

**Oil and Gas Royalty Valuation****FY2009 Request: \$1,000,000****Reference No: 31371****AP/AL:** Appropriation**Project Type:** Planning**Category:** Development**Location:** Statewide**Contact:** Leta Simons**House District:** Statewide (HD 1-40)**Contact Phone:** (907)465-2400**Estimated Project Dates:** 07/01/2008 - 06/30/2009**Brief Summary and Statement of Need:**

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

<b>Funding:</b>	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	Total
AK Cap Inc	\$1,000,000						\$1,000,000
Gen Fund			\$500,000		\$500,000		\$1,000,000
<b>Total:</b>	\$1,000,000	\$0	\$500,000	\$0	\$500,000	\$0	\$2,000,000

<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
<u>One-Time Startup:</u>	0	0
<b>Totals:</b>	0	0

**Additional Information / Prior Funding History:**

SLA93/CH79 \$ 100,000 Project completed  
 SLA04/CH159 \$ 200,000 Project completed  
 SLA06/CH82 \$ 1,000,000 Project almost completed \$4.8K left  
 SLA07/CH30 \$ 500,000 Project underway

**Project Description/Justification:**

Over the years the state has agreed to settle disputes over royalty valuation by allowing the lessees to pay their royalty obligations using various formulas based on the valuation terms of their leases. The settlement of the Alaska North Slope (ANS) Royalty Litigation led to three primary ANS royalty settlement agreements (between the State and ConocoPhillips, BP, and ExxonMobil) and each contain provisions to reopen the agreements and change 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 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. Because the volumes of royalty oil are substantial, even small variations in the formula used to determine destination value, or in the cost of deductions used to establish royalty value, have large-dollar consequences for the state. These activities should properly be viewed as a source of net revenue for the state, rather than a cost center.

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Where there are no settlement methodologies in place, royalty valuation and net profit share audits often are disputed by lessees and require a response from the state to assert its audit claims. In these situations, the division of oil and gas must vigorously develop its case by involving its own staff and bring in outside experts. The quality of this work and the expertise of both the staff and outside experts has a direct effect on the success of the state in recovering its audit claims and developing clear interpretations of the lease terms that govern value. Not all audits are disputed nor do many issues between the lessees and the state rise to a level that require a major effort to resolve but the state's ability to match the lessees' resources to enter any dispute assures that the state's royalty share is collected in a fair and reasonable way.

### Why is this Project Needed Now?:

During the current fiscal year the state expects to reopen its settlement agreement with ConocoPhillips. It is expected that tens of millions of dollars will be in play, and that we will be well into FY 2009 before the issues are fully resolved. Devoting insufficient resources to this project could therefore cost the state many millions of dollars. Because the reopener process follows a particular procedure and set of schedules, it is not possible to begin the process in FY 2008, freeze things in FY 2009, and then resume the state's efforts subsequently.

This project will provide funds that may be expended directly by DNR or that may 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:

<u>LINE ITEM</u>	<u>DOLLAR AMOUNT</u>	<u>DESCRIPTION (text)</u>
Services	\$ 1,000,000	Funding under this CIP will pay for expertise to develop and prosecute the state's position in royalty disputes, and to help optimize the state's royalty value.