NOTICE OF PROPOSED CHANGES IN THE REGULATIONS
of the
DEPARTMENT OF NATURAL RESOURCES

AND NOTICE OF PROPOSED CHANGES IN THE REGULATIONS
of the
DEPARTMENT OF NATURAL RESOURCES TO BE ADOPTED JOINTLY WITH THE DEPARTMENT OF REVENUE

The Department of Natural Resources proposes to adopt regulation changes in Title 11 of the Alaska Administrative Code by a adding a new chapter 25, establishing a method to determine the value of the state's royalty share of gas production and establish terms under which the state will exercise its right to switch between taking its royalty in value (as money) or in kind (in gas) for gas shipped in firm transportation capacity acquired through the first binding open season for a project licensed under the Alaska Gasline Inducement Act (AS 43.90). The Department of Revenue and the Department of Natural Resources propose to jointly adopt regulation changes in Title 11, within the new Chapter 25 of the Alaska Administrative Code, establishing qualifications for persons to receive certain inducements provided by the Alaska Gasline Inducement Act. Those regulatory changes proposed to be adopted by the Department of Natural Resources include the following:

(1) 11 AAC 25.010 identifies persons subject to the chapter, including persons that acquire the right to ship gas during the first binding open season for a natural gas pipeline project licensed under the Alaska Gasline Inducement Act (AS 43.90). It states that the proposed chapter establishes a method that a person can choose to calculate royalties due the state on certain North Slope gas production, and also establishes terms a person can choose which would govern the state's switch between taking certain royalties in value (as money) or in kind (as gas). These choices are royalty inducements.

(2) 11 AAC 25.040 requires a person qualified for royalty inducements to elect to take the inducements by certain deadlines and prohibits a person from taking an inducement repealed by amendment of these regulations.

(3) 11 AAC 25.050 identifies the requirements for gas to qualify for royalty inducements. The gas must be royalty-bearing, produced from a North Slope state lease, and transported in firm transportation capacity acquired under a bid made in the first binding open season for the project licensed under AS 43.90. The volume and duration of qualified gas is limited.

(4) 11 AAC 25.060 outlines the method for determining the value of the state's royalty share of gas production for persons choosing to use the method. It identifies certain reporting requirements for these persons. It prohibits any method that reduces the state's royalties to less than "zero" for residue gas, gas plant products, LNG, and CO2. It sets certain accounting standards.

(5) 11 AAC 25.070 sets out rules for allocating gas and costs upstream of the inlet to a natural gas pipeline originating at or near Prudhoe Bay. It identifies the gas that qualifies for an inducement and allocates certain costs between oil and gas lessees and the state, including costs of transporting that gas and CO2 and costs of making the gas ready to sell.

(6) 11 AAC 25.080 contains rules for allocation of gas and costs at and downstream of the inlet to a natural gas pipeline originating at or near Prudhoe Bay. This pipeline is referred to as the Alaska mainline. This section, together with 11 AAC 25.100, identifies the destination of gas eligible for resource inducements under the chapter, and requires an oil and gas lessee to pay royalties on the amount and composition of that gas produced from each state lease with access to the Alaska mainline.

(7) 11 AAC 25.090 provides for adjustments to the amount of gas eligible for resource inducements produced from a state lease on account of pipeline, plant, and tanker in-kind fuel requirements, gains, and losses.

(8) 11 AAC 25.100, together with 11 AAC 25.080, determine the destination of gas eligible for a resource inducement. 11 AAC 25.100 also establishes a method for determining the value of qualified gas at destination. It establishes criteria for designation of first destination markets for gas, and requires the department to designate published prices to be used in valuing gas in and upstream of first destination markets. It allows for changes in first destination markets and in the source of published prices.

(9) 11 AAC 25.110 sets out an alternative method for determining destination value when a published price for a first destination market is less than 95% of certain published prices, adjusted for transportation cost, in first destination markets and in market centers immediately downstream of certain first destination markets.

(10) 11 AAC 25.120 gives notice that the commissioner may adopt regulations at a later time to establish an alternative method for determining destination value for LNG.

(11) 11 AAC 25.130 states the method for determining value when there are no reliable published prices, including where qualified gas is delivered overseas. In these situations, gross proceeds earned from sale is the measure of value, unless the gas is transferred to an affiliate, in which case value is the fair market value determined by the commissioner.

(12) 11 AAC 25.140 requires the department to establish locations differentials. Location differentials are used when gas is sold upstream of a first destination market, or when reliable published prices are not available for gas plant products in a first destination market. Location differentials are set based on several factors, including transportation costs between two locations and on the difference between the published price available for one location and the prices paid in the other location.

(13) 11 AAC 25.150 requires the department to establish a quality differential for unprocessed gas so that its value can be determined with reference to published prices for residue gas and gas plant products. It also allows the department to establish a quality differential a person could choose to use instead of a deduction for processing costs. Quality differentials are set based on the cost of processing gas, the composition of gas, and standard deductions allowed by other governments or royalty owners.

(14) 11 AAC 25.160 requires that any compensation or charge by a quality bank or NGL bank for differences in quality of gas tendered to or received from a pipeline be accounted for in paying royalties.

(15) 11 AAC 25.170 allows a deduction from the value of the state's royalty share for the cost of transportation between the boundary of the unit where gas was produced and destination. Costs allowed for this purpose are limited to a lessee's actual costs or, if gas is shipped on a pipeline or LNG transportation affiliate, then to the affiliate's actual costs.

(16) 11 AAC 25.180 pertains to the cost of transportation that can be deducted from the state's royalty share where the transportation is provided by an unrelated transportation entity, generally allowing deduction of the actual cost paid to the unrelated party.

(17) 11 AAC 25.190 addresses the deduction from the state's royalty share for transportation costs for the Alaska mainline and Canada mainline licensed under the Alaska Gasline Inducement Act (AS 43.90) if those pipelines are affiliated with a lessee. The section would allow for the deduction of the negotiated rate offered in a plan for open season, unless that rate is higher than the price actually paid under a transportation services agreement, in which case the price actually paid is used.

(18) 11 AAC 25.200 addresses the deduction from the state's royalty share for transportation costs for pipelines other than the Alaska mainline and Canada mainline if those pipelines are affiliated with a lessee. The section would allow the deduction of the affiliated pipeline's actual costs as calculated under the section, unless higher than the price actually paid under a transportation services agreement, in which case the price actually paid is used to determine to the amount to be deducted.

(19) 11 AAC 25.210 establishes a method for calculating the cost of LNG transportation when provided by an affiliate of the lessee. Generally, the deduction allowed is similar to the deduction the Department of Revenue allows in computing oil and gas properties production tax, unless that deduction is higher than the price actually paid, in which case the price actually paid is used to determine the amount to be deducted.

(20) 11 AAC 25.220 identifies costs that cannot be deducted from the state's royalty share as costs for transportation of gas, in most cases without regard to whether transportation is provided by an affiliate, but in some instances applicable only to transportation provided by an affiliate.

(21) 11 AAC 25.230 sets out a method for determining a deduction for unused capacity for the Alaska mainline and Canada mainline and prohibits all other deductions from the state's royalty share for unused capacity.

(22) 11 AAC 25.240 allows a deduction from the state's royalty share for the cost of processing gas that occurs between the inlet to the Alaska mainline and destination. Costs allowed for this purpose are limited to a lessee's actual costs or, if gas is processed by an affiliate, then to the affiliate's actual costs. The section sets limits on deductions from the value of residue gas or methane.

(23) 11 AAC 25.250 pertains to the cost of processing where processing is provided by an unrelated party, generally allowing deduction from the state's royalty share of the actual cost paid to the unrelated party.

(24) 11 AAC 25.260 addresses the deduction from the state's royalty share of processing costs where the processing plant is affiliated with the lessee, allowing for the deduction of the affiliate's actual plant costs as calculated using a method set out in the section.

(25) 11 AAC 25.270 identifies costs that cannot be deducted from the state's royalty share as processing costs, in most cases without regard to whether processing is provided by an affiliate, but in some instances applicable only to processing provided by an affiliate.

(26) 11 AAC 25.280 provides rules for the allowance of the costs of an LNG liquefaction or regasification plant when determining the amount that may be deducted from the state's royalty share. With limited exceptions, the rules for the allowance of the costs of an LNG

liquefaction or regasification plant are the same as the rules for the allowance of the costs of a processing plant.

(27) 11 AAC 25.290 allows a person to choose to change certain terms governing the state's right to switch between taking its royalty in value (as money) and in kind (as gas). A lessee choosing to change terms is given longer advance notice of the state's decision to switch between taking gas or money, and is given both the opportunity and obligation to temporarily release pipeline capacity to the state or its royalty-in-kind purchaser at cost during the period royalty is taken in gas, as long as permitted by federal law.

(28) 11 AAC 25.300 specifies when and to the extent North Slope oil and gas leases and unit agreements are changed by a person's choice to take a royalty inducement.

(29) 11 AAC 25.310 sets out the frequency with which the department may review the regulations in this chapter.

(30) 11 AAC 25.320 addresses the reporting of and access to information and documents. It authorizes the commissioner to examine certain information for the purpose of meeting the department's statutory and other duties. It requires a person claiming the royalty inducements offered by the chapter to provide and report information, to amend royalty reports, and to pay interest on late payments.

(31) 11 AAC 25.330 establishes criteria for certain amendments to the chapter, and also requires a person that believes an amendment necessary to timely notify the department of the need and to provide supporting information.

(32) 11 AAC 25.340 relates to changes to the commissioner's designation of first destination markets, market centers, the source of published prices, location differentials, and quality differentials.

(33) 11 AAC 25.350 requires certain changes to the way a lessee reports on net profit share leases which are the source of gas valued for royalty purposes under this chapter.

(34) 11 AAC 25.360 states the method for and requirement to convert foreign currency and units of measurement when complying with the requirements of the chapter.

(35) 11 AAC 25.900 includes the definition of terms used in the chapter.

Those regulatory changes proposed to be jointly adopted by the Department of Natural Resources and the Department of Revenue include the following:

(36) 11 AAC 25.020 states the requirements a person must meet to qualify for resource inducements, including the following: A person must bid in a first binding open season for the licensed natural gas pipeline project, or be excused from submitting a bid, and also must execute other agreements required by the licensee. The person must agree to do other things required by law and must produce North Slope gas that is shipped in firm transportation capacity acquired under the bid and other related agreements. The person must submit certain documents to the departments by identified deadlines.

(37) 11 AAC 25.030 sets out the procedure to apply for a voucher for resources inducements, and to apply for a transfer of a voucher for resource inducements. It also limits the time and quantity for resource inducements obtained on the basis of a voucher.

(38) 11 AAC 25.900 contain definitions of certain terms used in 11 AAC 25.020 and 11 AAC 25.030.

You may comment on the proposed regulation changes, including the potential costs to private persons of complying with the proposed changes, by submitting written comments to:

Antony Scott
Alaska Department of Natural Resources, Division of Oil and Gas
550 W. 7th Ave., Ste. 800
Anchorage, AK 99501-3560

Or, via email to: antony.scott@alaska.gov, or by fax to: (907) 269-8938. Written comments must be received no later than 4:30 p.m., Monday, March 22, 2010. Written comments received are public records and are subject to public inspection.

If you are a person with a disability who needs a special accommodation in order to participate in this process, please contact Mary Kay Ryckman at (907) 269-8426 no later than Monday, March 15, 2010, to ensure that any necessary accommodations can be provided.

For a copy of the proposed regulation changes, contact the Oil and Gas Division at (907) 269-8611 or go to http://www.dog.dnr.state.ak.us/oil/

After the public comment period ends, the Department of Natural Resources will either adopt these or other provisions dealing with the same subject, without further notice, or decide to take no action on them. The language of the final regulations may be different from that of the proposed regulations. YOU SHOULD COMMENT DURING THE TIME ALLOWED IF YOUR INTERESTS COULD BE AFFECTED.

Statutory Authority: AS 38.05.020; AS 38.05.180; AS 43.90.310; AS 43.90.410.
Statutes Being Implemented, Interpreted, or Made Specific: AS 43.90.300; AS 43.90.310; AS 43.90.320; AS 43.90.330; AS 43.90.900.

Fiscal Information: The proposed regulation changes are not expected to require an increased appropriation.

DATE: February 18, 2010

Kevin Banks
Director, Oil and Gas Division
Department of Natural Resources

Jonathan E. Iversen
Director, Tax Division
Department of Revenue

ADDITIONAL REGULATIONS NOTICE INFORMATION
(AS 44.62.190(d))

1. Adopting Agency: Department of Natural Resources for 11 AAC 25, except for 11 AAC 25.020 – 11 AAC 25.030 and related definitions, and the Departments of Natural Resources and Revenue acting jointly for 11 AAC 25.020 – 11 AAC 25.030 and related definitions
2. General subject of regulation: royalty inducements under Alaska Gasline Inducement Act
3. Citation of regulations: 11 AAC 25.
4. Reason for the proposed action:
   ( ) compliance with federal law
   (x) compliance with new or changed state statutes
   ( ) compliance with court order
   (x) development of program standards
5. RDU/component affected:
   For the Department of Natural Resources: Oil and Gas Division, Resource Development/Oil and Gas Development
   For the Department of Revenue: Tax Division: Revenue Operations
6. Cost of implementation to the state agency and available funding (in thousands of dollars):
   For the Department of Natural Resources:

	Initial Year FY 2010	Subsequent Years
Operating Cost	$__0____	$__0____
Capital Cost	$__0____	$__0____
Federal receipts	$__0____	$__0____
General fund match	$__0____	$__0____
General fund	$__0____	$__0____
General fund/ program receipts	$__0____	$__0____
General fund/ mental health	$__0____	$__0____
Other funds (specify)	$__0____	$__0____

   For the Department of Revenue:

	Initial Year FY 2010	Subsequent Years
Operating Cost	$__0____	$__0____
Capital Cost	$__0____	$__0____
Federal receipts	$__0____	$__0____
General fund match	$__0____	$__0____
General fund	$__0____	$__0____
General fund/ program receipts	$__0____	$__0____
General fund/ mental health	$__0____	$__0____
Other funds (specify)	$__0____	$__0____

7. The name of the contact person for the regulations:
   Name: Antony Scott

Title: Commercial Analyst
Address: 550 W. 7th Ave., Ste. 800, Anchorage, AK 99501-3560
Telephone: (907) 269-8530
FAX: (907) 269-8938
E-mail: antony.scott@alaska.gov

8. The origin of the proposed action:

__x___ staff of state agency
______ federal government
______ general public
______ petition for regulation change
______ other (please list) ______________________________

9. DATE: February 18, 2010

Prepared by:

/s/Antony Scott
Commercial Analyst
Division of Oil and Gas
Department of Natural Resources
(907) 269-8530

/s/John Larsen
Audit Master
Tax Division
Department of Revenue
(907) 269-6620

The Department of Natural Resources Division of Oil and Gas, keeps a list of individuals and organizations interested in its regulations. Those on the list will automatically be sent a copy of all of the Oil and Gas Division's Notices of Proposed Regulation Changes. To be added to or removed from the list, send a request to:

Christina Holmgren
Department of Natural Resources, Division of Oil and Gas
550 W. 7th Ave., Ste. 800
Anchorage, AK 99501-3560

giving your name, and either your e-mail address or mailing address, as you prefer for receiving such notices.