Oil and Gas Litigation and Arbitration Support

FY2014 Request: $500,000
Reference No: 31371

AP/AL: Appropriation
Project Type: Planning
Category: Development
Location: Statewide
House District: Statewide (HD 1-40)
Impact House District: Statewide (HD 1-40)
Contact: Jean Davis
Estimated Project Dates: 07/01/2013 - 06/30/2016
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Brief Summary and Statement of Need:
This project will fund the cost of outside legal counsel and outside experts, and the State's costs of reopener arbitrations as the State proceeds with the renegotiation and arbitration of oil royalty issues.

Funding:	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	Total
Gen Fund	$500,000		$500,000		$500,000		$1,500,000
Total:	$500,000	$0	$500,000	$0	$500,000	$0	$1,500,000

☐ State Match Required ☐ One-Time Project ☐ Phased - new ☐ Phased - underway ☑ On-Going
0% = Minimum State Match % Required ☐ Amendment ☐ Mental Health Bill

Operating & Maintenance Costs:

	Amount	Staff
Project Development:	0	0
Ongoing Operating:	0	0
One-Time Startup:	0	
Totals:	0	0

Prior Funding History / Additional Information:
Sec4 Ch30 SLA2007 P99 L14 SB 53 $500,000
Sec1 Ch82 SLA2006 P79 L4 231 $1,000,000

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) that 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.

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 (DOG) 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.

WHAT IS THE ISSUE OR PROBLEM TO BE SOLVED?

The DOG has an ongoing need to fund the cost of outside legal counsel and experts for royalty reopener arbitrations. More oil is coming from leases not covered by existing royalty settlement agreements. Department of Natural Resources (DNR) will face potential disagreements over the interpretation of these "new form" leases and will need to resolve issues that arise in the audit of royalty paid under these new form leases. DNR may require funding to establish prospective measures of value to minimize disputes before they arise.

WHAT IS THE SCOPE OF WORK TO BE PERFORMED?

This request will provide funds for reimbursable agreements 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.

WHAT RESULTS WILL BE ACHIEVED AND/OR PRODUCTS PRODUCED?

In the past, capital project 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.

WHY IS THIS PROJECT NEEDED NOW – WHAT IS THE IMPACT OF REMAINING STATUS QUO?

Due to various occurrences regarding oil and gas leases, the DOG gets embroiled in litigation and arbitration. Funds received in 2006 and 2007 of $1,500,000 for Royalty Settlement Reopener Arbitration are approaching exhaustion. The DOG has no other funding to pay for upcoming litigation.

WHAT ALTERNATIVES WERE CONSIDERED TO SOLVE THE ISSUE OR PROBLEM, AND WHY WERE THEY NOT SELECTED?

The 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.

WHAT ACCOMPLISHMENTS HAVE BEEN ACHIEVED WITH PRIOR YEAR FUNDING?

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	DOLLAR AMOUNT	DESCRIPTION
Personal Services	$ 0	
Travel	$ 0	
Services	$ 500,000	Expertise to develop and prosecute the state's position in royalty disputes, and to help optimize the state's royalty value.
Commodities	$ 0	
Capital Outlay	$ 0	
Grants	$ 0	
PROJECT TOTAL	**$500,000**	