

**Oil and Gas Royalty Settlement Agreements Reopener Arbitration**

**FY2007 Request: \$1,000,000**  
**Reference No: 31371**

**AP/AL:** Appropriation  
**Category:** Development

**Project Type:** Planning

**Location:** Statewide  
**House District:** Statewide (HD 1-40)

**Contact:** Nico Bus  
**Contact Phone:** (907)465-2406

**Estimated Project Dates:** 07/01/2006 - 06/30/2008

**Brief Summary and Statement of Need:**

This project will fund the cost of outside legal counsel and outside experts, and the State's cost of reopener arbitrations as the State proceeds with the renegotiation and arbitration of royalty issues.

<b>Funding:</b>	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	Total
Gen Fund	\$1,000,000						\$1,000,000
<b>Total:</b>	\$1,000,000	\$0	\$0	\$0	\$0	\$0	\$1,000,000

<input type="checkbox"/> State Match Required	<input type="checkbox"/> One-Time Project	<input type="checkbox"/> Phased - new	<input type="checkbox"/> Phased - underway	<input checked="" type="checkbox"/> On-Going
0% = Minimum State Match % Required		<input type="checkbox"/> Amendment	<input type="checkbox"/> Mental Health Bill	

**Operating & Maintenance Costs:**

	<u>Amount</u>	<u>Staff</u>
Project Development:	0	0
Ongoing Operating:	0	0
One-Time Startup:	0	0
<b>Totals:</b>	<b>0</b>	<b>0</b>

**Additional Information / Prior Funding History:**

SLA98/CH139 - \$100,000

The project serves primarily as a fund for reopeners, due to the unpredictable and random timing and content of reopener requests.

**Project Description/Justification:**

The three primary ANS royalty settlement agreements (between the State and ConocoPhillips, BP, and ExxonMobil) each contain provisions to reopen the agreements and changing portions of the royalty oil valuation methodology. These "reopeners" offer the State and its lessees the opportunity to resolve disputes over royalty value, keep the royalty settlement agreements up-to-date, and avoid costly and time-consuming litigation. The State or the affected producer may exercise some of these "reopeners" (such as the "government action") at any time with no limits on when or how many times the reopener can be initiated. Other reopeners may only be exercised once every one to three years. These reopeners are often settled amicably without the trouble or expense of a full arbitration. When the royalty oil valuation methodology is changed as a result of a reopener usually a limited retroactive payment to the State or refund to the affected producer may be required. The new methodology will also be imposed prospectively and affect future State royalty revenues.

The State is now embroiled in a reopener arbitration with ExxonMobil that serves as an good example of what may be at stake for the State and how much it may cost the State to exercise/defend its rights under the royalty settlement agreements. In April 2005, DNR, Law, and its outside counsel successfully tried the first part of the reopener arbitration against ExxonMobil over the question of the destination value of the State's ANS royalty oil. This arbitration will yield approximately an additional \$22 million in royalty payments from ExxonMobil for 2001-05. Because the value of the State's royalty in-kind (RIK) sold during this period is, in part, also valued using ExxonMobil's formula, the State may expect retroactive adjustments for royalty oil sales between 2001 and 2004 that will exceed another \$26 million.<sup>1</sup> The first part of the reopener arbitration against ExxonMobil cost the State approximately \$1.5 million.

<sup>1</sup> Royalty payments from ExxonMobil calculated through June 2005; payments from RIK purchaser are for the period January 2001- March 2005. These amounts include interest.

The second part of the reopener arbitration with ExxonMobil is now underway and we can anticipate that, in the near future, the State or the other lessees may exercise reopener provisions in their respective royalty settlement agreements. If the reopeners progress to an arbitration, then we may also anticipate that the cost of the arbitration will be similar to the first part of the ExxonMobil reopener arbitration.

**Why This Project Is Needed Now:**

This CIP request will provide funds that will be RSA'd to the Department of Law to pay exclusively for contracts with outside counsel and experts to conduct the potential reopener arbitrations and to pay the State's share of the arbitration panel. In the past, CIP reopener funds have provided DNR with the capability to monitor the value provisions in the royalty settlements and to engage the producers in the first stages of reopener negotiations. These past reopener funds have been appropriately spent to initiate and usually successfully negotiate amendments to the royalty settlement agreements.

**Specific Spending Detail:**

Line Item Expenditures:

Services \$1,500,000

Line Item Detail Description:

Services – Funding under this CIP will pay for outside counsel and expert witnesses to represent the state in a trial before an arbitration panel.