

ALASKA LEGISLATURE COMMITTEE REPORTS
10959 HOUSE RESOURCES

Subsection (j)(5)

The assignment of all right, title and interest in a lease is a fundamental principle in the oil industry. Property trades will be greatly restricted if assignability of a royalty adjustment is not allowed. The ability and desire to acquire a lease that has favorable royalty terms may be the catalyst and incentive for a company to invest capital and employ new ideas in fields where the current owners may be less inclined. Companies are rationalizing properties and focusing investments in core areas to take advantage of their particular operational, infrastructure or informational strengths. Lost opportunity for earlier development of a lease or field is sure to occur if this limitation is imposed. The intent of this legislation should be to create opportunity with certainty, not further limit the creativity of the industry.

Subsection (j)(7)

This issue was thoroughly discussed in prior hearings with what we thought was an equitable compromise and consensus opinion of the parties testifying. We see no advantage to changing this Subsection and would prefer to see Subsection (6) of the House Finance version reinstated.

Subsection (j)(8)

Thirty (30) days rather than sixty (60) days is an appropriate time period for public comment. The whole review process needs to be streamlined wherever possible.

Subsection (j)(9)

Reviewing and addressing all the requirements under this Subsection will be very expensive, time consuming and may not be applicable in all circumstances. We believe the Commissioner should have the discretion to provide for the contents of the best interests finding and determination. The Department of Natural Resources is well equipped for this process. We feel it is unnecessary for this Subsection to be in the Bill, and in fact, the degree to which each of these conditions are to be investigated will be the subject of much debate. If the committee and legislature feel the need to include the details of the finding and determination in this Bill, then paragraphs (A) through (G) should only be suggestions of issues the Commissioner may consider in a royalty adjustment application.

Subsection (j)(12)

We have a similar comment in this Subsection as in Subsection (j)(4) in that legislative approval is unnecessary and administratively burdensome. We contend that Subsection (j)(10) of the House Finance Bill is more appropriate and should replace this Subsection.

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

Thank You

Union Oil Company of California
Testimony on CS HB 207
Senate Resources Committee
May 1, 1995

Mr. Chairman and members of the Resources Committee--My name is Kevin A. Tabler, Land Manager for Union Oil Company of California (Unocal) in Alaska. I appreciate this opportunity to be heard today and to present Unocal's comments on CS HB 207. I would like to begin my testimony by saying that the Sectional Analysis provided with the Bill is particularly helpful in making a more informed analysis of the Bill. Some of the concerns I expressed in last Wednesday's Hearing have been clarified by the Analysis and therefore the enclosed testimony more accurately reflects Unocal's view and opinion of the Bill today.

Subsection (j)(1)

From purely a Unocal perspective, based on its present acreage position, Unocal is not directly impacted by paragraph (A). Most of the Unocal leases held today are located within producing fields, some of which are nearing the end of their economic viability. We have however, testified in earlier hearings on this Bill that we have not endorsed the concept of Sunset Provisions.

Subsection (j)(4)

We believe the requirement for legislative approval under paragraph (A) will be a time consuming and unnecessary requirement resulting in an administratively burdensome process. Under the House Finance version of the Bill, adequate Commissioner oversight is provided under Subsection (j)(8).

In reading the provisions of paragraph (B) of this Subsection, it is unclear to me as to the intent of the language "in amount or value of the Production". If this is to mean a net 3% floor or a maximum 76% reduction of the current royalty rate, then Unocal is opposed to this revision. Under the House Finance version of the Bill, the floor established for producing and shut-in fields is 90%. There needs to be clarification on this point. Any increase in the floor reducing flexibility would be inconsistent with our position and prior testimony.

Subsection (j)(5)

Although we appreciate the attempt in this CS to address the assignability question, we believe a strong argument still exists for elimination of this restriction all together. The assignment of all right, title and interest in a lease is a fundamental principle in the oil industry. Property trades will be greatly restricted if assignability of a royalty adjustment is not allowed. Because of the confidential nature of property transactions, companies are not going to disclose their intent to the public in asking for permission to assign until negotiations are complete and commitments have been made. Prior approval does not work in this situation. A negative response to a request for assignment could jeopardize a potentially beneficial trade to the state. The ability and desire to acquire a

lease that has favorable royalty terms may be the catalyst and incentive for a company to invest capital and employ new ideas in fields where the current owners may be less inclined. Companies are rationalizing properties and focusing investments in core areas to take advantage of their particular operational, infrastructure or informational strengths. Lost opportunity for additional development of a lease or field is sure to occur if this unnecessary limitation is imposed. The intent of this legislation should be to create opportunity with certainty, not further limit the creativity of the industry. The state's best interest will not be served with this restriction.

Subsection (j)(7)

This issue of contractor selection was thoroughly discussed in prior hearings with what we thought was an equitable compromise and consensus opinion of the parties testifying. We see no advantage to changing this Subsection and would prefer to see Subsection (6) of the House Finance version reinstated. }

Subsection (j)(9)

Reviewing and addressing all the requirements under this Subsection will be very expensive, time consuming and may not be applicable in all circumstances. We believe the Commissioner should have the discretion to provide for the contents of the best interests finding and determination. The Department of Natural Resources is well equipped for this process. The degree to which each of these conditions are to be investigated will be the subject of much debate. If the committee and legislature feel the need to include the details of the finding and determination in this Bill, then paragraphs (A) through (D) should only be suggestions of issues the Commissioner may consider not requirements in a royalty adjustment application.

Subsection (j)(12)

We have a similar comment in this Subsection as in Subsection (j)(4) in that legislative approval is unnecessary, time consuming and administratively burdensome. We contend that Subsection (j)(10) of the House Finance Bill is more appropriate and should replace this Subsection.

In conclusion, we want and need a Bill and process that is, clear, fair, flexible and equitable, otherwise we will end up with a piece of legislation that is under utilized.

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

Thank You

ALASKA STATE LEGISLATURE

Interim:
600 East Railroad Avenue
Wasilla, Alaska 99654
(907) 373-1842
Fax (907) 373-4729



Session:
State Capitol Building
Juneau, Alaska 99801-1182
(907) 465-2186
Fax (907) 465-3818

REPRESENTATIVE VIC KOHRING DISTRICT 14

SPONSOR STATEMENT

SSHB 28

House Bill 28 will take a royalty adjustment system that has not been used and put in its place an understandable and usable adjustment method for fields that might otherwise prove to be uneconomic. It will provide a usable system for reduction of royalties belonging to Alaska so that the State can encourage production of oil and gas fields that might be marginal or not economically feasible were it not for such reductions.

As has been pointed out so many times, in this global market, Alaska needs to remain competitive in order to encourage development of its oil and gas resources. Development of these resources will provide a broader economic base, more employment for Alaskans and a safer, more stable environment for all concerned.

The 19th Alaska Legislature amended AS 38.05.180(j) and put in place, the current system. Unfortunately, the calculation contained in the current law is arguably unintelligible to many. The implementation of the current statute is too limiting in the flexibility allowed to the Commissioner to craft a deal acceptable to individuals and in the best interest of Alaska. Additionally, the process review put forth in the 1995 legislation is too burdensome and costly for the private sector and thus discourages people from making application. The end result is that oil is left in the ground that could be extracted and adding to the State's economic base.

Although the idea behind HB 28 is not new, it sets forth an understandable modification formula; protecting the public's interest in such proceedings and maintaining the public's ability to comment on the preliminary findings and determination made by the Commissioner. This legislation further maintains the involvement of the Legislature through the Legislative Budget and Audit Committee, a committee that holds meetings year round. HB 28 is consistent with the Governor's goal of increasing oil and gas production and increasing Alaska's resource revenue.

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

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

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329


MEMORANDUM

May 7, 2003

SUBJECT: CSSSHB 28 (Resources) -- a note on the treatment of the material added by the Resources Committee (Work Order No. 23-LS0177\W)

TO: Representative Hugh Fate
Chair of the House Resources Committee

FROM: Jack Chenoweth
Assistant Revisor of Statutes



Rather than give the new material adopted by the Resources Committee, communicated in Jim Pound's memo of this date, a paragraph of its own and to spare further paragraph renumbering within AS 38.05.180(j), I have added the new material to paragraph (6) as a new subparagraph (B). It appears in the accompanying "V" version at page 5, line 27 - page 6, line 8.

JBC:lmb
03-177.lmb

Enclosure

Insert new section after (6):

(7) may, with the mutual consent of the lessee or lessees making application for the royalty reduction under (1)(B) or (1)(C) of this subsection, request payment for the services of an independent contractor, selected from a list of qualified consultants to evaluate hydrocarbon development, production, transportation, and economics by the commissioner to assist the commissioner in evaluating the application and financial and technical data; if, under this paragraph, the commissioner requires payment for the services of an independent contractor, the total cost of the services that may be paid for by the lessee or lessees may not exceed \$150,000 for each application, and the commissioner shall determine the relevant scope of the work to be performed by the contractor; selection of an independent contractor under this paragraph is not subject to AS 36.30;

23-LS0177\U
Chenoweth
4/30/03

CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 28()

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

**Offered:
Referred:**

Sponsor(s): REPRESENTATIVES KOHRING AND ROKEBERG

A BILL

FOR AN ACT ENTITLED

1 **"An Act relating to adjustments to royalty reserved to the state to encourage otherwise**
2 **uneconomic production of oil and gas; 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(j) is amended to read:

5 (j) The commissioner

6 (1) may provide for modification of [AN INCREASE OR
7 DECREASE OR OTHERWISE MODIFY] royalty [, TO ALLOW FOR
8 PRODUCTION THAT WOULD NOT OTHERWISE BE ECONOMICALLY
9 FEASIBLE,] on individual leases, leases unitized as described in (p) of this section,
10 leases subject to an agreement described in (s) or (t) of this section, or interests
11 unitized under AS 31.05 [; THE COMMISSIONER MAY ACT UNDER THIS
12 SUBSECTION TO MODIFY THE ROYALTY]

13 (A) [AFTER JUNE 20, 1995 AND NOT LATER THAN JULY
14 1, 2015, SO LONG AS THE AUTHORITY TO MODIFY ROYALTY

1 UNDER THIS SUBPARAGRAPH HAS BEEN AUTHORIZED OR
2 REAUTHORIZED BY LAW WITHIN THE TEN YEARS PRECEDING THE
3 COMMISSIONER'S ACTION TO MODIFY THE ROYALTY,] to allow for
4 production from an oil or gas field or pool if

5 (i) the oil or gas field or pool has been sufficiently
6 delineated [SUFFICIENTLY] to the satisfaction of [ALLOW] the
7 commissioner [TO CONDUCT THE ANALYSES AND MAKE THE
8 FINDINGS REQUIRED BY THIS SUBSECTION]; [AND]

9 (ii) the field or pool has not previously produced oil or
10 gas for sale; and

11 (iii) oil or gas production from the field or pool
12 would not otherwise be economically feasible;

13 (B) to prolong the economic life of an oil or gas field or pool as
14 per barrel or barrel equivalent costs [PER BARREL OR BARREL
15 EQUIVALENT] increase or as the price of oil or gas decreases, and the
16 increase or decrease is sufficient to make future production no longer
17 economically feasible; or

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

20 (2) may not grant a royalty modification unless the lessee or lessees
21 requesting the change [MODIFICATION] make a clear and convincing showing that
22 a modification of royalty meets the requirements of this subsection and is in the best
23 interests of the state;

24 (3) shall provide for an increase or decrease or other modification
25 of the state's royalty share by a sliding scale royalty or other mechanism that
26 shall be based on a change in the price of oil or gas and may also be based on
27 other relevant factors such as a change in production rate, projected ultimate
28 recovery, development costs, and operating costs

29 [(A) CONDITION ANY ROYALTY MODIFICATION
30 GRANTED UNDER THIS SUBSECTION IN ANY WAY NECESSARY TO
31 PROTECT THE STATE'S BEST INTERESTS;

1 (B) DESCRIBE, IN THE FINDINGS AND
2 DETERMINATIONS REQUIRED BY THIS SUBSECTION, THE
3 RELEVANT FACTORS, INCLUDING PRICE, PROJECTED
4 PRODUCTION RATE OR VOLUME, PREDICTED ULTIMATE
5 RECOVERY, AND DEVELOPMENT, OPERATING, AND
6 TRANSPORTATION COSTS, UPON WHICH THE MODIFICATION IS
7 BASED;

8 (C) FOR A MODIFICATION UNDER (1)(A) OF THIS
9 SUBSECTION, SET OUT THE TERMS AND CONDITIONS, WHICH

10 (i) MUST INCLUDE A MECHANISM FOR
11 ADJUSTING ROYALTY PERCENTAGE BASED ON PRICE;
12 USING FORECASTS OF THE RANGE OF FUTURE PRICES AND
13 THEIR PROBABILITIES, THE MECHANISM MUST PROVIDE
14 THAT THE VALUE OF THE POTENTIAL REVENUE INCREASES
15 RESULTING FROM ROYALTY PERCENTAGE INCREASES
16 MUST EXCEED THE VALUE OF THE POTENTIAL REVENUE
17 LOSSES RESULTING FROM ROYALTY PERCENTAGE
18 DECREASES; AND

19 (ii) MAY INCLUDE, IN ADDITION TO THE
20 ROYALTY PERCENTAGE ADJUSTMENT BASED ON PRICE,
21 WHICH MUST MEET THE CONDITIONS SPECIFIED IN (i) OF
22 THIS SUBPARAGRAPH, A FURTHER ADJUSTMENT BASED ON
23 PRODUCTION RATE OR VOLUME FROM THE FIELD OR POOL;
24 AND

25 (D) FOR A MODIFICATION UNDER (1)(B) OR (1)(C) OF
26 THIS SUBSECTION, SET OUT THE TERMS AND CONDITIONS, WHICH
27 MAY INCLUDE SUBSTITUTION OF A SLIDING SCALE ROYALTY OR
28 OTHER MECHANISM TO MODIFY THE ROYALTY IF THERE IS A
29 CHANGE IN THE RELEVANT FACTORS, SUCH AS PRICE, PROJECTED
30 PRODUCTION RATE OR VOLUME, PREDICTED ULTIMATE
31 RECOVERY, AND DEVELOPMENT, OPERATING, AND

1 TRANSPORTATION COSTS, UPON WHICH THE MODIFICATION IS
2 BASED];

3 (4) may not grant a royalty reduction [MODIFICATION] for a field
4 or pool

5 (A) under (1)(A) of this subsection if the royalty modification
6 for the field or pool would establish a royalty rate of less than five percent in
7 amount or value of the production removed or sold from a lease or leases
8 covering the field or pool;

9 (B) under (1)(B) or (1)(C) of this subsection if the royalty
10 modification for the field or pool would establish a royalty rate of less than
11 three percent in amount or value of the production removed or sold from a
12 lease or leases covering the field or pool;

13 (5) [MAY NOT GRANT A ROYALTY MODIFICATION UNDER
14 THIS SUBSECTION WITHOUT INCLUDING AN EXPLICIT CONDITION THAT
15 THE ROYALTY MODIFICATION IS NOT ASSIGNABLE WITHOUT THE PRIOR
16 WRITTEN APPROVAL OF THE COMMISSIONER; THE COMMISSIONER
17 SHALL, IN THE PRELIMINARY AND FINAL FINDINGS AND
18 DETERMINATIONS, SET OUT THE CONDITIONS UNDER WHICH THE
19 ROYALTY MODIFICATION MAY BE ASSIGNED;

20 (6)] shall require the lessee or lessees to submit, with the application
21 for the royalty reduction [MODIFICATION], financial and technical data that
22 demonstrate that the requirements of this subsection are met; the commissioner
23 [SHALL]

24 (A) may require disclosure of only the financial and technical
25 data related to development, production, and transportation of oil and gas from
26 the field or pool that are reasonably available to the applicant
27 [NECESSARY TO MAKE A DETERMINATION AS TO WHETHER OR
28 NOT TO GRANT THE REQUEST FOR ROYALTY MODIFICATION]; and

29 (B) shall keep the data [DESCRIBED IN (A) OF THIS
30 PARAGRAPH] confidential under AS 38.05.035(a)(9) at the request of the
31 lessee or lessees making application for the royalty reduction

1 [MODIFICATION; THE CONFIDENTIAL DATA MAY BE DISCLOSED
2 BY THE COMMISSIONER TO LEGISLATORS AND TO THE
3 LEGISLATIVE AUDITOR AND AS DIRECTED BY THE CHAIR OR
4 VICE-CHAIR OF THE LEGISLATIVE BUDGET AND AUDIT
5 COMMITTEE TO THE DIRECTOR OF THE DIVISION OF LEGISLATIVE
6 FINANCE, THE PERMANENT EMPLOYEES OF THEIR RESPECTIVE
7 DIVISIONS WHO ARE RESPONSIBLE FOR EVALUATING A ROYALTY
8 MODIFICATION, AND TO AGENTS OR CONTRACTORS OF THE
9 LEGISLATIVE AUDITOR OR THE LEGISLATIVE FINANCE DIRECTOR
10 WHO ARE ENGAGED UNDER CONTRACT TO EVALUATE THE
11 ROYALTY MODIFICATION, IF THEY SIGN AN APPROPRIATE
12 CONFIDENTIALITY AGREEMENT];

13 (6) [(7)] may require the lessee or lessees making application for the
14 royalty reduction under (1)(A) of this subsection [MODIFICATION] to pay for the
15 services of an independent contractor, selected from a list of qualified consultants to
16 evaluate hydrocarbon development, production, transportation, and economics [,WHO
17 IS SELECTED] by the commissioner to assist the commissioner in evaluating the
18 application and financial and technical data; if, under this paragraph, the
19 commissioner requires payment for the services of an independent contractor,
20 the total cost of the services to be paid for by the lessee or lessees may not exceed
21 \$150,000 for each application, and the commissioner shall determine the relevant
22 scope of the work to be performed by the contractor; selection of an independent
23 contractor under this paragraph is not subject to AS 36.30;

24 (7) [(8)] shall

25 [(A)] make and publish a preliminary findings and
26 determination on the royalty reduction [MODIFICATION] application, [; IF
27 THE PRELIMINARY FINDINGS AND DETERMINATION CONCERNS A
28 ROYALTY MODIFICATION UNDER (1)(A) OF THIS SUBSECTION, THE
29 PRELIMINARY FINDINGS AND DETERMINATION SHALL ALSO BE
30 PRESENTED TO THE GOVERNOR FOR THE GOVERNOR'S APPROVAL
31 OR DISAPPROVAL; THE GOVERNOR MAY NOT DELEGATE A

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DETERMINATION TO APPROVE OR DISAPPROVE A PRELIMINARY FINDINGS AND DETERMINATION UNDER THIS SUBPARAGRAPH;

(B) FOR A ROYALTY MODIFICATION UNDER (1)(A) OF THIS SUBSECTION, IF THE GOVERNOR APPROVES THE PRELIMINARY FINDINGS AND DETERMINATION UNDER (A) OF THIS PARAGRAPH,

(i)] give reasonable public notice of the preliminary findings and determination, [;

(ii) CONCURRENTLY WITH THE ISSUANCE OF THE PUBLIC NOTICE, UNLESS DIRECTED BY THE LEGISLATIVE BUDGET AND AUDIT COMMITTEE TO DO OTHERWISE, MAKE AVAILABLE COPIES OF THE COMMISSIONER'S PRELIMINARY FINDINGS AND DETERMINATION ON THE ROYALTY MODIFICATION APPLICATION AND THE SUPPORTING FINANCIAL AND TECHNICAL DATA, INCLUDING THE WORK PAPERS, ANALYSES, AND RECOMMENDATIONS OF ANY CONTRACTORS RETAINED UNDER (7) OF THIS SUBSECTION, TO PERSONS AUTHORIZED UNDER (6)(B) OF THIS SUBSECTION TO REVIEW THE DATA;] and

[(iii)] invite public comment on the preliminary findings and determination during a 30-day period for receipt of public comment;

[(C) FOR A ROYALTY MODIFICATION UNDER (1)(B) OR (C) OF THIS SUBSECTION, IF THE PRELIMINARY FINDINGS AND DETERMINATION APPROVES A ROYALTY MODIFICATION,

(i) GIVE REASONABLE PUBLIC NOTICE OF THE PRELIMINARY FINDINGS AND DETERMINATION; AND

(ii) INVITE PUBLIC COMMENT ON THE PRELIMINARY FINDINGS AND DETERMINATION DURING A 30-DAY PERIOD FOR RECEIPT OF PUBLIC COMMENT;

1 (9) SHALL ADDRESS IN ANY FINDINGS AND
2 DETERMINATIONS REQUIRED UNDER THIS SUBSECTION THE
3 REASONABLY FORESEEABLE EFFECTS OF THE PROPOSED ROYALTY
4 MODIFICATION ON THE STATE'S REVENUE;]

5 (8) [(10)] shall offer to appear before the Legislative Budget and Audit
6 Committee on a day that is not earlier than 10 days and not later than 20 days
7 after giving public notice under (7) of this subsection, to provide the committee a
8 review of the commissioner's preliminary findings and determination on the royalty
9 reduction [MODIFICATION] application and administrative process [THE
10 SUPPORTING FINANCIAL AND TECHNICAL DATA]; if the Legislative Budget
11 and Audit Committee accepts the commissioner's offer, the committee shall give
12 notice of the committee's meeting to all members of the legislature; [IF, UNDER
13 (6)(B) OF THIS SUBSECTION, THE FINANCIAL AND TECHNICAL DATA
14 MUST BE KEPT CONFIDENTIAL AT THE REQUEST OF A LESSEE OR
15 LESSEES MAKING APPLICATION FOR THE ROYALTY MODIFICATION, THE
16 COMMISSIONER MAY APPEAR BEFORE THE COMMITTEE IN EXECUTIVE
17 SESSION;]

18 (9) [(11)] shall make copies of the preliminary findings and
19 determination available to

20 (A) the presiding officer of each house of the legislature;

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

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

25 (10) [(12)] shall, within 30 days after the close of the public comment
26 period under (7) [(8)] of this subsection,

27 (A) prepare a summary of the public response to the
28 commissioner's preliminary findings and determination;

29 (B) make a final findings and determination [AND PRESENT
30 IT TO THE GOVERNOR FOR THE GOVERNOR'S APPROVAL OR
31 DISAPPROVAL; THE GOVERNOR MAY NOT DELEGATE A DECISION

1 TO APPROVE OR DISAPPROVE A FINAL FINDINGS AND
2 DETERMINATION PRESENTED UNDER THIS SUBPARAGRAPH]; the
3 commissioner's final findings and determination prepared under this
4 subparagraph regarding a royalty reduction [MODIFICATION, IF
5 APPROVED BY THE GOVERNOR,] is final and not appealable to the court;

6 (C) transmit a copy of the final findings and determination
7 [PREPARED UNDER (B) OF THIS PARAGRAPH] to the lessee [OR
8 LESSEES MAKING APPLICATION FOR THE ROYALTY
9 MODIFICATION];

10 (D) with the applicant's consent [OF THE LESSEE OR
11 LESSEES APPLYING FOR THE ROYALTY MODIFICATION], amend the
12 applicant's lease or unitization agreement [OF THE LESSEE OR LESSEES
13 APPLYING FOR THE ROYALTY MODIFICATION] consistent with the
14 commissioner's [APPROVED] final decision [FINDINGS AND
15 DETERMINATION]; and

16 (E) make copies of the final findings and determination
17 available to each person who submitted comment under (7) [(8)] of this
18 subsection and who has filed a request for the copies;

19 (11) [(13)] is not limited by the provisions of AS 38.05.134(3) or (f) of
20 this section in the commissioner's determination under this subsection.

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

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

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

8 * **Sec. 3.** AS 38.05.180(s) is amended to read:

9 (s) When separate tracts cannot be individually developed and operated in
10 conformity with an established well-spacing or development program, a lease, or a
11 portion of a lease, may be pooled with other land, whether or not owned by the state,
12 under a communitization or drilling agreement providing for an apportionment of
13 production or royalties among the separate tracts of land comprising the drilling or
14 spacing unit when determined by the commissioner to be in the public interest.
15 Operations or production under the agreement are considered as operations or
16 production as to each lease committed to the agreement. The commissioner may not
17 reduce [DECREASE] royalty on leases in connection with a communitization or
18 drilling agreement except as provided in (j) of this section.

19 * **Sec. 4.** AS 38.05.180(t) is amended to read:

20 (t) The commissioner may prescribe conditions and approve, on conditions,
21 drilling, or development contracts made by one or more lessees of oil or gas leases,
22 with one or more persons, when, in the discretion of the commissioner, the
23 conservation of natural resources or the public convenience or necessity requires it or
24 the interests of the state are best served. All leases operated under approved drilling or
25 development contracts and interests under them, are excepted in determining holding
26 or control under AS 38.05.140. The commissioner may not reduce [DECREASE]
27 royalty on a lease or leases that are subject to a drilling or development contract except
28 as provided in (j) of this section.

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

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DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

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

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

February 14, 2003

SUBJECT: Draft SSHB 28 -- sectional analysis
(Work Order No. 23-LS0177\D)

TO: Representative Vic Kohring

FROM: Jack Chenoweth
Assistant Revisor of Statutes

Per Ben Grenn's request, set out below is an overview by bill section of draft SSHB 28, a measure relating to adjustments to royalty reserved to the state to encourage otherwise uneconomic production of oil and gas. The bill, as introduced, would replace the text of current AS 38.05.180(j). That subsection was last amended for other than stylistic reasons by ch. 85, SLA 1995 (SCS CSHB 207 (Finance) am S of the 1995 regular session). Proposed in this bill is replacement of much, but not all, of the current text of subsection (j) with the text of a House-passed predecessor version of the 1995 Act, CSHB 207 (Finance) am. The bill also makes conforming changes in three related subsections of AS 38.05.180.

Bill section 1. The provisions set out a series of changes to subsection (j). The principal substantive changes are as follows:

Paragraph (1) -- circumstances allowing for royalty modification:

-- at page 1, lines 6 and 7: explicit authority to change royalty by "an increase or decrease" is here deleted, retaining only the more generic reference to "modification";

-- at page 1, line 13 - page 2, line 3: the condition on modification that tied to authorization or reauthorization by law in a preceding 10 year period is removed as is the July 1, 2015, cutoff date authorizing royalty modifications;

-- at page 2, lines 12 - 14, 17 - 19, and 20 - 21: with respect to an oil or gas field or pool or portion of an oil or gas field or pool, additional conditions, all relating to a determination on the part of the commissioner of natural resources of economic "feasibility", are added for circumstances involving requests for royalty reductions involving new production, or for those sought "to prolong the economic life" of a field or pool or portion of either when decreasing oil or gas prices influence future production, or for those sought to reestablish production of shut-in oil or gas production;

Paragraph (2) -- showing required; applicable standard:

-- at page 2, lines 22 - 25: no substantive change is made in this paragraph; the insertion and deletion restores the choice of term first set out in the 1995 House-passed version;

Paragraph (3) -- conditions to be attached to requested royalty modification:

-- at page 2, line 26 - page 4, line 4: explicit authority to change royalty by "an increase or decrease or other modification" is added; specific detailed requirements relating to descriptions accompanying findings that support a royalty modification and detailed terms and conditions applicable to a modification, distinguishing in their terms as between modification of royalty to support new production versus modification relating to prolonging the life of a field or pool or modification to reestablish production of shut-in oil or gas, are replaced by a more generic, universally applicable, single standard ("*sliding scale royalty or other mechanism that shall be based on a change in the price of oil or gas and may also be based on other relevant factors . . .*"); the standard described is not new but its invariable application to *all* royalty modification-related change requests apparently would be;

Paragraph (4) -- limits on royalty modification:

-- at page 4, lines 5 - 14: modifies the application of the terms of the existing condition of paragraph (4) to have it apply only in the event of a royalty "reduction"; limits on the amount of the royalty that may be determined for new production versus modification relating to prolonging the life of a field or pool, or modification to reestablish production of shut-in oil or gas set out in current law are retained;

Paragraph (5) -- assignability of royalty modification:

-- at page 4, lines 15 - 21: eliminates the requirement of existing paragraph (5) that a royalty modification must be accompanied by a provision allowing the royalty modification to be assigned only with consent of the commissioner of natural resources;

Existing paragraph (6) -- procedures applicable to supporting data:

-- at page 4, line 22 - page 5, line 14: revises the text on public disclosure of information submitted to support an applicant's request for a reduction of royalty;

Existing paragraph (7) -- hiring and use of consultants:

-- at page 5, lines 15 - 23: revises the set of circumstances under which the commissioner may require evaluation by an independent contractor to limit it to instances of requested royalty reductions,

Existing paragraph (8) -- preliminary findings and determination; public notice and comment; procedures applicable to preliminary approval of governor and legislative review:

-- at page 5, beginning at line 24: amends the set of circumstances under which the commissioner must make and publish preliminary findings to limit it to instances of requested royalty reductions, and substitutes a common, more simplified public notice and comment process for all applications;

Existing paragraph (9) -- disclosure of the effects of royalty reduction:

-- at page 7, lines 1 - 4: eliminates the requirement of existing paragraph (9) obligating the commissioner of natural resources to include in the findings "the reasonably foreseeable effects of the proposed royalty modification on the state's revenue";

Existing paragraph (10) -- opportunity for and procedures applicable to Legislative Budget and Audit Committee review of preliminary findings and determination:

-- at page 7, lines 5 - 17: reinserts a deadline for the commissioner's appearance before the Legislative Budget and Audit Committee and eliminates explicit authority for the commissioner to appear before the committee in an executive session insofar as discussion may involve disclosure to the committee of confidential financial and technical data that support the commissioner's preliminary findings and determination;

Existing paragraph (11) -- transmittal of preliminary determination to legislature:

-- at page 7, lines 18 - 24: although renumbered, no change is made in this paragraph;

Existing paragraph (12) -- final action:

-- at page 7, beginning at line 25: eliminates the requirement that the governor approve the final findings and determination that are prepared by the commissioner; makes other word changes consistent with amendments set out earlier in the bill;

Existing paragraph (13) -- certain related provisions made inapplicable to limit the commissioner's authority to modify royalty under subsection (j):

-- at page 8, lines 19 and 20: no change is made in this paragraph.¹

¹ The provisions referenced in the text of this paragraph provide as follows:

Sec. 38.05.134. **Conversion to lease.** If the licensee requests and the commissioner determines that the work commitment obligation set out in an oil

and gas exploration license issued under AS 38.05.132 has been met, the commissioner shall convert to one or more oil and gas leases all or part, as the licensee may indicate, of the area described in the exploration license that remains after the relinquishments, removals, or deletions required by AS 38.05.132(d)(2). A lease issued under this section

...

(3) must be conditioned upon a royalty in amount or value of not less than 12.5 percent of production, except that the lessee who, proceeding under AS 38.05.131 - 38.05.134, under a lease issued in the Cook Inlet sedimentary basin who is the first to file with the commissioner a nonconfidential sworn statement claiming to be the first to have drilled a well discovering oil or gas in a previously undiscovered oil or gas pool and who is certified by the commissioner within one year of completion of that discovery well to have drilled a well in that pool that is capable of producing in paying quantities shall pay a royalty of five percent on all production of oil or gas from that pool attributable to that lease for a period of 10 years following the date of discovery of that pool, and thereafter the royalty payable on all production of oil or gas from the pool attributable to that lease shall be determined and payable as specified in the lease; the payment of the five percent royalty under this paragraph is authorized only to a holder of a lease who meets the requirements of AS 38.05.180(f)(4);

.....

[AS 38.05.180. Oil and gas leasing.] (f) Except as provided by AS 38.05.131 - 38.05.134 and 38.05.177, the commissioner may issue oil and gas leases on state land to the highest responsible qualified bidder as follows:

(1) the commissioner shall issue an oil and gas lease to the successful bidder determined by competitive bidding under regulations adopted by the commissioner; bidding may be by sealed bid or according to any other bidding procedure the commissioner determines is in the best interests of the state;

(2) whenever, under any of the leasing methods listed in this subsection, a royalty share is reserved to the state, it shall be delivered in pipeline quality and free of all lease or unit expenses, including but not limited to separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation off the lease or unit area;

(3) following a pre-sale analysis, the commissioner may choose at least one of the following leasing methods:
of not less than 12.5 percent in amount or value of the production removed or sold from the lease;

(A) a cash bonus bid with a fixed royalty share reserved to the state;

(B) a cash bonus bid with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease and a fixed share of the net profit derived from the lease of not less than 30 percent reserved to the state;

(C) a fixed cash bonus with a royalty share reserved to the state as the bid variable but no less than 12.5 percent in amount or value of the production removed or sold from the lease;

(D) a fixed cash bonus with the share of the net profit derived from the lease reserved to the state as the bid variable;

(E) a fixed cash bonus with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease with the share of the net profit derived from the lease reserved to the state as the bid variable;

(F) a cash bonus bid with a fixed royalty share reserved to the state based on a sliding scale according to the volume of production or other factor but in no event less than 12.5 percent in amount or value of the production removed or sold from the lease;

(G) a fixed cash bonus with a royalty share reserved to the state based on a sliding scale according to the volume of production or other factor as the bid variable but not less than 12.5 percent in amount or value of the production removed or sold from the lease;

(4) notwithstanding a requirement in the leasing method chosen of a minimum fixed royalty share, on and after March 3, 1997, the lessee under a lease issued in the Cook Inlet sedimentary basin who is the first to file with the commissioner a nonconfidential sworn statement claiming to be the first to have drilled a well discovering oil or gas in a previously undiscovered oil or gas pool and who is certified by the commissioner within one year of completion of that discovery well to have drilled a well in that pool that is capable of producing in paying quantities shall pay a royalty of five percent on all production of oil or gas from that pool attributable to that lease for a period of 10 years following the date of discovery of that pool, and thereafter the royalty payable on all production of oil or gas from the pool attributable to that lease shall be determined and payable as specified in the lease; for purposes of this paragraph, the reduced royalty authorized by this paragraph is subject to the following:

(A) only one reduction of royalty authorized by this paragraph may be allowed on each lease that qualifies for reduction of royalty under this paragraph;

(B) if, under this paragraph, application is made for a royalty reduction for a lease that was entered into before March 3, 1997, the commissioner may approve the application only if, on that date, the lease was a nonproducing lease that was not committed to a unit approved by the commissioner under (m) of this section, that is not part of a unit

Bill sections 2 - 4. These provisions make conforming amendments to subsections (p), (s), and (t) of AS 38.05.180, substituting "reduce royalty" for "decrease royalty" in places indicated.

Bill section 5. Under the referenced paragraph², there is in the State Procurement Code an exemption for contracts with experts retained by the commissioner of natural

under (p) or (q) of this section, and that has not been made part of a unit under AS 31.05;

(C) if application for a royalty reduction is made under this paragraph for a lease on which a discovery royalty was claimed or may be claimed under the discovery royalty provisions of former AS 38.05.180(a) in effect before May 6, 1969, the commissioner shall disallow the application under this paragraph unless the applicant waives the right to claim the right to a reduced royalty under the discovery royalty provisions of former AS 38.05.180(a) in effect before May 6, 1969; and

(D) the commissioner shall adopt regulations setting out the standards, criteria, and definitions of terms that apply to implement the filing of applications for, and the review and certification of, discovery oil and gas royalty certifications under this paragraph;

(5) notwithstanding and in lieu of a requirement in the leasing method chosen of a minimum fixed royalty share, or the royalty provision of a lease, for leases unitized as described in (p) of this section, leases subject to an agreement described in (s) or (t) of this section, or interests unitized under AS 31.05, the lessee of all or part of an oil or gas field identified in this section that has been granted approval of a written plan submitted to the Alaska Oil and Gas Conservation Commission under AS 31.05.030(i) shall, subject to (dd) of this section, pay a royalty of five percent on the first 25,000,000 barrels of oil and the first 35,000,000,000 cubic feet of gas produced for sale from that field that occurs in the 10 years following the date on which the production for sale commences; the fields eligible for royalty reduction under this paragraph, all of which are located within the Cook Inlet sedimentary basin, were discovered before January 1, 1988, and have been undeveloped or shut in from at least January 1, 1988, through December 31, 1997, are

- (A) Falls Creek;
- (B) Nicolai Creek;
- (C) North Fork;
- (D) Point Starichkof;
- (E) Redoubt Shoal; and
- (F) West Foreland.

² The text of the material to be repealed, paragraph (33) of AS 36.30.850(b), reads as follows:

Representative Vic Kohring
February 14, 2003
Page 7

resources to help evaluate the request for a royalty modification. One of the changes made in the bill shifts the contracting obligation from the department to the applicant. Repeal of the paragraph would eliminate the Procurement Code exemption for the retention of experts.

Bill section 6 gives the measure an immediate effective date.

JBC:med
03-152.med

(b) This chapter (i.e. the State Procurement Code) applies to every expenditure of state money by the state, acting through an agency, under a contract, except that this chapter does not apply to

. . . .

(33) contracts between the Department of Natural Resources and contractors qualified to evaluate hydrocarbon development, production, transportation, and economics, to assist the commissioner of natural resources in evaluating applications for oil and gas royalty increases or decreases or other oil and gas royalty adjustments, and evaluating the related financial and technical data, entered into under AS 38.05.180(j);

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: CS SS HB 28(O&G)
 () Publish Date: _____

Revision Date/Time (Note if correction): 4-10-03 Dept. Affected: Natural Resources
 Title Oil & Gas Royalty Modification BRU Resource Development
 Component Oil and Gas Development
 Sponsor Kohring, Rokeberg
 Requester House Resources Component No. 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

CHANGE IN REVENUES ()						
-------------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0
 Mark this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

HB 28 would amend AS 38.05.180(j) which addresses oil and gas royalty modifications. None of the amendments in CSSH 28(O&G) would provide additional fiscal impacts to the state beyond that already existing in statute.

Prepared by: Mark D. Myers Phone 269-8800
 Division Oil and Gas Date/Time 4/10/2003
 Approved by: Tom Irwin, Commissioner Date 4/10/2003
 Agency Natural Resources

Unocal Alaska
Union Oil Company of California
808 West 9th Avenue, P.O. Box 196247
Anchorage, Alaska 99519-6247
Telephone (907) 278-7600
Fax (907) 263-7698



Kevin A. Tabler, Manager
Land/Government Affairs

March 7, 2003

Representative Norman Rokeberg
State of Alaska Legislature
State Capitol
Juneau, Alaska 99801-1182

Re: Oil and Gas Royalty Modification
Information

Representative Rokeberg:

During my recent visit to Juneau, March 4, 2003, you asked me for certain background information regarding Union Oil Company of California's (Unocal) application to the Department of Natural Resources (DNR) for royalty relief under HB 207. Specifically, you asked two (2) questions:

1. You wanted to know our opinion and experience with the application process and as an applicant, our thoughts on the applicant for a royalty modification having input into the selection of a contractor; and
2. Information regarding the availability of certain data that may be requested by DNR in the application approval process, particularly over a property that was previously owned by another company.

Attached to this letter are copies of testimony I provided during the 1995 hearing process partially addressing the issues above. I also participated in answering questions at several hearings wherein I expressed Unocal views not specifically stated in the attached testimony. I hope the attached will provide some context to the following comments. It's clear from the outcome of the legislation in 1995 that some of the concerns expressed thru testimony and subsequent non-use of HB207 were proven correct. We applaud your efforts to correct these deficiencies.

UNOCAL Support

Concern over contractor selection was intensely debated in 1995. Unocal expressed concern over the necessity of adding additional costs to the process by not using DNR personnel to evaluate the applicant's submittal. It was felt then, and we continue to believe, DNR has the personnel to make the evaluation. Applicants may choose to contract the services of contractors or consultants to help in the analysis and preparation of an application only later to find the dollars expended will be of no value or duplicated in the DNR application approval process without selection input from the applicant; only the duty to pay for such additional services.

During the Unocal application process, we spent approximately \$250,000.00 in consulting fees when the total resulting benefit to Unocal would have amounted to around \$600,000.00. We hired Gaffney Cline as our consultant because the State of Alaska had just used them for a reserve study in Cook Inlet. The thought here was that Gaffney Cline would provide creditability and DNR would be comfortable with their work and our analysis. We ultimately pulled the application because we had over 12 months and too many man-hours involved to justify the time and expense for such a nominal benefit. The biggest problem with the process was that the requirements for justifying royalty reduction were undefined so the applicant did not know what criteria they were trying to satisfy. The process has to be simple, predictable, easily understood and administered. It can't be a process for DNR to try and get into the financial workings of a company in order to make a determination of what the DNR believes a reasonable rate of return should be. Additionally, it can't be a process where any relief is tied somehow to the state being made whole in the future. The reality may be the State won't be made whole in terms of royalty revenue receipts from future production but compensated through ancillary benefits.

With mature fields in Cook Inlet, when a royalty application is needed, the volumes of production and corresponding royalty associated therewith are such that life extension of the facility is the primary benefit. If you wait until the field is truly uneconomic to apply or qualify then there is very little benefit to the applicant since royalty relief does not really add enough revenue to significantly increase field life. The time to get relief is when you are still economic and there is potential to increase field life by investing more capital or expense dollars to increase production. With such an extension you have the ancillary benefits of jobs, taxes and the multiplying effect of money in a community.

Although we understood the concerns expressed in 1995 regarding contractor selection, if we have to have a selection process, a process where the DNR provides a list of approved contractors and the applicant can pick from the list and negotiate the price seems most fair. The criteria would be determined up front and the costs would be established to provide certainty to the process. The applicant can then decide if the cost is justified in proceeding with the application.

Secondly, the issue of data availability is an important one. Not all data that may be requested by the DNR is available for all facilities. In past years, properties have exchanged hands on a number of occasions and the resulting effect is each company has different policies for retaining, evaluating, maintaining and storing data. Historical data,

in particular financial and production data, is often lost, determined to be confidential or not provided at all.

In one Unocal transaction, the selling party decided to make duplicate copies of the files for their records. Labeled file jackets were removed and retained for the selling parties duplicate files. The original contents were bound by rubber bands, unidentified and placed in boxes for shipping. Upon arrival, we had no transmittal verification of what was sent. The selling company was later acquired by another company and the duplicate set of files destroyed. It took a year to sort out what was sent, and in the process, paperwork and files determined at the time to be of no value were destroyed.

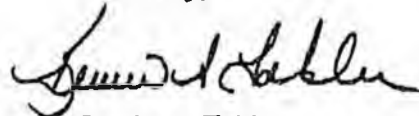
In another case, a property transferred to Unocal years ago, involved a Purchase and Sales Agreement and a Bill of Sale. No operational, financial or production data was ever received by Unocal. Additionally, it is not uncommon for geological and geophysical data licenses to be non-transferable. Unless the selling party has an ownership in the data, or the data is proprietary to the selling company, the purchaser may not be entitled to certain data requested or required by DNR for its royalty modification application review.

Finally, data acquired today has a better chance of being retained, inventoried and located due to electronic imaging. Historical information is bulky, cumbersome, requires storage and often destroyed as standard past operating procedure.

The issues of data availability and contractor selection become less problematic if the application process is clear and concise and the qualifying criteria quickly and automatically administered.

Hopefully, the foregoing answers your questions.

Sincerely,



Kevin A. Tabler

Attachments

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

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

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

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

Section 2.

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

AOGCC has clearly defined pools and separate horizons or zones associated with any recognized field. Similar testimony was provided Tuesday by DNR and we support their modification.

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

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

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

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

Four (4) of the ten (10) Unocal operated producing platforms produce less than 2,000 BOPD each. One (1) produces less than 900 BOPD. Expenses on all of these properties make them marginally profitable. In an effort to increase

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

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

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

Line 1 on page 4 indicates the commissioner's decision regarding a request is final and not appealable. This really is no change from the current Statute. If this provision is of concern to the committee or the Legislature, then perhaps a peer review of the decision could be conducted. In Tuesday's hearing, the

AOGCC provided a couple of alternative approaches to address the concern of oversight and appealability, both of which are acceptable to Unocal.

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

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

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

Thank You

HB

57

STATE OF ALASKA

REPRESENTATIVE
MIKE CHENAULT

Official Business

Interim:
145 Main St. Loop, Second Floor
Kenai, Alaska 99611
(907) 283-7223
Fax: (907) 283-3075



HOUSE OF REPRESENTATIVES

Session:
Capitol Building, Room 432
Juneau, Alaska 99801-1182
(907) 465-3779
Toll Free: (800) 469-3779
Fax: (907) 465-2833

SPONSOR STATEMENT HOUSE BILL 57

This bill proposes to add "manufacturer" as a further entity that may claim that benefit of the contract price as the basis for determining royalty due to the state of the gas production.

Lisa Parker
Corporate Community Relations
Agrium U.S. Inc.
P.O. Box 575
Kenai, Alaska 99611-0575

Dear Ms. Parker

As you requested, we have reviewed the fiscal note prepared by the Alaska Division of Oil and Gas for House Bill 57. The note hypothesizes certain revenue impacts from passage of the bill. The note does not, however, provide a complete picture of the Bill's potential economic benefits to the State of Alaska. The economic benefits of Agrium's Kenai operations were summarized in our report, *The Economic Impacts of Agrium Kenai Nitrogen Operations in Alaska, 2001*, dated October, 2002. This letter describes elements of that analysis that we find particularly relevant to HB 57.

In 2001 the Agrium Nikiski plant purchased 53 billion cubic feet of Cook Inlet natural gas worth approximately \$80 million. The plant's value-added processing used this raw material to create \$333 million in total economic output (the value of the finished product plus the indirect and induced economic impacts of plant operations (those that are *in excess of* Agrium's direct spending for goods and services). This \$6.28 of total economic output per Mcf is more than four times the value of the raw gas.

Another way of saying this is that the plant represents more than \$300 million each year in Alaska economic activity that would not otherwise have occurred. This is because there is currently no other high-value-added use for the Cook Inlet gas purchased by Agrium. In fact, the economic loss, should Agrium cease operations, would be somewhat greater, since the state would also lose its 90 percent share of the federal royalty associated with that portion of Agrium's feedstock that comes from federal leases.¹ The magnitude of the economic benefits to the state compared with the cost in "royalty foregone" under HB 57 is notable. The royalty foregone "cost" is only about 6% of the more than \$50 million per year that the plant creates in payroll and less than 1% of the plant's total economic output.

HB 57 is important because, by your description, loss of the Agrium economic engine appears a real possibility. The current royalty structure is indexed not to actual Cook Inlet gas transactions, but to those in the Lower 48, where market exchanges are facilitated by a broad network of transportation pipelines. The resulting high royalty values are helping to push the total effective cost of Agrium's natural gas feedstock toward a point at which the Nikiski plant will become uneconomic to operate. If that happens, unless there is an alternative buyer for the gas (currently unidentified), there will be little or no incentive either to produce the gas that Agrium currently buys or to

¹ Other factors also would come into play in the event of a plant shut-down, such as devaluation of local real estate, etc. However, these effects are beyond the scope of this discussion.

explore for more. As a result, the value to Alaska of the state gas that Agrium now purchases would decline to the net present value of that gas at some point in the future (i.e., when and if a new purchaser materializes). The value of all the gas that could be produced and sold to Agrium in the meantime would be lost forever.²

The accompanying table shows the projected value to the state of imposing the higher royalty structure compared with the value of uninterrupted Agrium operations using a royalty structure based on actual contract value. (All figures in nominal dollars).

Please let us know if we can provide any further information.

Sincerely,



Jim Calvin
Partner

² More precisely, that unsold gas would remain in the ground until such time as a means exists for production and sales *in excess of* what Agrium would have used in the interim (and, one must presume, for a purpose other than production of ammonia and urea). The expected net present value of these market conditions seems likely to approach zero.

Benefits and Costs of HB 57 Based on Escalating Contract Value

FY	State Leases	Royalty Share	Contract Value	Royalty Value	Difference	Economic Costs	Economic Benefits			
						Royalty Foregone	Royalty Paid	Payroll Impacts	Industrial Property Taxes	Total Economic Output
Thousand cubic feet per year			\$/Mcf	\$/Mcf	\$/Mcf					
2003	25,885,747	3,453,159	1.50	2.37	0.87	3,004,248	5,179,738	50,000,000	2,400,000	333,000,000
2004	25,885,747	3,453,159	1.54	2.43	0.89	3,080,305	5,310,871	51,500,000	2,400,000	341,430,380
2005	25,885,747	3,453,159	1.63	2.57	0.94	3,257,771	5,616,847	53,045,000	2,400,000	361,101,266
2006	25,885,747	3,453,159	1.71	2.70	0.99	3,422,561	5,900,967	54,636,350	2,400,000	379,367,089
2007	25,885,747	3,453,159	1.80	2.84	1.04	3,600,027	6,206,943	56,275,441	2,400,000	399,037,975
2008	25,885,747	3,453,159	1.89	2.98	1.09	3,777,493	6,512,919	57,963,704	2,400,000	418,708,861
2009	25,885,747	3,453,159	1.97	3.12	1.15	3,954,959	6,818,896	59,702,615	2,400,000	438,379,747
						24,097,365	41,547,181	383,123,109	16,800,000	2,671,025,316

The table is structured to foster comparison with the Division of Oil and Gas fiscal note, Table 2.³ For simplicity, baseline contract value and economic impacts shown for 2003 reflect actual figures from the McDowell Group report "The Economic Impacts of Agrium Kenai Nitrogen Operations in Alaska, 2001." No attempt was made to adjust these baseline figures to reflect any changes that may have occurred between 2001 and 2003.

Projections for future years are based on the following additional assumptions:

- Agrium operates at 100 percent capacity, which was the case in 2001, the year for which economic impacts were calculated.
- The average "Contract Value" at which Agrium purchases gas is assumed to escalate at the same rate Division of Oil and Gas projects for "Royalty Value".⁴ The effect of using the actual 2001 contract value as the nominal contract value for 2003, together with annual increases proportional to those of the royalty value is to reduce the "Royalty Foregone" under HB 57 from \$36 million (per the original fiscal note) to \$24 million.
- "Royalties Paid" equal the "Royalty Share" times the "Contract Value."
- Increases in payroll impacts are 3 percent per year, based on Agrium's anticipated cost of labor.
- "Total Economic Output" is the sum of gross sales value of Agrium production and the indirect and induced effects of company spending. The ratio of these components is roughly 2 to 1. Payroll and industrial property taxes shown represent part of Agrium's total economic output. Economic output is an inherently broad and somewhat imprecise measure. For simplicity, in this analysis it is assumed to increase in proportion to raw materials cost (contract value).
- Amounts shown are in nominal (not discounted) dollars

³ Minor differences in calculated values between the two tables are the result of rounding.

⁴ Agrium believes this is a reasonable expectation.



Kenai Chamber of Commerce
402 Overland
Kenai, Alaska 99611
(907) 283-7989
(907) 283-7183 (Fax)

RESOLUTION 2003-01

A RESOLUTION IN SUPPORT OF "AN ACT AMENDING THE MANNER OF DETERMINING THE ROYALTY RECEIVED BY THE STATE ON GAS PRODUCTION AS IT RELATES TO THE MANUFACTURE OF CERTAIN VALUE ADDED PRODUCTS"

WHEREAS, the Kenai Chamber of Commerce has over 350 business members, and

WHEREAS, the manufacturing of value added resources in the State of Alaska serve as a catalyst to economic development in Alaska; and

WHEREAS, one of the state's premier value added manufacturing industries is located on the Kenai Peninsula; and

WHEREAS, this industry, Agrium Kenai Nitrogen Operations, is exceptional for its combination of high pay levels, amount and concentration of expenditures in Alaska; and

WHEREAS, Agrium Kenai Nitrogen Operations is one of the few industries adding value to Alaska's natural resources using Cook Inlet natural gas to create anhydrous ammonia and two forms of urea; and

WHEREAS, Agrium Kenai Nitrogen Operations purchases natural gas from producers in Cook Inlet; and

WHEREAS, Agrium Kenai Nitrogen Operations markets its products around the world competing against major world competition which is primarily based upon the monetization of trapped gas resources; and

WHEREAS, Agrium Kenai Nitrogen Operations is the Kenai Peninsula's third largest private employer and accounts for an additional 700 jobs in Alaska and the Kenai Peninsula; and

WHEREAS, Agrium Kenai Nitrogen Operations expenditures in Alaska are spread to over 250 businesses statewide with 118 companies located on the Kenai Peninsula; and

WHEREAS, House Bill 57 has been introduced which will provide for the State of Alaska to enter into agreements with non-affiliated natural gas producers to accept as the price for the State's royalty share the price established in an arm's length contract



Kenai Chamber of Commerce
402 Overland
Kenai, Alaska 99611

(907) 283-7989

(907) 283-7183 (Fax)

negotiated between the natural gas producer and a manufacturer of value added producers; and

NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF DIRECTORS OF THE KENAI CHAMBER OF COMMERCE:

SECTION 1: That the Kenai Chamber of Commerce urges the 23rd Alaska State Legislature to enact HB 57, "An Act Amending The Manner Of Determining The Royalty Received By The State On Gas Production As It Relates To The Manufacture Of Certain Value Added Products."

SECTION 2: That copies of this resolution shall be sent to all members of the 23rd Alaska State Legislature and Governor Frank Murkowski.

SECTION 3: That this resolution takes effect immediately upon its enactment.

UNANIMOUSLY PASSED BY THE KENAI CHAMBER OF COMMERCE OF THE CITY OF KENAI ALASKA, this 7th day of February, 2003.

Cherie L. Brewer

Cherie L. Brewer
Chamber Board President

Suggested by: City Council

CITY OF KENAI

RESOLUTION 2003-08

A RESOLUTION OF THE COUNCIL OF THE CITY OF KENAI, ALASKA, SUPPORTING HB57, "AN ACT AMENDING THE MANNER OF DETERMINING THE ROYALTY RECEIVED BY THE STATE ON GAS PRODUCTION AS IT RELATES TO THE MANUFACTURE OF CERTAIN VALUE ADDED PRODUCTS."

WHEREAS, Agrium Kenai Nitrogen Operations is exceptional for its combination of high pay levels, amount and concentration of expenditures in Alaska; and,

WHEREAS, Agrium Kenai Nitrogen Operations is one of the few industries adding value to Alaska's natural resources using Cook Inlet natural gas to create anhydrous ammonia and two forms of urea; and,

WHEREAS, Agrium Kenai Nitrogen Operations purchases natural gas from producers in Cook Inlet; and,

WHEREAS, Agrium Kenai Nitrogen Operations markets its products around the world competing against major world competition which is primarily based upon the monetization of trapped gas resources; and,

WHEREAS, Agrium Kenai Nitrogen Operations is the Kenai Peninsula's third largest private employer and accounts for an additional 700 jobs in Alaska and the Kenai Peninsula; and,

WHEREAS, Agrium Kenai Nitrogen Operations expenditures in Alaska are spread to over 250 businesses statewide with 118 companies located on the Kenai Peninsula; and,

WHEREAS, House Bill 57 has been introduced which will provide for the State of Alaska to enter into agreements with non-affiliated natural gas producers to accept as the price for the State's royalty share the price established in an arm's length contract negotiated between the natural gas producer and a manufacturer of value added products, like Agrium Kenai Nitrogen Operations.

NOW, THEREFORE, BE IT RESOLVED BY THE COUNCIL OF THE CITY OF KENAI, ALASKA, the following:

Section 1: The Kenai City Council urges the 23rd Alaska State Legislature to enact HB 57, "An Act Amending the Manner of Determining the Royalty Received by the State on Gas Production as it Relates to the Manufacture of Certain Value Added Products."

Section 2: Copies of this resolution shall be sent to all members of the 23rd Alaska State Legislature.

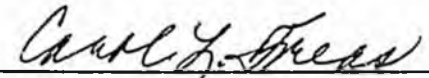
Section 3: This resolution takes effect immediately upon its enactment.

PASSED BY THE COUNCIL OF THE CITY OF KENAI, ALASKA, this 19th day of February, 2003.



JOHN J. WILLIAMS, MAYOR

ATTEST:



Carol L. Freas, City Clerk

Introduced by: Mayor, Superman
Date: 02/18/03
Action: Adopted
Vote: 8 Yes, 0 No, 1 Absent

**KENAI PENINSULA BOROUGH
RESOLUTION 2003-024**

**A RESOLUTION SUPPORTING THE PASSAGE OF HOUSE BILL 57 AND SENATE
BILL 50 AMENDING THE MANNER OF DETERMINING THE ROYALTY
RECEIVED BY THE STATE ON GAS PRODUCTION AS IT RELATES TO THE
MANUFACTURE OF CERTAIN VALUE-ADDED PRODUCTS**

- WHEREAS,** Agrium Kenai Nitrogen Operations is exceptional for its combination of high pay levels, amount and concentration of expenditures in the Kenai Peninsula Borough and Alaska; and
- WHEREAS,** Agrium Kenai Nitrogen Operations is one of the few industries adding value to Alaska's natural resources by using Cook Inlet natural gas to create anhydrous ammonia and two forms of urea; and
- WHEREAS,** Agrium Kenai Nitrogen Operations purchases natural gas from producers in Cook Inlet; and
- WHEREAS,** Agrium Kenai Nitrogen Operations markets its products around the world competing against major world competition which is primarily based upon the monetization of trapped gas resources; and
- WHEREAS,** Agrium Kenai Nitrogen Operations is the Kenai Peninsula's third largest private employer and accounts for an additional 700 jobs in Alaska and the Kenai Peninsula Borough; and
- WHEREAS,** Agrium Kenai Nitrogen Operations expenditures in Alaska are spread to over 250 businesses statewide with 118 companies located within the Kenai Peninsula Borough; and
- WHEREAS,** House Bill 57 and Senate Bill 50 have been introduced which will provide for the State of Alaska to enter into agreements with non-affiliated natural gas producers to accept as the price for the State's royalty share the price established in an arm's length contract negotiated between the natural gas producer and Agrium Kenai Nitrogen Operations;

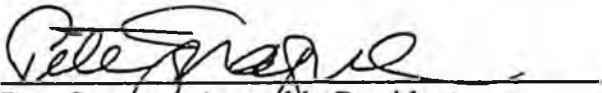
NOW, THEREFORE, BE IT RESOLVED BY THE ASSEMBLY OF THE KENAI PENINSULA BOROUGH:

SECTION 1: That the Kenai Peninsula Borough Assembly urges the 23rd Alaska State Legislature to enact House Bill 57 and Senate Bill 50, Acts amending the manner of determining the royalty received by the state on gas production as it relates to the manufacture of certain value added products.

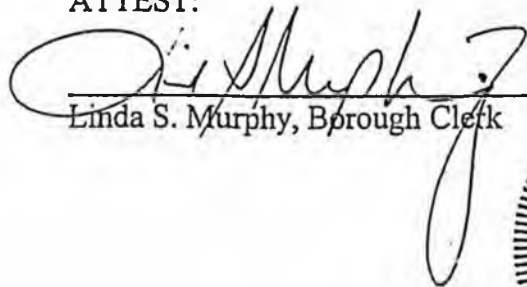
SECTION 2: That copies of this resolution shall be sent to Senator Tom Wagoner, Senator Alan Austerman, Representative Mike Chenault, Representative Paul Seaton, Representative Kelly Wolf and Governor Frank Murkowski.

SECTION 3: That this resolution takes effect immediately upon its enactment.

ADOPTED BY THE ASSEMBLY OF THE KENAI PENINSULA BOROUGH THIS 18TH DAY OF FEBRUARY 2003.


Pete Sprague, Assembly President

ATTEST:


Linda S. Murphy, Borough Clerk



THE
FOLLOWING
DOCUMENT(S)
ARE
POOR
ORIGINAL
COPIES

kenai

nitrogen operations

Impact on Local Economy

The Kenai Operation provides employment for more than 296 full time employees who earn approximately \$26 million in wages and benefits. The plant also pays about \$3.6 million in local property taxes and spends more than \$14 million a year to buy local goods and supplies.

Caring for the Kenai

We also are proud to sponsor the nationally acclaimed Caring for the Kenai environmental awareness contest that annually challenges local high school students to answer the question "What can I do, create, invent or improve to better care for the environment of the Kenai Peninsula?" The program has not only raised the level of environmental awareness on the Kenai, but has also generated many practical ideas that have improved our environment.

In April, 2001, President George W. Bush honored Kenai Peninsula youth by presenting a President's Environmental Youth Award to three young people who had participated in our "Caring for the Kenai" environmental awareness program. In return, the students gave the President a "Caring for the Kenai" jacket.

Caring for the Kenai - President George W. Bush presented with a "Caring for the Kenai" jacket.



Partners in the Community

Agrium employees live and work on the Kenai Peninsula, and they are deeply involved in activities that enrich the lives of all its citizens. They coach hockey, soccer, football, basketball and Little League baseball. Many serve in leadership roles in organizations such as Boys and Girls Clubs, 4-H, Girl Scouts and Boy Scouts. Others participate as teachers at the Kenai Peninsula College, as advisors in the Junior Achievement program, as first aid instructors and as Sunday school teachers.

Kenai Nitrogen Operations is a strong supporter of the United Way, with Employee donations matched dollar for dollar by the Company. And we are active volunteers on business and professional organizations as well as government boards and commissions.

"More than seventy years in the fertilizer business have taught us how to compete and stay ahead of the competition."

Agrium

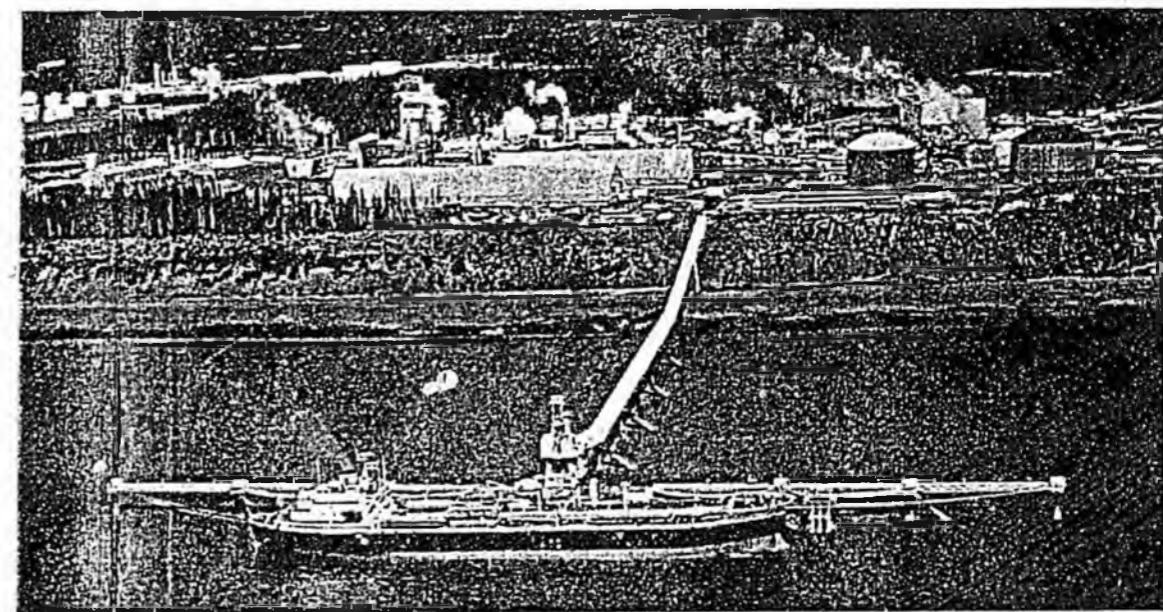
kenai

nitrogen operations

Agrium Inc. produces more than 11 million tons (10 million tonnes) of fertilizers annually. Nitrogen fertilizer products account for some 8.2 million tons (7.5 million tonnes) of that total. Potash fertilizers account for 1.7 million tons (1.5 million tonnes) and phosphate fertilizers for 1.1 million tons (1 million tonnes).

Agrium is also one of the largest agricultural retailers in the United States, supplying products and related services to growers in 24 states under the retail banners of Crop Production Services and Western Farm Service. We are also a leading fertilizer retailer in Argentina, with outlets operating under the trade name Agroservicios Pampeanos.

Agrium's commitment to the communities where we operate is actively demonstrated through open and honest communications, responsible environmental stewardship, putting safety first and by investing in a bright tomorrow.



Kenai Nitrogen Operations is located 10 miles (16 km) north of the City of Kenai, Alaska on Cook Inlet. Accessible by air, water and land, the complex is made up of two ammonia plants and two urea plants. The ammonia plants have a combined annual production capacity of about 700,000 (net) tons (630,000 tonnes) of anhydrous ammonia and 1.1 million tons (1 million tonnes) of urea per year. That's enough to fertilize a strip of farmland 16 miles (25 km) wide stretching from Los Angeles to New York.

The principal raw materials for the ammonia and urea fertilizers manufactured by the Kenai plant are natural gas, water and air. Natural gas is piped to the facility from nearby gas fields.

The facility consists of two separate ammonia/urea production and utility plants. The original plant was completed in 1968. Its size was approximately doubled in 1977.

Due to its proximity to Asia, much of the fertilizer produced at Kenai is exported to Pacific Rim nations. In 2000, more than \$154 million worth of products were sold to overseas markets.

From our facilities in North and South America, more than 5,000 Agrium employees supply growers around the world with fertilizers to sustain the production of nutritious and safe food for millions of people.

Agrium

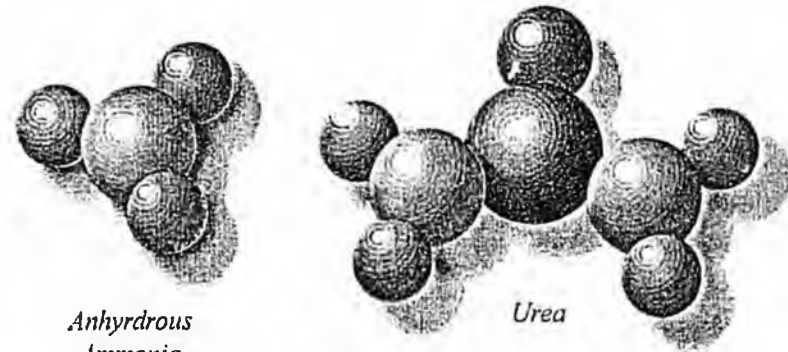
Kenai Nitrogen Operations
P.O. Box 575,
Mile 21, Spur Highway
Kenai, Alaska
99611
Phone: (907) 776-8121
Fax: (907) 776-5579
<http://www.agrium.com>

PUBLISHED 1201
PRINTED IN CANADA

Nourishing a Growing World

Fertilizer Products

It is estimated that 50 percent of the food production in North America is the direct result of nitrogen-based fertilization. Nitrogen is the plant nutrient most commonly deficient in western agriculture. The ammonia and urea fertilizers produced at Kenai Nitrogen Operations play a major role in promoting high yields of nutritious food crops. Without them, not only would food prices rise, but food quality would also diminish.



Anhydrous Ammonia

Urea

- Hydrogen
- Nitrogen
- Carbon
- Oxygen

Ammonia and urea are found in nature. Without them, life as we know it would not be possible. Ammonia is a vital part of every living cell, and urea is a natural byproduct of the breakdown of protein in the digestive system.

In terms of their nutrient content, the nitrogen fertilizer products produced at Kenai Nitrogen Operations are identical to 'organic' fertilizers. The source of plant nutrients is irrelevant to the yield or quality of the fruit, grain or vegetable matter produced by the plant.

Anhydrous ammonia is a liquid fertilizer, manufactured by combining nitrogen gases from the atmosphere with hydrogen derived from natural gas and water. The natural gas reacts with superheated steam (between 1300°F (700°C) and 1400°F (760°C)) in the presence of a catalyst to separate hydrogen, from the natural gas, reacts with nitrogen from the atmosphere to form anhydrous ammonia. The word "anhydrous" simply means "without water."

Urea is a solid fertilizer, made by reacting carbon dioxide and ammonia under extreme pressure at 375°F (190°C). The resulting molten mixture is then processed into small, white, crystalline spheres, called prills or granules. Urea is the major fertilizer traded in international commerce, accounting for approximately 50 percent of the nitrogen fertilizer traded around the world.

Ammonia and urea are also used in many other applications including cattle feed, paper, synthetic fibers, resins, refrigeration, waste treatment, rocket propellants, household cleaners, even medicines.

Environmental Stewardship

We are continually working to reduce the environmental impact of our operations. Complying with state and federal environmental regulations is just a beginning. Environmental considerations are a part of all our business decisions.

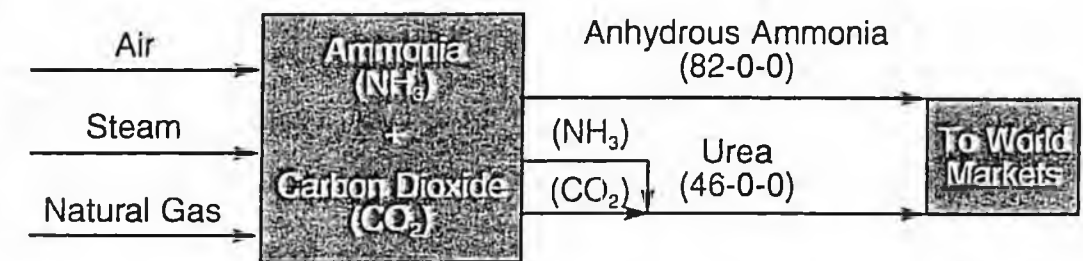
Our environmental protection begins with the safety of our employees. Everyone benefits from having a safe workplace, which comes from careful attention to safe operating procedures, emergency preparedness and preventative maintenance. These practices reduce the potential for plant upsets which could impact the environment.

Since 1996 we have reduced hazardous waste generation at the plant by 99 percent. We accomplished this by replacing a process solution that produced a hazardous byproduct with one that generates no waste, and by replacing solvent and caustic dip tanks with part washers that use hot water and soap.

We have an aggressive pollution prevention plan, and continually look for opportunities to reduce waste volume and toxicity. Our waste minimization efforts have received praise from the Alaska Department of Environmental Conservation and have been recognized by Alaska's Green Star Program.

We continually implement efficiency improvements to reduce atmospheric emissions and burn less fossil fuel. In spring, 2001, the start-up of an electric cogeneration facility eliminated more than 500 tons (455 tonnes) per year of nitrogen oxide emissions.

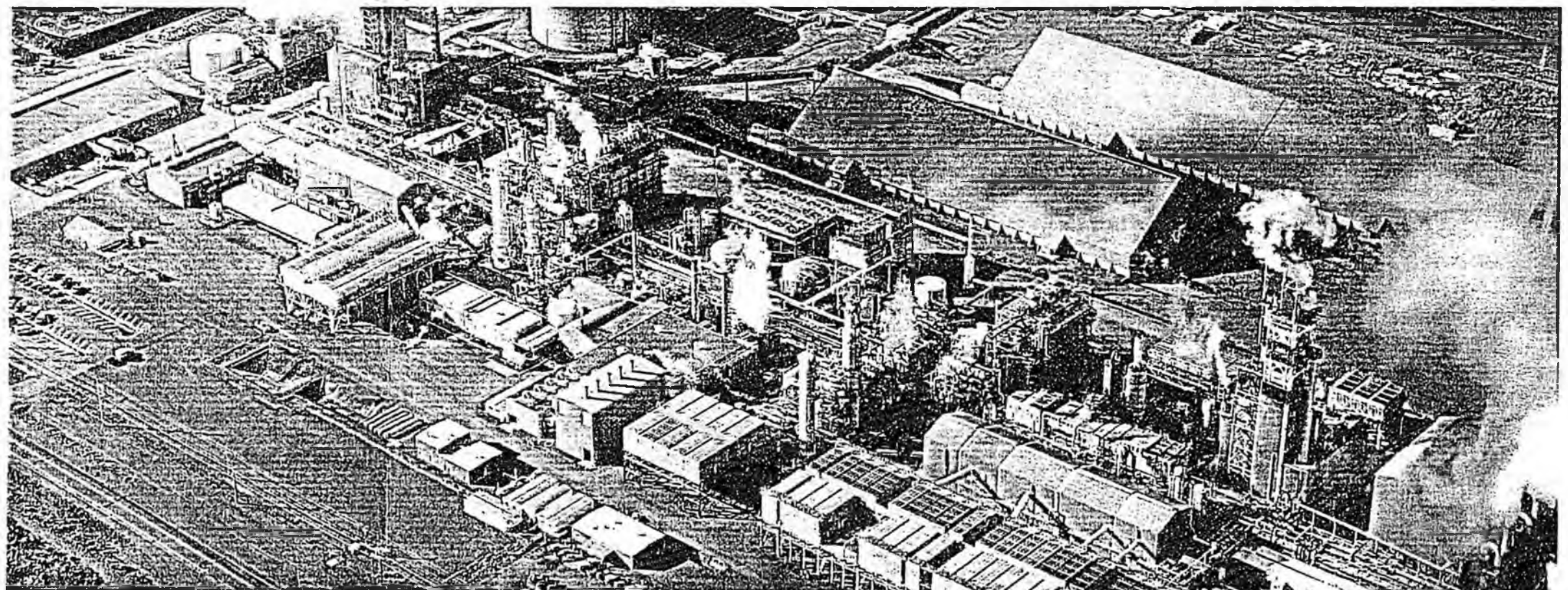
Raw Materials and Products



Best Management Practices

To ensure that our customers always receive safe, competitively-priced products, Agrium is committed to best management practices in the production, distribution and use of everything we make. For the grower, getting the best value for every dollar spent on crop production is more important today than ever before.

The proper use of Agrium anhydrous ammonia and urea fits well into Best Management Practices. The fertilizers produced at the Kenai plant are an effective aid in helping growers achieve maximum efficiency while minimizing environmental impact.



FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: _____
 Bill Version: HB 57
 () Publish Date: _____

Revision Date/Time (Note if correction): 2/11/2003 Dept. Affected: Natural Resources
 Title Royalty Gas Contracts BRU Oil and Gas Development
 Component Oil and Gas Development
 Sponsor Chenault
 Requester House Oil and Gas Component No. 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

CHANGE IN REVENUES ()		**See Revenue Impact Analysis Below**		
-------------------------------	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

****This bill amends AS 38.05.180(aa) requiring DNR to enter into agreements with lessees to use the price for gas established in contract between the lessee and a manufacturer as the value of the state's royalty share. HB 57 will result in a loss of state revenues. Should only one manufacturer apply under AS 38.05.180(aa), the state could lose an estimated \$33.4 million in royalties over a period of seven years (see Table 3, below). However, proposed amendments in HB 57 are worded more broadly than just one company. Interpretation of "manufacturer" may be broadly interpreted to apply to disposition of all royalty gas subject to in-state processing (e.g. LNG, NGLs). Therefore, this \$33.4 million could significantly understate the total revenue impact of HB 57. Furthermore, a much larger revenue impact could occur with a major sale of North Slope royalty gas, since both Prudhoe Bay's existing Central Gas Facility and any new gas treatment facilities are apt to add value to gas treated in these facilities.**

Prepared by: Mark D. Myers Phone 269-8800
 Division Oil and Gas Date/Time 2/11/03 1:09 PM
 Approved by: Tom Irwin, Commissioner Date 2/11/2003
 Agency Natural Resources

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. HB 57

ANALYSIS CONTINUATION

The estimates in Table 1 show the impact HB 57 would have had on the value of royalty gas dispositions to the Nikiski fertilizer plant operated by Agrium U.S. Inc., had HB 57 been in effect during the period 2000-02. The cumulative impact would have been approximately \$8.2 million in nominal dollars.

The estimates in Table 2 illustrate the forward impact of HB 57 on state royalty revenue based on the assumption that Unocal supplies all of the input gas requirements to the Nikiski fertilizer plant through FY 2009. The estimates in Table 2 indicate that the state would forego approximately \$36.6 million in royalty revenue or about \$5.2 million per year over the period FY 2004-09. The benefit to Agrium would be half of these amounts because the Unocal-Agrium gas supply contract requires that both parties share equally in any royalty adjustments.

Table 1. Impact of HB 57 on State Royalty Revenue, 2000 - 2002

	Gas Production from State Leases (Thousand Cubic Feet per Year)	State Royalty Share	State Royalty Percent (%)	Contract			Royalty Foregone (\$ per Year)	Discount/Compound Factor 0.08	Discounted Royalty Foregone (\$ per Year)
				Value	Royalty Value	Diff			
2000	26,337,176	3,431,229	13.03%	\$1.20	\$1.70	\$0.50	\$ 1,715,814	121.2%	\$ 2,079,597
2001	27,004,457	3,573,255	13.23%	1.38	2.20	0.81	2,907,105	112.2%	3,262,844
2002	24,315,609	3,353,117	13.77%	1.47	2.55	1.08	3,621,743	103.9%	3,763,826
Average				\$1.35			\$8,244,462		\$9,106,267

**Table 2. Impact of HB 57 on State Royalty Revenue: Fixed Supply
FY 2003 - 2009**

FY	Gas Production from State Leases (Thousand Cubic Feet per Year)	State Royalty Share	State Royalty Percent (%)	Contract			Royalty Foregone (\$ per Year)	Discount/Compound Factor 0.08	Discounted Royalty Foregone (\$ per Year)
				Value	Royalty Value	Diff			
2003	25,885,747	3,452,534	13.34%	\$1.20	\$2.37	\$1.17	\$ 4,045,087	96.2%	\$ 3,892,387
2004	25,885,747	3,452,534	13.34%	1.20	2.43	1.23	4,219,421	89.1%	3,759,389
2005	25,885,747	3,452,534	13.34%	1.20	2.57	1.37	4,701,181	82.5%	3,878,355
2006	25,885,747	3,452,534	13.34%	1.20	2.70	1.50	5,182,941	76.4%	3,959,069
2007	25,885,747	3,452,534	13.34%	1.20	2.84	1.64	5,664,700	70.7%	4,006,545
2008	25,885,747	3,452,534	13.34%	1.20	2.98	1.78	6,146,460	65.5%	4,025,264
2009	25,885,747	3,452,534	13.34%	1.20	3.12	1.92	6,628,220	60.6%	4,019,226
							\$36,588,010		\$27,540,236

The analysis in Table 3 is similar to Table 2 except that the current contractual gas supply commitment to the plant declines sharply after FY 2005. Cumulative royalties foregone for this supply of gas would be \$22.0 million (as before, this benefit would be shared equally between Agrium and Unocal). The implied yearly gas shortfall during FY 2006-09 is supplemented with *new gas* from 3rd-party producers. Royalty production from new gas also would be eligible for cumulative HB 57 benefits equal to \$11.4 million. In this situation, Agrium is assumed to realize 100 percent of the benefits. Table 3 indicates that the state would forego a total of about \$33.4 million in royalty revenue or about \$4.8 million per year (undiscounted) over the period FY 2004-09. Detailed assumptions used for the estimates in Tables 2 and 3, plus several sensitivity scenarios, are described below.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. HB 57

ANALYSIS CONTINUATION

**Table 3. Impact of HB 57 on State Royalty Revenue: Changing Supply
FY 2003 - 2009**

Unocal Commitments Under Existing Gas Supply Contract								
FY	Total (1000 Cubic Feet per Year)	State Leases	Non-State	State Royalty Share	Contract	Royalty	Diff	Royalty
					Value	Value		Foregone
					(\$ per Mcf)			(\$ per Year)
2003	53,500,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.37	\$1.17	4,045,820
2004	51,900,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.43	\$1.23	4,230,642
2005	53,500,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.57	\$1.37	4,713,683
2006	38,600,000	19,300,000	19,300,000	2,574,620	\$1.20	\$2.70	\$1.50	3,874,594
2007	21,199,999	10,600,000	10,600,000	1,414,040	\$1.20	\$2.84	\$1.64	2,325,817
2008	14,000,000	7,000,000	7,000,000	933,800	\$1.20	\$2.98	\$1.78	1,666,540
2009	9,100,000	4,550,000	4,550,000	606,970	\$1.20	\$3.12	\$1.92	1,168,156
Royalty Losses Under Existing Gas Supply Contracts =								\$22,025,252

New Gas Produced from Other 3rd-Party Producers								
FY	Total (1000 Cubic Feet per Year)	State Leases	Non-State	State Royalty Share	Contract	Royalty	Diff	Royalty
					Value	Value		Foregone
					(\$ per Mcf)			(\$ per Year)
2003	1,728,506	1,728,506	-	230,583	\$2.00	\$2.37	\$0.37	\$ 85,691
2004	1,728,506	1,728,506	-	230,583	\$2.00	\$2.43	\$0.43	98,033
2005	1,728,506	1,728,506	-	230,583	\$2.00	\$2.57	\$0.57	130,287
2006	14,100,000	9,447,000	4,653,000	1,260,230	\$2.00	\$2.70	\$0.70	888,360
2007	31,500,001	21,105,001	10,395,000	2,815,407	\$2.00	\$2.84	\$0.84	2,378,463
2008	38,700,000	25,929,000	12,771,000	3,458,929	\$2.00	\$2.98	\$0.98	3,405,960
2009	43,600,000	29,212,000	14,388,000	3,896,881	\$2.00	\$3.12	\$1.12	4,382,316
Royalty Losses Under New gas Supply 3rd-Party Contracts =								\$11,369,110
Total Royalty Losses from Existing & Potential 3rd-Party Contracts (Nominal) =								\$33,394,362
Total Royalty Losses (Discounted) =								\$25,481,582

Assumptions

1. Annual gas consumption at the fertilizer plant is equal to about 52 billion cubic feet per year (Bcf), based on historic rates of gas usage over the past five years.
2. State leases account for approximately half (initially about 25.9 Bcf per year) of the total gas usage at the plant; the remaining one-half is from federal and private leases.
3. The state royalty share of gas dispositions to the plant is 13.34 percent.
4. The contract value used in transactions between Unocal and Agrium is \$1.20 per thousand cubic feet (Mcf) of gas; \$1.35 per Mcf is used for sensitivity analysis (below) based on the average of the contract price observed over the past three years, due to high ammonia spot prices.
5. Royalty value is indexed to the Alaska Department of Revenue prevailing value for Cook Inlet Gas (DOR PV). The Division of Oil and Gas forecasts DOR PV to increase from about \$2.50 per Mcf today, to \$3.12 per Mcf in FY 2009, based on the historic, long-term trend observed over the period 1995-02.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. HB 57

ANALYSIS CONTINUATION

Assumptions (Continued)

6. The underlying analysis in Table 2 is built on the assumption that Unocal supplies 100% of plant input-gas requirements through FY 2009. The analysis in Table 3 draws from the "Annual Contract Quantity" (ACQ) commitments contained in the existing Unocal-Agrium gas supply contract. During the later years of the contract, the ACQ falls from the approximate plant capacity of about 53 Bcf per year in FY 2005 to 9.1 Bcf per year in FY 2009.
7. The implied gas shortfall in Table 3 is made up of *new gas* from 3rd-party producers but at a higher cost of \$2.00 per Mcf. This implies a smaller contract-price differential for new gas dispositions to the plant when compared with the forecast of DOR PV. It is further assumed that about 2/3 of new gas is produced from state leases that are subject to the provisions of HB 57; the remaining 1/3 is new gas production from private and federal lands.

Sensitivity Analysis

Several alternative gas-supply scenarios are considered. **Case A:** Assume that the average formula-driven, gas-supply contract value is \$1.35 per Mcf instead of \$1.20 (see assumption #4). All else equal, this would lower the estimate of royalties foregone from \$33.4 million to \$31.0 million. **Case B:** If the fertilizer plant operates at 75% capacity due to input gas supply shortages from both existing and 3rd-party producers then, all else equal, estimated royalties foregone would fall from \$33.4 million to \$25.0 million. **Cases A and B combined** would reduce royalty foregone from \$33.4 million to \$23.3 million.

FISCAL NOTE

STATE OF ALASKA
2003 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 57(O&G)
(H) Publish Date: 2/26/03

Revision Date/Time (Note if correction): 2/11/2003 Dept. Affected: Natural Resources
Title: Royalty Gas Contracts BRU: Oil and Gas Development
Component: Oil and Gas Development
Sponsor: Chenault
Requester: House Oil and Gas Component No.: 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

CHANGE IN REVENUES ()		**See Revenue Impact Analysis Below**				
-------------------------------	--	---------------------------------------	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2003) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2004 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

**This bill amends AS 38.05.180(aa) requiring DNR to enter into agreements with lessees to use the price for gas established in contract between the lessee and a manufacturer as the value of the state's royalty share. HB 57 will result in a loss of state revenues. Should only one manufacturer apply under AS 38.05.180(aa), the state could lose an estimated \$33.4 million in royalties over a period of seven years (see Table 3, below). However, proposed amendments in HB 57 are worded more broadly than just one company. Interpretation of "manufacturer" may be broadly interpreted to apply to disposition of all royalty gas subject to in-state processing (e.g. LNG, NGIs). Therefore, this \$33.4 million could significantly understate the total revenue impact of HB 57. Furthermore, a much larger revenue impact could occur with a major sale of North Slope royalty gas, since both Prudhoe Bay's existing Central Gas Facility and any new gas treatment facilities are apt to add value to gas treated in these facilities.

Prepared by: Mark D. Myers Phone 269-8800
Division: Oil and Gas Date/Time 2/11/03 1:09 PM
Approved by: Tom Irwin, Commissioner Date 2/11/2003
Agency: Natural Resources

FISCAL NOTE #1

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(O&G)

ANALYSIS CONTINUATION

The estimates in Table 1 show the impact HB 57 would have had on the value of royalty gas dispositions to the Nikiski fertilizer plant operated by Agrium U.S. Inc., had HB 57 been in effect during the period 2000-02. The cumulative impact would have been approximately \$8.2 million in nominal dollars.

The estimates in Table 2 illustrate the forward impact of HB 57 on state royalty revenue based on the assumption that Unocal supplies all of the input gas requirements to the Nikiski fertilizer plant through FY 2009. The estimates in Table 2 indicate that the state would forego approximately \$36.6 million in royalty revenue or about \$5.2 million per year over the period FY 2004-09. The benefit to Agrium would be half of these amounts because the Unocal-Agrium gas supply contract requires that both parties share equally in any royalty adjustments.

Table 1. Impact of HB 57 on State Royalty Revenue, 2000 - 2002

	Gas Production from State Leases (Thousand Cubic Feet per Year)	State Royalty Share	State Royalty Percent (%)	Contract			Royalty Foregone (\$ per Year)	Discount/Compound Factor 0.08	Discounted Royalty Foregone (\$ per Year)
				Value (\$ per Mcf)	Royalty Value (\$ per Mcf)	Diff (\$ per Mcf)			
2000	26,337,176	3,431,229	13.03%	\$1.20	2.70	\$0.50	\$ 1,715,614	121.2%	\$ 2,079,597
2001	27,004,457	3,573,255	13.23%	1.38	2.20	0.81	2,907,105	112.2%	3,262,844
2002	24,315,609	3,353,117	13.79%	1.47	2.55	1.08	3,621,743	103.9%	3,763,826
Average				\$1.35			\$8,244,462		\$9,106,267

**Table 2. Impact of HB 57 on State Royalty Revenue: Fixed Supply
FY 2003 - 2009**

FY	Gas Production from State Leases (Thousand Cubic Feet per Year)	State Royalty Share	State Royalty Percent (%)	Contract			Royalty Foregone (\$ per Year)	Discount/Compound Factor 0.08	Discounted Royalty Foregone (\$ per Year)
				Value (\$ per Mcf)	Royalty Value (\$ per Mcf)	Diff (\$ per Mcf)			
2003	25,885,747	3,452,534	13.34%	\$1.20	\$2.37	\$1.17	\$ 4,045,087	96.2%	\$ 3,892,387
2004	25,885,747	3,452,534	13.34%	1.20	2.43	1.23	4,219,421	89.1%	3,759,389
2005	25,885,747	3,452,534	13.34%	1.20	2.57	1.37	4,701,181	82.5%	3,878,355
2006	25,885,747	3,452,534	13.34%	1.20	2.70	1.50	5,182,941	76.4%	3,959,069
2007	25,885,747	3,452,534	13.34%	1.20	2.84	1.64	5,664,700	70.7%	4,006,545
2008	25,885,747	3,452,534	13.34%	1.20	2.98	1.78	6,146,460	65.5%	4,025,264
2009	25,885,747	3,452,534	13.34%	1.20	3.12	1.92	6,628,220	60.6%	4,019,226
							\$36,588,010		\$27,540,236

The analysis in Table 3 is similar to Table 2 except that the current contractual gas supply commitment to the plant declines sharply after FY 2005. Cumulative royalties foregone for this supply of gas would be \$22.0 million (as before, this benefit would be shared equally between Agrium and Unocal). The implied yearly gas shortfall during FY 2006-09 is supplemented with *new gas* from 3rd-party producers. Royalty production from new gas also would be eligible for cumulative HB 57 benefits equal to \$11.4 million. In this situation, Agrium is assumed to realize 100 percent of the benefits. Table 3 indicates that the state would forego a total of about \$33.4 million in royalty revenue or about \$4.8 million per year (undiscounted) over the period FY 2004-09. Detailed assumptions used for the estimates in Tables 2 and 3, plus several sensitivity scenarios, are described below.

FISCAL NOTE #1

STATE OF ALASKA
2003 LEGISLATIVE SESSION

BILL NO. CSHB 57(O&G)

ANALYSIS CONTINUATION

**Table 3. Impact of HB 57 on State Royalty Revenue: Changing Supply
FY 2003 - 2009**

Unocal Commitments Under Existing Gas Supply Contract								
FY	Total (1000 Cubic Feet per Year)	State Leases	Non-State	State Royalty Share	Contract	Royalty	Diff	Royalty
					Value	Value		Foregone
					(\$ per Mcf)		(\$ per Year)	
2003	53,500,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.37	\$1.17	4,045,820
2004	51,900,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.43	\$1.23	4,230,642
2005	53,500,000	25,885,747	25,885,747	3,453,159	\$1.20	\$2.57	\$1.37	4,713,683
2006	38,600,000	19,300,000	19,300,000	2,574,620	\$1.20	\$2.70	\$1.50	3,874,594
2007	21,199,999	10,600,000	10,600,000	1,414,040	\$1.20	\$2.84	\$1.64	2,325,817
2008	14,000,000	7,000,000	7,000,000	933,800	\$1.20	\$2.98	\$1.78	1,666,540
2009	9,100,000	4,550,000	4,550,000	606,970	\$1.20	\$3.12	\$1.92	1,168,156

Royalty Losses Under Existing Gas Supply Contracts = **\$22,025,252**

New Gas Produced from Other 3rd-Party Producers								
FY	Total (1000 Cubic Feet per Year)	State Leases	Non-State	State Royalty Share	Contract	Royalty	Diff	Royalty
					Value	Value		Foregone
					(\$ per Mcf)		(\$ per Year)	
2003	1,728,506	1,728,506	-	230,583	\$2.00	\$2.37	\$0.37	\$ 85,691
2004	1,728,506	1,728,506	-	230,583	\$2.00	\$2.43	\$0.43	98,033
2005	1,728,506	1,728,506	-	230,583	\$2.00	\$2.57	\$0.57	130,287
2006	14,100,000	9,447,000	4,653,000	1,260,230	\$2.00	\$2.70	\$0.70	888,360
2007	31,500,001	21,105,001	10,395,000	2,815,407	\$2.00	\$2.84	\$0.84	2,378,463
2008	38,700,000	25,929,000	12,771,000	3,458,929	\$2.00	\$2.98	\$0.98	3,405,960
2009	43,600,000	29,212,000	14,388,000	3,896,881	\$2.00	\$3.12	\$1.12	4,382,316

Royalty Losses Under New gas Supply 3rd-Party Contracts = **\$11,369,110**

Total Royalty Losses from Existing & Potential 3rd-Party Contracts (Nominal) = **\$33,394,362**

Total Royalty Losses (Discounted) = **\$25,481,582**

Assumptions

1. Annual gas consumption at the fertilizer plant is equal to about 52 billion cubic feet per year (Bcf), based on historic rates of gas usage over the past five years.
2. State leases account for approximately half (initially about 25.9 Bcf per year) of the total gas usage at the plant; the remaining one-half is from federal and private leases.
3. The state royalty share of gas dispositions to the plant is 13.34 percent.
4. The contract value used in transactions between Unocal and Agrium is \$1.20 per thousand cubic feet (Mcf) of gas; \$1.35 per Mcf is used for sensitivity analysis (below) based on the average of the contract price observed over the past three years, due to high ammonia spot prices.
5. Royalty value is indexed to the Alaska Department of Revenue prevailing value for Cook Inlet Gas (DOR PV). The Division of Oil and Gas forecasts DOR PV to increase from about \$2.50 per Mcf today, to \$3.12 per Mcf in FY 2009, based on the historic, long-term trend observed over the period 1995-02.

ANALYSIS CONTINUATION

Assumptions (Continued)

6. The underlying analysis in Table 2 is built on the assumption that Unocal supplies 100% of plant input-gas requirements through FY 2009. The analysis in Table 3 draws from the "Annual Contract Quantity" (ACQ) commitments contained in the existing Unocal-Agrium gas supply contract. During the later years of the contract, the ACQ falls from the approximate plant capacity of about 53 Bcf per year in FY 2005 to 9.1 Bcf per year in FY 2009.
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Sensitivity Analysis

Several alternative gas-supply scenarios are considered. **Case A:** Assume that the average formula-driven, gas-supply contract value is \$1.35 per Mcf instead of \$1.20 (see assumption #4). All else equal, this would lower the estimate of royalties foregone from \$33.4 million to \$31.0 million. **Case B:** If the fertilizer plant operates at 75% capacity due to input gas supply shortages from both existing and 3rd-party producers then, all else equal, estimated royalties foregone would fall from \$33.4 million to \$25.0 million. **Cases A and B combined** would reduce royalty foregone from \$33.4 million to \$23.3 million.

WORK DRAFT

WORK DRAFT

23-LS0303V
Chenoweth
2/25/03

CS FOR HOUSE BILL NO. 57()

F.Y.I.

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTY-THIRD LEGISLATURE - FIRST SESSION

BY

Offered:
Referred:

Sponsor(s): REPRESENTATIVES CHENAULT, Whitaker

Clean copy
before Resources
Tomm.

A BILL

FOR AN ACT ENTITLED

1 "An Act amending the manner of determining the royalty received by the state on gas
2 production as it relates to the manufacture of certain value-added products."

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

4 * Section 1. AS 38.05.180(aa) is amended to read:

5 (aa) Within 90 days after the written request of a lessee of a lease issued under
6 this section or of a lessee of federal land from which the state is entitled under
7 applicable federal law to receive a share of the royalty on gas production, the
8 commissioner shall enter into an agreement with the lessee to use or accept the price
9 for the gas established in the contract between the lessee and a gas or electric utility,
10 or between the lessee and a manufacturer of agricultural chemicals, as
11 appropriate, as the value of the state's royalty share of gas production sold by the
12 lessee under the contract

13 (1) but only if

14 (A) for a contract between the lessee and a gas or electric

WORK DRAFT

WORK DRAFT

23-LS0303U

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utility, the primary function of the utility with which the lessee has entered into the contract is to provide, either directly or by selling at wholesale to another utility, gas or electricity to the general public, including residential consumers, within the utilities' service areas, and the utility with which the lessee has entered into the contract is not an affiliated interest, as that term is defined in AS 42.05.990, with the lessee or with a subsequent purchaser of more than 10 percent of the utility's gas or electricity; or

(B) for a contract between the lessee and a manufacturer of agricultural chemicals, the primary function of the manufacturer is to engage in the production of a value-added product, and the manufacturer with which the lessee has entered into the contract is not affiliated with the lessee or with a subsequent purchaser of more than 10 percent of the manufacturer's value-added product; for purposes of this subparagraph, the parties to a contract or purchase are affiliated if, in the judgment of the commissioner, one of the parties to the contract or purchase exercises substantial influence over the policies and actions of the other as evidenced by relationship based on common ownership or family interest or by action taken in concert without regard to whether that influence is based upon stockholdings, stockholders, officers, or directors; and

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

(A) the contract price is unreasonably low;

(B) the prospective reduction in royalty receipts would not be balanced in a contract entered into for a circumstance described

(i) in (1)(A) of this subsection by increased benefits to in-state gas and electric consumers; or

(ii) in (1)(B) of this subsection by employment opportunities or other tangible benefits to the state;

(C) the lessee and the utility or manufacturer of agricultural chemicals, as appropriate, are related in management, ownership, or other aspect; and

WORK DRAFT

WORK DRAFT

23-LS0303V

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

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

(2) "price for the gas established in the contract" includes tax reimbursement amounts, deliverability and other charges, and other forms of consideration paid by the gas or electric utility or by the manufacturer of agricultural chemicals, as appropriate, under the contract;

* Sec. 3. AS 38.05.180(hh) is amended by adding a new paragraph to read:

(4) "manufacturer of agricultural chemicals" means a person that is a business entity primarily engaging in the manufacturing of nitrogenous and phosphatic based fertilizers, mixed fertilizers, pesticides, and similar chemicals for agricultural purposes.

HB

61

John A. Barnes, P.E.
Alaska Business Unit Manager

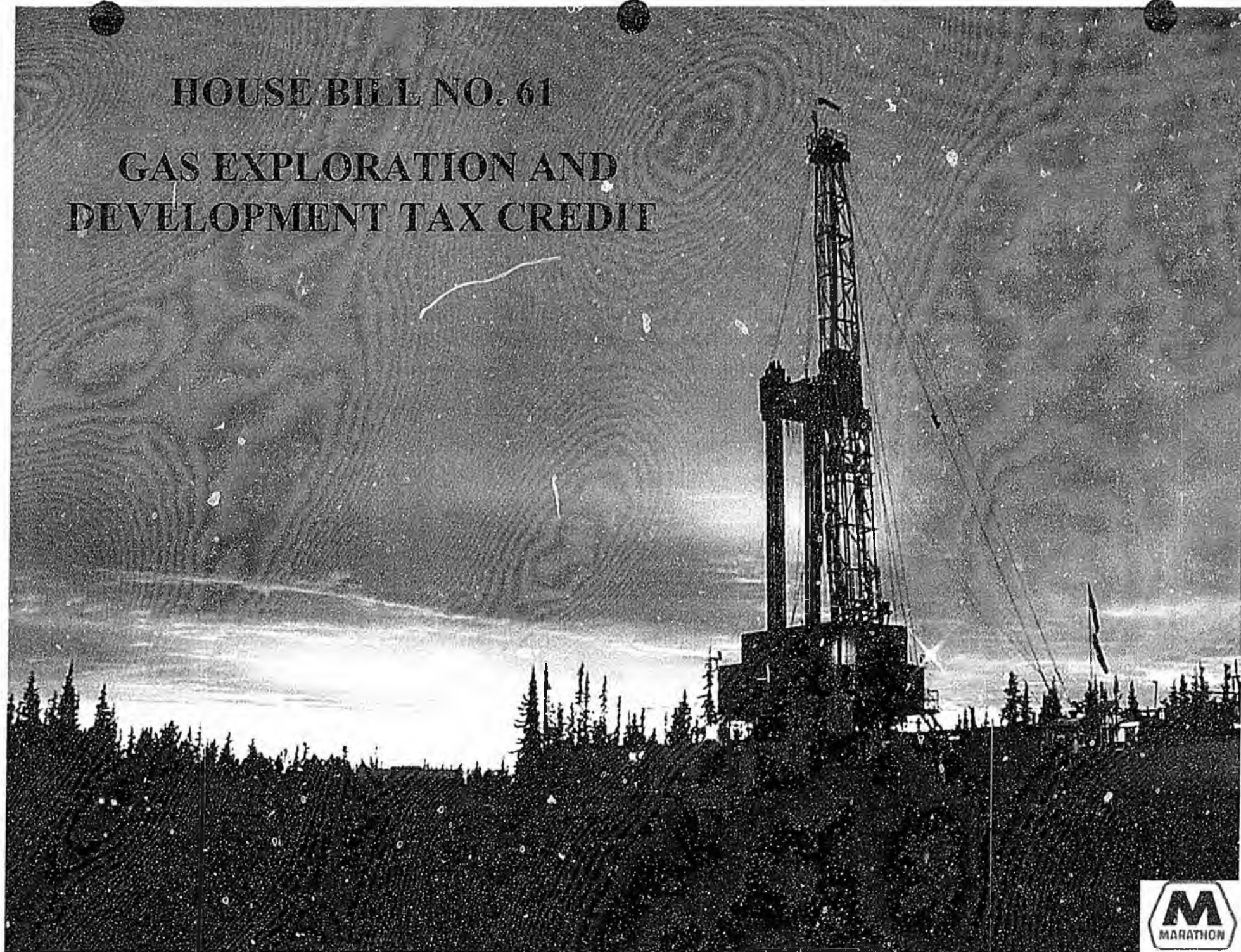


Marathon Oil Company

P.O. Box 196168
Anchorage, AK 99519-6168
Telephone 907/564-6400
FAX 907/564-6489
Email jabarnes@marathonoil.com

HOUSE BILL NO. 61

**GAS EXPLORATION AND
DEVELOPMENT TAX CREDIT**





HB 61 – What Does it Do

- Creates income tax credit to encourage exploration and development of gas reserves south of Brooks Range
- Primary focus is on Cook Inlet, but applies to other basins
- Focus is on natural gas.
- Levels the playing field somewhat with other exploration opportunities around the world.
- Draws more E&P Capital to Cook Inlet



HB 61 – How Does it Work?

- Applies to 10% of Qualified Capital Investment
- Applies to 10% of Qualified Expense
- May offset no more than 50% of corporate income tax in any one year (up to five additional years)
- Only applies to successful efforts.
- Incentive can be factored into project economics.

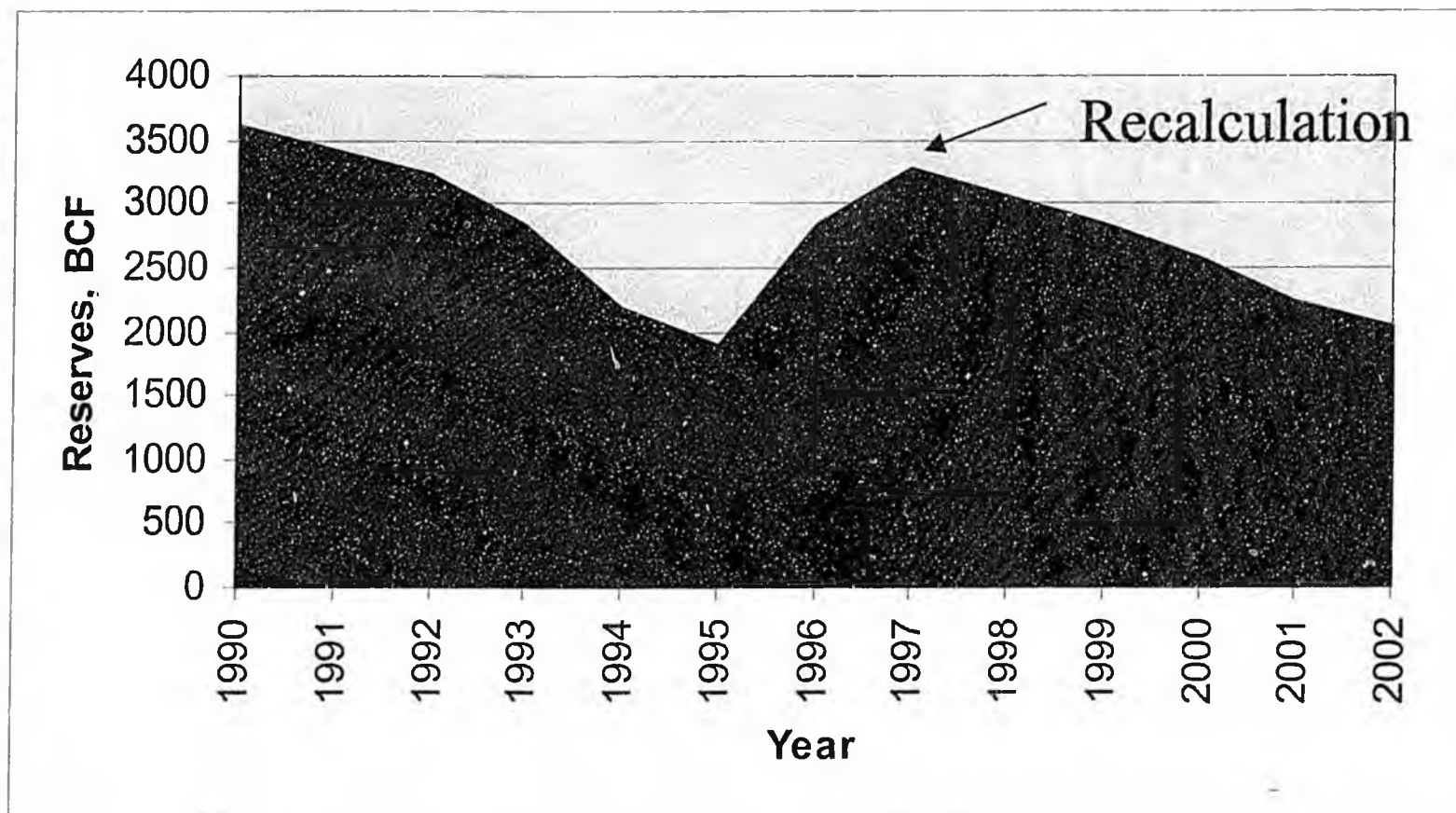


HB 61 – Why is it needed?

- Natural Gas Reserves have been and are continuing to decline in the Cook Inlet.
 - Current Cook Inlet proven natural gas reserves are estimated at 2 TCF
 - (Based on DNR DOG 2002 report, less 2002 production)
- Despite recent increase in Cook Inlet exploration activity, reserves are not being replaced on an annual basis



Cook Inlet Proven Gas Reserves



Source: Alaska DNR

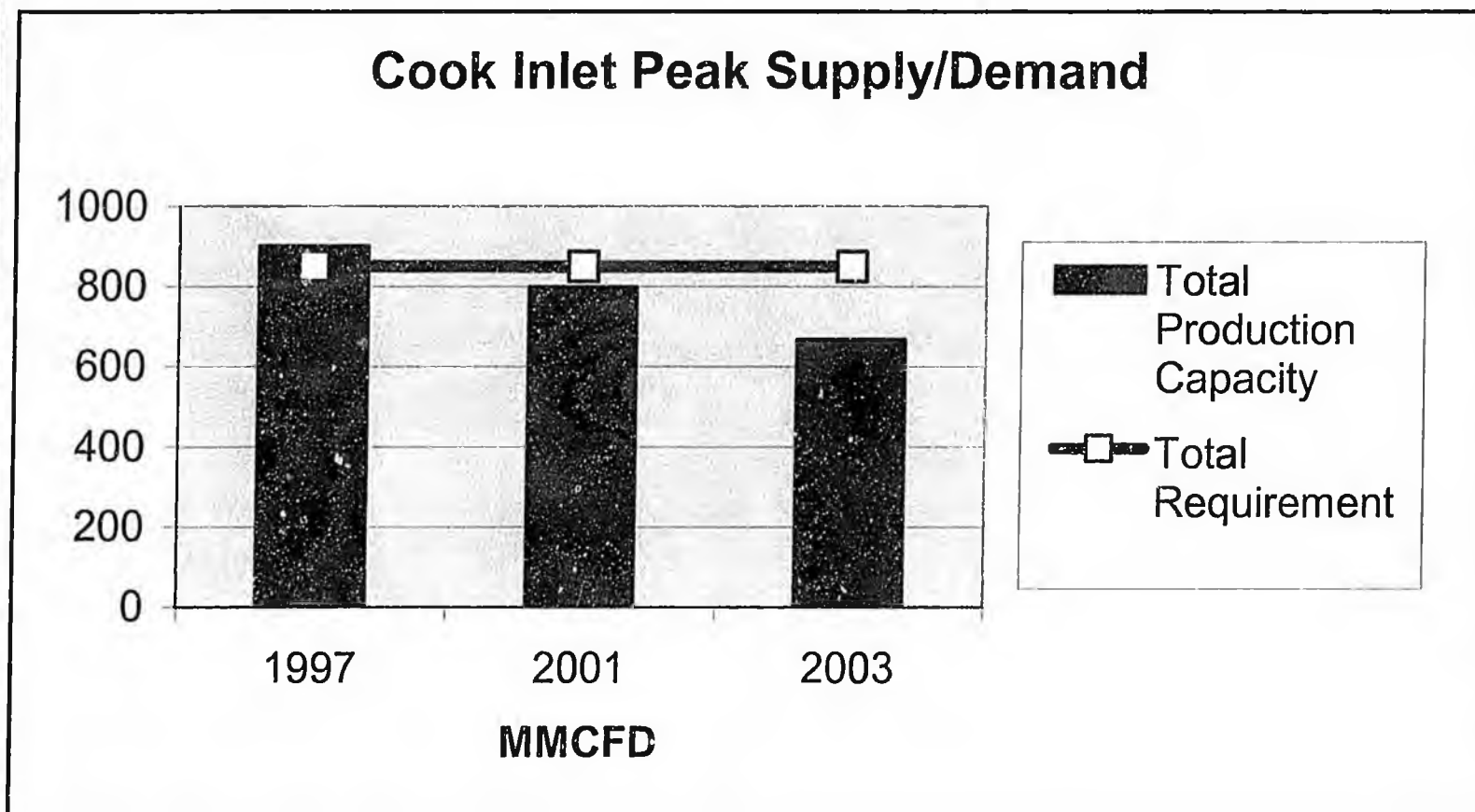


HB 61 – Why is it needed?

- Cook Inlet deliverability has declined over last several years.



HB 61 – Why is it needed?





HB 61 – Why is it needed?

- Supply and demand rationalization is occurring.
 - Not enough gas to feed low price consumer.
 - Gas price increasing
 - Enstar average gas cost (WACOG) \$2.55/mcf
 - Most recent Enstar contract gas price \$2.75 to Henry Hub
 - Henry Hub recently over \$9.00/mcf



Cook Inlet Reserves & Resources

- Current proven reserves – 2000 BCF
 - Approximately 10 year production life, assuming no decline.
- Potential Gas Committee Resource Estimates
 - Probable Reserves – 1050 BCF
 - Possible Reserves – 2100 BCF



Impacts to State of Alaska

- Stimulates Cook Inlet, and potentially other basin exploration.
- Aids in maintaining Cook Inlet 200+ BCF/year production.
 - Equivalent to a 13th month of North Slope Production.
- Provides gas for Cook Inlet utilities, industrials, jobs, royalties, taxes.



Fiscal Impact to State of Alaska

- Incentive will be clearly positive to State of Alaska, factors are...
 - How many developments will be incentivized?
 - How much gas will be discovered?
 - What will be the gas sales price (royalty value)?
 - How much will be spent for exploration and development?
 - Successful efforts driven – no incentives for dry holes



Fiscal Impact to State of Alaska

- Conceptual Estimate of Impact, assumptions:
 - Varied field size from 0 to 500 BCF
 - Development Cost \$0.50/mcf
 - Royalty – 12.5%
 - Severance Tax – 7.5%
 - Ad valorem – 2.7%
 - Gas sales price - \$2.50/mcf



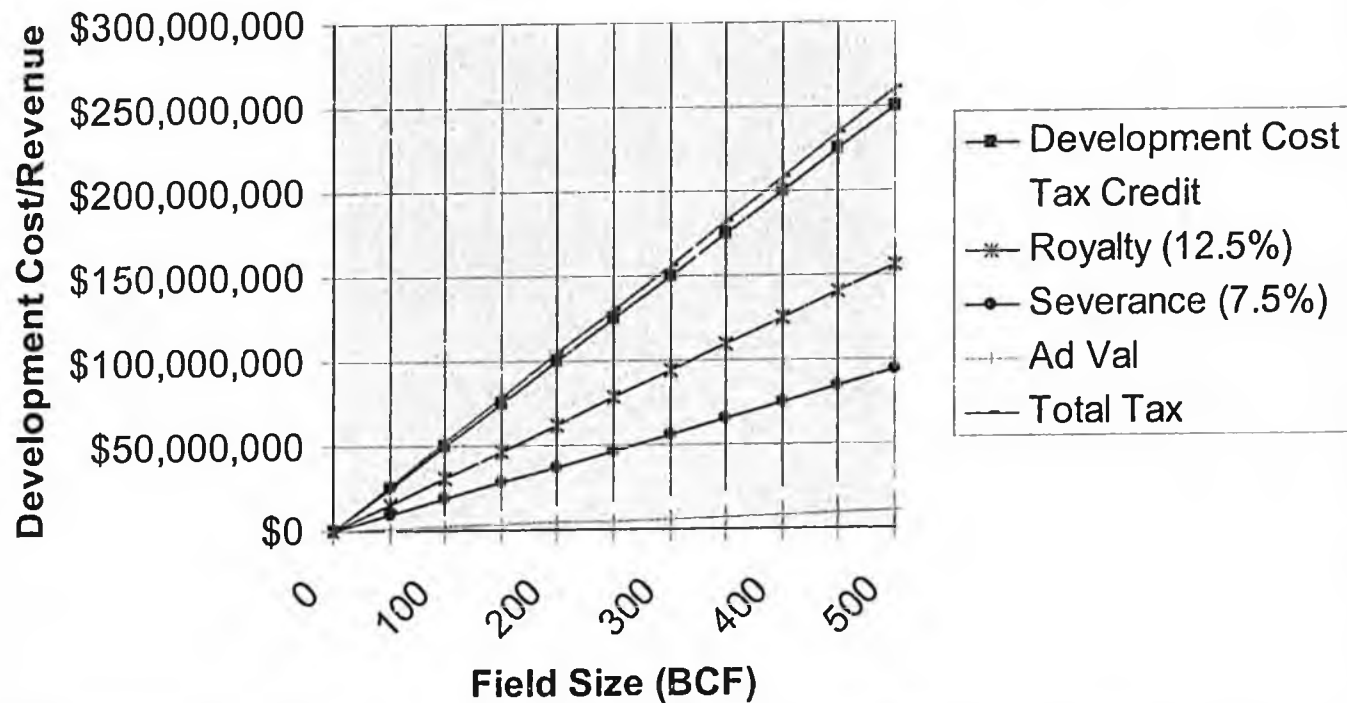
Fiscal Impact to State of Alaska

Field Size (BCF)	Development Cost	Tax Credit	Gross Revenue	Royalty (12.5%)	Severance (7.5%)	Ad Val	Total Tax:
0	0	0	0	0	0	0	0
50	\$25,000,000	\$2,500,000	\$125,000,000.0	\$15,625,000	\$9,375,000	\$1,050,000	\$26,050,000
100	\$50,000,000	\$5,000,000	\$250,000,000.0	\$31,250,000	\$18,750,000	\$2,100,000	\$52,100,000
150	\$75,000,000	\$7,500,000	\$375,000,000.0	\$46,875,000	\$28,125,000	\$3,150,000	\$78,150,000
200	\$100,000,000	\$10,000,000	\$500,000,000.0	\$62,500,000	\$37,500,000	\$4,200,000	\$104,200,000
250	\$125,000,000	\$12,500,000	\$625,000,000.0	\$78,125,000	\$46,875,000	\$5,250,000	\$130,250,000
300	\$150,000,000	\$15,000,000	\$750,000,000.0	\$93,750,000	\$56,250,000	\$6,300,000	\$156,300,000
350	\$175,000,000	\$17,500,000	\$875,000,000.0	\$109,375,000	\$65,625,000	\$7,350,000	\$182,350,000
400	\$200,000,000	\$20,000,000	\$1,000,000,000.0	\$125,000,000	\$75,000,000	\$8,400,000	\$208,400,000
450	\$225,000,000	\$22,500,000	\$1,125,000,000.0	\$140,625,000	\$84,375,000	\$9,450,000	\$234,450,000
500	\$250,000,000	\$25,000,000	\$1,250,000,000.0	\$156,250,000	\$93,750,000	\$10,500,000	\$260,500,000



Fiscal Impact to State of Alaska

Conceptual Effect of Incentive Tax Credit





HB 61 – Conclusions

- Based on conceptual model, total tax take from one (incentivized) development covers tax credit for about 10 equivalent fields.
- Credit is needed now!
 - Not enough exploration in Cook Inlet to meet demand.
 - New discoveries will take a minimum of 3 years to bring to first gas



HB 61 – Success Measures

- Increased Lease Activity
- Increased Drilling Rig Activity
- Increased Construction Activity
- Increased Production and Deliverability
- Credits Applied to Income Tax
 - For every dollar of credit approximately **TEN DOLLARS** were spent successfully developing new reserves, and ultimately paying new taxes!

Dana L. Olson
AC-30 box 5438
Wasilla, AK 99654
28 MAR 2003

To House Resources
AND AK Legislature.

HB 61 AND "NOTICE"

The proposed Bill HB 61 is not ^{AK} constitution
Addressing the people Article 1 § Sec 2
Source of Government AND VIOLATED it.
" AND IS INSTITUTED SOLELY
FOR THE GOOD OF THE PEOPLE
AS A WHOLE"

AS 43.20 IS THE ALASKA NET INCOME
TAX ACT.

I claim ...

This bill is not address graduated ...
"income taxes, involving as they do
the concept of ability to pay, are
based upon intelligible grounds of
policy

ALASKA S.S. CO. v MULLANEY,
12 ALASKA 594, 180
F 2d 805 (9th Cir 1950).

Where the topic is addressed as a
whole, sunsets / repeals may
be legitimate. But this bill is not
addressing the topic as a whole.
Nor addressing Article 1 § Sec 1

I ~~state~~ ^{state} A State policy ACMP
STANDARD. . . .

"REASONABLY AND FORESEENABLY"

I claim the AK legislature has
knowledge to predict / assume /
rationalize that this bill addresses
known beneficiaries to this bill.
And that this bill address them only.
I claim its too narrow of construction
and outside ~~constitution area~~
^{constitutionality}
~~the~~ parameters of Article 1 Sec 15
prohibited state action.

IF Article 1; sec 15 is not violated
then it can be argued that
best interest finding / determination
can be revoked; where changes ^{new} or knowledge
have negated / the premises it was
based on. I cite AK SURVIVAL U DNR 1986
AND SB 196 (1987) sec 19 AS A LEGAL
BASIS.

The decision makers have not
considered social impacts of their
rule making or indirect affects.

I cite VIII sec 8 (LEASES)
"Subject to reasonable
(concurrent uses)

This would imply a lessee
knew or had reason to believe
probably costs when they
requested the lease. And it WAS
pror considered in best interest
Finding / determination. Otherwise
Why doesn't the state develop
it own resources?

^{AK Constitution}
VIII ~~B~~ Sec 10 Public notice (Best interest finding)
not provided if the lease did not ^{determination}
provide or considered this information.
(due process' not afforded) VIOLATES
VIII sec 16. AK Constitution

Please attach this with this bill

Sincerely
Dance Polson
28 Mar 2003