 5,000 feet;

31 (2) by taking a reduction in the payment of royalty under this
32 subsection, the lessee waives any right that the lessee might otherwise have under its

1 lease, unit agreement, or other agreement with the state to deduct, against royalty due
2 the state, any field costs associated with the production of the heavy oil for which the
3 reduction is taken:

4 (3) when a reduction in payment of royalty is obtained on the
5 production of heavy oil under this subsection, for a period of 20 years after the last
6 day on which a royalty payment reduction is taken under this subsection, the lessee
7 may not apply for further adjustment of royalty, whether through contract or a
8 provision of law authorizing a royalty modification, on the production of oil from the
9 well for which a reduced royalty was taken under this subsection:

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13 production from a single well.

14 (5) in this subsection,

15 (A) "field costs" includes the lease or unit expenses identified
16 in (f) of this section.

17 (B) "heavy oil" means oil having a weighted average equal to
18 or less than 20 degrees API gravity as the term "API gravity" is defined in
19 AS 43.55.900.

20 • Sec. 2. This Act takes effect immediately under AS 01.10.070(c).



Alaska State Legislature

Senate Resources Committee

Official Business

State Capitol
Juneau AK 99801

MEMO

TO: Legal Services
via fax: X2029 this page only

FROM: Annette Kreitzer, Aide to
Senate Resources Committee

DATE: April 20, 1996

RE: CS HB 325 : North Slope Heavy Oil Royalty Modification

Please draft a Resources committee substitute for HB 325 using 9-LS1122U (HB0325d) with the following amendments:

- 1) Page 2, Line 3:
DELETE:
[ACTUAL]
- 2) Page 2, Line 22:
DELETE:
[TWO]
Insert:
six
- 3) Page 2, Lines 28-29:
DELETE ALL MATERIAL
Insert:
(E) only if the deepest producing perforation of the well from which the heavy oil is produced is shallower than 5,000 feet.
- 4) Page 3, Lines 3-7:
DELETE ALL MATERIAL
Insert:
(3) when a reduction in payment of royalty is obtained on the production of heavy oil under this subsection, for a period of 20 years after the last day on which a royalty payment reduction is taken under this subsection, the lessee may not apply for any further adjustment of royalty, whether through contract or any provision of law authorizing a royalty modification, on the production of oil from the well for which a reduced royalty was taken under this subsection.
- 5) Page 3, Line 8:
DELETE:
[500]
Insert:
450



Alaska State Legislature

NOTE TO REPRESENTATIVE GREEN (Jeff Logan); and to KEN BOYD:
These are the amendments proposed for HB 325. Please look over and let
me know if you have further suggestions, comments or if you disagree with
Official these amendments. AK (X4907) Juneau AK 99801

MEMO

TO: Legal Services
via fax: X2029 this page only

FROM: Annette Kreitzer, Aide to
Senate Resources Committee

DATE: April 20, 1996

RE: CS HB 325 : North Slope Heavy Oil Royalty Modification

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- 1) Page 2, Line 3:
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Insert:
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- 3) Page 2, Lines 28-29:
DELETE ALL MATERIAL.
Insert:
(E) only if the deepest producing perforation of the well from which
the heavy oil is produced is shallower than 5,000 feet.
- 4) Page 3, Lines 3-7:
DELETE ALL MATERIAL.
Insert:
(3) when a reduction in payment of royalty is obtained on the
production of heavy oil under this subsection, for a period of 20 years after the last day on
which a royalty payment reduction is taken under this subsection, the lessee may not apply
for any further adjustment of royalty, whether through contract or any provision of law
authorizing a royalty modification, on the production of oil from the well for which a
reduced royalty was taken under this subsection.
- 5) Page 3, Line 8:
DELETE:
[500]
Insert:
450

- END -

Conclusion

*Top Revenue
20 million
via 2007
100 million*

1) Page 1, line 15 set the \$15 per barrel level as the point below which heavy oil will qualify for reduced royalty. At what point is it intended that the \$15 price be measured?

in 100% market when 100% of the oil is produced

2) Page 2, line 22—why was a two year period selected for production records retention rather than using the same period for which the state has audit rights for taxes and royalties?

3) Page 3, line 8—the 500 barrel limit needs to be changed to 450, as amended on the House floor.

Page 3, line 9—provides that, for the purposes of calculating the volume of oil to which royalty reduction applies in wells with dual compilations, production is to be added together. What happens if oil with a higher gravity is blended with lower gravity oil to produce a blend that is higher gravity than the low gravity oil, but lower than the 20 degrees API cut-off under the bill?

*100%
100%*

*100%
100%*

*100%
100%*

*100%
100%*

*100%
100%*

Proposed Amendment to CSIB 325(FIN) am

Amend P. 3, ls. 3-7 as follows:

(3) when a reduction in payment of royalty is obtained on the production of heavy oil under this subsection, for a period of 20 years after the last day on which a royalty payment reduction is taken [ALLOWED] under this subsection, the lessee may not [CLAIM OR OBTAIN THE BENEFIT OF AN] apply for any further adjustment of royalty, whether through contract or any provision of law authorizing a royalty modification, on the production of heavy oil from the well for which a reduced royalty was taken under this subsection [UNDER CONTRACT OR ANY OTHER PROVISION OF LAW AUTHORIZING A ROYALTY MODIFICATION]

incorporate into

*Copy
578-2559*

Rationale for Proposed Amendment to CSHB 325(FIN) am

In the House Finance Committee, HB 325 was amended to ensure that, if a lessee claimed the legislation's five-year incentive for a new heavy oil well, it could not, after those five years, seek an additional royalty reduction on continued heavy oil production from that well. The prohibition would last 20 years.

HB 325 benefits the state because, in return for materially improving project economics through a five-year reduced royalty, the state would receive full royalties—at either 12.5% or 20%—over the remainder of the projected 40-year field life of the development. The Finance Committee amendment was aimed at assuring that those full royalties were actually received after the five-year incentive period ended.

Unfortunately, by barring a lessee from claiming any reduced royalty on the "production of oil" for 20 years, the Finance Committee seems to have prohibited any reduced royalty for *any oil production* in Alaska, and not just the heavy oil for which the incentive was taken. The proposed amendment confines the prohibition to its intended reach.

Replace the language on p. 2, ls 28-29 with the following language:

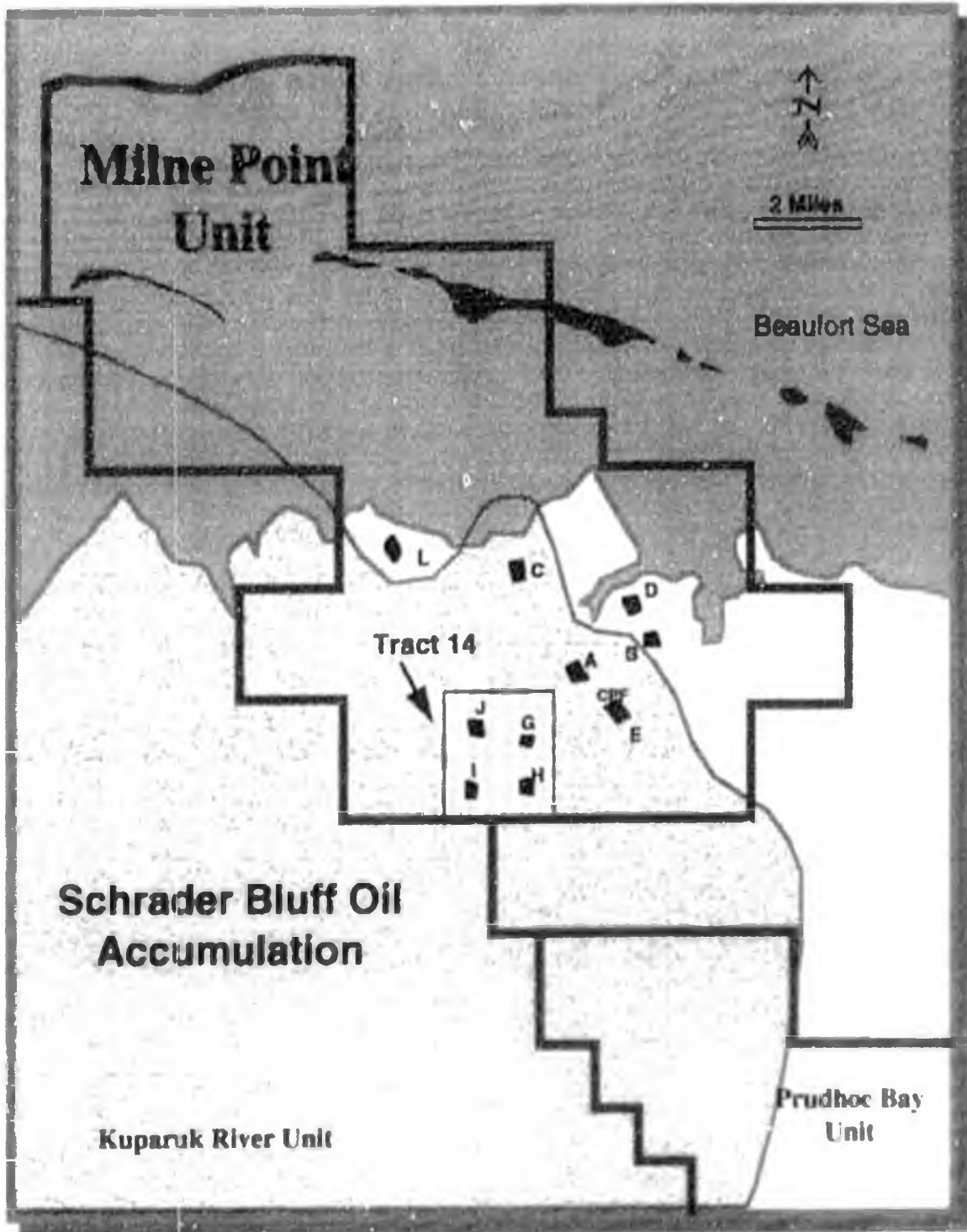
(E) only if the deepest producing perforation of the well from which the heavy oil is produced is shallower than 5,000 feet;

OXY USA Inc.

Presentation to the Senate Resources Committee on

CSHB 325(FIN) am

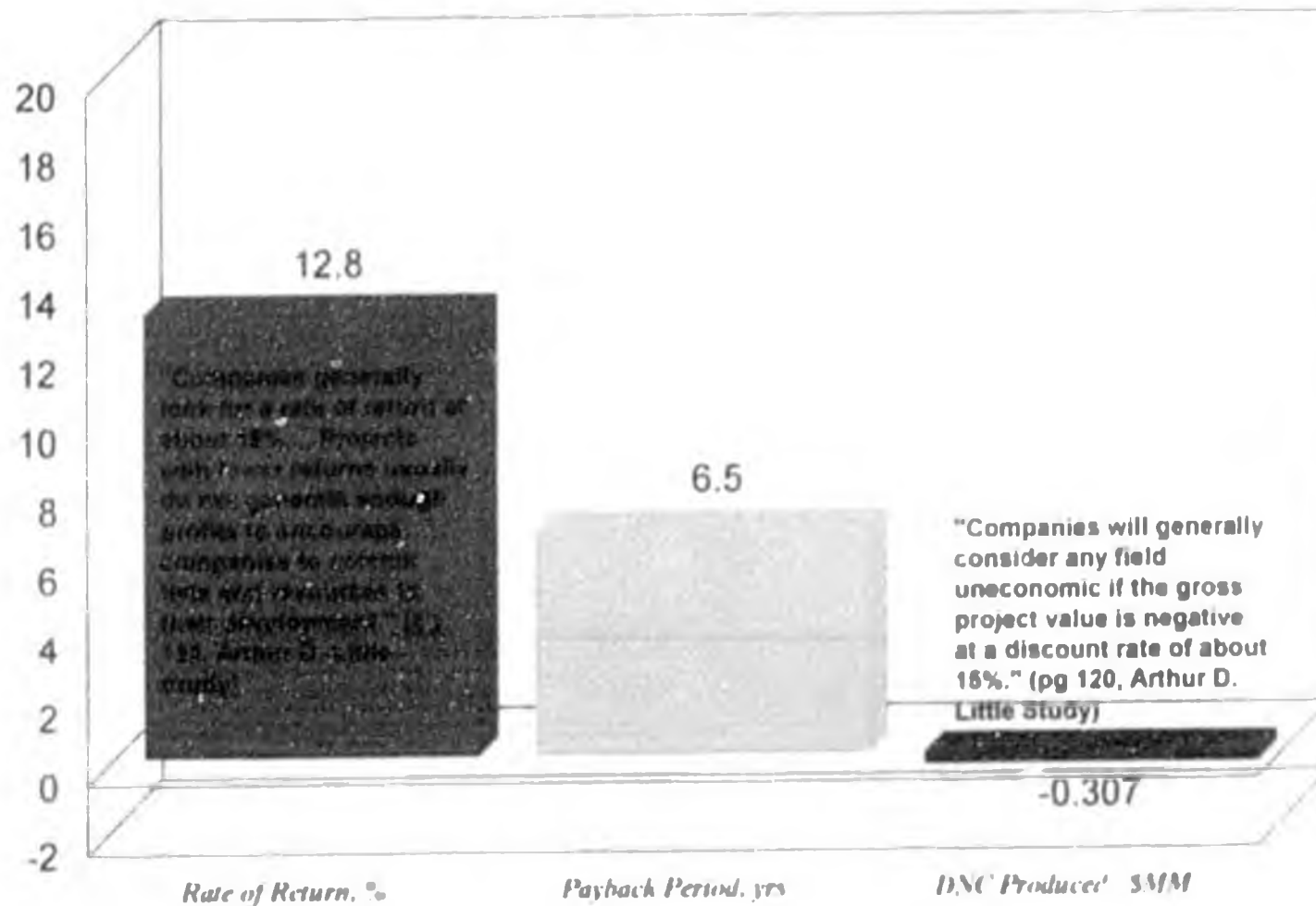
April 17, 1996



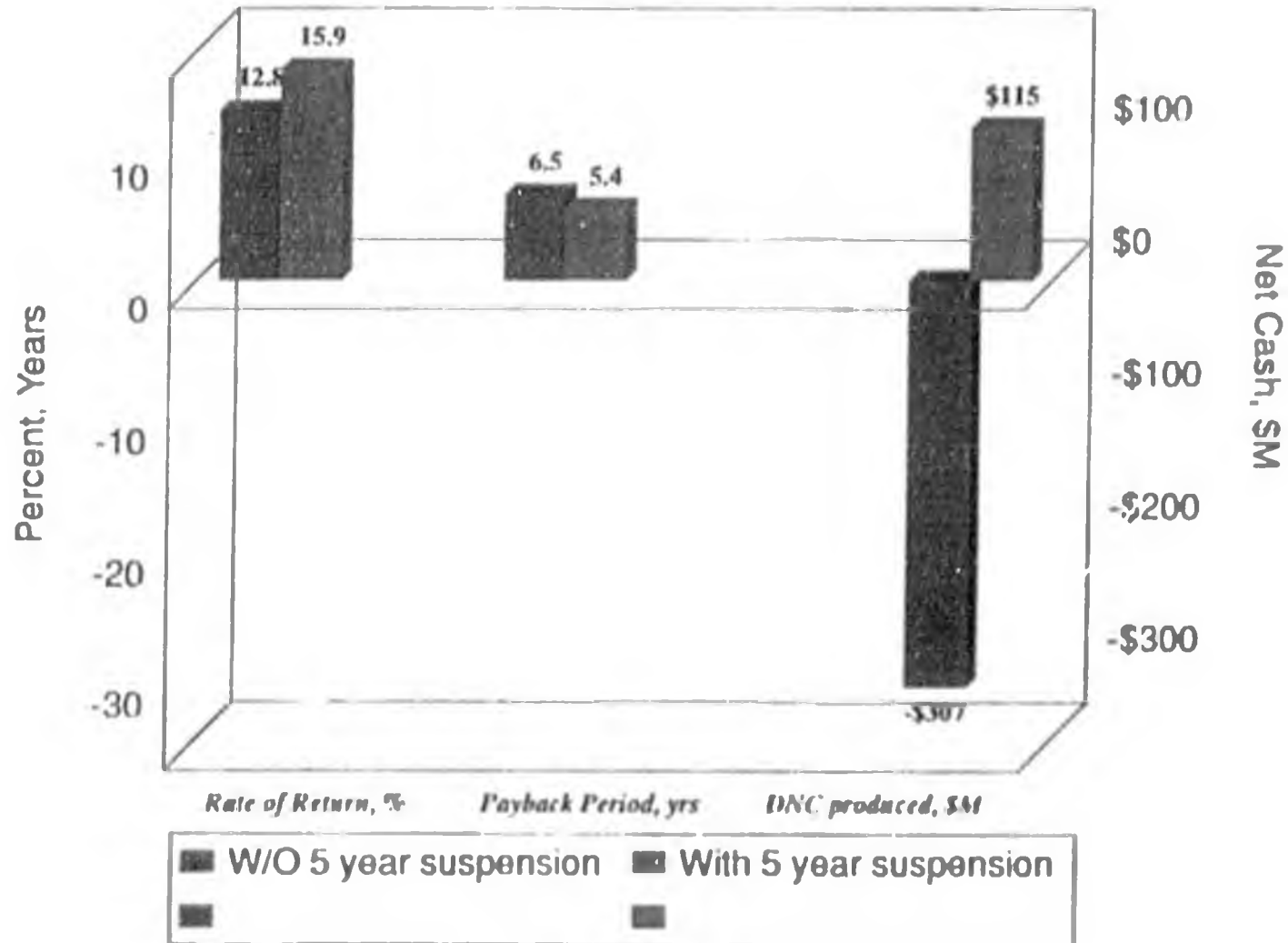
Schrader Bluff Oil Accumulation

Typical Heavy Oil Well Economics

Based on the 5 best wells to date in Tract 14



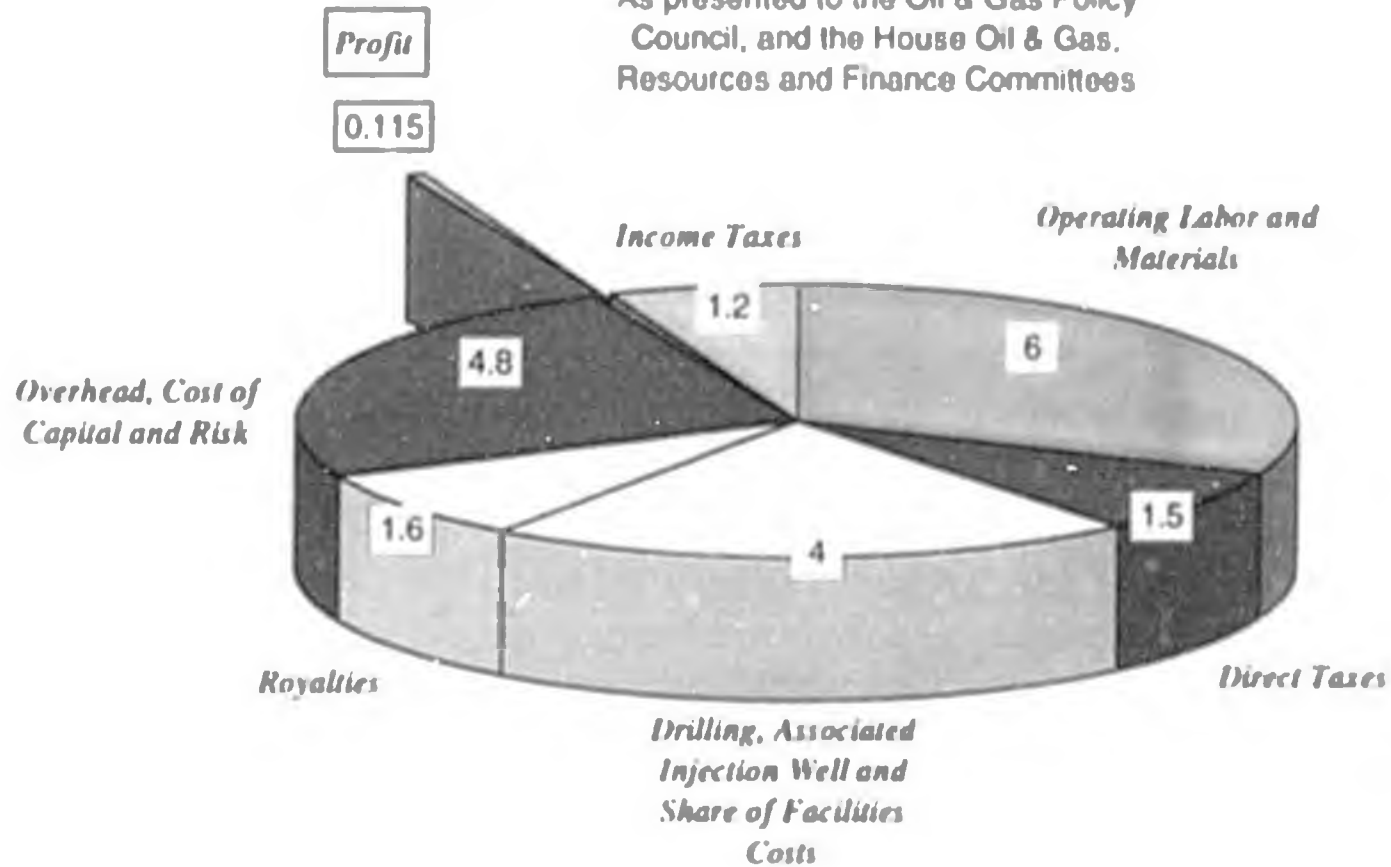
The Effect of Royalty Suspension on Schrader Bluff Economics



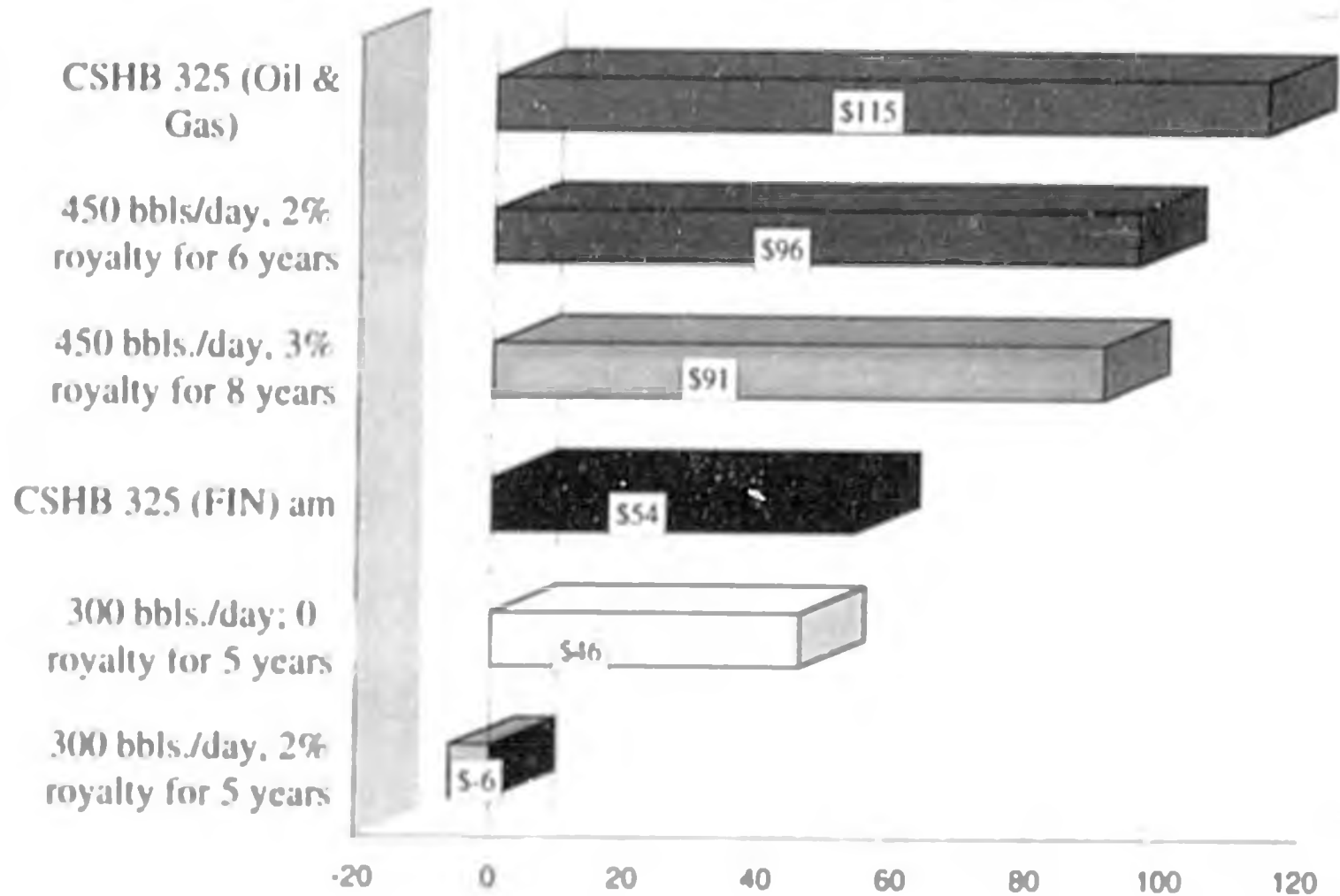
Where the Revenues from Heavy Oil Development Go

OXY Per Well Economics (in millions)

As presented to the Oil & Gas Policy Council, and the House Oil & Gas Resources and Finance Committees

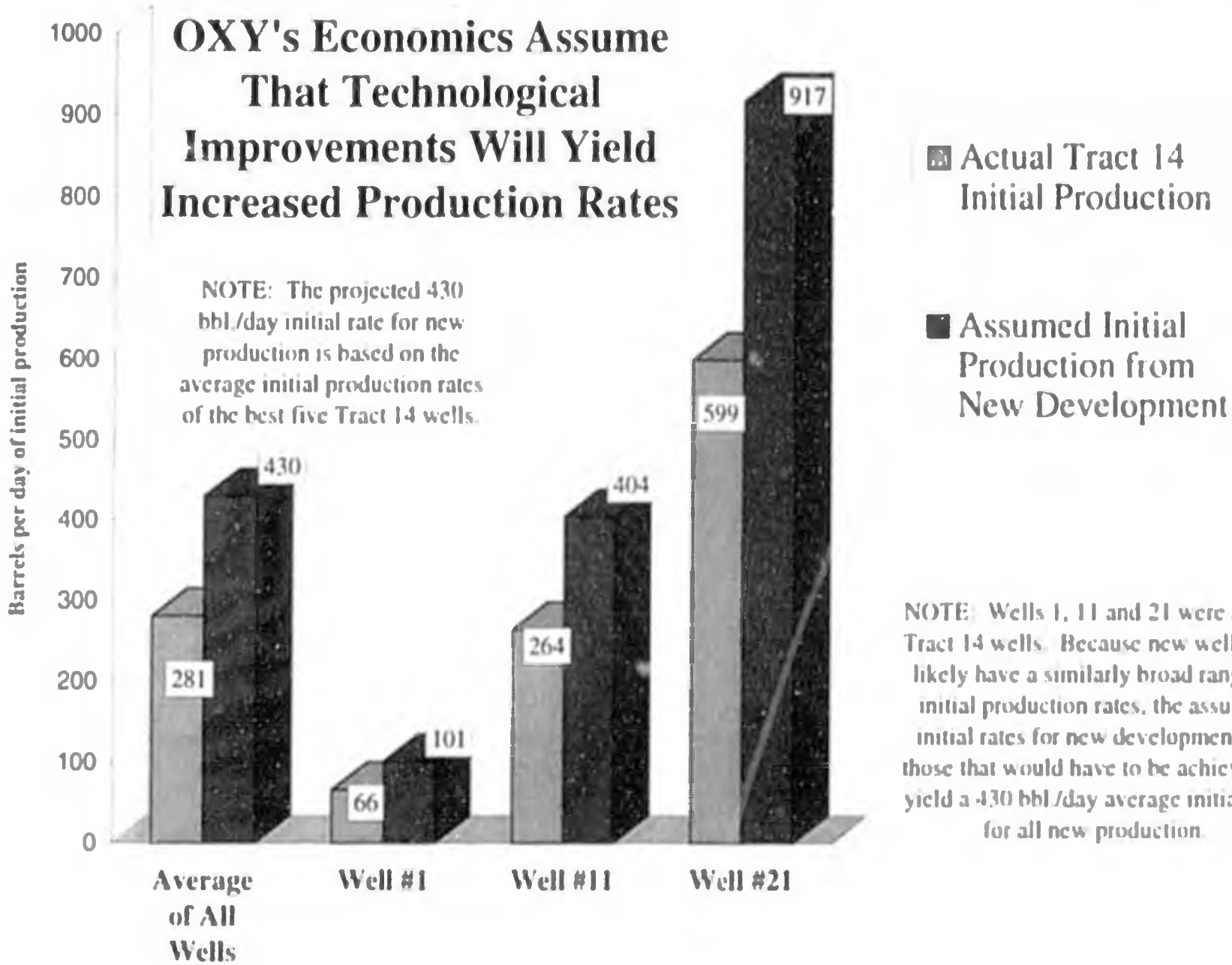


Projected Profit from Each \$4 Million Well and Facility Investment Under Various Scenarios



In thousands of dollars @ a 15% discount

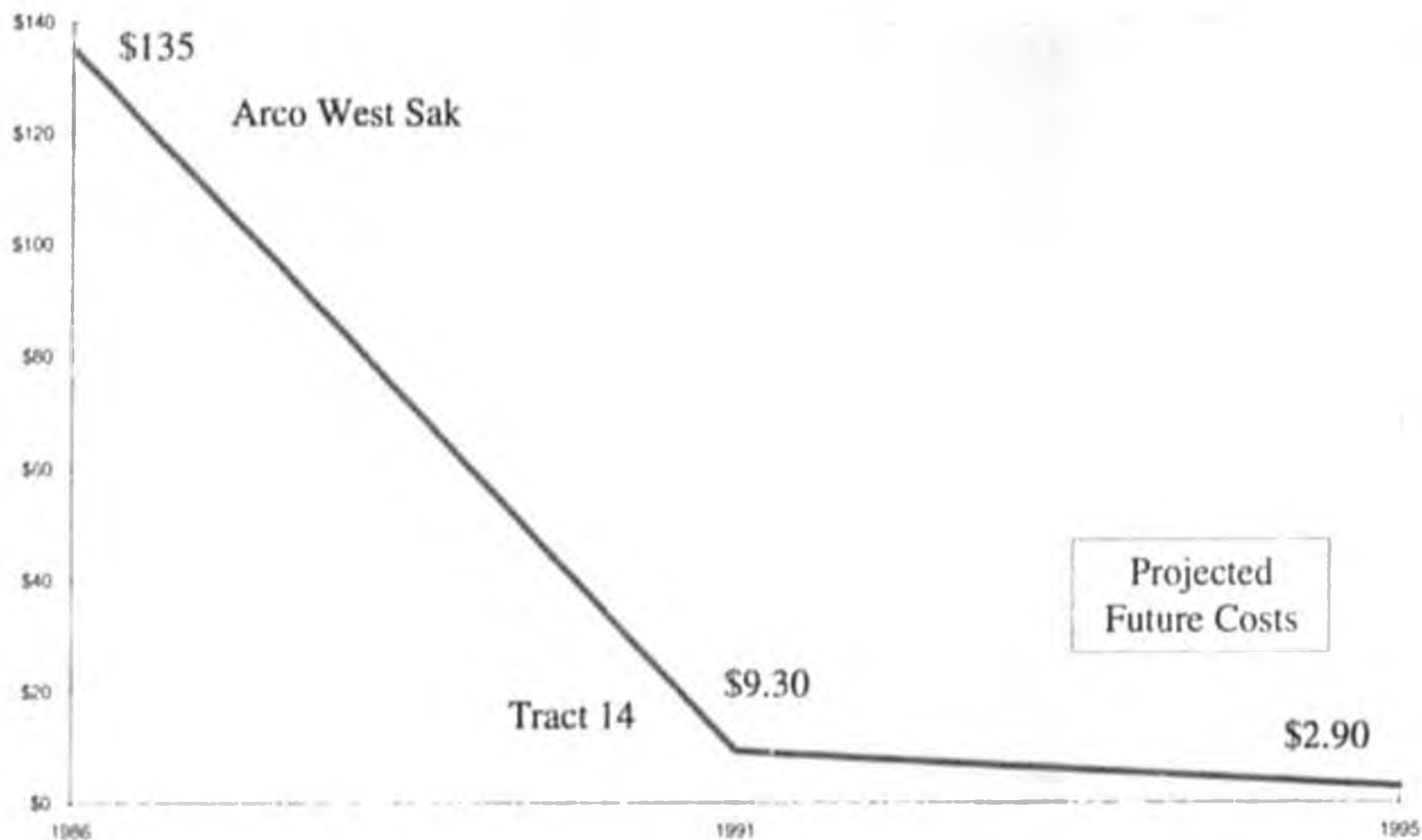
OXY's Economics Assume That Technological Improvements Will Yield Increased Production Rates



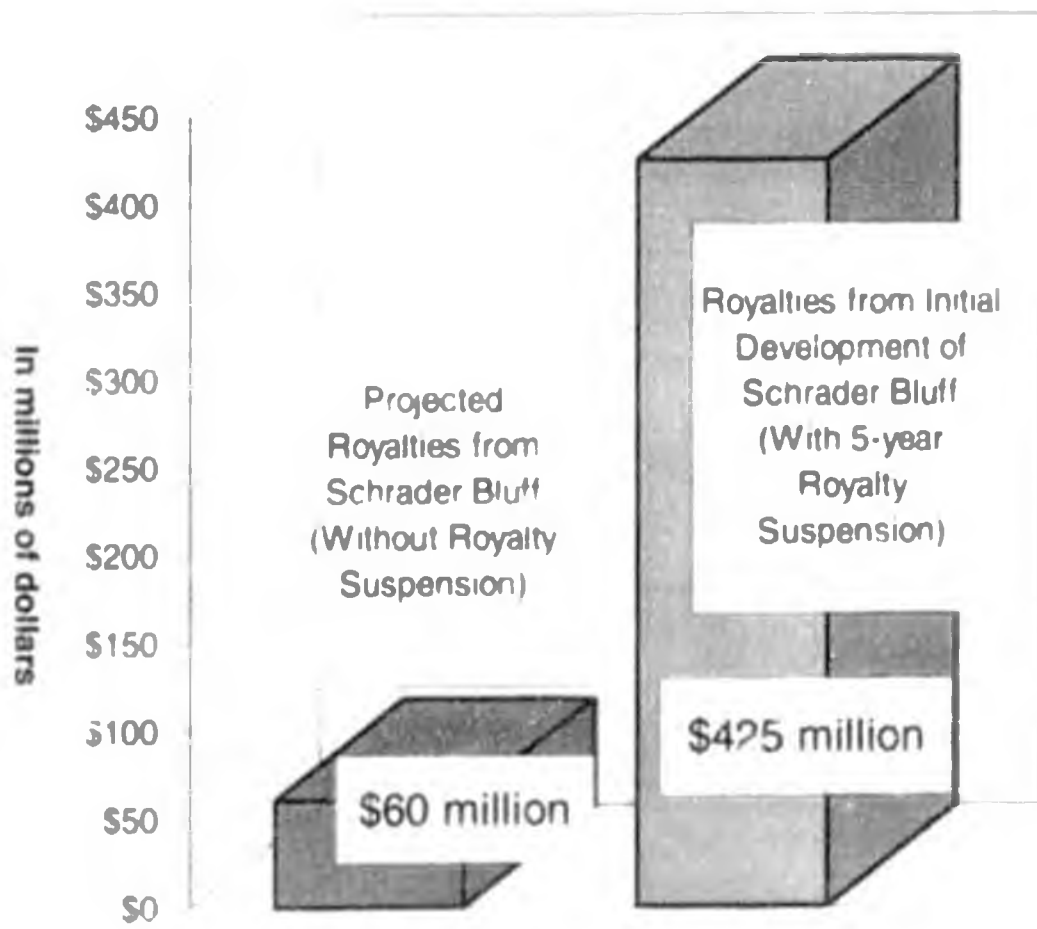
NOTE: Wells 1, 11 and 21 were actual Tract 14 wells. Because new wells will likely have a similarly broad range of initial production rates, the assumed initial rates for new development are those that would have to be achieved to yield a 430 bbl/day average initial rate for all new production.

History of ANS Heavy Oil Development Costs

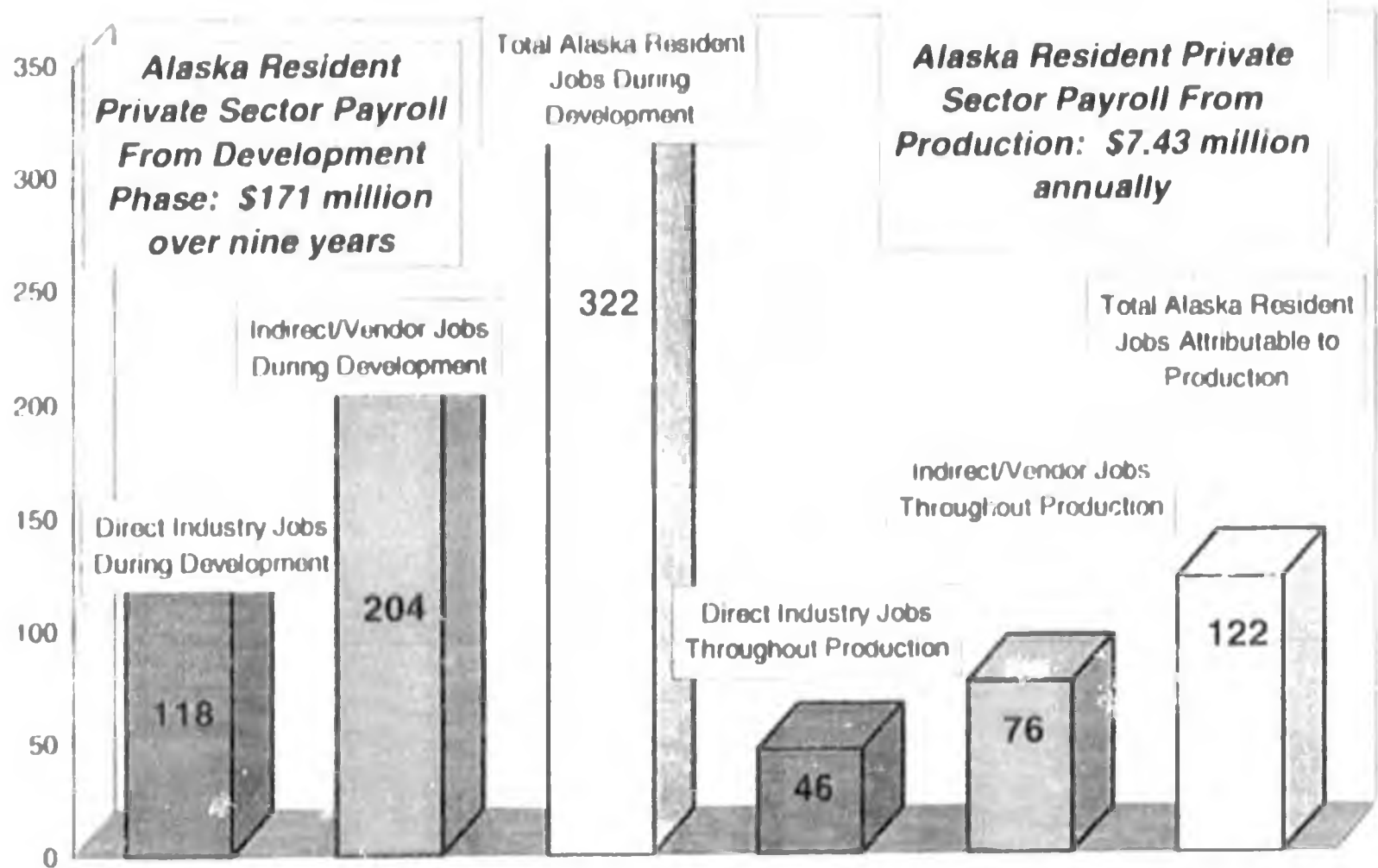
In dollars per barrel



Two Paths for Schrader Bluff



Alaska Resident Private-Sector Jobs Created by Schrader Bluff Development



APR 19 1996

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April 19, 1996

The Honorable Loren Leman
Alaska State Senate
State of Alaska
Senate Resources Committee
Capitol Building, Room 113
Juneau, Alaska 99801

Re CSHB 325(FIN) am

Dear Senator Leman

During House debates on HB 325 (relating to heavy oil), OXY USA Inc. was asked why the discretionary relief process established in HB 207 last session was not adequate to encourage development of Alaska's heavy oil reserves. In response, OXY submitted the enclosed letter, which we're offering for your consideration in connection with Senate Resources Committee deliberations on the legislation.

Thank you in advance for your time spent reviewing the enclosed correspondence.

Sincerely,

SIMPSON, TILLINGHAST,
SORENSEN & LORENSEN



Jonathan K. Tillinghast

Enclosure

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February 2, 1996

The Honorable Joe Green
Alaska State House of Representatives
State Capitol, Room 24
Juneau, Alaska 99801-1182

Re: Application of HB 207 to Heavy Oil
Our File No. 840.2

Dear Representative Green

OXY USA Inc ("OXY") has asked us to respond to Division of Oil and Gas Director Kenneth Boyd's January 30, 1996 letter to Representative Bill Williams regarding the possible use of HB 207 to accomplish the goals of HB 325. In summary, we are confident that HB 207, as it currently exists, cannot be used to fashion an effective ANS heavy oil incentive. To cure the problems associated with HB 207, as it applies to ANS heavy oil, we believe that last year's law would need to be amended to substitute the process and substance of HB 325 for the discretionary procedures set out in HB 207.

To begin with, OXY very much agrees with Mr. Boyd that HB 325 furthers the "primary purpose" of HB 207. OXY, in fact, entered the debate over heavy oil only in response to Governor Knowles' invitation to the private sector to explore new partnerships to develop Alaska's untapped energy resources.

However, HB 207 was never intended as the sole, nor even the principal vehicle for accomplishing that goal. Before each of the several legislative committees that considered HB 207 last session, DNR Commissioner John Shively stressed that HB 207 was only a tentative beginning, and that more concrete initiatives would follow. As Commissioner Shively explained to the Senate Resources Committee:

There are a variety of ideas about how to provide the oil industry with the incentive to develop marginal oil fields.

HB 207 was a compromise effort that can be implemented this year, as opposed to other ideas that can be studied by the Governor's Oil and Gas Policy Commission (sic).

Minutes, Senate Resources Committee, April 22, 1995 at 8. Commissioner Shively made the same point to your committee:

[Shively] said the Administration believes there are a number of things which can be done, both in the state's best interest and in the oil industry's best interest, to help encourage greater oil development. He noted part of that may be done now but the bulk of that will be done through the study the Governor's Oil and Gas Policy Council will be conducting over the next several years.

Minutes, House Resources Committee, March 32, 1995 at 3, emphasis added. As Commissioner Shively explained to the House Oil and Gas Committee, HB 207 was simply a quick first step from a new administration

[Shively] said, he thinks there are other roads, and some other additional legislation. He stated it was his decision, at this point, given the newness of the Administration, that this is something we can do this year. However, the Governor has appointed the Oil and Gas Policy Council, and one of their responsibilities is to look at other methods of providing incentives for oil development, and for a healthy oil industry. He then stated they consider this to be just the first step.

Minutes, House Oil and Gas Committee, March 9, 1995 at 4

Heavy oil, in particular, was excluded from the HB 207 debate. Last April, OXY sought the advice of both the administration, and the legislature, on the most appropriate vehicle for addressing heavy oil incentives. At the time, both felt that HB 207 was the wrong vehicle for that endeavor, and that the heavy oil issue should instead be treated

Similarly, Commissioner Shively told the Senate Finance Committee that

A number of ideas have been proposed to provide incentives for development of marginal fields in Alaska. Early in this administration, the proposed royalty incentive was determined to be something we could do this year while the oil and gas policy commission (sic) examines other methods of making the state more competitive, internationally.

Minutes, Senate Finance Committee, May 8, 1995

separately, over the interim, through the Oil and Gas Policy Council and the appropriate legislative committees

OXY appreciates the administration's interest in encouraging heavy oil development, through HB 207 or any other means. That interest re-enforces DNR's long-held view that, under the existing fiscal environment, heavy oil development isn't likely to occur.^{2/} The effort, unfortunately, is procrustean.^{3/} The goals of HB 325 can't be forced into HB 207's structure for six reasons:

1. Schrader Bluff is ineligible under HB 207

Mr. Boyd is correct that HB 207 does not authorize royalty relief in all circumstances, but rather under only three tightly-defined conditions. Mr. Boyd argues that the second of those circumstances--the "Declining Field" circumstance set out in AS 38 05 130(j)(1)(B)--might be made to fit Schrader Bluff.^{4/}

The "Declining Field" clause in HB 207 was intended to apply to older fields that are reaching their economic limit because production is declining, and per-barrel costs are correspondingly rising. It is, in short, the Cook Inlet clause, and was never intended to apply to stimulate initial development of new fields that had experienced only pilot drilling.

The limitations of that clause, and its inapplicability to Schrader Bluff, are apparent from three different angles

a. The language of the clause. By its terms, the clause allows royalty relief only: (1) to "prolong the life" of an oil field, and (2) "as costs per barrel increase"

The purpose of HB 325 is not to "prolong" Schrader Bluff's field life, for at the moment (and save for a pilot project) there is nothing to prolong. HB 325's purpose, rather, is to encourage *initial development* of an essentially untapped field.^{5/}

As our white paper, *An Opportunity to Develop Alaska's Heavy Oil Resources*, explains, DNR's Spring, 1994 production forecasts concluded that the entire Milne Point Unit (inclusive of Schrader Bluff) would be abandoned in 2006, while that agency's Spring, 1995 forecasts predicted unit abandonment in 2011. Neither forecast assumed any heavy oil development, save for the minor production flowing from the Tract 14 pilot project. Some projected heavy oil development first appeared in the Department of Revenue's Fall, 1995 forecasts because of methodology changes that were unrelated to the actual likelihood of Schrader Bluff development.

Procrustes, you'll recall, was the villainous son of Poseidon who forced travelers to fit into his wooden bed by stretching them on a rack, or cutting off their limbs.

Mr. Boyd briefly argues that the third circumstance--where royalty relief may be granted to "reestablish production of shut-in oil"--might also be availing. There is no shut-in production at Schrader Bluff, and, through the Tract 14 pilot wells, the field produces and sells 3,000 bbls/day.

Indeed, one would think that, if any of HB 207's three bases for royalty relief were applicable to Schrader Bluff, it would be what Mr. Boyd calls the "New Pool" clause of AS 38 05 130(j)(1)(A). However, Mr. Boyd concedes that this basis is unavailable because it excludes

Moreover, "costs per barrel" are not increasing at Schrader Bluff, as they are in Cook Inlet where constant operating expenses are being spread over fewer and fewer barrels. To the contrary, one essential goal of BP's and OXY's pilot efforts has been to reduce per barrel costs, and, as BP has testified before your committee, continued *decreases* in per barrel costs are as essential to field development as is an effective legislative incentive.

b. HB 207's legislative history. Commissioner Shively explained to the Senate Finance Committee that the "Declining Field" clause was only intended to cover "fields that are declining or about to be shut in."⁶¹ The clause, the Commissioner added, addressed only fields "that might be abandoned" (*id.*), and DNR's position paper on HB 207 made it clear that the clause was aimed only at providing relief at the end of a field's life. The clause, the agency said, covered:

Oil and gas fields whose economic life may be prolonged in light of increasing costs in the later stages of production.

"CS for HB 207 (FIN) AM QUESTIONS AND ANSWERS," (hereinafter "DNR Paper") undated at 1; emphasis added. These were what the agency called "mature producing fields,"⁶² or what Chair Rokeburg more directly described as "old uneconomic fields...e.g. Cook Inlet."⁶³

The administration and the legislature knew what the "Declining Field" clause encompassed. The clause was directed at Cook Inlet fields, and not initial development of ANS heavy oil.

c. Prior DNR precedent. HB 207 added only one category of fields eligible for royalty relief--Mr. Boyd's "New Pools," the most frequently cited example being the Badami field. As DNR consistently reminded the legislature, the Declining Field clause pre-dated HB 207.

The current law allows the commissioner to grant royalty reduction to prolong the economic life of a field or to reestablish shut-in production.

any field that has "previously produced oil or gas for sale." The statute thus fails to account for new fields from which some production has occurred from test or pilot drilling. Whether that omission was intentional or inadvertent, it's still nonetheless fatal to Schrader Bluff's eligibility under HB 207.

⁶¹ Minutes, Senate Finance Committee, May 8, 1995.

⁶² *Id.* at 3.

⁶³ Memorandum, Chair Rokeburg to Members of Senate Finance Committee, May 5, 1995 at 2.

DNR Paper at 1, emphasis added. Indeed, DNR often cited its pre-existing authority under the Declining Field clause as a defense to claims that HB 207 gave the agency excessive discretion. Granting royalty relief under the Declining Field clause, Commissioner Shively told the House Oil and Gas Committee, "is really not something new to the office."⁹ Indeed, and as Mr. Boyd explained to the Senate Finance Committee, the Conoco/OXY royalty relief application had been decided under that clause.¹⁰

The Conoco decision, in which Conoco and OXY were denied any adjustment to the special royalty surcharge imposed on some Milne Point production at the time the Milne Point Unit was formed, concluded that relief could not be granted under the Declining Field clause until near the very end of field life. Until then, any prognosis about field economics would be dependent on projections of future oil prices, and the inherent uncertainties in forecasting the future price of oil made it *impossible* for Conoco to make the requisite "clear" showing of entitlement to relief. Said the hearing officer

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 [under the Declining Field clause] at this time.

*It is very difficult, if not impossible, to provide such [clear] evidence here, since the Milne Point field is in the very early stages of production.*¹¹

The Declining Field clause, DNR ruled, was available only to Cook Inlet fields, where but a few production years remained. Younger fields were ineligible. And given that

(1) the Declining Field clause, according to DNR, was simply transferred into HB 207

⁹ Minutes, House Oil and Gas Committee, March 9, 1995 at 4.

¹⁰ Minutes, Senate Finance Committee, May 8, 1995.

¹¹ 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) (hereinafter "Conoco Decision"), December 28, 1990 at 15-16.

(2) the former standard of requiring a "clear" showing was replaced in HB 207 by an even more stringent "clear and convincing showing" requirement;¹² and

(3) Schrader Bluff's potential 41-year field life is nearly twice as long as the Kuparuk Formation field life at issue in the Conoco decision.

Mr. Boyd's suggestion that the future development of ANS heavy oil be adjudicated under the Declining Field clause does not give ground for optimism.

II. HB 207 Does Not Allow Royalty Suspensions

Mr. Boyd has suggested an amendment to HB 207 that might obviate Schrader Bluff's eligibility problem. However, amending HB 207's eligibility requirements would not lessen any of the other difficulties inherent in relying on that statute.

The first of these other problems is HB 207's mandatory 3% royalty floor for Declining Fields. AS 38 05 180(j)(4)(B).

As our white paper explains (*see n. 2, ante*), heavy oil fields are materially different from the kinds of fields considered in the debate over HB 207. Their initial production rates are low; however, production then declines quite gradually thereafter, and the field enjoys a remarkably long life--in Schrader Bluff's case, an estimated 41-years.

Thus, and as the white paper demonstrates, the State of Alaska would likely earn considerably more royalty income from a five-year royalty suspension at the outset of production (which is what HB 325 envisions) than from a reduced royalty spread over the life of the field (as HB 207 envisions).

Indeed, the white paper estimates that the State of Alaska *would lose about \$800,000 per well* if it imposed a 5% field royalty under HB 207 rather than enacting HB 325. *Id.* at 39, Chart 16.

As the white paper also discusses, Arthur D. Little, in its report to the Oil and Gas Policy Council, faulted Alaska for insisting on a one-size-fits-all royalty policy that is insensitive to the peculiarities of particular marginal fields. HB 207's royalty floor may make sense as a general proposition, but it disserves both the public's and industry's interest in developing heavy oil. In this respect, then, HB 207 proves Arthur D. Little's point, and it also underscores the wisdom of Commissioner Shively's repeated cautions to the legislature that HB 207 was never intended to address every oil and gas incentive issue.

III. HB 207 Addresses Only Lease-Based Royalty Relief

HB 207 only authorizes royalty relief for leases and unitized interests. AS 38.05.180(j)(1). It does not envision royalty relief targeted to individual wells that may be owned by several lessees.

HB 325, conversely, purposefully targets only individual new heavy oil wells. In so doing, it denies any incentive to production from pre-existing heavy oil wells, or production from other oil-bearing formations in the unit. In this way, it ensures that incentives are offered only when they serve the bill's primary purpose--to encourage new heavy oil drilling.

Also, HB 325's five-year suspension limit applies on a per well basis, so that the state can begin receiving royalties early in the field's development. And it imposes its 500/bbl/day cap on a per well basis, because individual well production rates are the best measure of whether the heavy oil property as a whole requires the incentive.

HB 207's lease-based approach does not seem suited to the kind of targeted relief, and targeted safeguards, contained in HB 325.

IV. HB 207 is Burdened By an Unrealistic Economic Test

In the Conoco decision, the hearing officer concluded that an oil company should invest in a prospective oil and gas development, and needs no incentive, if it projects a rate of return from that venture at least equal to the then-current yield on a risk-free 90-day U.S. Treasury bill. *Conoco Decision* at 10.

OXY thought this an unreasonable standard. If an investor can earn the same rate of return from: (1) a risk-laden oil venture; or (2) a T-bill, why would that investor not simply purchase the T-bills?

This standard was imposed by a prior administration. However, nothing in HB 207 expressly altered that standard. And unless and until DNR reconsiders the matter, this standard remains a formidable obstacle to any worthwhile development incentive.

V. HB 207 Fails to Achieve Three Other Goals of HB 325

Our white paper lists seven criteria for any effective heavy oil incentive. HB 207 fails each of these three:

a. Immediacy. As BP has testified before your committee, there is a window of opportunity for developing ANS heavy oil that, as experience has shown, may pass quickly. Mr. Boyd has testified that DNR could complete an HB 207 application for heavy oil in as few as three months. However, given that:

(1) Alaska's only prior royalty reduction proceeding, the Conoco/OXY Milne Point proceeding, required 15 months to complete simply at the agency level; and

(2) HB 207's process is considerably more complex than prior law's,¹³

we believe that one year is a more realistic minimum;

(b) Certainty. As you know, HB 207 accords DNR considerable discretion. Indeed, no matter how compelling the applicant's economic case, DNR remains free to deny or limit relief under an open-ended "public interest" standard. AS 38.05.180(j)(3)(A). As a result, no prudent investor would commit capital on the assumption that adequate relief under HB 207 would be granted. To the contrary, any investment decision made in 1996 would necessarily assume that relief would ultimately be denied, and

(c) Credibility. Our white paper argues that any heavy oil incentive should draw on successful experience in other oil producing jurisdictions. The Arthur D. Little report called royalty suspensions a tried and successful tool to stimulate investment in marginal fields, and the white paper lists the United States, and seven producing states, as jurisdictions that have employed royalty and tax suspension to do just that. In Texas alone, a high-cost gas well tax suspension resulted in a 400% increase in gas wells drilled, and 104,000 additional employment years, over the suspension's four-year history. *Id.* at 35

Conversely, Alaska's discretionary royalty reduction history is less encouraging. There has been only one such completed process, and after nearly four years of agency and court proceedings, the principal applicant--Conoco--sold its interest in Milne Point and left the state.

Besides its certainty, HB 325, in contrast to HB 207, benefits from its simplicity. As we've seen, the only prior completed royalty reduction proceeding in Alaska consumed 15 months before the agency. As would be the case with HB 207, each individual lessee was required to present a complete, lessee-specific economic case. Even though it owned but an 8.81% interest in Milne Point, OXY was forced to bear six-figure fees and costs associated with the application, as well as a considerable disruption of company operations.

Independent companies with smaller interests in Alaska, or with only prospective interests in the state, will not be attracted to our state by potentially complex administrative proceedings with uncertain outcomes. Once again, Arthur D. Little's

¹³ Among the steps required by HB 207 are: (1) preparation of preliminary and final findings; (2) a mandatory 30-day public comment period; (3) possible selection of an independent consultant; (3) preparation and agency review of the consultant's report; (4) agency audits; (5) possible legislative committee review, and (6) gubernatorial review.

admonition is pertinent. Alaska, for too long, has built its royalty policies around large, profitable fields run by large interest holders. As a result, the gene pool of Alaska's oil industry continues to shrink, and reliance on HB 207 to spur ANS heavy oil development would do nothing to reverse that trend.

VI. HB 325 Enhances the Legislature's Role in Setting State Royalty Policy

HB 325 reflects the belief that, *where it is possible to do so*, the legislature itself should set royalty policy. That wasn't possible with HB 207, since its broad scope encompassed too many varying situations to admit of direct legislative management.

HB 325, on the other hand, focuses only on a single, well-understood development challenge. As a result, it invites a reassertion of legislative involvement in this sphere, if the legislature chooses to take that opportunity. In part, that's because there seems something of a consensus that ANS heavy oil is unlikely to be developed without an effective incentive. A better opportunity for direct legislative involvement is, in our view, unlikely to present itself.

On behalf of OXY, let me extend our thanks for the consideration that I know you, and the House Resources Committee members, will give to the thoughts expressed in this letter. If you or any committee member have any further questions, please don't hesitate to contact me.

Sincerely,

SIMPSON, TILLINGHAST, SORENSEN & LORENSEN

Jon K. Tillinghast

* For years, the departments of Natural Resources and Revenue took that position, and nothing has changed since the Spring of 1995 when that view was last articulated. For their part, companies such as BP, OXY, Arco and Conoco have invested over \$270 million in ANS heavy oil pilot projects over the past decade. If, for example, Schrader Bluff could be economically developed without changes in the state's fiscal structure, its owners would have plainly seized the opportunity to recover that investment a long time ago. Our white paper discusses the technical, logistic and economic hurdles associated with heavy oil development in detail, and we've heard no one suggest that the case was overstated.

SIMPSON, TILLINGHAST, SORENSEN & LORENSEN, P.C.

The Honorable Joe Green
February 2, 1996
Page 10

cc Senator Loren Leman
Representative Norman Rokeburg
The Hon John Shively
Mr. Kenneth A Boyd
Members, House Resources Committee

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

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Fax transmittal



To: *Senator Loren Leman*

Fax Number: *907-465-3810*

From: *Ken Boyd*

Date & Time: *4/22/98*

Number of Pages (including cover sheet): *25*

Comments:

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April 22, 1996

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

Dear Senator Leman:

The division would like to make a few comments regarding HB 325 to the Senate Resources Committee. The division pointed out many issues pertaining to HB 325 in its letter to Representative Hanley dated February 13, 1996. (Attachment 1). While some of the problem-areas addressed in the letter have been resolved, many of the division's comments are still pertinent, and the division is prepared to address any questions the committee may have regarding that letter or this.

Heavy Oil Economics for the Milne Point Project Has Not Been Independently Analyzed.

As you may be aware, Representative Hanley requested that the division perform an economic analysis of the effect of HB 325 on royalties from the Schrader Bluff formation within the Milne Point Unit (MPU). In a hearing before the House Finance Committee, both OXY USA Inc. (Oxy) and BP Exploration (Alaska) Inc. (BPXA) offered to make available to the division the backup information supporting their economic claims in their testimony and White Paper dated January 22, 1996. This backup would have allowed the division to perform a proper, and independent, economic analysis for the House Finance Committee. The division formally requested the backup on February 9, 1996. Oxy submitted a (confidential) response on March 7. The response was lacking in some details which Oxy said BPXA would supply, and some of Oxy's assumptions seemed questionable to the division.

BPXA responded on April 8, two months after the division's request (and a week after the bill passed out of the House). BPXA provided a lot of data, but their response lacks an economic model and any explanation (in contrast to what BPXA provided in the discussion of the Northstar economics) about how the data provided translate to the economic conclusions presented in a (confidential) summary sheet. Moreover, the division has not had the opportunity to meet with BPXA geologists, engineers, and commercial staff to discuss the reasonableness of assumptions like reserve estimates, recovery rates, capital costs, operating costs, and effects of new

The Honorable Loren Leman

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April 22, 1996

technology on development. Commissioner Shively and I met with Bruce Policky of BPXA and discussed some of these issues. In order to expedite the division's analysis, I asked Mr. Policky to provide a "Northstar type" spreadsheet analysis for the MPU data under the provisions of the current form of HB 325 (because the data which BPXA did provide assumed a former version of the bill, e.g., 500 barrels of oil per day and zero percent royalty). The division has not received a response. Simply put, the division is unable to provide the Senate Resources Committee the level of economic analysis that it has provided the committee in the Northstar hearings.¹

Preliminary Analysis Shows the Milne Point Heavy Oil Project Meets the Companies' Hurdle Rates.

The division does not necessarily endorse the 15 percent hurdle rate which Oxy and BPXA claim that they need.² Nevertheless, the division's preliminary review of Oxy's information suggests that the Milne Point heavy oil project for Oxy appears to exceed the 15 percent hurdle rate without any royalty relief. BPXA's confidential summary sheet shows that at least under one scenario the Milne Point heavy oil project for BPXA would exceed the 15 percent hurdle rate without any royalty relief. The division awaits further information from the companies before reaching its conclusion.

HR 325's Economic Effect on Heavy Oil Development in Other Units Has Not Been Analyzed at All.

The division has not performed any economic analysis on the effect of HB 325 on heavy oil development in the West Sak/Schrader Bluff accumulation in the Kuparuk River Unit (KRU) or

¹ Interestingly, Oxy has asserted that the state should grant heavy oil incentives because the United States Department of Interior (DOI) did. The DOI took no action, however, until the United States Department of Energy (DOE) performed a detailed economic analysis, conducted over a two year period, of the effects of the proposed incentives on federal revenues. The analysis concluded that while royalty revenues might be reduced, overall federal revenues would increase. Furthermore, based on the analysis, the relief applied to California heavy oil production and did not apply to Wyoming production because expanding the program would have resulted in a cost to the government. Moreover, unlike the proposal in HB 325, the DOI regulation sets a sliding scale with the royalty rate at 12.5% at an API gravity of 20, and applies to properties rather than individual wells. Finally, the State and Tribal Royalty Audit Committee, which includes the State of Alaska, opposed this move by the DOI because they felt that there had been an inadequate showing of need and state revenues would be decreased. A copy of the Federal Register announcing the adoption of the final rule is provided as Attachment 2.

² Ed Behm of OXY testified that he did not know his own company's cost of capital and that overhead was not included in Oxy's economics. Without knowing this information, it is impossible to determine a company's "hurdle rate." In their White Paper at pages 23-24, BPXA and Oxy state that the hurdle rate "is built on four components :: (1) The cost of capital -- (2) Overhead -- (3) Risk -- (and 4) Profit. They also state that "these four 'hurdle rate' components combine to require at least a 15% projected rate of return from any new investment ..." If Mr. Behm does not know his own cost of capital and overhead, what was the basis for the 15% hurdle rate? If BPXA and Oxy have different cost of capital and overhead, shouldn't their hurdle rates be different?

The Honorable Loren Leman

3

April 22, 1996

that accumulation in the Prudhoe Bay Unit (PBU), nor has it been asked to do so. Both units have heavy oil at depths less than 5,000 feet, the current cut-off in HB 325. Mr. Behm of Oxy testified that the West Sak/Schrader Bluff accumulation in the KRU is the same type of sands as that in the MPU. He further expected that the technology to develop the accumulation in the KRU would be the same as in the MPU. ARCO Alaska Inc. (AAI), the operator of KRU, has neither testified to the legislature nor presented information to the division regarding the bill's effect on KRU heavy oil development. Ken Thompson, AAI president, has publicly indicated that AAI may begin some heavy oil development in the KRU in the near future. BPXA is a major lease owner in the KRU.

BPXA, the operator of the West end of the PBU where heavy oil is located, has neither testified to the legislature nor presented information to the division regarding the bill's effect on heavy oil development in the PBU. John Denis, BPXA's supervisor of PBU new business development, has stated in print that initial heavy oil production in the PBU could begin as early as 1997, early enough to take advantage of the HB 325's provisions. A copy of the article describing BPXA's plans for heavy oil at the PBU is provided as Attachment 3.

HB 325 Fails to Adequately Address Innovation

The information presented by BPXA and Oxy shows that the cost of developing heavy oil has been dramatically reduced over a very short period of time. According to BPXA and Oxy, in 1984, heavy oil development costs were \$135.00/barrel. Only five years later, development costs were reduced to \$9.30/barrel, a 93 percent reduction. Current development costs are \$2.75/barrel, a 70 percent reduction from 1989. BPXA estimates costs could fall to as low as \$1.80/barrel, another 35 percent reduction. HB 325, however, has a ten year sunset even though new technology and other innovations should dramatically improve heavy oil economics in the very near future. Indeed, BPXA and the DOE are spending \$10.6 million under a cooperative agreement to study Schrader Bluff-Milne Point heavy oil development at a research facility in Oklahoma. A copy of an article discussing the research project is provided as Attachment 4. Under HB 325, even if current and future cost reduction efforts decrease the costs to the point where Schrader Bluff is much more competitive, the state will not receive any royalty for the first five years production for new wells drilled over the next ten years.

HB 325 Does Not Provide for Alaska Hire.

In the Northstar debate, the Senate Resources Committee has expressed concern over the Alaska hire provisions in the proposed amendments to the Northstar leases. HB-325 contains no local hire provision whatsoever. An analysis of royalty reduction for heavy oil under HB-207 would allow the commissioner full flexibility to negotiate local hire terms.

The Honorable Loren Leman

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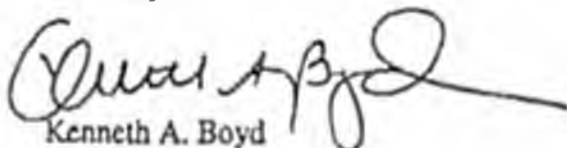
If Heavy Oil Development Would Not Occur Without Royalty Relief, Then HB207 Is the Proper Vehicle.

The royalty exemption in HB 325 is inflexible. The relief is awarded without any showing of any economic necessity. This is especially important in light of BPXA's statement that it may not need royalty relief and it may very well continue forward with heavy oil development even if it receives no royalty incentive. HB 325 does not provide the state with any upside potential. It does not require any commitment to employ Alaska residents. It does not guarantee any development. These are all factors which the commissioner of the Department of Natural Resources would consider in deciding whether to grant royalty relief under HB 207.

The administration is committed to having Alaska's oil resources developed in an environmentally and economically sound manner. It is entirely possible that some form of royalty relief will be needed to assist in getting our heavy oil resources developed. I would strongly suggest that the last two weeks of legislative session is not the most opportune time to create a new royalty policy for several billion barrels of heavy oil. While the division continues to believe that HB 207 is the proper vehicle for granting heavy oil relief if it is warranted, the next course of action may be to have industry, the State and interested legislators meet after session to craft a workable and sensible solution. As described above, the Department of Interior took a long, hard look before deciding on a royalty relief package. Even if you believe that HB-207 is not the right vehicle, we still owe the people of Alaska a careful, thorough analysis of the facts before launching into a "one size fits all" royalty reduction policy.

We will be pleased to work with the committee to help resolve this important issue.

Sincerely,



Kenneth A. Boyd
Director

DEPARTMENT OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

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February 13, 1996

The Honorable Mark Hanley
Co-Chair, Finance Committee
Alaska State Legislature
State Capitol, Room 507
Juneau, AK 99801-1182
MAIL STOP 3100

Dear Representative Hanley:

Several statements have been made recently regarding the merits of HB 325 and the Department of Natural Resources' position on HB 325. In particular, I refer to Jon Tillinghast's letter on behalf of OXY USA Inc. ("OXY") to Rep. Green dated February 2, 1996, the white paper dated January 22, 1996, by BP Exploration (Alaska) Inc. ("BP") and OXY, and testimony presented to the House Finance Committee on February 8, 1996. Some of the statements that have been made are inaccurate and, in some instances, are in error. I would like to address these statements and assumptions and point out some issues that should also be considered in evaluating HB 325.

A Little Background on 'Heavy Oil.' 'Heavy oil,' as defined in HB 325 and in federal regulations, focuses on crude oil with a weighted average gravity of 20 degrees API or less, corrected to 60 degrees F. Heavy oil on the North Slope comprises one of the State's largest known, undeveloped hydrocarbon resources. The volume of North Slope heavy oil in the ground is enormous; it compares in volume to the oil originally in place in the Prudhoe Bay Unit ("PBU") Sadlerochit reservoir. It is, however, found in shallower, thinner deposits and it is much more viscous (less able to flow) than other North Slope oil. The State owns at least one eighth royalty in this resource (some of the leases have a one fifth royalty), and the resource and its infrastructure are subject to all the applicable taxing authorities of the state and local governments.

The known accumulations areas on the North Slope of 'heavy oil' that would apply to qualify for this proposed royalty exemption include (1) a large continuous accumulation in the Schrader Bluff formation that stretches across and into three different units and is called by the different operators the West Sak sands in the Kuparuk River Unit ("KRU"), the Schrader Bluff formation in the Milne Point Unit ("MPU"), and the West Sak sands in the western part of the PBU; (2) the Heavy Oil/Tar Zone of the Sadlerochit formation within the PBU; and (3) portions of the Badami Unit and the Point Thomson Unit. No heavy oil accumulations are known in the Cook Inlet area.

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The Schrader Bluff in the MPU and the Heavy Oil/Tar Zone of the Sadlerochit formation within the PBU would be able to take advantage of the HB 325 exemption immediately. Any production from Badami and Point Thomson is uncertain. The KRU and PBU do not have facility sharing agreements in place to permit production of oil from the West Sak sands through the existing KRU (Kuparuk formation) facilities and PBU (Sadlerochit formation) facilities.

The Division does not know if the heavy oil in the Schrader Bluff formation in the MPU or KRU will ever be produced on a large commercial scale. ARCO has indicated that it may begin development of the West Sak in the near future. BP, the largest working interest owner in the MPU, has stated that it plans to continue to work on heavy oil development even if there are no incentives granted. Although oil price will always be the primary driver in the development decision, the drilling, well completion and well production technology will influence any large-scale development decision. Heavy oil production projects undertaken so far have been small demonstration projects. Knowledge gained from heavy oil projects in more temperate climates is of some use, but on the North Slope cold temperatures decrease the ability of the heavy oil to flow or be produced to the surface.

Even when production space becomes available in the KRU, West Sak development will presumably compete with higher producing projects. Using today's proven technology, a very good West Sak or Schrader Bluff well produces 300-400 BOPD. In contrast, a new marginal well in the KRU (Kuparuk formation) produces 800 BOPD. A new well in the marginal parts of PBU (Sadlerochit) produces 1000 BOPD.

Specific comments regarding the proposed HB 325 legislation

1. A heavy oil royalty exemption pursuant to HB 325 may avoid the HB 207 process, but it may expose the state to revenue losses it might not have to incur. The currently proposed royalty exemption is inflexible. There is no discretion in this legislation and no requirement to justify the economic necessity for the royalty exemption. There is no provision that would condition the royalty exemption to require the lessees to reinvest the foregone royalty dollars in "heavy oil" projects in Alaska. This inflexibility may also mean that when the five (5) years are over, the royalty will return to its original rate causing the operator to cease production (shut-in the well).

2. Further, the first 500 bpd of heavy oil production would be exempt from royalty payment with this legislation. Under the current oil and gas production tax statutes, AS 43.55, the first 300 BOPD are exempted from production tax. If this legislation passes, the state would receive no economic return (no taxes and royalties) from the first 300 bpd per well of "heavy oil". This may raise a constitutional issue about the legislature giving away the state's income in violation of Article VIII, section 2 of the Alaska Constitution. The mandate against such 'giveaways' is embodied in AS 38.05.180(a)(1)(A).

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3. The legislation would apparently circumvent any negotiated agreements (unit agreements or litigation settlement agreements or HB 207 royalty reduction agreements) between the state and lessee(s) regarding the obligation to pay royalty. For example, effective December 30, 1993, the State and OXY (one of the MPU owners) entered into an agreement to settle to certain litigation between the parties. As part of this settlement agreement, the parties negotiated limits on future royalty reductions in the MPU. With respect to Schrader Bluff production from the MPU, this legislation, if passed, would circumvent the Article 5 provisions of the State/OXY settlement agreement.

4. The legislation should define 'daily production from a well' to prevent an operator from producing a well less than 24 hours in a day to qualify for the exemption. In other words, in order to qualify for the royalty exemption, 'daily production from a well' should mean continuous production from a well over a 24 hour period.

5. The definition of the term "well" needs to be addressed in the legislation. Is a sidetrack of an existing well a new well that qualifies for the royalty exemption? Do multi-lateral wellbores count as two or more separate wells? Would a dual completion count as two separate wells? Would a sidetrack drilled in 1999 from a well drilled in 1997 restart the five year clock?

6. The current wording of HB 325 uses the phrase "value at the wellhead, net of eligible field cost deductions." It is difficult to determine what value is being referenced. For State royalty purposes, the value is determined at the appropriate LACT meter for all current North Slope royalty payors pursuant to the royalty settlement agreements. Field cost deductions are allowed only in certain circumstances under the State's leases and royalty settlement agreements. Therefore, no wellhead value is ever calculated. The proposed legislation does not detail what field cost deductions are eligible but for logic and conformity sake, the value should be measured at the LACT meter before any field cost deductions.

7. Further, there is no obvious reason nor is any evidence presented as to why a "wellhead value" of \$15.00 should be the trigger for returning the royalty to its original rate. Such a value seems quite high compared to the LACT meter values seen over the past few years. A Department of Revenue economist has testified that this \$15.00 value would be approximately \$21.50 (money of the day; ANS West Coast) and the only time this price has been reached since 1987 was during the Kuwait War. Given that the legislation also includes an inflation factor, it appears unlikely that the \$15.00 threshold will ever be invoked.

8. The possibility exists that structural locations within the Kuparuk Formation in the KRU and the Sadlerochit formation in the PBU produce 'heavy oil,' that is, these reservoirs produce oil with a gravity of 20 degree API or less. Is it the intent of the legislation to exempt portions of these reservoirs from the payment of royalty?

9. As described above, where reservoir fluid properties vary across the structure, the legislation creates a situation where wells are drilled in locations to take advantage of the royalty

exemption and not in locations for more efficient reservoir management/recovery. Incentives should not be put in place that distort the efficient use of resources. This was definitely a consideration when the federal government proposed its heavy oil incentive. The BLM recently promulgated a rule (effective March 11, 1996) to reduce royalty rates for properties that produced "heavy oil" with a gravity of 20 degree API or less. The royalty reduction applies to producing properties (such as leases, units, etc.) rather than to individual wells, and is based on the weighted average gravity of the oil produced by all wells on the property. Weighted average gravity was used to prevent gravity manipulation by selective production of wells with heavier crude on a property. The use of weighted average gravity also encourages maximum recovery from all wells within a property by removing the economic advantage of selective production.

10. Thought should be given to the administrative burden created by the above situation. Incentives should not be put into place that allow "gaming the system" by selective production of wells on a lease with "heavy oil". Increased oversight would be required to monitor individual well production tests, fluid sampling from the individual wells, laboratory fluid analysis procedures, etc.

11. The heavy oil royalty exemption offers a cash incentive to the lessees on a single well basis. If the state's royalty is eliminated, an individual "heavy oil" well producing 500 hpd would not pay the following royalty, assuming a \$10.00/bbl LACT meter oil value:

$$500 \text{ BOPD} \times 0.125 \text{ royalty rate} \times \$10/\text{BO} \times 365 \text{ days/yr} = \$228,125/\text{yr}$$

[If the royalty = 20 percent, the royalty amount = \$365,000/yr]

12. What motivation do the lessees have to increase production higher than 500 BOPD if by doing so they are "penalized" by a royalty?

13. If the heavy oil wells are so marginally economic that, under an HB 207 application, plus or minus 3% (the minimum royalty under HB 207) is significant, how can those wells ever be competitive against other projects in large companies such as BP?

14. What message would this incentive send to the public and to other marginal resource producers if the heavy oil producers are given blanket relief without any requirement to show economic need? This is especially important in light of the fact that BP has stated that it does not need royalty relief and it plans to continue forward with Schrader Bluff development even if it receives no royalty incentive. Regarding BP's pending application for royalty reduction, BP was quoted as saying that

But BP says it isn't serious about the application and doesn't expect the state to approve it. It was submitted only to comply with the terms of a contract between BP and OXY USA Inc., ...OXY pays BP about \$100,000 a year under the contract, said BP

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spokesman Paul Laird, but BP has to apply for a royalty reduction to keep the money coming. ...

BP pays the state a 20 percent royalty - one out of every five barrels of oil produced - on the eight leases involved in the application; it wants that rate cut to 12.5 percent, or one in every eight barrels. ...

"We are not going in for royalty relief or restructuring for Milne," Palmer said in an interview last week. "It's not needed." ...

"BP calls request for cut a formality," Anchorage Daily News (Stan Jones) pages D-6,7, April 21, 1995.

On state incentives in general, BP has stated that incentives affect only the pace of development:

What we have said is that fiscal terms will influence the pace of development. However, we plan to continue with our work on heavy oil even if there are no new incentives. If there are incentives, then we believe that the pace of development could be accelerated.

"BP says state incentives will set the pace for North Slope oil development," Letter by James A. Palmer, Director, External Affairs, BP, Anchorage Daily News, February 7, 1996.

BP's position contradicts Mr. Tillinghast's statement that there is "something of a consensus" that "ANS heavy oil is unlikely to be developed without an effective incentive." Tillinghast, page 9. Another industry player, new to Alaska, Anadarko Petroleum Corporation ("Anadarko"), also contradicts Mr. Tillinghast's statement of consensus. This past fall, John Seitz, Vice President, Exploration at Anadarko told the Oil and Gas Policy Council that.

I hope the State resists the temptation to create a myriad of targeted incentives to prop up uneconomic production or attract ephemeral or inconsequential investment. Whatever ends up being adopted or enacted should be substantive and apply uniformly to the entire industry. We are not now, and have never been advocates of legislation or regulation that tends to provide economic "incentives" to a special class of operator or to one type of production. We are, in fact, uncomfortable when the playing field is anything but level. We are willing to compete with anybody as long as the ground rules are reasonable and universal.

[emphasis in original] Presentation to the Governor's Oil and Gas Policy Council, September 7, 1995.

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15. If indeed, development will probably take place regardless of the incentive, how can HB 325 possibly be a fiscally efficient measure and why should the State commit to giving up a right to receive income from its property if the lessees involved are unwilling to commit also at this time? HB 325 is fiscally inefficient, if measured by the conclusions reached in a recent study for the Department of Revenue on behalf of the Oil and Gas Policy Council, because it is not profit based, and because it allows a royalty reduction where none is needed. See Arthur D. Little/John Gault, "Review of International Competitiveness of Alaska's Fiscal System," Preliminary Report for the State of Alaska, Department of Revenue, September, 1995. The evidence to date, discussed above, suggests that BP does not need a royalty reduction and BP has testified that BP may go forward with the project even without the incentive. Testimony of Bruce Policky, BP, February 8, 1996, House Finance Committee. The BP/OXY white paper suggest that a 15 percent rate of return will make a project "competitive." OXY has stated that if the proposed incentive is granted, it will achieve a rate of return of 15.9 percent and will likely go forward with the project. Its rate of return without the incentive is 12.8 percent. BP testified that its rate of return is 2 to 3 percent higher than OXY's rate of return, which would put it at 14.8-15.8 without the incentive: competitive already under OXY's standards.

16. If the true motivation of this incentive is to more quickly recover development costs, the Legislature might consider a net profit share structure or other profit-based system. Profit-based systems are progressive, rather than regressive, and fiscally efficient. See Arthur D. Little/John Gault, "Review of International Competitiveness of Alaska's Fiscal System," Preliminary Report for the State of Alaska, Department of Revenue, September, 1995.

Comments on Mr. Tillinghast's letter:

17. While it is true as Mr. Tillinghast states in his February 2, 1996 letter, that the Department of Natural Resources supported HB 207 as the "first step" in implementing incentives for marginal oil fields, it does not logically follow that HB 325 is required to be the second step or is the correct second step.

18. The Governor's Oil and Gas Policy Council, which is charged with investigating and proposing such incentives, has not proposed any incentives yet. Although heavy oil was one issue discussed by the Oil and Gas Policy Council, the Council did not propose HB 325.

19. The discussions and debate leading to the enactment of HB 207 last year did not specifically exclude heavy oil, as Mr. Tillinghast's letter would imply. In fact, the very reason why the language "or pool" was added to HB 207 was to allow separate "pools" within a "field" to be granted royalty relief. The specific example used on a number of occasions was the West Sak, a heavy oil pool which is otherwise known as the Schrader Bluff pool. Commissioner Shively testified that under the new provisions of HB 207, the West Sak could qualify for

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royalty reduction while the Kuparuk pool, which underlies West Sak, might not qualify.¹ Although Mr. Tillinghast's letter on behalf of OXY suggests that the Schrader Bluff pool within the MPU cannot qualify for royalty reduction under AS 38.05.180(j) (the HB 207 reduction provisions), his statements contradict the actions of BP. BP submitted a royalty reduction application (currently suspended) for the MPU, including production from Schrader Bluff.

It is not the fact that Schrader Bluff field contains heavy oil that appears to cause OXY difficulty in approaching relief under HB 207. By prior agreement with the State, OXY is barred from applying for royalty reduction at Milne Point field for five years from July 1994 on some leases and for the life of the unit for eight specified leases. See Section 5.3 of the OXY/State Settlement Agreement. The fact that the timing of the pool's life does not, to OXY apparently, neatly fit into any of the three categories of HB 207 may be a symptom but not the root cause of OXY's problem.

Other marginal fields without heavy oil production undoubtedly fall within such a 'gray' area also. If indeed necessary, the most efficient "fix" is an amendment to the HB 207 provisions. The Division proposes that this could be accomplished by amending the language in AS 38.05.180(j)(1)(B) to read as follows:

(B) to prolong the economic life of an oil or gas field or pool as costs per barrel or barrel equivalent increase or to allow for production of a heavy oil pool, which is defined as an oil pool that produces crude oil of a weighted average gravity of 20 degrees (American Petroleum Institute) or less, corrected to 60 degrees Fahrenheit; or

20. No application for royalty relief in the Schrader Bluff pool under the HB 207 provisions has been rejected as improper under the HB 207 provisions. If the lessees truly will not go forward with any further development or operations in the Schrader Bluff pool, then any relief applied for and granted would be to "prolong the life of the pool." OXY provides no information on how or if the costs per barrel for Schrader Bluff oil are expected to increase. Therefore, opinions by some that Schrader Bluff oil cannot be granted relief under the existing statute appear premature.

21. Mr. Tillinghast's discussion of the Conoco royalty relief application is incomplete. The Conoco and OXY applications for royalty relief were initiated under the pre-HB 207 statutes. When the department denied the applications, Conoco and OXY appealed the agency decisions and initiated an independent action in the superior court. This independent superior court action slowed the agency appeal and when Conoco and OXY's independent action reached the Alaska

¹ For example: "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." Page 4, DNR's Briefing Paper for Senate Resources Committee (April 1995)

Supreme Court, it was rejected. Litigation takes time, no question about it, and the tale of the prior Conoco/OXY royalty reduction application would have been much shorter had the agency appeal been allowed to proceed and the premature action in superior court not been initiated and litigated. The current HB 207 provisions do not allow such litigation. Moreover, time has vindicated the agency's decision. BP purchased Conoco's interest in Milne Point Unit and has since then invested over \$200 million and increased production by 25% without any royalty relief. Further, according to the current operator, BP, production is expected to triple within the next few years, again without royalty relief. Any claims that Conoco left Alaska because it needed royalty relief and could not get it are clearly disproved. Conoco made its own decisions about investing and managing Milne Point and about leaving the state.

22. Mr. Tillinghast assumes that a T-bill interest rate would be imposed on a new royalty relief application. That was the rate determined by the department under the pre-HB 207 statute to be representative of a return that might be expected for a field where the major capital investments have already been made, not a field at the beginning of its development and production life. Not only does the department now have different statutory authority, but nothing would constrain it to apply that rate of return to different scenarios.

23. Mr. Tillinghast's statement that this proposal does not give any incentive to "production from other oil-bearing formations in the unit" (Tillinghast, page 6, part III) is inaccurate. Production from the Schrader Bluff pool will, to a certain degree, lower the per barrel cost of production within the unit by spreading the gross costs over a larger volume, which would increase the economic life of the other pools involved. It will also lower the TAPS tariff for all of BP's other North Slope production. An incentive therefore results.

The BP/OXY white paper dated January 22, 1996.

24. The paper discusses a pool life of 41 years for Schrader Bluff but proposes royalty suspension for individual wells. Mixing well economics and field economics results in an inaccurate analysis. Most of the wells will not have a productive life of anywhere near 41 years; therefore, the up front five year royalty suspension comprises a much larger percentage of the individual well life than it does of the total pool life.

25. Well by well economics do not reflect the integrated field economics. Any field undoubtedly has at least a few marginally economic wells; that does not necessarily put the entire field in need of royalty relief.

26. The white paper's authors assume that the State would choose a flat 5 percent royalty as the relief alternative offered. The State is not constrained to that particular figure; indeed, flexibility is one of the advantages of the HB 207 provisions. In any case, the current royalty reduction floor is 3 percent.

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27. The analysis assumes that the well costs equal the average costs of Tract 14 wells through 1991. This cost does not then take into account significant savings touted by North Slope operators like BP from advances in drilling since 1991 (when drilling on Tract 14 by Conoco ceased) such as using coiled tubing units and multi-lateral completions. The analysis does not address the cost for BP as the new operator and a party with significantly more North Slope drilling and operating experience than OXY or Conoco. The analysis does not project that the operator will most certainly be attempting to reduce costs through increased experience levels in the future. The white paper touts significant cost reduction achievements so far: from \$135MM for 13 wells and associated facilities at West Sak to \$126MM for 22 wells and associated facilities at Tract 14. BP/OXY's White Paper, page 14. Unless the lessees have abandoned all efforts at cost reduction, further increases have most likely been achieved since 1991 and should continue into the future. Under HB 325, even if current and future cost reduction efforts decrease the costs to where Schrader Bluff is much more economically competitive, the State will not receive any royalty for the first five years of any well's production.

28. The analysis assumes that operating costs remain the same as those in 1995. This presumes that 1995 was an "average" year in spite of the fact that operatorship had just changed. It also does not account for any efficiencies or economies of scale gained by increasing the size of the project and by gaining more experience or technology.

29. The analysis assumes that OXY is the appropriate corporate model to use to determine what rate of return may be expected from this project. In fact, it is likely quite the opposite. OXY has not only the minority share of the working interest (8.81%) but it also does not own downstream interests which would benefit from additional production. It would appear to be inappropriate to concentrate on royalty relief for that small interest owner when the majority interest owner (91.19%) would at the same time receive additional unaccounted for benefits for additional production (its downstream benefits and a royalty holiday on leases that have a 20 percent royalty rate).

30. The white paper refers several times to the DNR production forecast that includes Schrader Bluff production. It must be noted that the DNR forecast is a very general forecast based on minimal information about future Schrader Bluff production and little if any about the operator's internal long range plans. The white paper authors have incomparably more knowledge and data on Schrader Bluff than the DNR personnel and DNR's forecast is based on announced or existing development plans, not on speculative development.

The white paper refers to the new federal heavy oil incentive program and other state marginal well incentive programs. Several points need to be clarified here:

31. As discussed above in paragraph 9, the federal program is applied on a property by property basis, not on an individual well basis.

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32. The federal program has not yet started. It will be effective on March 11, 1996. See 81 FR 4748 (Feb. 8, 1996).

33. The federal program does not eliminate all royalty because "that would jeopardize the [Department of Interior's] efforts in securing a fair return for public land resources." 81 FR 4748. Moreover, achieving the maximum economic return is not the primary focus of the federal program. 81 FR 4750.

34. The other state programs are almost all tax incentives. There is no mention of what the corresponding royalty owners gave as incentives, if anything. A taxing authority imposes taxes pursuant to the government's sovereign powers, to raise revenue based on the existence of a property or activity within a certain area at a certain time. A royalty owner, on the other hand, is essentially receiving payment in return for allowing the lessee to take the minerals pursuant to a contract (the lease). In essence, under HB 325, the State would be giving away property with no showing of economic need to do so, and furthermore, with the knowledge that the lessees have no obligation to do anything in return.

35. Analysis of the federal heavy oil incentive program suggests that application of federal royalty policies to state royalty policies does not necessarily benefit the state and that increased production will never offset the foregone royalties. The federal revenues are only increased as a result of increased income and other taxes. Further, in the federal program, the waived royalties that the federal government is predicted to recoup as federal taxes will not necessarily 'flow through' to the affected state. There is no assurance that relief afforded under the federal program will be used to benefit lands within the borders of the state that foregoes the royalties and under HB 325, there is no assurance that the 'benefit' of the relief afforded will be reinvested in Alaska.

HB 325 does not guarantee the State anything in exchange for the incentive. There is no guarantee the companies will go forward with heavy oil production if the incentive is granted. There is also no showing that they will not go forward without it; in fact, as discussed below, quite the contrary. There is no commitment by industry that if the relief is granted, they will continue producing heavy oil once the incentive ceases. There is no requirement of reinvestment of any of the earnings in further heavy oil production or research in Alaska. Moreover, there is no commitment by industry that Alaskans will be hired for the jobs they say will be created. Nor is there any commitment to build modules for the MPU in Alaska. Under HB 207, the commissioner could insist on these types of commitments before granting royalty relief. HB 325 grants relief without any commitment.

The white paper authors also refer to Scott Goldsmith's study of the impact on the Alaskan economy in general if royalty relief were granted.

36. Contrary to what the white paper authors would imply, Mr. Goldsmith's study did not assume a royalty suspension; it assumed a flat 6 percent royalty.

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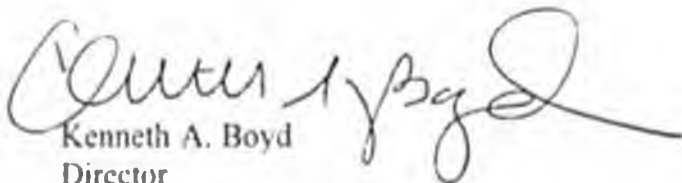
37. The Goldsmith study predicted numerous jobs being created by such royalty relief. According to the white paper, the Goldsmith study predicts that the State will add 27 additional State government jobs during the development phase and 10 additional State government jobs during the field life. It is unclear that the additional state government jobs are a real 'benefit' to society; they might be a cost instead. These jobs arise as a response to a predicted increase in demand for government services imposed by the population impact of a marginal development. What is the nature of these jobs? Without royalty on the additional production, how will these demands be met? What revenue will pay for the additional state government jobs?

Moreover, even if these industry jobs were created, there is no guarantee that the Alaskans would be hired for them and there is no guarantee that fabrication of equipment and facilities needed would be done in Alaska.

Summary. To briefly sum up a lengthy discussion, the Division of Oil and Gas maintains that any royalty reduction or royalty exemption for the production of "heavy oil" should be based on need. In the long run, a heavy oil incentive like that proposed in HB 325 should result in greater state revenues through the increased production and development of the resource. HB 325 does not meet these goals. By imposing mandatory blanket reductions, there may be insufficient relief to leases in true jeopardy, windfalls to those without need of the relief, and an inability to insure that any cost savings will be used to develop and operate the leases eligible for the relief. The process required to award a royalty reduction under the existing HB 207 provisions assures that the royalty reduction is necessary to stimulate development. Furthermore, a HB 207 royalty reduction may be conditioned to respond to changing market conditions (price), and changes in capital and operating costs as technology improves, and may include other provisions tailored to relief applied for. The Division maintains its recommendation that, if any legislative change is necessary to encompass pools such Schrader Bluff, the easiest, most effective change should be through a simple amendment to the existing AS 38.05.180(j) provisions.

This letter covers numerous issues; nevertheless, if you have further questions (or answers), please don't hesitate to contact me.

Very truly yours,



Kenneth A. Boyd
Director
Division of Oil and Gas

Attachment 2

wil

4748 Federal Register / Vol. 61, No. 27 / Thursday, February 8, 1996 / Rules and Regulations

Dated: January 2, 1996.
William J. Muryzki,
Acting Regional Administrator,
40 CFR part 300 is amended as follows:

PART 300—(AMENDED)

1. The authority citation for part 300 continues to read as follows:

Authority: 33 U.S.C. 1321 (e)(1); 42 U.S.C. 6901-6937; E.O. 12777, 58 FR 34787, 3 CFR 1991 Comp., p. 351; E.O. 12820, 52 FR 2923, 3 CFR 1987 Comp., p. 183.

Appendix B—(Amended)

2. Table 1 of Appendix B to part 300 is amended by removing the Clothier Disposal site, Greedy, New York.
(FR Doc. 96-3718 Filed 2-7-96; 8:48 am)
BOUND CODE 4000-02-8

DEPARTMENT OF THE INTERIOR**Bureau of Land Management****43 CFR Part 3100**

(WO-310-09-1210-2411)

RUM 1004-ACEO

Promotion of Development, Reduction of Royalty on Heavy Oil

AGENCY: Bureau of Land Management, Interior.

ACTION: Final rule.

SUMMARY: The Bureau of Land Management is issuing this final rule to amend the regulations relating to the waiver, suspension, or reduction of rental, royalty, or minimum royalty. This action is being taken to promote the production of heavy oil. The amendment establishes the conditions under which the operators of properties that produce "heavy oil" (crude oil with a gravity of less than 20 degrees) can obtain a reduction in the royalty rate. The amendment should encourage the operators of Federal heavy oil leases to place marginal or uneconomical shut-in oil wells back in production, provide an economic incentive to implement enhanced oil recovery projects, and delay the plugging of these wells until the maximum amount of economically recoverable oil can be obtained from the reservoir or field.

DATE: This rule will be effective March 11, 1996.

ADDRESSES: Inquiries should be sent to: Director (140), Bureau of Land Management, Room 235A, Main Interior Building, 1848 C Street, N.W., Washington, D.C. 20240.

FOR FURTHER INFORMATION CONTACT: Dr. John W. Hebout, Bureau of Land Management, (202) 432-0340.
SUPPLEMENTARY INFORMATION:

- I. Introduction
- II. Summary of Rule Adopted
- III. Response to Public Comments
- IV. Procedural Matters
- V. Regulatory Text

I. Introduction

A proposed rule to provide royalty relief for producers of heavy oil was published in the Federal Register notice of April 10, 1995 (60 FR 18081) with the comment period ending June 9, 1995. The comment period was reopened June 15, 1995 (60 FR 31683) and closed July 17, 1995.

On March 30, 1995, an outdated version of this proposed rule was published in the Federal Register (60 FR 18426) by mistake. That proposed rule publication was withdrawn, and the Federal Register notice of April 10, 1995 (60 FR 18081) was published in its place as the proposed rule.

The following are questions and answers designed to provide an introduction to this rule.

When does the Department of the Interior (Department) consider granting royalty relief?

In order to encourage the greatest ultimate recovery of oil and in the interest of conservation, the Secretary, upon a determination that it is necessary to promote development, may reduce the royalty on an entire leasehold or any portion thereof (Section 30 of the Mineral Leasing Act, 30 U.S.C. 209).

Existing section 3103.4-1 of Title 43, Code of Federal Regulations, provides two forms of Federal oil and gas royalty reduction—on a case-by-case basis upon application and for stripper wells. The provision concerning stripper well properties allows royalty reduction for properties that produce an average of less than 18 barrels of oil per eligible well per well-day.

The Bureau of Land Management (BLM) believes that royalty relief for producers of heavy crude oil is needed to promote the development of heavy oil.

Why is heavy oil royalty relief needed?

Above all, this royalty relief is needed to promote the development of heavy oil. Eliminating all royalties would be the most effective way to promote development, but that would jeopardize the Department's efforts in securing a fair return for public land resources. Royalty relief has to be considered in light of all the Department's responsibilities and objectives. The

balance this rule strikes is to have a royalty rate that promotes development while ensuring the public receives reasonable compensation.

Cyclical swings in the price for crude oil are common. BLM believes that future price decreases are possible, or even likely. The effect of this rule will provide a buffer against these decreases for heavy oil produced from Federal land. As many as two-thirds of all marginal properties (including non-heavy oil properties) could be lost during a period of sustained low oil prices (Marginal Wells, A Report of the National Petroleum Council, 1994, p. 3). The danger in losing the marginal wells is that, although production from individual wells may be small, their collective production is significant, accounting for one-third of lower-48 State onshore domestic production. Heavy oil production, from both Federal and non-Federal lands, makes up almost one-half of this third (Marginal Wells, A Report of the National Petroleum Council, 1994, p. 80). Heavy oil wells typically incur higher production costs, thus increasing their vulnerability. Were these heavy oil wells abandoned, the United States would lose this significant portion of domestic production.

What will happen as a result of this rule?

This rule should encourage the operators of Federal heavy oil leases to place marginal or uneconomical shut-in oil wells back in production, provide an economic incentive to implement enhanced oil recovery projects, and delay the plugging of these wells until the maximum amount of economically recoverable oil can be obtained from the reservoir or field.

According to a Department of Energy (DOE) analysis of its TORIS (Tertiary Oil Recovery Information System) data, the size of economically recoverable reserves from Federal lands will be significantly enhanced by this amendment. For instance, at a West Texas Intermediate (WTI) crude oil price of \$18 a barrel, DOE projects that this rule will increase recoverable reserves of about 54 million barrels to about 87 million barrels for the State of California. At \$18 a barrel, DOE projects that this rule will increase recoverable reserves of about 103 million barrels to about 180 million barrels for the State of California. At \$20 a barrel, DOE projects that this rule will increase recoverable reserves of about 133 million barrels to about 220 million barrels for the State of California. A proportionately larger increase in recoverable reserves is anticipated when oil prices range toward \$20 a barrel because major recovery projects may

become economically feasible. Were this rule not promulgated, DOE projects these increases in recoverable reserves would most likely occur.

Since the State of California produces almost 91 percent of lower-46 State onshore heavy oil production, the vast majority of recoverable reserve increases stemming from this royalty relief will most likely come from this State. Significant recoverable reserve increases are not anticipated in the other States since fewer properties will qualify for this relief.

When will this rule apply?

The rule will take effect March 11, 1988. However, the BLM may suspend or terminate all royalty reductions granted under this rule and terminate the availability of further relief under this rule—

(1) upon 6 months' notice in the Federal Register when BLM determines that the average WTI oil price has remained above \$14 per barrel over a period of 6 consecutive months or

(2) after September 10, 1989, if the royalty rate reductions authorized by this rule have not been effective in reducing the loss of otherwise recoverable reserves.

How will this royalty relief affect royalties and revenues?

According to the DOE TOPIS analysis, although oil royalties may decline in some instances, the effects to overall Federal and State revenues should be largely neutral except in the State of California. (Revenues include all forms of income including royalties.) Slight decreases in overall revenues could be possible at some oil prices for States with moderate levels of heavy oil production. In California, the DOE analysis projects small decreases or sizable increases in State revenues depending on the price of oil (Letter Report from Department of Energy dated July 28, 1984).

II. Summary of Rule Adopted

The final rule establishes a sliding scale royalty rate for qualifying heavy-oil-producing properties. The sliding scale is intended to somewhat offset the reduced prices paid for oil as oil gravity decreases. The reduced royalty rate applies to qualifying heavy oil properties rather than individual wells, because production is normally not reported for individual oil wells, and is based on the average gravity of the oil weighted by the production of heavy oil from each well within the property. A weighted average gravity is used to prevent gravity manipulation by selectively producing wells on a property with heavier gravity crude. Using a weighted average of oil gravity

encourages maximum recovery from all wells within a property by removing the economic advantage of selective production.

The rule provides that either the operator (as defined at 43 CFR 3100.0-5) or the payer (as defined at 30 CFR 208.2) must calculate the weighted average gravity of the oil—measured on the American Petroleum Institute (API) scale—produced from a property every 12 months to determine the appropriate royalty rate. In no case, however, would the royalty rate exceed the rate established by the terms of the lease.

The section amended by this rule also provides for royalty rate reductions for stripper oil wells. Some provisions of this final rule are similar to the provisions of the existing regulations that pertain to stripper wells.

The final rule was modified in response to comments and for clarification. Section 3103.4 was redesignated to aid the reader in distinguishing the various forms of royalty reduction and accompanying provisions. Separate sections were established for the stripper oil and heavy oil royalty reduction provisions. The discussion of royalty rate determinations in § 3103.4-3(b)(8) was modified by adding two examples and clarifying the text. Section 3103.4-3(b)(8) was modified to extend the review period until 1988. Cross references were modified where appropriate throughout Part 3100 to reflect the redesign of § 3103.4.

III. Responses to Public Comments

A total of 309 comments were received on the proposed rule. An overwhelming majority supported the proposed rule. A few commenters recommended changes.

Comments suggested that the review period be extended for a period of 4 or 5 years rather than the 3 years stated in the proposed rule. It was always the BLM's intention that the rule be in place at least 4 years before it was evaluated. Unanticipated delays in the rulemaking process, however, have rendered the original 1987 deadline unreasonably short. Therefore, the BLM concurs with this suggestion and the rule has been modified to extend the review period until 1994.

A comment stated that the \$14 trigger for rule suspension was too high while another comment stated that \$14 was too low. Based on data developed from DOE's TOPIS database, the BLM believes that \$14 is an appropriate trigger to suspend the rule. The data indicates that State and Federal Royalty reductions are offset by increased recoverable reserves up until the point

that WTI crude oil prices reach approximately \$24/bbl. Past that point, recoverable reserve increases appear to taper off. In addition, the TOPIS data show that when WTI prices climb above \$24/bbl the royalty reduction is no longer a determining factor for decision-making investments in enhanced oil recovery technologies.

Comments suggested that the CFR 3103.4-4 regulations be revised for clarity and simplicity. The BLM agrees and has revised the section for clarity.

A comment suggested that the qualifying period for a heavy oil royalty rate reduction coincide with the one established for a stripper oil property royalty reduction. While the BLM agrees that there is value in making the stripper and heavy oil royalty rate reduction processes as similar as possible, this is not always practicable. The heavy oil rule qualifying period was made flexible in order to acknowledge the fact that many qualifying, low-production properties may not remove or sell oil every month even if their production is continuous. Thus, many properties may require even more than a calendar year (the stripper property qualifying period) to accumulate 3 months of sales or oil removal.

One comment requested that the calculation method for requesting a reduced royalty rate be extended beyond the proposed 60 days. The BLM believes that 60 days is sufficient time for an operator to notify the BLM of a new royalty rate. The stripper property royalty reduction program has a similar notification period which appears to be working well.

Some comments stated that a greater royalty rate reduction was necessary. They suggested that this be accomplished by using a power curve rather than a straight line to calculate royalty rates. The BLM considered calculating royalty rates by both power curves and straight-line methods. The DOE's TOPIS data, however, indicated that neither method was clearly advantageous over the other in terms of increasing recoverable reserves; energy within a narrow range of WTI crude oil prices. Because it is not possible to predict future oil prices, the BLM has chosen to remain with a straight-line royalty reduction for purposes of simplicity as well as to parallel the stripper property royalty reduction rule.

Some comments stated that the rule should use 25 degrees as a "heavy oil" cutoff (rather than the 20 degrees proposed) in order to maximize the rule's effects and to provide the rule's benefits to as many operators as possible. Although there is no single accepted definition for "heavy oil,"

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standard academic and industry practice is to reserve the term for crudes oils of less than 20 degrees API. The U.S. tax code also uses a 20 degree definition.

One comment stated that BLM should evaluate the stripper oil royalty reduction before granting heavy oil royalty relief. The BLM is in the process of evaluating the stripper well provisions. The stripper well provisions have not been in place long enough to make a substantive assessment.

One comment strongly opposed heavy oil royalty relief, stating that the BLM has no data which demonstrates that the leases eligible for the relief cannot be operated successfully under the lease terms or that the continued operation of such heavy crude leases is in serious, unavoidable jeopardy. Although this is an important merit question, this is not the criterion for relief that is serving as the basis of this recommendation. The Secretary, acting through the Assistant Secretary—Land and Minerals Management, concludes, based on the DOE analysis cited in the introduction, that this rule is necessary to promote the development of heavy oil. Recoverable reserves are projected to be significantly less in the absence of the royalty relief provided by this rule.

One comment stated that this rule will provide immediate relief on leases in true jeopardy and windfalls for those without need. The BLM believes that there are enough standards in terms of the economic pressure on producers of heavy oil that any such relative disparities in levels of relief should be inconsequential. Furthermore, the rule is sensitive to the particular gravity of the heavy oil being produced, so that producers of less valuable heavy oil receive a higher proportion of royalty relief.

One comment stated that even if State revenues increase, royalty reductions will hurt State revenues. (Revenue includes all forms of income including royalties.) According to the DOE analysis, the effects in Federal and State revenues should be largely neutral. High royalty decreases could be possible at some oil prices for States with moderate levels of heavy oil production.

In California, where almost 61 percent of the heavy oil production takes place, the DOE analysis generally projects small to moderate decreases in royalties. For instance, at \$18 a barrel (WTT), DOE projects that this rule will decrease California royalties by about \$3.5 million, while increasing California public sector revenue by about \$18 million. At \$18 a barrel (WTT), DOE projects that this rule will decrease-

California royalties by about \$24

million, while decreasing California public sector revenues by about \$1 million. At \$10 a barrel (WTT), DOE projects that this rule will increase California royalties by about \$1 million, while increasing California public sector revenue by about \$104 million. The wide variations in sensitivity to the price of oil are due to numerous variables, including the propensity for oil companies to invest in major recovery projects at certain oil prices. (Lower prices from Department of Energy issued July 29, 1984.)

IV. Procedural Matters

This rule is not a major Federal action significantly affecting the quality of the human environment and that no detailed statement pursuant to section 102 (2)(C) of the National Environmental Policy Act of 1969 (42 U.S.C. 4321(c)) is required.

This rule has been reviewed under Executive Order 12566.

The BLM has determined that this final rule will not have a significant economic impact on a substantial number of small entities under the Regulatory Flexibility Act (5 U.S.C. 601 et seq.). The BLM has prepared a regulatory flexibility analysis, if available upon request from the address listed at the beginning of this rule. Additionally, the BLM has determined, under Executive Order 12838, that the rulemaking will not cause a taking of private property.

The BLM has verified that these regulations meet the applicable standards provided in sections 2(a) and 2(b)(2) of Executive Order 12778. The information collection requirements of this rule have been approved by the Office of Management and Budget under 44 U.S.C. 3501 et seq. and paid catalog numbers 1010-0060 and 1004-0141.

The principal author of this final rule is Dr. John W. Hubert, Senior Technical Specialist, Public Group, advised by Charles Hines of the Regulatory Management Team, Bureau of Land Management.

List of Subjects for 43 CFR Part 3100

Land Management Bureau, Public Lands—mineral resources, Oil and gas production, Mineral royalties.

For the reasons stated in the preamble, and under the authorities cited below, Part 3100, Group 3100, Subchapter C, Chapter II of Title 43 of the Code of Federal Regulations is amended to set forth below:

V. Regulatory Text

PART 3100—OIL AND GAS LEASING

1. The subjectry citation for part 3100 continues to read as follows:

Authority: 30 U.S.C. 181, et seq.; 30 U.S.C. 311-316.

Subpart 3103—Fees, Rentals and Royalty

§ 3103.3-8 (Amended)

2-3. Section § 3103.3-3 is amended by removing the cross reference “§ 3103.4-3(d)” in the introductory text and adding in its place the cross reference “§ 3103.4-4(d).”

4. § 3103.4 is amended by revising the heading to read as follows:

§ 3103.4 Production Incentives.

§ 3103.4-6 (Redesignated as § 3103.4-4) 3. Section 3103.4-3 is redesignated as § 3103.4-4.

5. Section 3103.4-1 is amended by redesignating paragraphs (c) and (d) as paragraphs (a) and (b) of a new § 3103.4-3. “Stripper well royalty reductions.” Section 3103.4-3 is further amended by redesignating paragraph (c) as (a), and revising the section heading and paragraph (b)(1) to read as follows:

§ 3103.4-3 Royalty reductions.

(b)(1) An application for the benefits under paragraph (a) of this section on other than stripper oil well leases or heavy oil properties must be filed by the operator/owner in the proper BLM office. Royalty reductions specifically for stripper oil well leases or heavy oil properties are discussed in § 3103.4-2 and § 3103.4-3 respectively. The application must contain the serial number of the leases, the names of the record title holders, operating rights owners (sublessees), and operators for each lease, the description of lands by legal subdivision and a description of the relief requested.

7. Newly designated § 3103.4-3, paragraph (b)(2)(i)(A) is amended by removing the cross reference “(d)(2)(ii)” and adding in its place the cross reference “(b)(3)(ii).”

8. A new § 3103.4-3 is added to read as follows:

§ 3103.4-3 Heavy oil royalty reductions.

(A) A heavy oil well property is any Federal lease or portion thereof segregated for royalty purposes, a continuous oil well, or a unit period leasing area, operated by the same operator, that produces crude oil with a weighted average gravity of less than 20 degrees as measured on the American Petroleum Institute (API) scale.

(2) An oil completion is a completion from which the energy equivalent of the oil produced exceeds the energy equivalent of the gas produced (including the extracted liquids hydrocarbons) or any completion producing oil and less than 80 MCF of gas per day.

(b) Heavy oil well property royalty rate reductions will be administered according to the following requirements and procedures:

(1) The Bureau of Land Management requires no specific application form for the benefits under paragraph (a) of this section for heavy oil well properties. However, the operator/payer must notify, in writing, the proper BLM office that it is seeking a heavy oil royalty rate reduction. The letter must contain the serial number of the affected lease (or, as appropriate, the communitization

agreement number or the unit agreement name); the names of the operators for each lease; the calculated new royalty rate as determined under paragraph (b)(3) of this section; and copies of the Purchaser's Statements (sales receipts) to document the weighted average API gravity for a property.

(2) The operator must determine the weighted average API gravity for a property by averaging (adjusted to rate of production) the API gravities reported on the operator's Purchaser's Statement for the last 3 calendar months preceding the operator's written notice of intent to seek a royalty rate reduction, during each of which at least one sale was held. This is shown in the following 3 illustrations:

(i) If a property has oil sales every month prior to requesting the royalty rate reduction in October of 1998, the

operator must submit Purchaser's Statements for July, August, and September of 1998:

(ii) If a property has sales only every 6 months, during the months of March and September, prior to requesting the rate reduction in October of 1998, the operator must submit Purchaser's Statements for the months of September 1995, and March and September 1996:

(iii) If a property has multiple sales each month, the operator must submit Purchaser's Statements for every sale for the 3 entire calendar months immediately preceding the request for a rate reduction.

(3) The following equation must be used by the operator/payer for calculating the weighted average API gravity for a heavy oil well property:

$$\frac{(V_1 \times O_1) + (V_2 \times O_2) + (V_3 \times O_3)}{V_1 + V_2 + V_3} = \text{Weighted Average API Gravity for a property}$$

Where:
 V₁ Average Production (Bbl/d) of Well #1 over the last 3 calendar months of sale
 V₂ Average Production (Bbl/d) of Well #2 over the last 3 calendar months of sale
 V₃ Average Production (Bbl/d) of each additional well (V₄, V₅, etc.) over the last 3 calendar months of sale

O₁ Average Gravity (degrees) of oil produced from Well #1 over the last 3 calendar months of sale
 O₂ Average Gravity (degrees) of oil produced from Well #2 over the last 3 calendar months of sale
 O₃ Average Gravity (degrees) of each additional well (O₄, O₅, etc.) over the last 3 calendar months of sale

Example: Lease "A" has 3 wells produced in the following average rates over 3 sales months with the following associated average gravities: Well #1, 6,000 bbl/d, 13° API; Well #2, 8,000 bbl/d, 21° API; Well #3, 2,000 bbl/d, 14° API. Using the equation above—

$$\frac{(4,000 \times 13) + (6,000 \times 21) + (2,000 \times 14)}{(4,000 + 6,000 + 2,000)} = 17.2 \text{ Weighted Average API Gravity for property}$$

(4) For those properties subject to a communitization agreement or a unit participating area, the weighted average API gravity for the lease included in that specific communitization agreement or unit participating area must be determined in the manner prescribed in paragraph (1)(i) of this section and applied to all property subject to Federal regulation in the communitization agreement or unit participating area.

(i) The operator/payer must use the following procedure to enter or delete a royalty rate reduction under this section:
 (1) Qualifying royalty rate determination.
 (A) The operator/payer must calculate the weighted average API gravity for the property proposed for the royalty rate reduction in order to verify that the property qualifies as a heavy oil well property.
 (B) Provisions that have occurred or will occur that it uses to deny production (its field rule) qualify for this royalty rate reduction. However, no additional royalty reductions will be granted until the property has a sales history of at least 3 production seasons (see paragraph (1)(ii) of this section).
 (2) Calculating the weighted royalty rate. If the Federal lease or production denied (e.g.,

communitization or unit agreement) qualify as heavy oil property, the operator/payer must use the weighted average API gravity provided above in the last whole degree (e.g., 11.7 degree API becomes 11 degrees), and determine the appropriate royalty rate from the following table:

ROYALTY RATE REDUCTION FOR HEAVY OIL

Weighted average API gravity (degrees)	Royalty Rate (degrees)
1	
2	
3	
4	
5	
6	
7	
8	
9	
10	
11	
12	
13	
14	
15	
16	
17	
18	

ROYALTY RATE REDUCTION FOR HEAVY OIL—Continued

Weighted average API gravity (degrees)	Royalty Rate (degrees)
19	11.2
20	12.2

(ii) New royalty rate effective date.

The new royalty rate will be effective on the first day of production 3 months after BLM receives notification by the operator/payer. This rate will apply to all oil production from the property for the next 12 months (plus the 3 calendar month grace period during which the next 12 months' royalty rate is determined in the next year). If the API gravity is 20 degrees or greater, the royalty rate will be the rate in the table below.

Example: BLM receives notification from an operator on June 8, 1998. There is a two-month grace period before new royalty rates in