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30 September 2013

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Department of Natural Resources
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RECEIVED

SEP 30 2013

**DIVISION OF
OIL AND GAS**

Re: Proposed NPSL Regulations & Proposed Changes to the Production Tax (PT) Form

Dear Mr. Bidwell:

BP Exploration (Alaska) Inc. (“BPXA”) respectfully submits the following comments regarding the proposed amendments by the Department of Natural Resources (“DNR”) to regulations in 11 AAC 04 captioned “Payment of Oil and Gas Royalties, Rents, and Bonuses” (the “Payment Regulations”) and 11 AAC 82 captioned “Oil and Gas Leasing” (the “NSPL Regulations”) regarding net profit share (“NPS”) obligations under state oil and gas leases (“NPSLs”) providing for a sharing of net profits as determined thereunder from the respective leases. With this letter is enclosed an Appendix (which by this reference are incorporated as an integral part of these comments the same as if fully set out herein) containing BPXA’s comments on DNR’s Production Tax (PT) Form and the proposed changes to it.

Introduction.

To set a context of these comments, BPXA begins by noting three basic principles. First, NPSLs — like other leases that DNR enters into regarding the use or occupation of state land — are contracts between the State and the respective lessees. Second, contracts involve a mutuality of rights and obligations of each party to the other, and a contract arises from a meeting of the minds between the parties about their respective rights and obligations to one another. The parties can alter those contractual rights and obligations at any time, but ordinarily only through a mutual agreement on those alterations that is itself, effectively, a contract. Third, both the Constitution of the United States and the Constitution of the State of Alaska expressly prohibit the State of Alaska (the “State”) from “impairing the Obligation of Contracts,” although this prohibition does not prevent the State from unilaterally making immaterial changes such as changing the postal address for giving notice by mail to the State under a contract.

BPXA acknowledges that, even if DNR agrees 100 percent with these principles as set out above, DNR almost surely does not agree completely with BPXA about what, exactly, is or is not a material change, nor about whether any particular amendment being proposed by DNR is

material or not. The intent and purpose of these comments are not to argue over whatever points of difference there might be between BPXA and DNR about contract impairment, nor to change somehow any grounds for the parties' respective views. In other words, these comments are — and must be seen as — nothing more and nothing less than what they purport to be: namely, comments on the substance of the proposed regulations, their workability, and suggestions to improve them.

Proposed amendments to regulations in 11 AAC 04.

“Instructions” under 11 AAC 04.040(a) and (d), 11 AAC 04.199(7). The proposed amendments would delete the existing reference to, and adoption by reference of, a specific set of instructions regarding “[s]upporting documentation” to be submitted with a “royalty report”, and would replace it with a generic reference to whatever “instructions [may be] prescribed by the department” in the future.

BPXA believes those “instructions” themselves will very likely be “regulations” under AS 44.62. AS 44.62.640(3) defines the term “regulation” and provides in pertinent part:

(3) “regulation” means every rule, regulation, order, or standard of general application or the amendment, supplement, or revision of [such] to implement, interpret, or make specific the law enforced or administered by [the agency adopting the rule, regulation, order or standard] ...; “regulation” does not include a form prescribed by a state agency or instructions relating to the use of the form, but this provision is not a limitation upon a requirement that a regulation be adopted under this chapter when one is needed to implement the law under which the form is issued; ... phraseology may not be used to avoid or circumvent this chapter; whether a regulation, regardless of name, is covered by this chapter depends in part on whether it affects the public or is used by the agency in dealing with the public. [emphasis added]

As the emphasized language in the quotation shows, “every rule ... or standard of general application” is a regulation, although “a form ... or instructions relating to the use of the form” are specifically excluded from this broad general definition.

However, this exclusion applies only to “instructions relating to the use of the form” (emphasis added) — i.e., instructions about how to fill it out or where it should be sent. For example, if the instructions said to remit \$5 along with the form as a filing fee, changing the instructions to make the fee \$10 would be a regulation because the change is not to an instruction “relating to the use of the form”. Changing the fee would “affect[] the public” and the way “the agency ... deal[s] with the public” by increasing the public’s cost of doing business with the agency. Thus, having a regulation saying that the amount of the fee is the amount prescribed in the instructions, thereby allowing the fee to be changed simply by changing the instructions, would be to use “phraseology ... to avoid or circumvent this chapter[.]”

In the same sense, changing the instructions regarding “[s]upporting documentation” so as to increase that documentation, the level of detail in it, and the costs of preparing or assembl-

ing that documentation for filing, would not be instructions about the “use” of that form. Each new set of instructions would therefore be a regulation under AS 44.62.640(3), and the issuance of each new set of instructions would be subject to judicial invalidation under AS 44.62.300 “for a substantial failure to comply with [the procedures under] AS 44.62.010 – 44.62.320[.]”

Moreover, if DNR wants to use forms and instructions to prescribe what “[s]upporting documentation” is required, it could do so without raising any of these questions about whether the “instructions” are regulations or not.

11 AAC 04.040(a) currently refers to, and adopts by reference, a specific set of instructions about “[s]upporting documentation”. To change the instructions and the required documentation, DNR could simply amend 040(a) so it similarly refers specifically to, and adopts by reference, the new set of instructions that are to be followed. The new instructions would be published in conjunction with the public notice of the new amendment to 040(a) so the public could know what the effect of the amendment would be.

With this approach to 040(a), 040(d) could be amended to refer to “instructions adopted by reference in (a) of this section” instead of “instructions prescribed by the department” as proposed. This would avoid any need to amend subsection (d) each time subsection (a) and the instructions it adopts by reference are changed. Similarly, the clause beginning “as required” in 11 AAC 04.199(7) — which currently refers to “instructions adopted by reference in 11 AAC 04.040(a)” — would not need to be changed at all.

On the other hand, if DNR adopts the amendments to 11 AAC 04.040(a) and (d) and 11 AAC 04.199(7) as proposed, it will risk being seen as trying to avoid or block public comments on changes to the “instructions” about “[s]upporting documentation”.

Ambiguities, inconsistencies and conflicts between 11 AAC 04 and 11 AAC 83. The present scope of Chapter 04 of Title 11 of the Alaska Administrative Code is reflected in its caption: “Payment of Oil and Gas Royalties, Rents and Bonuses”. Matters regarding NPS leasing are set out in Chapter 83 of the Title as Article 3 (11 AAC 83.201 – 11 AAC 83.295) captioned “Net Profit Share Leasing”. BPXA is concerned that the proposed addition of “and NPSL” in the definition of “royalty report” in 11 AAC 04.199(7) will unnecessarily create, in separate Chapters of Title 11, two sets of regulations that would each address NPSL reporting and the parties’ respective rights and remedies arising from the NSPL reports.

In the Chapter 04 regulations, 11 AAC 04.030 provides for the timing of payments for royalty, lease rentals, minimum royalty and bonus payments; section 040 deals with supporting documentation for royalty, lease rentals and minimum royalty in subsections (a), (b) and (c), respectively; and section 050 addresses methods of payment and the order in which DNR will apply the funds it receives from a lessee. Section 060 covers DNR’s audits or investigations of a lessee’s reports and payments to ensure they are properly made and provides for DNR to give the lessee notice of any over- or underpayment found to have been made. 11 AAC 04.100 provides that appeals by lessees are to be made in accordance with 11 AAC 02.010 – 11 AAC 02.080.

In the NPSL-specific regulations, 11 AAC 83.245 addresses what NPSL lessees are to report and when, as well as DNR's auditing of those reports. Section 247 of Chapter 83 addresses DNR's audit-based redeterminations of reported NPS amounts and payments, section 250 addresses NPS lessees' protests of such redeterminations, and sections 252, 255 and 257 address procedures for handling and resolving such NPSL protests instead of adopting the ones in 11 AAC 02.010 – 11 AAC 02.080 by reference.

These two sets of procedures for reporting, audit and appeals are not the same.

The "Royalties, Rents and Bonuses" regulations and procedures in 11 AAC 04 currently do not apply to NPS obligations. 11 AAC 04.010 specifically provides —

15 AAC 04.010. APPLICABILITY. (a) The provisions of this chapter [i.e., 11 AAC 04] apply to royalty, rental, and bonus payments in connection with all state oil and gas leases.

(b) This chapter does not apply to the accounting, reporting, and payment of the state's net profit share interest in connection with net profit share leases under 11 AAC 83.210 – 11 AAC 83.295. [emphasis added]

DNR is not proposing to amend 11 AAC 04.010(a) stating that Chapter 04 applies only to "royalty, rental, and bonus" payments for "all" leases, including NPSLs. Nor is DNR proposing to amend subsection (b) specifically excluding NPS obligations from the scope of Chapter 04.

The logic behind the present bifurcation under 11 AAC 04.010 is clear and compelling. Every state oil and gas lease — whether competitive or noncompetitive, NPS or non-NPS — has provisions for the lessee to pay royalty, rental and a bonus (or to conduct exploration work in lieu of a bonus). *See* AS 38.05.131 – 38.05.134; AS 38.05.180(f). Ergo, having the rules for these three universal kinds of oil and gas lease payments in a single location (Chapter 04) promotes and ensures uniformity and consistency in the reporting and payment of these obligations, and in any audits thereof and subsequent appeals from the audits. And 11 AAC 04.010(a) provides for precisely that.

In contrast, NPSLs uniquely create a further obligation on the lessee, which is to share the net profits from the respective NPSL. It is thus appropriate that the regulations addressing the particulars about how the net profits are to be determined would also include provisions both for the NPSL lessee to report and pay the NPS obligations, and also for procedures relating to the audit and any subsequent proceedings with respect to those unique obligations. And 11 AAC 04.010(b) provides for precisely that.

The proposed introduction of NPS obligations into the "royalty reports" definition in 11 AAC 04.199(7) would blur this clear distinction between the universal payment obligations and the unique NPS obligation, but without changing 11 AAC 04.010 which creates the distinction in the first place.

Further, to the extent the procedures for royalty reporting, audits and appeals are not the same as those for NPS reporting, audits and appeals, there would be conflicts between the two

sets of procedures. For instance, royalty reports and payments are due the last day of the calendar month following the month of production under 11 AAC 04.030(a), but reports for a producing NPSL are due 60 days after the end of the production month under 11 AAC 83.245(b). If NPS obligations are reported along with royalty on a payment summary report (S1) as proposed, when is that (S1) due — the end of the month after the production month, or 60 days after the end of the production month?

In addition, if royalties and NPS payments are reported on the same (S1) payment summary report, the data set for royalties on that report will be different from the reported NPS data because royalty reports are due the month after production, while NPS reports are due 60 days after the production month. Thus, for example, a combined royalty-NPS (S1) filed in February would have royalty data for January production and NPS data for December production, which means different volumes, different spot prices for ANS oil, and (for these particular months) even different pipeline tariffs. The only practicable way to avoid such chronological inconsistencies on a combined (S1) — in the absence of NPSL lessees' agreement to advance their NPS reporting by a month — would be for DNR to offer them a deferral of the reporting and payment of royalty until the 60th day after the production month so the same month's data are being reported on an (S1) for both obligations.

At the very least, two sets of procedures promise to create confusion for NPSL lessees in the future. And with an administrative fee of \$75-a-day per "report" for untimely reporting under one set of procedures that would be timely under the other, this could suddenly become expensive for an NPSL lessee who cannot be sure which procedure is applicable.

Potential unconstitutionality of proposed amendments to 11 AAC 04.040(a) and (d), 11 AAC 04.199(7) as applied. Assuming for the sake of discussion that setting requirements for "[s]upporting documentation" through "instructions prescribed by the department" would not be invalid under AS 44.62.300, there are no objective standards or other constraints on how burdensome or cumbersome those "instructions" might be. If compliance with the instructions becomes sufficiently onerous, they could become unconstitutional "impair[ments of] the Obligation of Contracts" for lessees of existing NPSLs.

It is also possible that, without any opportunity for public comment on changes to those "instructions", these proposed regulations, if adopted, might violate the guarantee in Article I, section 7 of the Alaska Constitution that "[t]he right of all persons to fair and just treatment in the course of legislative and executive investigations shall not be infringed." This provision would be applicable in the context of NPS reporting because the filing of "reports" with the information and "[s]upporting documentation" prescribed by the "instructions" constitutes the first step in DNR's investigation to determine whether a lessee's NPS obligation is properly fulfilled.

Proposed repeal of 11 AAC 04.080(a)(4). BPXA has no objection to the repeal of paragraph (a)(4) of this regulation.

Proposed amendments to regulations in 11 AAC 83.

Proposed amendments of 11 AAC 83.209. BPXA has no objection to the proposed bifurcation of the present regulation into two subsections, (a) and (b).

The clarification in the new subsections (c) and (d) that ending balances in the production revenue account are zero if the balance is transferred is a welcome change that is also written up well.

Proposed amendments of 11 AAC 83.220. These amendments appropriately reflect changes made to the production tax (AS 43.55) by chapter 10 SLA 2013.

Proposed amendments of 11 AAC 83.231. The amendment to subsection (a) would make explicit that which currently is merely implied. It is prudent to do that.

As proposed, the new subsection (e) in 11 AAC 83.231 would forbid changes in a lessee's NPS obligation arising from retroactive redeterminations of oil or gas previously allocated the lessee's NPSL (including retroactive redeterminations of royalty or overriding royalty volumes) from being treated and reported as extraordinary production revenue or loss. Currently, retroactive changes in a lessee's NPS obligation due to retroactive changes in regulated pipeline tariffs or bona fide arm's-length sales prices for oil and gas from the NPSL are treated as extraordinary production revenue or loss and are fully recognized for NPS purposes in the month in which that revenue or loss is realized, as opposed to being recognized in the month when the oil or gas was produced, and DNR is not proposing to change this.

BPXA does not see any grounds or justification for making this proposed distinction. Both of the present sources of extraordinary production revenue or loss are beyond an NPSL lessee's ability to change retroactively. The tariffs of a regulated pipeline are regulated by the Federal Energy Regulatory Commission ("FERC") or the Regulatory Commission of Alaska ("RCA"), and any retroactive changes to those tariffs can only result from an order to that effect by FERC or the RCA. Likewise, sales prices in a "bona fide arm's-length" contract cannot be changed by the NPSL lessee, and particularly not retroactively, without the agreement of the purchaser.

Retroactive redeterminations of oil and gas previously allocated to an NPSL are similarly outside the lessee's power or control. Such redeterminations are, or are equivalent to, changes to the tract factors for that NPSL and at least one other lease in the respective unit or participating area, and the lessee(s) of the other lease(s) must agree to the change. Moreover, since an NPSL by definition involves state lands, DNR's approval is required before any changes to the tract factors can take effect. *See* 11 AAC 83.371. The second sentence in proposed subsection (e) expressly acknowledges that such approval will have been made.

In other words, the adoption of 11 AAC 83.231(e) as proposed would mean that retroactive changes to pipeline tariffs regulated by FERC or RCA and retroactive changes to bona fide arm's-length sales prices that purchasers agree to will result in extraordinary production

income or loss, but not retroactive changes to allocation factors that DNR itself has to approve before they can take effect. This seems extraordinarily unfounded, if not arbitrary and capricious. Unfortunately, because the only public hearing in conjunction with these regulations was limited to the Production Tax (PT) Form, there was no occasion to ask DNR what justification it might see for making this distinction.

While BPXA opposes 15 AAC 83.231(e) as proposed, we believe there could be a helpful clarification if, first, the first proposed sentence in 231(e) were adopted without the word “not” that currently appears in the phrase “is not an extraordinary production revenue or loss under this section” at the end of that sentence, and second, if the other two proposed sentences in (e) were not adopted at all.

Proposed amendments of 11 AAC 83.241. These amendments appropriately reflect changes made to the production tax (AS 43.55) by chapter 10 SLA 2013. We note, however, a typographical error in the second line of 15 AAC 83.241(a)(2)(A): “AS 43.55.011(f)(1) (5)” should be AS 43.55.011(f)(1) – (5)”.

Proposed amendments of 11 AAC 83.245(b). The proposed amendments to this subsection of the regulation suffer from essentially the same problems and issues as the proposed changes to 11 AAC 04.040 and 11 AAC 04.199(7) discussed above. Instead of calling for NPSL lessees to report their NPS obligations “on forms prescribed by the department” as 11 AAC 82.-245(b) currently provides, the proposal would allow DNR to alter the substance, scope and level of detail of the reporting requirements merely by changing the “instructions” on those forms. As explained in the discussion above regarding the Chapter 04 regulations, the problem with this proposed approach is fourfold.

One, the instructions themselves could very well be “regulations” that can only be validly adopted if the procedures of AS 44.62.010 – 44.62.320 are followed. So if there is even a reasonable chance that those procedures would have to be followed in order to change the “instructions”, then why not have 245(b) incorporate by reference the specific “instructions” DNR want NPSL lessees to use as 11 AAC 04.040(a) currently does, and then change that reference in the regulation each time it wants to change those “instructions”?

Two, the “instructions” on the (AC), (VV) and (PT) NPS reporting forms could conflict with the “instructions” on the (S1) royalty reporting form under 11 AAC 04.199(7). Or they could be duplicative of the (S1) instructions, requiring an NPSL lessee needlessly to report the same information twice.

Three, there are no objective standards or “sideboards” on what the “instructions” might “prescribe”. This means that, without any opportunity for public comment even on draconian changes to those “instructions”, the adoption of this proposed approach might violate the guarantee of “fair and just treatment in ... executive investigations” under Article I, section 7 of the Alaska Constitution.

Finally, there is also the possibility that if compliance became sufficiently onerous or

difficult to fulfill under the “instructions”, there could be significant claims by lessees of existing NPSLs that their contractual obligations under those leases were being impaired.

Proposed adoption of 11 AAC 83.245(h). The proposed adoption of 11 AAC 83.-245(h)(1) – (4) would establish an administrative fee of \$75 per day for tardiness in responding to four situations set out in those paragraphs. The fifth paragraph in subsection (h) would say that “each schedule and attachment” for an NPSL report to show “production, valuation, costs, or other payments associated with the NPSL lease ... is considered a separate report” subject to this new \$75-a-day administrative fee.

Technical issues. 11 AAC 83.245(h), as proposed, has a preamble declaring that “[t]he division will charge an administrative fee of \$75 per day, beginning on the first day after the division provides notice to the lessee.” Structurally and grammatically, the preamble and its fee are applicable “for” each situation described in the five paragraphs that follow it. This structure of the subsection and the particular choice of words in the preamble and some of the paragraphs present a fair number of technical problems and unanswered questions.

1. The preamble has its \$75-a-day fee “begin[] on the first day after the division provides notice to the lessee,” but does not specify when such a notice is deemed to have been “provide[d.]”
 - A. If the notice is given by electronic means, is it “provide[d]” on the date when the division sends it, or on the date when the lessee opens the message and reads it?
 - B. If the notice is given the old fashioned way through the U.S. Postal Service, there is almost always a difference between the date of mailing and the date of delivery unless the notice is mailed at the very same post office where the lessee has its postal box (and even then there could be a difference if the notice is mailed shortly before the post office’s closing time). The question — which will arise much more often in this context than for electronic media — still remains whether notice is “provide[d]” when it is sent (mailed) or when it is received (delivered).
 - C. And what if there is a delivery failure, electronic or otherwise? How is such a failure to be shown to have happened, who has to make that showing, and how convincing does the evidence of the failure have to be in order to establish that the failure occurred?

The regulation should not leave such questions as these unanswered.

2. In paragraph (h)(1) the \$75-a-day fee in the preamble is made applicable “for” an “original NPSL report ... not received by the division by the designated due date”. This raises two questions.
 - A. Is the “designated due date” a date that is explicitly “designated” in the division’s “notice to the lessee”, or is it generically “designated” by 11 AAC 82.-245(b)? Regarding the latter, it seems somewhat odd to say a regulation

“designate[s]” a due date instead of speaking of a due date “under” that regulation. Yet, in terms of the sense of what paragraph (1) is saying, perhaps this is how it should be understood. If so, then this could easily be made explicit, and ought to be, simply by replacing “the designated due date” with “the due date under (b) of this section”.

- B. When does the \$75-a-day fee begin — on the day after the “designated due date” or on the day after the division’s “notice to the lessee”? Here the answer is clear: it’s the day after the “notice” is “provide[d] to the lessee,” not the “due date”, because the preamble specifically says the “\$75 per day [fee] begin[s] on the first day after the division provides notice to the lessee”. We cannot speculate whether this is actually what DNR intends for such late-reporting situations, however.
3. In paragraph (h)(2) the \$75-a-day fee in the preamble is made applicable “for” a timely-filed “original NSPL report” that is incomplete; i.e., it “does not contain all the documentation and information as required” by the “instructions” called for “under 11 AAC 83.245(b)”. The principle question here is when the \$75-a-day fee begins to accrue. The answer is the same as for paragraph (1) and for the same reason, but this time it more clearly makes sense for the fee to run from the day when DNR gives the lessee notice that the division has determined that the report as filed is incomplete.
4. In paragraph (h)(3) the \$75-a-day fee in the preamble is made applicable “for ... revisions to a NPSL report [that is] not filed within 30 days after issuance of the notice that a revision is required or by the date required in a settlement agreement[.]” The issue again is when the fee starts to accrue.
- A. When the division gives a lessee “notice that a revision is required”, is that also the “notice” “provide[d] to the lessee” that the preamble calls for? If they are the same, then why should the \$75-a-day fee start the day after that notice when the lessee has 30 days after the notice in which to file the revision? If they are not the same, then what if the division for whatever reason does not, or cannot, “provide[the second] notice to the lessee” when the 30 days for the lessee to file the revision are up — should the \$75-a-day start on the 31st day after the first notice instead of the day actually required under the preamble, which is the day after the division finally “provides” that second notice? In bad facts like this, there could easily be a strong temptation on the part of the division to read the preamble badly and interpret it in some now unforeseen way so that the fee would start on the 31st day after the first notice. Either paragraph (3) or the preamble should be rewritten to prevent such ambiguous situations from arising.
- B. Paragraph (3) also applies the \$75-a-day fee in the preamble to “revisions resulting from [a] settlement[that are] ... not filed ... by the date required in [the] settlement agreement”. The preamble would not start the \$75-a-day fee until the date after “the division provides notice to the lessee” that the revision resulting from a settlement has not been “filed by the date required in [that]

settlement agreement”. Again, the concern is about what happens if the division for whatever reason does not, or cannot, provide promptly the notice, required by the preamble, that the due date under the settlement has just passed. As the regulation is proposed, right now one cannot say what would happen.

5. In paragraph (h)(4) the \$75-a-day fee in the preamble is made applicable “for ... failure to make NPSL payments when due under 11 AAC 83.245[.]” Here, again, the question is when the fee would begin to run — on the day after the date the payment was “due under 11 AAC 83.245” or on the day after the “division provides notice to the lessee” that the payment was not received on or before its due date. One might expect the former to be DNR’s preference, but the latter is what 15 AAC 83.235(h) as proposed would actually provide.

Paragraph (h)(5) also does not fit structurally or logically with the preamble of that subsection. Here is what is literally written when paragraphs (1) – (4) are omitted for the sake of clarity:

(h) The division will charge an administrative fee of \$75 per day, beginning on the first day after the division provides notice to the lessee, for ... (5) for the purposes of determining whether to charge an administrative fee under this section, for a NPSL report submitted under 11 AAC 83.245(b) each schedule and attachment included in the NPSL report that is required to clearly present the facts of production, valuation, costs, or other payments associated with the NPSL lease for which the NPSL report is submitted is considered a separate report.

The technical problem here about the structure and content of subsection (h) is much more substantial than the mere fact that the word “for” effectively appears twice back-to-back between the end of the preamble and the beginning of paragraph (5).

Paragraphs (h)(1) – (4) are all situations “for” which the preamble is applicable: late reports, incomplete reports, revised reports, and late payments. But (h)(5) addresses the issue of how many items would be subject to the \$75-a-day fee when one of those situations in (h)(1) – (4) occurs. Structurally it should be a separate subsection that refers back to subsection (h).

Indeed, putting this number-of-reports-for-which-a-fee-may-be-imposed issue into a separate subsection is exactly what is done in the royalty-reporting context in 11 AAC 04.080, which seems to be the exemplar from which 15 AAC .83.245(h) is derived. The royalty section 080(a) begins with a preamble exactly the same as the NPS one proposed in 245(h), and the situations in 080(a)(1) – (3) and (5) are the royalty counterparts of the NPS situations in proposed 245(h)(1) – (4). The rule in the royalty regulation about the number of reports to which its fee applies is set out as 080(b), not as a paragraph in 040(a).

Oddly, both 15 AAC 04.080(b) and proposed 15 AAC 83.245(h)(5) speak about “determining whether to charge an administrative fee” or not. This oddness arises because the preambles in both regulations specifically prescribe that “[t]he division will charge [the] fee” (emphasis added), suggesting that charging a fee is what always happens.

In the royalty context there is another regulation, 15 AAC 04.090, which allows the DNR commissioner to “waive an administrative fee established under 11 AAC 04.080”. This second regulation creates the possibility that an administrative fee regarding a royalty report might not be imposed. Thus, 080(b) — instead of speaking about the purpose of “determining whether to charge [a] ... fee”, which is the subject for the other regulation 090 — should speak in terms of what it is providing for, and open with something like “For the purpose of determining how many administrative fees may be charged under this section with respect to a royalty report submitted under 11 AAC 04.040 for a lease”.

If 15 AAC 83.245(h), the NPS counterpart of 11 AAC 04.080, is going to be adopted essentially as proposed, then the language currently in (h)(5) could be adapted the same way as the language in 11 AAC 04.080(b) should be, in order to reflect accurately what 245(h)(5) would do : allowing a fee to be charged for individual “schedule[s] and attachment[s] within an NPS report, rather than speaking of “determining whether to charge [a] ... fee”. Further, if (h)(5) is adopted, then an NPS-reporting counterpart to 11 AAC 04.090 should also be adopted in order to authorize fee waivers for NPS reports corresponding to the fee waivers that currently can be made for royalty reports.

Substantive issues. 11 AAC 04.080 — “establish[ing]”¹ the \$75-a-day “administrative fee” for royalty reports — was adopted effective 21 February 1998. *See* Alaska Administrative Register 145. Proposed 11 AAC 83.245(h), if adopted, would likewise establish a new \$75-a-day administrative fee for NPS reports. Neither fee respectively is, or would be, imposed on the set of “schedule[s] and attachment[s] included in the [royalty or NPS] report” as a whole, but on “each [such] schedule and attachment included in the ... report that is required to clearly present the facts of production, valuation, costs, or other payments associated with the ... lease for which the ... report is submitted”.

For a single monthly NPS report filed for a given lease, the number of “administrative fee[s]” applicable to it would, under 11 AAC 83.245(h)(5) as proposed, depend on how many “schedule[s] and attachment[s]” the “instructions” require to be included in that report. Since DNR under 15 AAC 83.245(b) as proposed could change the “instructions” for NPS reports at any time, it is not possible now to determine with any great degree of confidence how many such “schedule[s] and attachment[s]” might end up being required for each NPSL report under the “instructions” for it.

For purposes of illustration through a hypothetical example, let us consider what kinds of information 11 AAC 83.245(b)(1) – (5) currently require in each NPS report, and estimate how many “schedule[s] and attachment[s]” (for simplicity, we will simply refer to them as “schedules” without quotation marks) might be required to present each category or type of required information.

- Paragraph (b)(1) requires reporting of “the volume and disposition of all oil and gas production” from each NPSL, so let us assume there is one schedule for oil volume and dis-

¹ “Establish” is the word that DNR itself uses in 11 AAC 04.090 uses to describe what 11 AAC 04.080 did regarding the fee.

- position, and another for gas volume and disposition. **2 schedules per NPSL**
- Paragraph (b)(2) requires reporting of “the value of oil or gas” from each NPSL, so let us assume there is one value schedule for oil and another for gas. **2 schedules per NPSL**
 - Paragraph (b)(3) requires, for each NSPL, the reporting of the balances of, and items going into or out from, the production revenue account (11 AAC 83.209), the development account (11 AAC 83.212), and the net profit payment account (11 AAC 83.214) for that lease. Let us assume there is one schedule for each account. **3 schedules per NPSL**
 - Paragraph (b)(4) requires “the monthly profit share of the lessee and the monthly net profit payment due the state” for each NPSL. Let us assume that the lessee’s “profit share” and the State’s “net profit payment” from a given NPSL can be presented on a single schedule. **1 schedule per NPSL**
 - Paragraph (b)(5) requires the calculations of the development account credits (11 AAC 83.220) and the production tax lease allowance (11 AAC 83.241) for each NPSL. Let us assume that the credits require one schedule and the lease allowance another. **2 schedules per NPSL**

In addition to these 10 schedules, there are the NPS reporting forms themselves — the (AC), (VV) and (PT) reports — plus an (S1) report under 11 AAC 04.040(a) as proposed, for a total of 14 items per NPS report that could each suffer “an administrative fee of \$75 per day” if the package of materials comprising that report is received late, is found to be incomplete by DNR,² or is a revision that is not filed on time. In other words, for an NPS report and schedules for an NPSL falling into any one of these three categories, the administrative fees for that single NPSL would exceed \$1,000 per day.

That’s a pretty hefty “administrative fee” to create unilaterally for an NPSL contract without the lessee’s consent.

The possibility — perhaps even the likelihood — of “fees” so large or perhaps even larger for a single lease illustrates the huge significance of DNR’s proposal to amend the regulations so they would refer to “instructions” that “prescribe” the number and kinds of schedules that need to be filed along with the report forms themselves. If those “instructions” can be changed at will by DNR without a need for public notice and comments under AS 44.62.010 – 44.62.320, would that provide NPSL lessees with “fair and just treatment in the course of ... executive investigations” into the fulfillment of their NPS obligations? Would the unilateral establishment of such large “fees” withstand scrutiny as an “impair[ment of] the Obligation of Contracts”? And if an NPSL lessee were to challenge the validity of these regulations (if adopted as proposed) on these or other grounds, why should that lessee not challenge also the existing counterparts to these proposals that DNR has already created unilaterally for royalty reporting in 11 AAC 04?

² In any situation involving incompleteness, 11 AAC 83.245(h)(5) as proposed would not limit the \$75-a-day administrative fee only to the incomplete forms and schedules. Instead, “each schedule and attachment included in the NPSL report that is required to clearly present the facts of production, valuation, costs, or other payments associated with the NPSL lease ... is considered a separate report” (emphasis added), with nothing whatsoever about the completeness or incompleteness of individual schedules or attachments included in the report.

These questions are not meant as a challenge to DNR. But BPXA is not the only NPSL lessee.

As noted earlier in these comments, this is not an occasion to debate such questions. BPXA believes the real question today is, how would the adoption of these regulations as proposed improve the environment for investing billions and billions of dollars in Alaska for oil and gas production in the future? We fear that their adoption as proposed would harm – not improve – the investment environment here.

We therefore request DNR to reconsider these proposed regulations and change them to reflect and accommodate our concerns and those, if any, submitted by other NPSL lessees. We also ask for your consideration of our comments in the Appendix regarding the (PT) form. There seems to be good potential in the proposals that could be released if DNR works with industry and the public to improve them.

Very truly yours,

BP EXPLORATION (ALASKA) INC.



Diane Colley

Assistant Controller

Production Revenue Accounting

Appendix enclosed

APPENDIX

COMMENTS ON NET-PROFIT-SHARE REPORTING FORM (PT)

30 September 2013

The comments in this Appendix are submitted by BP Exploration (Alaska) Inc. in conjunction with its comments dated 30 September 2013 about net-profit-share lease regulations proposed by the Department of Natural Resources, and are incorporated by reference into the comments on those proposed regulations the same as if they were fully set out therein. Terms defined in the comments on the proposed regulations are used in this Appendix with the same respective meanings.

Each reference herein below to a line number is not to an Excel[®] row number in the PT Report spreadsheet, but to DNR's report "Line No" in column E.

Comments regarding cell formulas and formats

- Line 25 PTR-PT-GVPOPO Gross Value at Point of Production for Oil and NGLs: should be formatted as dollars.
- Line 32 PTR-PT-GVPOPG Gross Value at Point of Production for Gas should be formatted as dollars.
- The cell formulas in Lines 26, 27, 33 and 34 need to accommodate zero volumes in the denominator, which would be the case for non-producing leases, leases that are shut-in for the entire month, or leases with no gas production.
- Line 70 PTB-PT PTGVROPB Petroleum Production Tax Dollar Per Barrel for non-GVR oil (legacy stair-step credit rate): the formula sets the per barrel credit to \$8 when the legacy oil GVPP is zero. Is that the intention, or should this be zero? This is a matter of appearance for the form, not substance, because the calculated stair-step credit is zero when GVPP is zero.
- Line 72 PTB-PT-PTNO Portion of taxable volumes that is "new" (non-"legacy"): This is identified as an input item, but it isn't input. The cell formula refers to the input item in L58.

Design comments

- GVR Lines 22-28 for Oil and NGLs and Lines 29-35 for Gas require the filer to input volumes for AS 43.55.160(f) new oil or gas and for AS 43.55.160(f)(1) and (g) new oil or gas from "high" royalty leases. It then proceeds to use these volumes to allocate GVPP to the various categories. Since the intention of the VV Volumes and Value is to segregate volumes by various categories, and since NPSL lessees have to segregate volumes anyway for these categories, why not simply segregate and/or identify volumes on the VV by the three categories: legacy, new production subject to 20% GVR and new production subject to 30% GVR? Then these 14 PT lines could be replaced by a simple summation of the TV – RYE (total value less royalty expense) dollars from the VV. No allocation would be necessary, and this is much simpler.
- QCE (comment on existing design): There are two sets of lines that calculate the AS 43.55.165(e)(18) \$0.30/boe QCE exclusion and the resulting adjusted QCE:
 - Section A development account (lines 12-18), and
 - Section B QCE credit (lines 39 – 44).

If the three BOE volume lines (lines 40-42) were moved to Section A, then Section B could simply start with the adjusted QCE previously calculated. This would also eliminate the confusing circular dependencies where Section A uses BOEs from Section B, and Section B uses expenditures (Total Overhead Items and Reimbursements to Operator) from Section A. Additionally this would eliminate the inconsistent approach of displaying the \$0.30/boe exclusion figure in Section A but not in B; it would only be displayed in Section A where the QCE is calculated.

- Loss Credit (comment on existing design): There are two sets of lines that calculate the Loss Credit:
 - Section C Loss Carry Forward Calculation before production (lines 48-50), and
 - Section H Loss Carry Forward Credit Against Production Revenue Account (lines 85-86).

The Loss Credit calculation is the same in either case. The only difference is whether the lease is in production or not, which determines whether it is reported on the AC under the Production Revenue Account or the Development Account. The two sections also have an inconsistent approach of displaying the credit percent: it appears in Section C but not in Section H. It would be simpler to have a single loss calculation, separate from the determination of how it is reported on the AC report, which is addressed at the end of the PT form.

- Legacy stair-step and New Oil credits: Lines 69 – 74 have been added to calculate the new SB21 credits, but they are added at the middle of Section E (Petroleum Production Tax Lease Allowance Before Credits Calculation). First, it is confusing to add a set of credit-calculation lines to a section that is labeled as ‘Before Credits’. Second, there is no reason to add it there. Section E currently calculates the Base Tax, Min Tax and the ‘Higher Of’ Base + Progressivity or Min Tax. None of these calculations is dependent on the calculations for the new credits.
- Flow of Credit calculations (comment on existing design, which is being further complicated by the addition of new credits): Overall, the placement of the lines for the various credits is very confusing. A logical “flow” of calculations would be Net Revenue or GVPP (revenue less Production Revenue and Development expenditures) first, then the various types of tax (Base, Progressivity, Minimum), and finally the various types of credits (QCE, Loss, Small Producer, and now the New Oil \$5/bbl and Legacy stair-step). But the various credit sections are scattered somewhat haphazardly through these logical steps. The lines for QCE and Loss (before production) credits appear ahead of the tax lines, the lines for the New Oil \$5/bbl and Legacy stair-step credits follow the Progressivity and Base Tax lines, and the lines for the Small Producer and Loss (after production) credits follow the lines for the Minimum and Higher Of tax. It would be much less confusing if all the credit lines followed the lines for the various tax amounts.
- PT totals for PR and DV account reporting (comment on existing design, which is further complicated by the addition of new credits): There are three lines at the bottom of the PT report that flow into the AC Accounts report:
 - Line 87 PPC-PT-PTDC is the sum of QCE and Loss before Production credits, and is reported on the AC under the Development Account;
 - Line 86 LCC-PT-PTLRC is the Loss after Production credit; and
 - Line 84 PTL-PT-PTLA is the Production Tax Lease Allowance net of the Small Producer, New oil \$5/bbl and Legacy stair-step credits.

These lines are reported on the AC under the Production Revenue Account. It is confusing to have some of the PR credits netted against the PTLA with only the PR Loss credit separate. Why shouldn’t the PTLA just be the tax allowance, and have a line that summarizes the PR credits, like the approach for the DV credits?