

**ALASKA STATE LEGISLATURE  
JOINT COMMITTEE ON NATURAL GAS PIPELINES**

Anchorage, Alaska

August 14, 2001

1:47 p.m.

**SENATE MEMBERS PRESENT**

Senator John Torgerson, Chair  
Senator Pete Kelly  
Senator Johnny Ellis (via teleconference)  
Senator Donald Olson, alternate

**SENATE MEMBERS ABSENT**

Senator Rick Halford

**HOUSE MEMBERS PRESENT**

Representative Scott Ogan  
Representative John Davies  
Representative Hugh Fate, alternate  
Representative Reggie Joule, alternate

**HOUSE MEMBERS ABSENT**

Representative Joe Green, Vice-Chair  
Representative Brian Porter  
Representative Mike Chenault, alternate

**OTHER LEGISLATORS PRESENT**

Senator Gary Wilken  
Representative Jim Whitaker

**COMMITTEE CALENDAR**

**NATURAL GAS PIPELINE PRESENTATIONS**

Update on the report required by SB 158

Alaska Oil & Gas Conservation Commission

Department of Law

Gas Pipeline Office

Testimony - North Slope Borough Assembly

Alaska Highway Natural Gas Policy Council (rescheduled from 8/15/01)

Public Testimony

Legislative Legal Counsel (scheduled but not heard)

**WITNESS REGISTER**

Mr. Wilson L. Condon  
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Department of Revenue  
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Petrie Parkman & Co.  
(No address provided)

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**ACTION NARRATIVE**

**TAPE 01-9, SIDE A**

**CHAIRMAN JOHN TORGERSON** called the Joint Committee on Natural Gas Pipelines meeting to order at 10:47 p.m. Members present during the meeting were Senators Torgerson, Kelly, Ellis (via teleconference), and Olson, and Representatives Ogan, Davies, Fate (alternate), and Joule (alternate). Other legislators present were Senator Wilken and Representative Whitaker.

CHAIRMAN TORGERSON confirmed that on teleconference were the Juneau and Anchorage Legislative Information Offices (LIOs). He then informed members that there would be public testimony from the North Slope Borough at approximately 5:30 p.m., with more than the stated three-minute limit being allowed. In addition, the Alaska Highway Natural Gas Policy Council was being rescheduled from the following day. Furthermore, U.S. Senator Stevens may be an addition to the agenda for August 15 at 5 p.m.

NATURAL GAS PIPELINE PRESENTATIONS

Update on the report required by SB 158

Number 02.21

CHAIRMAN TORGERSON reminded members that SB 158 directed the Department of Revenue to look into potential ownership of the pipeline - either partial or total - by the State of Alaska. He mentioned a possible port authority concept or a possible corporation whereby Alaskans could buy some of it, for example. Commissioner Condon has selected two companies to proceed with that study; a representative from one of those companies would speak today along with Commissioner Condon.

Number 03.34

MR. WILSON CONDON, Commissioner, Department of Revenue, discussed the work the department has undertaken with respect to SB 158, enacted during the last legislative session. That bill directed the Department of Revenue to undertake a fairly detailed study with respect to possible state financial participation or some other form of state assistance in the financing of a project for the commercialization of North Slope gas.

COMMISSIONER CONDON told members that as he reported in the July hearing, [the department] was in the final stages of completing contract negotiations with CH2M Hill and Petrie Parkman & Co. ("Petrie Parkman"). Those negotiations are completed, and the companies have commenced work. The department is assisting in some of the legwork, but doesn't yet have anything to report, other than that "we're doing the work."

COMMISSIONER CONDON said "we" have talked with some committee members about some specific aspects of the project and have interviewed a number of Alaskan leaders about the pros and cons of state ownership. He introduced Bill Garner of Petrie Parkman, an investment banking firm specializing in the energy industry, and pointed out a company resume [in packets].

Number 07.26

MR. WILLIAM S. ("BILL") GARNER, Petrie Parkman & Co., offered to describe the firm and then provide his own background, since he will be the lead person on this project. In addition, he would discuss the requirements of SB 158 and how Petrie Parkman, CH2M Hill, and the commissioner's office will proceed to prepare that report.

MR. GARNER pointed out that although Petrie Parkman doesn't have a presence in Alaska, it is the world's leading oil and gas investment and banking specialist; that is all the company does, which differentiates it from other investment banks. It provides a full suite of services including divestiture and merger advisory services, strategic advice, equity research, sales of securities, underwriting, private placement, bankruptcy services, and advising governments on energy-related initiatives.

MR. GARNER informed members that Petrie Parkman was founded in 1989 by the former lead investment bankers from The First Boston Corporation ("First Boston") who left First Boston when it merged with Credit Suisse. Today Petrie Parkman has offices in Denver, Houston, and London. The capital markets operations are handled exclusively in Denver, including research, IPO (initial public offering) activities, writing research reports on other companies, providing high-level strategic advice, and handling financial aspects for companies. The Houston office, where Mr. Garner is based, handles mergers and acquisitions, transactions, and advice to governments. The company has about 35 specialist professionals; about half are from the investment banking business and about half, including Mr. Garner, are from industry.

MR. GARNER noted that in the past 12 years, Petrie Parkman has closed more than \$35 billion of oil and gas mergers and acquisitions in more than 250 separate transactions, making it one of the most active firms in the world in this business. Named the Best Energy Research Boutique by Institutional Investor magazine on numerous occasions, in 2001 Petrie Parkman was called by Petroleum Economist magazine one of the world's leading investment banks in terms of the monetary value of oil and gas transactions it has closed.

Number 09.15

MR. GARNER turned attention to two of Petrie Parkman's major projects for governments. First, it represented the U.S. Department of Energy under the Clinton Administration in the sale of the Elk Hills Strategic Naval Petroleum Reserve, which resulted in the largest monetary privatization in the history of the U.S. Second, Petrie Parkman is currently the advisor to the Kingdom of Saudi Arabia in the largest natural gas investment project in the world, the Natural Gas Initiative.

MR. GARNER explained that the kingdom is, in essence, reversing many years of policy: rather than developing its hydrocarbon reserves itself, it is now encouraging the world's largest oil and gas companies to invest approximately \$20 billion in integrated natural gas projects within the kingdom over the next ten years. This includes not only exploration and production,

but also the construction of pipelines, processing facilities, petrochemical plants, power plants, and desalination plants; the fuel for each facility would be natural gas, and Saudi Arabia is believed to have some of the largest natural gas reserves in the world. Having begun that project two years ago, Petrie Parkman is "in the thick of it" now; it announced the winners of the bidding rounds and signed the first agreements with those companies in June, and is now assisting the kingdom in drafting definitive documents for that investment.

MR. GARNER reported that Petrie Parkman has been active in the Lower 48 in various transactions. A major project this year was defending Barrett [Resources] in a hostile takeover attempt by Shell Oil, which eventually led to an acquisition by the Williams Companies. He noted that the handout delineates other projects the firm has worked on.

MR. GARNER informed members that both Mr. Petrie and Mr. Parkman will assist [on the Alaskan project]. Mr. Petrie's involvement is primarily in advising the chairmen of companies on strategic matters and in directing research activities. A graduate of [the U.S. Military Academy at] West Point and a past member of the board of directors of the National Association of Petroleum Investment Analysts, Mr. Petrie has served as president of that organization; has served on the Securities and Exchange Commission's Advisory Board on Oil and Gas Accounting; has delivered a number of technical papers to the Society of Petroleum Engineers on the subjects of petroleum valuation, merger and acquisition trends, and energy policy; frequently appears in the media, including being interviewed on a variety of energy policy matters on television programs such as "Wall Street Week" and "The McNeil Lehrer News Hour" and on CNBC and Fox News; and has been quoted frequently in Barrons magazine, including the [July 27, 2001] issue.

MR. GARNER reported that Mr. Parkman, who heads the Houston office, began his career in the industry and later became head of the oil and gas mergers and acquisitions operations for First Boston.

MR. GARNER offered his own credentials. He heads the firm's international practice and is "the pipeline guy." His background is in natural gas pipelines, and he was the former general counsel of the fourth-largest natural gas pipeline company in the world in terms of miles of pipe, K N Energy, Inc. (which since has merged with Kinder Morgan, Inc.); he noted that neither of those firms has been active in Alaska. Following that, he was appointed head of the international group at K N Energy, Inc. He began work with Petrie Parkman approximately 18 months ago, and primarily works on pipeline projects and international projects.

Number 13.58

MR. GARNER turned attention to SB 158. He told members preliminary work has begun with the commissioner's office. The first process is talking to the stakeholders. It is critical, before addressing details, to get a better understanding of what citizens, legislators, proponents, and opponents have to say about this idea; therefore, CH2M Hill and staff of the commissioner's office have undertaken those interviews in Alaska. Those at Petrie Parkman will talk to the companies and the proposed project developers because it is important to get their sense about these requirements.

MR. GARNER told members the remaining part of the examination will be undertaken following that. This includes examining the history of state participation in the Trans-Alaska Pipeline System (TAPS) and other natural gas pipeline proposals that have come before the state; determining the current status of the various gas pipeline proposals; identifying and quantifying key uncertainties associated with project development such as construction costs, operating costs, tariffs, and throughput; examining available financial participation options of the state, such as full or partial ownership through public or private corporations or other entities; looking at sources of funds such as the permanent fund earnings reserve or the constitutional budget reserve fund; looking at debt alternatives, including revenue bonds, general obligation bonds, and so forth; looking at the feasibility of the state's guaranteeing private debt or guaranteeing debt in general; and looking at other alternatives such as state ownership not of the pipe itself, but of the capacity within the pipe.

MR. GARNER reported that following that, evaluation criteria will be developed regarding what will be in the best interest of the state. These include determining what kinds of returns the state should be looking at; what the impact criteria are for the state's cash flow and bond rating; what the impact is of the availability of state credit to fund other essential public services; looking at conflicts of interest and issues associated with state ownership in such a project versus the state's obligation to regulate various aspects; and looking at economic development generally in the state and the impact of the natural gas pipeline regarding project costs, the feasibility of the project, the project timing, and the project participants, for example. Then the various options will be evaluated against the evaluation criteria, and recommendations will be arrived at, as required in SB 158. That work will continue through the autumn; the report is due to the legislature no later than January 31,

2002. Mr. Garner stated his understanding that [Commissioner Condon] would be making periodic progress reports as well.

Number 17.41

CHAIRMAN TORGERSON asked whether Mr. Garner is familiar with other governments, particularly in the U.S., that are part owners of lines. He also asked whether there are similar studies that might be looked at for comparison.

MR. GARNER replied that in the U.S., early in the history of the development of the natural gas industry, there were situations in which this occurred, primarily as economic development initiatives; states and local governments would participate in projects primarily as a means to either stimulate investment or to meet some other political or environmental concern. For example, when Denver got natural gas, one issue related to taking the community off of coal, because of air-pollution issues, and putting it on natural gas; there was a lot of state and municipal activity at that stage. Mr. Garner added:

We're going to examine where that might exist today, but it's ... certainly not a common feature in the development of the industry today. Now, internationally it is. Certainly in the case of Saudi Arabia, where we're working, the Saudi Arabian government intends to take equity participation interest in certain of the projects. And the reason they're going to do that would be their perceived rate of return, security issues for the kingdom itself; they hate to turn over certain strategic parts of their infrastructure ... to non-Saudi entities.

And you see these kinds of activities in ... a lot of places where you have state-owned oil companies - Mexico, for example, Indonesia, places like that. ... But it's a different situation than ... what you have. There probably [are] ... some analogies that can be drawn, and maybe some ideas that can be drawn here, but typically in those countries you're dealing with different problems altogether than what you have here.

Number 20.34

REPRESENTATIVE DAVIES asked Mr. Garner to comment on rate-of-return issues. He noted that for a company investing, there are different rate-of-return considerations than for a state. For example, a state might take the point of view that infrastructure development may be an adequate return on the investment.

MR. GARNER replied that it will be examined as part of this report. These companies, however, are for-profit entities, and have to make a return for their shareholders; how they look at this project will be different from how the state will. Furthermore, it will be regulated by the Federal Energy Regulatory Commission (FERC); a lot of these issues will be regulated by the federal government in terms of maximum allowed rates of return. He pointed out that in a regulated pipeline, an opportunity for huge rates of return generally don't exist; it will be in the 10-15 percent range, and probably on the lower end of that.

REPRESENTATIVE DAVIES responded that he was thinking more about when the issue is being evaluated as to whether the state should take ownership. In that regard, what rate of return should the state be looking at, as a state, not as a private entity? He asked whether there has been consideration of that issue yet.

MR. GARNER said not yet. It is an important question, however, because states get involved in these kinds of projects for lots of strategic reasons other than necessarily to make a high rate of return for their own income purposes.

Number 22.26

REPRESENTATIVE FATE referred to Mr. Garner's mention of the state's obligation to regulate the pipeline. He asked Mr. Garner whether he anticipates looking in depth at what effect any federal regulation may have upon those state regulations, and whether that may influence it to the extent, perhaps, that it will be impossible for the state to either regulate it or enter into any financial agreement.

MR. GARNER answered:

I think only indirectly, sir. I think that that pretty much exceeds what we're trying to do. I think we're going to focus more on ... the things we know the state will have to regulate. And some of these areas, I just think it's probably going to exceed the scope of this project.

MR. GARNER suggested that others could comment on that better.

CHAIRMAN TORGERSON informed Representative Fate that the issue likely would be touched upon at the next day's discussions with FERC, Bob Loeffler, the Department of Law, and [Legislative Legal Services] personnel.

Number 24.03

COMMISSIONER CONDON noted that Chairman Torgerson had provided him a list of topics to cover; he read item 2, which stated [original punctuation and capitalization provided]:

Representatives of the LNG Sponsor Group testified that the Port Authority concept provides little, if any, economic benefit to its project. [The Alaska Gasline] Port Authority has stated that its structure is available to the producers and it can provide significant economic benefits to a project. What is your Department's current view? Additionally, the Port Authority's route would cross lands outside the participating municipalities' borders. What is your view of the Port Authority's jurisdiction outside their respective municipalities' borders?

COMMISSIONER CONDON told members:

We're not ready to answer either of those questions. I can tell you that we are looking at ... a structure like the Port Authority as one of the models that we'll be analyzing to see whether it makes sense. And so we will have a view on that issue, and I simply haven't turned my attention to the question of whether or not the Port Authority can construct a project that's partly outside the physical boundaries of the member municipalities.

CHAIRMAN TORGERSON informed members that he had written most of the testifiers a letter, posing questions. He noted that Commissioner Condon would be before the committee again the following day to answer questions relating to taxes and other issues. Recalling testimony that "they" would be tax-exempt outside their jurisdictions, outside the City of Fairbanks, he commented, "I don't see where they would be, but that's what I was hoping you would have an answer for. But that's a difficult question apparently."

COMMISSIONER CONDON replied that he didn't know whether it was difficult or not. He apologized for not addressing it.

Number 26.26

REPRESENTATIVE DAVIES referred to Mr. Garner's testimony and commented that the sale of Elk Hills and [Petrie Parkman's] role in Saudi Arabia both "move in the direction of privatization." He asked Mr. Garner, "Would you characterize your firm as being biased in that direction of privatization, or are you ... going to take a look at this from a fairly evenhanded point of view?"

MR. GARNER answered:

Definitely evenhanded; that's what our firm is ... known as. In fact, some people would say we're too evenhanded. ... We are not in the pockets of anyone. We just [are] presented projects and look at them and give people the answer, whether they want to hear that answer or not. In those particular projects, that was just the nature of the assignments. There's nothing to be drawn from there.

And in fact, interestingly enough, I remember sitting in Riyadh, Saudi Arabia, literally a year ago this week, debating some of the same issues [in] a very generic sense [that] I think you will be debating in the legislature next year about the proper role of governments in these kinds of projects. And so, ... even Saudi Arabia I wouldn't necessarily characterize as a privatization. It's more of a situation where the kingdom legitimately is trying to do the best thing for its country to increase employment, to ... increase revenues available to the country, and exploit a valuable resource in the kingdom in a proper manner.

CHAIR TORGERSON surmised that the commissioner has made available to Mr. Garner the past reports and studies done on this; he said this isn't the first time [the legislature] has looked at this.

MR. GARNER responded in the affirmative.

CHAIR TORGERSON added that he isn't sure what has changed from the last time, other than the will to look at it again. He asked whether there were further questions; none were offered.

CHAIR TORGERSON announced an at-ease at 2:15 p.m. He called the meeting back to order at 2:31 p.m.

#### Alaska Oil & Gas Conservation Commission

MS. CAMMY OECHSLI TAYLOR, Commissioner, Alaska Oil & Gas Conservation Commission, Department of Administration, came forward to give a PowerPoint presentation in response to written questions posed to her earlier by Chairman Torgerson. [The first six minutes of Ms. Taylor's testimony were not recorded on the tape. The questions and the printed versions of the PowerPoint slides are available in committee packets, and text from the presentation is provided here; original punctuation and capitalization are provided, but formatting may be changed].

[The first slide showed a map of the Alaska North Slope.]

**Outline of Testimony [slide 2]**

Overview of AOGCC Role  
Conservation Orders Affecting North Slope Gas Sales  
Evaluation Process for Major Gas Sales  
    Overview of Contractor Scoping Study  
        Objectives  
        Recommendations

**Alaska Oil and Gas Conservation Commission [slide 3]  
(AOGCC)**

Independent, quasi-judicial agency

Established under the Alaska Oil and Gas Conservation Act (AS 31).

Regulatory authority - outlined in Title 10, Chapter 25 of the Alaska Administrative Code

**Mission**

Protect the public interest in oil and gas resources.

The Oil and Gas Conservation Act requires all oil and gas drilling, production and measuring operations to be conducted in a manner that prevents physical waste of the resource, promotes greater ultimate recovery and affords all owners of oil and gas rights an equal opportunity to recover their fair share of the resource.

**AOGCC Function [slides 4 and 5]**

**PREVENT PHYSICAL WASTE OF THE RESOURCE**

Technical evaluation of proposals for major gas sales, enhanced oil recovery, and gas cap liquids recovery.

Evaluate drilling programs to ensure proper well design, construction and well control equipment.

Inspect wells and drilling projects to verify compliance with approved regulations, procedures and safety requirements for drilling and production practices.

#### **PROTECT CORRELATIVE RIGHTS**

Provide all owners of oil and gas rights the opportunity to recover their fair share of the resource through well spacing provisions, permit review, and pooling authority.

#### **ADJUDICATE DISPUTES BETWEEN OWNERS**

Provide a public forum to resolve disputes between owners.

#### **ENSURE GREATER ULTIMATE RECOVERY**

Analyze production data, including reservoir pressure, gas-oil ratios, water cut, etc., to ensure these variables fall within the accepted parameters necessary to provide for greater ultimate recovery.

Review and approve development proposals, including plans for enhanced oil recovery operations.

#### **INDEPENDENTLY ASSESS OIL AND GAS DEVELOPMENT**

Independently audit/verify that oil and gas exploration & development proposals are in compliance with the purposes and intent of Title 31.

#### **PROTECT ALASKA'S UNDERGROUND SOURCES OF DRINKING WATER**

Provide engineering and geological review of all activities that affect potential sources of drinking water.

#### **AOGCC PRIMARY SERVICES [slide 6]**

Regulate, monitor and inspect all subsurface activities directly related to oil and gas exploration and production including the design and integrity of wells, well control procedures and equipment, reservoir management plans and proposed underground injection programs.

Issue pooling rules and conservation orders.

Approve and monitor plans for reservoir development and enhanced oil recovery.

Approve permits for initial drilling, re-drill, sidetrack, and cementing and well completion operations.

Inspect drill rigs and wells to [ensure] compliance with AOGCC regulations.

Witness safety valve, mechanical integrity, and blowout prevention

Witness meter-proving, calibration, and oil quality tests.

Enforce well spacing rules, monitor production rates, inject

Monitor and evaluate gas flaring.

Collect and maintain all oil and gas production records.

Collect and maintain all well history files and well log records

Administer Alaska's Underground Injection Control (UIC) program and the annular waste disposal program.

**Powers and Duties of Commission  
Related to Major Gas Sales [slide 7]**

Investigate to determine whether or not waste exists or is imminent.

Require plans of reservoir development and operation in order to prevent waste, [ensure] a greater ultimate recovery of oil and gas, and protect correlative rights.

Regulate for conservation purposes the quantity and rate of the production of oil and gas.

See AS 31.05.030.

[Tape recording begins here]

MS. TAYLOR discussed the following slide:

**Waste [slide 8]**

In addition to its ordinary meaning includes

The inefficient, excessive, or improper use of, or unnecessary dissipation of reservoir energy;

Operating or producing in a way that reduces the amount of oil

See AS 31.05.170(14).

MS. TAYLOR informed listeners that gas currently is reinjected for pressure maintenance in Prudhoe Bay. If gas is sold instead of being reinjected, the state needs to know whether the loss of reservoir energy will result in reduced oil recovery. It is also important to know what alternatives may be available that could mitigate the loss of that reservoir energy.

MS. TAYLOR turned attention to the next slide, which read:

**Applicable Conservation Orders [slide 9]**

**Pool Rules for the Prudhoe Oil Pool - Conservation Order 341C Consolidated Pool Rules for Prudhoe Oil Pool**

**Rule 9 Pool Maximum Gas and Oil Offtake Rates**

Maximum 2.7 billion standard cubic feet per day of gas offtake (BSCFD)

Contemplated a 2 BCFD pipeline sales rate (salable product)

Gas offtake from PBU has always been well below this set limit

Rule 9 written in 1977.

**Rule 12 Prudhoe Bay Miscible Gas Project**

Operator to maintain the reservoir pressure at 250 psi above the minimum miscibility pressure.

MS. TAYLOR explained that one specific question asked [by Chairman Torgerson] related to the applicable conservation orders that currently exist. In 1994, she reported, the commission undertook a consolidation of the numerous conservation orders that had been written with respect to Prudhoe Bay; amended twice since then, it is referred to as Conservation Order 341C. Two rules within that conservation order specifically address the impact of gas offtake from Prudhoe Bay. As noted above, [rule 9] is the pool maximum gas offtake rate, set at 2.7 billion standard cubic feet per day of gas offtake; written in 1977, it contemplated a 2 billion cubic feet (BCF) [a day] pipeline sales rate. The other, rule 12, is sometimes referred to by AOGCC staff as the "pressure decline speed limit"; it specifically requires the operator to maintain the reservoir pressure at 250

psi [pounds per square inch] above the minimum miscibility pressure.

MS. TAYLOR reported that separate and aside from gas sales, the operator is currently involved in a pressure studies initiative and has begun an initial information exchange with the commission on its plans.

MS. TAYLOR turned attention to the following slide:

**Current Status [slide 10]**

Fundamental assumptions upon which rule 9 was established are not valid.

PBU Gas Offtake rules must be based upon  
Current knowledge  
Sound reservoir management

PBU Operators have stated to AOGCC that gas sales may have a detrimental effect on oil recovery.

The AOGCC has not yet been provided with current technical information regarding Major Gas Sales

MS. TAYLOR told members that the commission believes it is important to recognize that rule 9 was written on pre-1977 information. The perception of that reservoir is significantly different from how it was perceived when [rule 9] was created. The AOGCC believes a gas offtake rule must be based on current knowledge and sound reservoir management; however, the timing for a hearing to revisit the offtake rule depends on acquiring relevant data or an application from the operator.

MS. TAYLOR noted that the operators have consistently stated to the AOGCC, over the years, that they would expect early gas sales to have a detrimental effect on oil recovery. Currently, the AOGCC hasn't been provided with any technical information regarding major gas sales or an application that specifically addresses timing or volumes. The AOGCC anticipates a hearing with a BP reservoir group, however, within the next two to three weeks, for a more detailed discussion on the types of information that the AOGCC expects to receive in order to evaluate a proposal; it is expected that a schedule will be set out at that meeting for when the AOGCC can anticipate receiving the information.

MS. TAYLOR indicated AOGCC staff had asked her to relate the following: in the context of reservoir performance being so significantly different from that in the late 1970s, the

incremental recovery from Prudhoe Bay of the 3.5 [billion] barrels of recoverable oil is the largest addition to reserves since Prudhoe Bay was discovered. The second largest was Kuparuk. The 3.5 billion barrels is a significant amount.

MS. TAYLOR turned attention to the following slide:

**AOGCC Gas Sales Evaluation Process [slide 11]**

Scoping Study

Technical evaluation

MS. TAYLOR explained that the AOGCC, in preparation for what will subsequently be a major gas sale, has prepared a two-pronged process. She addressed the next slide:

**Gas Sales Scoping Study [slide 12]**

**Consultant Review**

Blaskovich Services, Inc. June 2001

**Objectives**

[Identify] conservation issues associated with gas sales from the Prudhoe Oil Pool.

Identify technical issues affecting ultimate hydrocarbon r

Consider multiple complex interactive recovery mechanism

Provide alternatives for AOGCC technical evaluation

MS. TAYLOR emphasized that the scoping study was completed in June 2001 by Blaskovich Services, Inc. The objectives of that review are listed above, with an additional objective of providing the AOGCC with a range of costs [for the alternatives].

MS. TAYLOR brought attention to the following slide, specifying that it relates to the conclusions from Mr. Blaskovich's report:

**Conclusion - Consultant Review [slide 13]**

**Oil Recovery Impact**

Oil and Condensate Recovery likely to decrease under Gas Sales

Unless delayed until later into field

However, if carefully planned and managed Gas sales  
Can extend field life  
Potentially increase total Hydrocarbon Recovery

### **Maximum Recovery vs. Owner Economics**

#### **Industry Precedents**

Few industry precedents for early gas withdrawal  
Field management difficult, but does not mean this  
endeavor will be unsuccessful

#### **Options**

Independent Studies  
Critique and peer Review of owner studies  
Work directly on Owner project teams

MS. TAYLOR, addressing oil recovery impacts discussed in the slide, told members the AOGCC's mission and challenge is to evaluate how [gas sales] are managed and to look at the alternatives being proposed for maintaining reservoir pressure. She noted that the report pointed out a natural tension between the state's desire to maximize hydrocarbon recovery and the owners' economics. Furthermore, Mr. Blaskovich had reviewed literature available in the public domain, as well as industry precedents, and found few industry precedents for early gas withdrawal before the end of field life in oil recovery. Although field management might be difficult with these proposals, however, he believes the endeavor could be successful.

MS. TAYLOR informed members that Mr. Blaskovich's report also reviewed a number of options, broken down into general categories; they included doing completely independent studies, doing a critique and peer review of owner studies, and working directly on the owner project teams.

MS. TAYLOR presented the next slide:

### **Recommended Approach [slide 14]**

Independent Analysis and Critique

Smaller, Mechanistic Models to study processes

Focus on Technical issues of greatest impact on decisions

Do a credible job

Concurrent with Owner Studies (potentially ahead)

Use WIO data whenever possible

Rely on basic data, avoid debates about detailed models

Serious critique of WIO data & results

Credibility high if right questions are asked (based upon w

Avoid endless debate about who has the best model

This is a Combination of Options 1C and 3 from Blaskovich Study

MS. TAYLOR explained that the ultimate recommendation made by Mr. Blaskovich, in conjunction with his discussions with [the AOGCC's] technical staff, is a hybrid between two extremes: having the state do a full field model that essentially duplicates companies' efforts, and just accepting the information provided by the operators to the commission. She deferred to Commissioner Heusser to provide a description of the technical aspects of that recommendation.

MS. JULIE M. HEUSSER, Commissioner, Alaska Oil & Gas Conservation Commission, Department of Administration, reiterated that the current approach is two-pronged, a hybrid that avoids either extreme. The AOGCC's current thinking is that the type of evaluation that would provide the most value to the AOGCC and the state would be a combination of an independent analysis plus a critique of the working-interest owner data and results.

MS. HEUSSER explained that one clear message in Mr. Blaskovich's scoping study is that recovery from the Prudhoe Bay field is complex, with a variety of connected, interdependent mechanisms in a delicate balance; withdrawing gas in the form of major gas sales would interrupt that balance. The AOGCC therefore plans to use smaller, mechanistic models to understand how fluids move through the reservoir; this will allow the AOGCC to focus on technical issues that will have the greatest impact on the decisions. "We won't look at everything, but we'll look at the important ones," she remarked. She reiterated that there has been little industry experience with major gas sales from an oil reservoir that has not finished producing oil; therefore, there is no place that the AOGCC can go to look at actual experience.

MS. HEUSSER mentioned the timing of the gas sale; the question of what the pressure maintenance needs are; and the question of what the ramp-up rates and timing will be. She also mentioned optic points, commenting that right now it appears that most of the gas

could come from what used to be called the oil-rim wells. Should there be a need for an increased gas sales rate, she asked, what is the effect of taking gas off of the gas cap? The AOGCC also wants to look at the effect of gas withdrawal from the reservoir on the management of the existing "water flood enhanced oil recovery projects."

MS. HEUSSER told members the AOGCC's goal is to do a credible job, which requires evaluating not only the gas cap, but also the reservoir and the gravity drainage areas, as well as areas involved in water flood and EOR [enhanced oil recovery], which all interact with each other: when fluids are removed from one portion, fluids move in from another portion, and there may be a loss in oil recovery, or condensate, associated with moving fluids around.

MS. HEUSSER informed the committee that the ideal is to perform AOGCC's evaluation concurrently with the owners' studies; however, the AOGCC understands that the owners already have started their reservoir studies. While the AOGCC may be a little behind, it is believed the AOGCC can proceed at a pace that will allow it to not impede any gas-sales decisions in the near future. Ideally, the AOGCC also could use the working-interest owner data wherever possible; this is necessary to independently validate the data, to ensure that the results are believable. The AOGCC wants to know what data is going in, and wants to make sure the data is representative of what the commissioners believe the reservoir to be; that way, the commission will have more confidence in the results.

MS. HEUSSER noted that the AOGCC also has proposed to do a critique of the data and the results, which is, effectively, a peer review. "The credibility of our evaluation will be high if we study and ask the right questions," she told listeners. "That will allow us to feel comfortable that what is being proposed by the working-interest owners really is in the best interest of the state, to ensure greater ultimate hydrocarbon recovery."

MS. HEUSSER turned attention to the next slide:

#### **Timing Issues**

AOGCC approvals dependent upon:

Access to Operator information.

Availability of agency Staff.

Access to specialized expert(s) training in and familiar with

MS. HEUSSER told members the AOGCC has no fixed answer to Chairman Torgerson's question regarding timing. [That written question asked the presenters to address the length of time the AOGCC anticipates it will take to approve any action necessary for the development and production of Prudhoe Bay gas for sale.] Instead, she offered the following:

Basically, with our current recommended approach, we believe that it's going to take about a year ... to do the reservoir evaluation of the effects of major gas sales. The actual approval process is pretty straightforward. Once we receive a package and our evaluation is done, we put out a public notice, and with ... 30 days to respond, will hold a hearing, and then we have 30 days to issue a decision after the hearing. So that's basically how the process works.

Now, there are some potential slow-downs to this, and that is access to operator information. As Commissioner Taylor mentioned, we have a meeting that is currently scheduled for sometime in the next two to three weeks to meet with representatives of the working-interest owners and to provide them with additional clarification on our information requests.

Also, it's going to be dependent upon availability of agency staff. As most of you are aware, we have had a very difficult time recruiting and filling our technical staff positions. We were very fortunate to obtain legislative approval for salary increases. We have filled one of our outstanding positions, but we are in the process of accepting applications for a second position. However, ... our staffing levels never really reflected the need to do the major gas sales reservoir evaluation at this time. We've been told that it was always five years down the road or seven years down the road. So there may be some additional staffing needs that we'll need to consider. Now, whether that be permanent employees or whether or not we use contractors, that would be something that we would need to evaluate [to] make sure that we're doing the right thing.

Also, we need to have access to specialized experts that are both trained in and familiar with large-scale compositional reservoir modeling techniques. This is basically because in order for us to be effective in our critique of the working-interest owner data and results, these are the type of models that they're using; they're very sophisticated, and ... they're

fairly new within the last ten-fifteen years or so. And it takes ... specialized experience in order to evaluate their results.

MS. TAYLOR added that one question asked [by Chairman Torgerson] related to the status of any discussion with the Prudhoe Bay lessees regarding what orders or permits they will need [from the AOGCC] in order to develop and produce gas for sale [from the Prudhoe Bay reservoir], including the volume of gas available for sale at the startup of a gas pipeline and the commencement of full blowdown of the gas cap. She noted that the information the AOGCC has received in discussions with the operators has been general, consisting of a general outline of when they expect to be reviewing certain things, but without any specific data.

**TAPE 01-9, SIDE B**

MS. TAYLOR expressed hope that following the meeting scheduled in the next two to three weeks, the AOGCC will have a better layout of the "roadmap" ahead.

MS. TAYLOR referred to the last written question asked of the presenters, which requested an explanation of how the AOGCC intends to fund, on a program receipt fee basis, the study for which the AOGCC previously had requested \$500,000 in general funds, as well as an explanation of the scope of the study. She told listeners the scope of the study, as Commissioner Heusser had described, is somewhat dependent on what the actual parameters will be once the operators come to the AOGCC with a specific proposal and timing. It will be within the model of the two-pronged hybrid described by Commissioner Heusser.

MS. TAYLOR reported that the AOGCC funding request that went through the legislature last year was made part of the overall gas line package. It is the AOGCC's understanding now that the Department of Natural Resources (DNR) will enter into an agreement with the producers, and will collect from them through its statutory designated program receipt authority; through an RSA [reimbursable services agreement], that will go to the AOGCC.

Number 01.70

MS. TAYLOR offered to answer questions and invited members to come to the AOGCC's offices for any further information.

CHAIRMAN TORGERSON asked whether the AOGCC needs an application from the producers before going forward.

MS. TAYLOR answered that with respect to revisiting rule 9, which currently sets a gas limit for offtake, for a number of years the

commission has felt that rule is no longer current. The commission has not moved to reevaluate it, however, until such time as the AOGCC either has an application or more specific information about the reservoir and about proposed plans, in order to "make a better-informed rule about what amount and at what time gas could be taken from the reservoir." She added that it would also depend upon what alternatives the operators had for reservoir energy replacement.

CHAIRMAN TORGERSON referred to timing issues and asked whether those depend on whether the AOGCC gets the information from the operators.

MS. TAYLOR asked whether that is with respect to the actual technical review.

CHAIRMAN TORGERSON answered in the affirmative.

MS. TAYLOR replied that the recommendation for the kind of hybrid review described by Commissioner Heusser is dependent upon the information that would be provided by the operators.

CHAIRMAN TORGERSON asked whether the AOGCC needs that to amend rule 9. He specified, "Do you need Commissioner Heusser's report ... for the data you need to make a decision on amending rule 9?"

MS. TAYLOR replied, "To do it intelligently. Otherwise, I think that you could just delete the rule and wait until someone came with a proposal and further information."

CHAIRMAN TORGERSON asked, "You said it'd take a year to do this - a year after what?"

MS. TAYLOR answered, "A year after we receive some detailed information from the working-interest owners."

CHAIRMAN TORGERSON offered his understanding that the AOGCC theoretically would get this information from the operators, and then would make sure it is correct somehow, by hiring the right people, for example.

MS. TAYLOR responded in the affirmative.

CHAIRMAN TORGERSON suggested that is assuming the AOGCC doesn't need any additional data.

MS. TAYLOR replied, "That is our best understanding at the moment. The more information that we're provided, perhaps that timeframe would be shorter. But based on the hybrid approach that we'd like to take, we're estimating a year."

CHAIRMAN TORGERSON commented that he finds it a little odd that the producers aren't addressing the AOGCC, in meetings upfront, regarding whether rule 9 will even be amended. He asked whether this is an assumption on the part of the producers that they can pump the 6 billion [cubic] feet a day out of the field, and that the AOGCC will approve that. He requested Ms. Taylor's opinion, then said she didn't have to answer that; he noted that the producers aren't sharing information on many aspects.

CHAIRMAN TORGERSON then asked whether the economics to the state treasury are driving the decision. Noting that the economics involve the loss of oil versus the increase in gas, he asked, "How do you weigh that?"

MS. TAYLOR replied:

Actually, Title 31 doesn't provide us with any opportunity to balance the economics of it. Title 31 directly addresses hydrocarbon recovery. And so that comparison or that evaluation is left to other departments and the legislature. Our evaluation is to look ... at avoiding waste and promoting that ultimate recovery, within reason and, of course, to the extent that we're not doing it blindly of what the costs are.

CHAIRMAN TORGERSON asked whether a 10 percent loss of oil production is something the AOGCC would or would not approve. He also asked whether that meets the AOGCC's criterion of maximum hydrocarbon recovery.

MS. TAYLOR responded:

I don't think there's a magic answer. ... One of the things that I think people find most surprising is that when you have a pool of oil in the ground and someone is developing that, they don't recover 100 percent of that. And perhaps Ms. Heusser can address ... the specifics of what's normally expected and where this fits in. So I think there's an element of reasonableness and an element of sound engineering principles.

MS. HEUSSER added:

This is a difficult question to answer, about what's a reasonable amount of oil to give up in exchange for ... major gas sales at Prudhoe Bay. Previous public testimony by both operators and working-interest owners [has] suggested that the oil loss is at least ... 500

million barrels. ... That's a chunk of oil. What percentage ... is it of the original oil in place? Well, in the grand scheme of things ... it is less than 10 percent. The 500 million barrels of potential lost oil and condensate, that is a low-end number that we have heard testimony on before.

Is a 10 percent loss reasonable? 1 percent? [10] percent of ... the current recoverable reserves at Prudhoe Bay is ... about 1.4 billion barrels; it's a lot. So 5 percent is 700 million barrels. So that just kind of ... gives you some points of reference.

We don't know at this time ... what a reasonable figure is for loss of oil and condensate reserves. There is oil in the gas cap, what's called relic oil. When you start taking gas off, you get fluids moving around, so you lose oil because you've moved them further away from where they were originally deposited. ... That will be a point of discussion: what is a reasonable trade?

CHAIRMAN TORGERSON, on another subject, said it sounded from Ms. Taylor's testimony as though perhaps another agency can override the AOGCC's decisions. He suggested the legislature is one such entity, then asked whether anybody can veto the AOGCC's decision and OK a gas sale.

MS. TAYLOR answered, "I guess ... our position right now would be that without authorization from the commission, they would be at least in violation of Title 31."

CHAIRMAN TORGERSON asked whether DNR has a say in what limits of hydrocarbons are recoverable, for example, or whether the governor can call and say to make it work.

MS. TAYLOR replied:

There is no one out there who could call us and tell us, "Make it work." DNR can certainly appear as a party in front of the commission and provide testimony. ... I'd also like to add that part of the evaluation that is part of this difficult question about what's lost and what's not is also a challenge for the commission to evaluate what other alternatives might be out there with respect to mitigating that loss of oil recovery when the gas is taken for sale. And that's part of this process of evaluation, and it's part of - I'm fairly certain - what the companies are also looking at.

CHAIRMAN TORGERSON asked how much information is confidential.

MS. TAYLOR answered:

The commission's confidentiality provisions generally, with respect to subsurface information on particular wells, is governed by, generally, a 24-month confidentiality. So the subsurface information that relates to a particular well, 24 months after ... they've completed the well, is available publicly. There is some technical information that, if provided voluntarily under Title 31, can be held confidential. The other general aspect is under the general statutory trade secret requirements. And some of that information, they have to meet a certain standard, but if they meet that, that can be maintained confidentially.

REPRESENTATIVE DAVIES referred to the Blaskovich study, suggesting it said two apparently contradictory things: oil recovery is likely to decrease, and if it is carefully planned, it could extend the life and increase recovery. He said it sounds as if Mr. Blaskovich's assumption was that it wouldn't be carefully planned. He asked, "In reading that study, ... do you agree that there are things that we could do that, with carefully planned gas recovery, would actually enhance oil recovery? And what are those things?"

MS. HEUSSER replied:

One of the provisions of Conservation Order 341C is that the working-interest owners continue to evaluate pressure maintenance options. One of their recent proposals to us has been called the pressure support initiative, which is basically gas-cap water injection. That is one way that pressure decline can be mitigated.

There [is] also optimizing your field production rates. Where you physically take your reservoir fluids from is another means that can be used to manage reservoir pressure decline or reservoir energy decline. There are a number of things that could be done.

REPRESENTATIVE DAVIES asked, "So do you ... fundamentally agree with that statement that ... a carefully planned gas sale could increase total hydrocarbon recovery?"

MS. HEUSSER answered:

There's a timing question. So, in essence, that is correct. The timing of the gas sale, if it's ... somewhere off in the future, gives you more opportunity to recover your hydrocarbons and to cycle gas and recover additional hydrocarbons from your gas cap. So there's the timing issue, carefully planned.

And there's the pressure or reservoir energy mitigation issues that can help maintain the reservoir pressure, maintain the reservoir energy, and allow you to recover -- I'm not saying it's necessarily more oil, but ... you would lose less.

REPRESENTATIVE DAVIES asked whether 500 million is the right order of magnitude, and whether that is for Prudhoe Bay or the entire North Slope.

MS. HEUSSER said that number is just for Prudhoe Bay. She deferred to Ms. Taylor, noting that a range has been quoted.

MS. TAYLOR responded, "I think the range we've heard historically has been 400 to 500 [million], but ... in the context that we have heard, it has been very loosely used, with no identifiable date at which that gas would begin to be taken off the reservoir."

REPRESENTATIVE DAVIES asked whether that is for a year's recovery.

MS. TAYLOR answered, "Based on the current production rate, yes."

REPRESENTATIVE OGAN inquired about the total reserves in Prudhoe Bay.

MS. TAYLOR replied that Prudhoe Bay's total current estimated recoverable oil reserves are "about 13 billion."

REPRESENTATIVE OGAN said that differs from what BP just put out in its statistical review of U.S. energy in 2001, which was 4.9 billion barrels.

MS. HEUSSER asked whether this is comparing apples to apples, however. In response to a further question, she added, "Estimated recoverable oil reserves are ... in the neighborhood of 13 billion; there was, like, 23 billion oil in place, and they expect to recover something on the order of 13 billion of that."

REPRESENTATIVE OGAN asked whether the 500 million loss touted in the past was based on a draw of 2 BCF. He asked whether the fact

that now people are talking about 4 [BCF] affects it significantly.

MS. HEUSSER replied:

The 500-million barrel potential loss came with no qualifiers, except that rule 9 does allow for gas sales of 2 BCF per day, which equates to something like 2.7 BCF per day offtake. So ... if you're comparing apples to apples, we believe that's the correct context.

REPRESENTATIVE OGAN said he isn't a petroleum engineer, but it seems that if twice as much gas is drawn down as that rule allows, there will be more of a loss, faster.

MS. HEUSSER responded:

When you take out twice as much gas, your pressure decline does accelerate. And oil recovery is a function of pressure decline. So is it linear? ... I don't know the answer to that.

And I just had a note from Mark Myers: what you're seeing in your report right there is BP is quoting remaining reserves. And what I quoted you was total reserves. So ... they are pretty much saying the same thing.

REPRESENTATIVE OGAN said he would be curious to see how the total loss would "pencil out" with a 4 BCF draw.

MS. HEUSSER replied, "That is one of the things that we will be taking a look at, the effect of gas offtake or gas sales rate on the various recoveries."

SENATOR KELLY asked how much water will be able to replace the gas that might be removed. He also asked whether that is an unknown technology.

MS. HEUSSER answered that it isn't an unknown technology. She acknowledged that she would have to "talk around" this question, then stated:

The pressure support initiative will put gas in the gas cap area, and that will be a means to help the reservoir pressure decline - level off. However, in the water flood areas where we're currently injecting water, our voidage, our oil and water produced from those areas, is more than the water and gas being injected into those areas. And ... the very simple

reason behind that is reservoir management: when you overinject, you move fluids from one area to another and you have the potential to lose recovery. So it's not so simple as ... "you take one barrel of fluid out, or equivalent gas, and put one barrel of water in." It's never that easy. It's a function of where you do it and how you manage your reservoir.

SENATOR KELLY stated his understanding, then, that water is never going to be able to replace gas, although in some circumstances it could be used.

MS. HEUSSER replied, "I hate to use the word 'never.'"

SENATOR KELLY asked whether there are other reasons why water wouldn't be used, such as environmental reasons.

MS. HEUSSER answered:

I am not really the person to address that. I am not familiar with any environmental reasons that would preclude [it], except ... there may be some limit on the amount of seawater that can be taken from Prudhoe Bay and be available for gas-cap water injection. I understand their plans are to use seawater, as opposed to produced water.

MS. TAYLOR added:

I think that with respect to the areas in which we regulate the underground injection of water for purposes of enhanced recovery, there aren't any as long as the proposal is done according to our regulatory criteria. And I'm not aware of there being any difficulties in the Prudhoe area ... mechanically, with respect to environmental regulations. And that deals with the potential sources of drinking water. And we're not aware of any.

REPRESENTATIVE DAVIES returned to the question of timing. He asked when the AOGCC can begin the study. He acknowledged the need to have data and a more specific idea of what the development plan will be before a study will be optimal. He asked, however, whether there are other things the AOGCC can be doing now, following on the scoping study, to prepare to move ahead and to jump-start the process in order to keep the time to a year.

MS. TAYLOR replied:

Absent information - any sort of technical data - one of the reasons for the recommendation that we actually use the technical data provided by the operator - that they use to build their models - was so that you'd [have] some consistency.

A lot of technical information is provided by the operator to the state. The time it would take to put that information in a useful fashion, to do that same exercise, would be fairly overwhelming at this point. Our hope is to actually move forward on a decision about how to proceed with this evaluation so that we can actually begin the procurement process in terms of getting an RFP [request for proposals] out there and finding out more specifically what it would cost and who's out there available to do this kind of work, and hopefully that can be lined up ahead of time. We'll have a better indication in the next two to three weeks when we actually meet with the reservoir group at BP to hear more specifically about what their timing schedule looks like.

MS. HEUSSER added, "Using the working-interest owner data and quality checking that basically eliminates disagreements. It ... streamlines the whole process."

REPRESENTATIVE DAVIES asked, "Can you request that data in advance of an application?"

MS. HEUSSER answered yes.

REPRESENTATIVE DAVIES further asked, "Can you anticipate the sort of data you're going to need and then just simply request it?"

MS. HEUSSER replied:

Yes. In fact, we have done that. We have written to the operator and specifically outlined the type of information that we're looking for, and requested from them confirmation on the timing that we could expect to have that information. And that is what's prompting this meeting in approximately two to three weeks.

REPRESENTATIVE FATE commented that in several hearings it was stated, by the owners, that 4 BCF a day would have little or no effect on oil production. He expressed concern about the timing issue, saying [legislators] have been under the illusion "that they've been doing a study" and that there will be at least 4 BCF a day, or even 6 BCF a day. He stated:

Here we are now, backing up, talking about rule 9 and what has to be done ... to confirm either whether or not 2.7 billion a day is going to decrease or 4 billion is going to decrease the production of the remaining oil in Prudhoe Bay. And to me, Mr. Chairman, ... it's backing up the cart here, when we need to go forward with it. And we've been discussing 4 billion. Apparently, it's been an illusion. Is that correct? Is this an illusion?

MS. TAYLOR answered:

We're not privy to the information about the 4 BCF a day. Are you hearing that the 4 BCF are to be coming from the Prudhoe field, or are they coming from other places as well?

REPRESENTATIVE FATE responded:

We understand the Prudhoe field, because that's where most of the gas will be coming from. And we've been told this. So we just took it - or at least I certainly took it - to mean that there had been, certainly, studies on whether or not 4 BCF would in fact diminish the production of the oil.

MS. TAYLOR replied:

I guess we would be hopeful, then, that if the studies have already been done when we meet with them in two to three weeks, we would anticipate receiving information relatively quickly.

CHAIRMAN TORGERSON responded:

I don't know if they've really finished the studies, but I do know that we've plugged different numbers in for loss of oil in certain economic models that we've been running ... on the production, and most of those come from conversations with the producers ... or other places that would show a loss.

CHAIRMAN TORGERSON added that he understands Representative Fate's displeasure with finding out that there are a lot more hoops to jump through to sell gas. He said there are certain steps that it seems would be done first, and one is to get approval to sell it before spending \$100 million "to even see if you want to do it." He indicated that is one reason he wanted to hear from the AOGCC, to address concerns the committee has heard.

REPRESENTATIVE OGAN surmised that the AOGCC's decision could be litigated and overruled by the courts.

MS. TAYLOR affirmed that, specifying that any decision made by the commission can be appealed to the superior court.

CHAIRMAN TORGERSON thanked the presenters and said he would take them up on the offer to visit the AOGCC. He asked that they call his office after the upcoming meeting in order to provide a briefing. He noted that the next scheduled meeting for this committee will be in September, and he suggested it may be worthwhile to address the AOGCC's upcoming meeting as part of that agenda.

CHAIRMAN TORGERSON called an at-ease at 3:30 p.m. He called the meeting back to order at 3:33 p.m.

#### Department of Law

MR. JACK GRIFFIN, Assistant Attorney General, Oil, Gas & Mining Section, Civil Division (Anchorage), Department of Law, came forward, noting that he is the head of the Oil, Gas & Mining Section. He presented answers to the written questions posed to him earlier by Chairman Torgerson. He suggested the questions about overlifting were prompted at least in part by SCR 10; that dealt with a proposal by an entity called Netricity, which had an interesting idea for a gas development project on the North Slope involving an Internet "server farm."

MR. GRIFFIN paraphrased the introduction to his written response, which read [original punctuation and capitalization provided]:

#### INTRODUCTION AND GENERAL COMMENTS

What is overlifting and underlifting?

"Overlifting" and "underlifting" are terms used in agreements among two or more parties with interests in production that describe situations where one or more of the parties has, in a given production period, taken more or less production than that party's allocable share. If a party takes more than its share, it has overlifted its production; if less, it has underlifted. Generally speaking, when one party overlifts its production, one or more of the other parties will be underlifting – that is, receiving less than the share of production to which it is entitled.

For an example let us assume two parties, A and B, have equal production interests in a field, so that

each month each party is entitled to 50% of the hydrocarbon stream sold or removed from the field. If A incurs marketing or transportation problems in a month, he may find at the end of that month that he lifted only 45% of the field's production, while B has lifted 55%. A has underlifted his production, while B has overlifted his.

The parties with interests in production often agree in advance to the terms and conditions that govern the reconciliation that must occur in the event of overlifting or underlifting by the parties. These are sometimes called balancing agreements. Balancing may occur in a number of different ways, but perhaps the most common are by (1) adjusting the amount of production each party is entitled to lift in subsequent production periods, or (2) making cash payments.

In our example, balancing could occur by having A take 55% of the next month's production while B takes 45%. Assuming the production for both months was equal, A and B each would have received their 50% share over the two-month period. Alternatively, B – the overlifter – could simply pay A the cash value of the extra 5% of production that it had received that month.

The causes of overlifts and underlifts may include, but are not limited to: marketing problems of one or more party; governmental action in the form of legislation or regulation; disruption or absence of facilities for accepting an owner's share of production for some period of time; inability or refusal of a purchaser to take delivery of an owner's share of production for some period of time; unanticipated cessation or decline of production; drainage; and variations among parties as to information, expectation, and risk aversion. See Williams and Meyers, 11th ed., p. 78.

While overlifts and underlifts often occur because of unforeseen circumstances or slight hiccups in day-to-day operations, they can also be planned for and expressly negotiated. For example, parties with varying interests in production from several pools in a field may use overlifts and underlifts, instead of cash payments, to align their equity interests across the field. That is essentially what happened at Prudhoe Bay, among most of the working interest owners there, following the BP-ARCO merger and Phillips' acquisition of ARCO's Alaska assets.

What is the State's interest in production at Prudhoe that might be overlifted or underlifted?

The State, of course, has an interest in production from its North Slope leases. With respect to gas, those leases give the State the right to a royalty share of the gas that is "produced and saved and sold or used off [the lease] ...." Gas that is used for repressuring the reservoir, or for enhanced oil recovery, is not subject to a royalty obligation. At Prudhoe Bay, the State's royalty interest [under the leases] is generally 12.5%.

MR. GRIFFIN presented the first question posed by Chairman Torgerson and his own answer, which read:

I. OVERLIFTING

1) Are there any statutory provisions that are relevant? If so, what are they and why?

There are no statutory provisions that specifically address the State's ability to overlift oil or gas. Consistent with the general powers granted under the Alaska Land Act, AS 38.05, we believe the Commissioner of Natural Resources has inherent authority to negotiate an overlifting agreement with a producer or group of producers where the Commissioner concludes such an agreement furthers the best interests of the State. Assuming the Commissioner intends to commit the overlifted gas to a royalty in-kind (RIK) sale, AS 38.06.055(a) becomes relevant, as it provides that the RIK contract must be approved by the legislature.

MR. GRIFFIN went over the underlifting and overlifting basics again at a members' request. In response to a question by Representative Davies regarding whether the state would attach the royalties based on what should have been the right amount, he said in most circumstances when the overlifts and underlifts are "the little ... blips in production" [the state] doesn't pay attention to that. If someone has a 30 percent share in production, for example, the royalty will be based on that share, rather than looking at slight overlifts or underlifts in a particular month. However, if the parties have negotiated to overlift or underlift for an extended period, the state would probably look at that arrangement, ask how the royalty interest should apply, "and then go talk to them about it." He said it might go either way.

REPRESENTATIVE DAVIES noted that the state might have a different interest in the different shares.

MR. GRIFFIN agreed, adding, "That's why we might look at it differently." [Ends mid-speech because of tape change].

**TAPE 01-10, SIDE A**

MR. GRIFFIN concluded by saying a number of different factors must be considered. Except for a negotiated underlift or overlift, he reiterated, most of those little overlifts and underlifts "we look the other way on."

CHAIRMAN TORGERSON asked whether the balancing agreement that "was because of the merger between Phillips and ARCO" was finalized.

MR. GRIFFIN replied that he would need to check to be certain, but his understanding is that the overlifts and underlifts necessary to accomplish the realignment among the major working-interest owners has, in fact, ended.

CHAIRMAN TORGERSON said he was interested in the overall agreement; he asked whether it was finalized and signed off on, with the different provisions in it.

MR. GRIFFIN answered yes.

REPRESENTATIVE OGAN asked whether Chevron had been the "sticking point" in that realignment, and whether that had been worked out.

MR. GRIFFIN remarked that perhaps he'd misunderstood Chairman Torgerson's question. He then stated:

There isn't complete alignment at Prudhoe Bay. Right now, my understanding is that not all of the ... working-interest owners at Prudhoe Bay have aligned their interests. The agreement I was thinking of was the -- there is an agreement among some of the working-interest owners to align their interests as much as possible; that agreement has been signed. But the alignment at Prudhoe Bay is not complete.

CHAIRMAN TORGERSON asked what that means [for the state].

MR. GRIFFIN replied:

What it means might depend on the particular question.

I think that in terms of how the three largest working-

interest owners at Prudhoe Bay look at things, in a sense, they've been simplified. Now, the fact that there hasn't been complete realignment means that the ... Prudhoe Bay Operating Agreement, in all of its complexity, is still out there and still ... being followed - at least that's my understanding.

CHAIRMAN TORGERSON asked, "You're not negotiating that or in on the negotiations with the balancing agreement?"

MR. GRIFFIN said no.

CHAIRMAN TORGERSON asked who is handling that.

MR. GRIFFIN answered:

Right now, that is a commercial matter among the owners at Prudhoe Bay. Once they have been able to negotiate a complete alignment, they'll come to the Department of Natural Resources and request permission for the cross-assignment of leases to ... reflect the realignment, and the department will consider that request on its merits.

CHAIRMAN TORGERSON asked, "Is our 12.5 percent a party to that?"

MR. GRIFFIN replied, "We'll get our 12.5 percent no matter what happens."

CHAIRMAN TORGERSON asked whether the state is a signer on the agreement.

MR. GRIFFIN answered:

The state would not be a signer on the agreement between the companies, but the Department of Natural Resources has to approve any assignment of a lease interest. So in that sense, it can't happen without the Department of Natural Resources' blessing. My understanding would be that the Department of Natural Resources supports ... the companies' efforts to realign the interests at Prudhoe Bay.

SENATOR KELLY asked whether, with the agreement not finalized, everything could go back to "square one." He also asked whether there is just one holdout that needs to be addressed.

MR. GRIFFIN replied:

My understanding of the arrangements that are in place to date would be that we'd never go all the way back to square one. I think there are actually two companies ... that have not agreed to a complete realignment of their interests - I think Chevron and Texaco. ... There may be arrangements with one or both of the companies that I'm not aware of, but they certainly haven't come to the Department of Natural Resources with signed agreements reflecting the fact that ... everyone has aligned their interests. But ... over 90 percent of the interests at Prudhoe Bay have been realigned, and the fact that one or two ...

SENATOR KELLY interjected, asking whether that 90 percent is "carved in stone."

MR. GRIFFIN answered:

The department has approved the cross-assignment of lease interests ... for those working-interest owners at Prudhoe Bay who have aligned their interests. So, in that sense, it is ... carved in stone. It's not carved in stone in the sense that they could always come back to the Department of Natural Resources, I suppose, and ask to do something different. But ... I would doubt that very much.

CHAIRMAN TORGERSON returned attention to the presentation.

MR. GRIFFIN again paraphrased portions of the written response to question 1 regarding overlifting [text provided previously].

CHAIRMAN TORGERSON surmised that basically the state could do that with the permission of the producers.

MR. GRIFFIN said it would be a negotiation.

CHAIRMAN TORGERSON mentioned Netricity, which would take gas in advance of having a pipeline; it totally would be overlifting by the state, he suggested, because there wouldn't be any line at all. Chairman Torgerson remarked that he isn't sure legislation isn't needed. If, for example, the producers say the route is not economical "or we get beat out by some of their other projects around the world that they're working on," the state may want to take its 12.5 percent royalty in advance. He also said he wasn't sure it followed the examples laid out by Mr. Griffin.

MR. GRIFFIN pointed out that subsequent answers [to Chairman Torgerson's written questions] would address that.

MR. GRIFFIN paraphrased question 2 and the response, which read:

2) Are there any lease provisions that are relevant? If so, what are they and why?

The lease provisions that create the State's royalty interest in gas and its right to take its royalty gas in-kind are relevant, in the sense that they describe the production interest that would be "overlifted."

MR. GRIFFIN addressed the third question, which read, along with the response:

3) Is there an explicit right in any of the provisions? If not, is there an implied right?

There is no express or implied "right" under the leases for the State to overlift gas produced from Prudhoe Bay.

MR. GRIFFIN specified that there is no express or implied right in the leases for the state to unilaterally decide that it wants to take more than its royalty share of what is produced and removed or sold from the lease.

MR. GRIFFIN turned attention to question 4, which read, along with the response:

4) Has the Prudhoe Bay Unit Agreement or any other agreement between the state and the producers modified any of our rights?

Nothing in the Prudhoe Bay Unit Agreement or any other agreement between the State and the producers has created a right for the State to overlift its gas. If anything, these agreements reinforce the conclusion that the State has no "right" to unilaterally decide to take a quantity of gas that exceeds its royalty share of the gas stream that is currently being sold or used outside of the Unit.

MR. GRIFFIN paraphrased question 5 and the response, which read:

5) Assuming that under the current agreements or applicable law, there is a questionable right to take royalty in-kind before a major gas sale, is there a legislative fix that you could recommend?

The Department of Law cannot recommend a legislative fix at this time. The State has not decided that taking a large volume of gas in-kind before a major gas sale is in the State's best interests. Moreover, the producers have indicated a willingness to discuss the terms of a gas balancing agreement with the State in the event it wishes to pursue an actual sale of gas to Netricity. For its part, Netricity has also been talking to the producers about purchasing gas, and our understanding is that Netricity is currently working on a more detailed proposal that addresses some of the issues their initial proposal left unaddressed. The question of whether the State should pursue the Netricity proposal alone therefore may become moot.

Finally, while this may go without saying, legislation that would attempt to force the producers to provide the State a right under its leases that was not part of their original bargain is likely to run afoul of the Impairments of Contracts clause of the United States Constitution.

MR. GRIFFIN emphasized that should the Netricity scenario occur, the state would have to discuss how to make the producers whole later. For example, would there be a cash payment or a trade in production? And if the latter, at what time would that occur? All these would have to be talked about, as well as the physical steps necessary to take the gas from the field and "get it to our potential customer." Mr. Griffin added that to his understanding, Netricity has been talking to the producers about purchasing gas. He explained:

They came to us and talked to us. I think the Department of Natural Resources expressed some curiosity about why, if this was such a good deal, the producers didn't seem interested. And I think at that time Netricity just hadn't spoken with the producers.

I understand that since that time Netricity has spoken with the producers and, in fact, is ... in the process of putting together a more detailed proposal, to answer some of the questions that were presented to it that they weren't prepared to answer at their first set of meetings.

So I guess the point of that is, we may not have to enter this negotiation over what a gas balancing agreement is going to look like. We may not be pursuing that option on our own.

MR. GRIFFIN emphasized that if the legislature was trying to alter the terms of the deal that the producers struck when they first signed the leases with [the state], there would be a potential problem under the Impairments of Contracts clause of the U.S. constitution. There are many ways to get a result; however, the state probably shouldn't think about trying to change the terms of [producers'] agreements with the state through legislation.

MR. GRIFFIN turned attention to question 6, which read, along with the response:

6) In any event, what action has the administration taken to reach a voluntary gas balancing agreement with the producers so that the state could take its royalty gas in-kind before a major gas sale?

As indicated above, the producers have expressed a willingness to discuss such an agreement with the State. However, my understanding is that Netricity has informed DNR that it wishes to pursue its options with the producers. As a consequence, it has asked the State not to take any additional actions in furtherance of its initial proposal at this time. This suggests that the need for a gas balancing agreement with the producers may never materialize.

MR. GRIFFIN added that consistent with that, "we haven't been pushing the producers for a gas balancing agreement."

MR. GRIFFIN turned attention to underlifting. He pointed out that because underlifting is the corollary to overlifting, some answers would be parallel to the previous ones. He addressed question 1, which read, along with his response:

## II. UNDERLIFTING

1) Are there any statutory provisions that are relevant? If so, what are they and why?

AS 38.05.180(1) specifically addresses the Commissioner's authority to negotiate underlifting agreements. It provides:

Subject to the provisions of AS 31.05, the commissioner has discretion to enter into an agreement whereby, with the consent of the lessee, the state's royalty share of oil and gas production may be stored or retained in

storage by the lessee, or the commissioner may enter into an agreement with one or more of the affected field lease holders to trade current royalty production from a field for a like amount, kind, and quality of future production, on the condition that the state receives back its stored or traded royalty share during the first half of the estimated field life or no later than 15 years after start of production, whichever is sooner.

That statutory provision was adopted after the State negotiated the Prudhoe Bay Unit Agreement. During the negotiation of that agreement, the State sought to include an express provision allowing it to underlift Prudhoe Bay production. The State ultimately dropped that request.

MR. GRIFFIN noted that AS 38.05.180(1) addresses underlifting without actually using that term, and indicated AS 31.05 contains the conservation statutes. He pointed out that the statute in question reflects a preference for balancing with future production, as opposed to balancing with cash payments. As to why that statute exists, he told members:

This statute was adopted soon after we negotiated the Prudhoe Bay Unit Agreement. And in the course of negotiating that unit agreement, the state was in fact trying to include, within the confines of the unit agreement, a specific provision that would allow it to underlift ... oil and gas. And ultimately the state did not succeed in getting that into the unit agreement. At some point, we dropped ... the request. ... The legislative history is a little bit unclear on this, but ... the most natural reading of the history, I suppose, is that this ... particular provision was a natural outgrowth or consequence of not including the underlifting provision ... in the unit agreement.

MR. GRIFFIN turned attention to question 2, which read, along with his response:

2) Is there an explicit right in any of the [lease] provisions? If not, is there an implied right?

As with overlifting, there is no express or implied "right" under the leases for the State to underlift gas produced from Prudhoe Bay.

MR. GRIFFIN addressed question 3, which read, along with his response:

3) Has the Prudhoe Bay Unit Agreement or any other agreement between the state and the producers modified any of our rights?

Nothing in the Prudhoe Bay Unit Agreement or any other agreement between the state and the producers has created a right for the State to underlift its gas. As previously indicated, the State sought to include such a right in the Prudhoe Bay Unit Agreement, but was unsuccessful. If anything, the State's agreements with the producers reinforce the conclusion that the State has no "right" to unilaterally decide to take a quantity of gas that differs from its royalty share of the gas stream that is currently being sold or used outside of the Unit.

MR. GRIFFIN turned attention to question 4, which read, along with his response:

4) Assuming that under the current agreements or applicable law, there is no right to delay taking royalty in-kind after a major gas sale, is there a legislative fix that you [the Department of Law] could recommend?

The legislature adopted the appropriate fix when it enacted AS 38.05.180(1). As with overlifting, legislation that would attempt to force the producers to provide the State a right under its leases that was not part of their original bargain is likely to run afoul of the Impairments of Contracts clause of the United States Constitution.

MR. GRIFFIN added that in the department's view, AS 38.05.190(1) was the appropriate fix to the extent a fix was necessary. The caution about not changing the leases through legislation applies to unit agreements and other agreements, he noted.

MR. GRIFFIN next addressed question 5 and the response, which read:

5) Would a gas balancing agreement between the state and the producers be necessary for the state to underlift?

Yes.

MR. GRIFFIN turned attention to question 6, which read, along with the response:

6) Has the state ever entered into a gas balancing agreement with a producer?

Not on the North Slope and not to our knowledge in the Cook Inlet. However, we are still reviewing historical records of oil and gas production in the Cook Inlet to see if the State ever entered such an agreement.

MR. GRIFFIN turned attention to the next set of questions, relating to lease termination in the event that there is no gas pipeline. He paraphrased question 1 and the first part of the response, which read:

### III. LEASE TERMINATION

1) If the Producers assert that a gas line cannot be built and [as a consequence] fail to market the gas, can the state terminate the leases for breach of contract?

At Prudhoe Bay, where there are ongoing oil and gas production operations, the answer is almost certainly not.

The question that has been posed really has two parts. The first is whether the producers' failure to build a gasline and market the gas constitutes a breach of their leases or other agreements with the State. If so, the second part is whether termination of the leases is the appropriate remedy for that breach.

A decision by the [producers] not to build a gasline is unlikely to be a breach unless the State can show that the producers failed to exercise prudent business judgment in reaching that decision. This standard is also referred to as (or perhaps is a sub-part of) the reasonable prudent operator standard, and generally requires the lessee to act in good faith, exercise competence in making business judgments, and give due regard to the lessor's (the State's) interests.

REPRESENTATIVE OGAN asked whether "prudent business" includes prudent business within the state or would have to include a worldwide scope. He pointed out that there are projects competing with Alaskan gas. He offered Point Thomson as an

example, saying it has never really been developed and is "pretty much a gas field."

MR. GRIFFIN answered that he believes it is an interesting question. To his knowledge, he said, that has never really been addressed in any of the cases. He offered his belief that the state could well take the position that "the lessee's agreements are with us; that's what establishes our relationship; we don't have a relationship with their other business dealings throughout the world, and so the duty that is owed us is a reasonable, prudent judgment based on the merits of our project, and not how our project necessarily compares to other projects ... in the world." Mr. Griffin added that he doesn't know that the courts would accept that argument, but said, "I acknowledge that it could be an argument that we might raise."

MR. GRIFFIN noted that the second part of question 1 is what the appropriate remedy is, if it can be shown that there has been a breach. Would termination be the appropriate remedy? He told members that at Prudhoe Bay, he believes the answer is no. There are substantial investments at Prudhoe Bay, as well as ongoing oil and gas production operations. He paraphrased a portion of his written response, which read:

Assuming for the moment that the State could show that a decision not to build a gasline was the result of something other than prudent business judgment, the question of the appropriate remedy arises. Generally speaking, whether termination of an oil and gas lease is an appropriate remedy will depend on the particular facts in a given case. The general rule, however, is that a court will avoid remedies like termination where damages are adequate to redress the harm occasioned by the breach. A court is highly unlikely, in our view, to consider termination an appropriate remedy where, as at Prudhoe Bay, there are substantial investments and ongoing production operations by the lessees. It is also improbable, in our view, that the State would consider termination of the leases there to be in its best interests.

MR. GRIFFIN emphasized his belief that a court is unlikely to terminate unless it can be shown that an award of monetary damages is somehow inadequate. He doesn't believe the state would be able to say that the failure to build a gas line requires that the leases at Prudhoe Bay be terminated, and that there is no other adequate remedy.

MR. GRIFFIN read question 2 and paraphrased the response, which together read:

2) Are there any other provisions in the lease which the state can use to terminate the leases if the Producers declare the gas uneconomic to market?

Putting aside the question of whether termination is the appropriate remedy if the State could in fact show a breach, there are several implied covenants in the leases that might be invoked under appropriate circumstances [in defense of the state's rights]. These include the implied covenant to reasonably develop the leases, the implied covenant to market, the implied covenant of diligent and proper operation, and the implied covenant of good faith and fair dealing.

MR. GRIFFIN read question 3 and paraphrased the response, which read:

3) Assuming that the state does not approve the Producer's plan of development for Prudhoe Bay because it is not in the state's best interest, can the state terminate the Unit Agreement and the leases within that Unit?

If the producers' fail to comply with a DNR-approved plan of development at Prudhoe Bay, DNR may declare the Unit in default. 11 AAC 83.374. At that point it would be incumbent upon the State to seek appropriate relief from the courts. For the reasons already articulated, the courts probably would not consider termination of the Unit and the underlying leases an appropriate remedy.

MR. GRIFFIN explained that for each field on the North Slope, the producers are required to submit a plan of development to DNR. That is reviewed by the department and then, usually after some give and take, approved by DNR. The operator then continues to produce oil and/or gas from the field in accordance with that plan. This question asks what happens if an agreement cannot be reached and the department does not approve a plan.

MR. GRIFFIN again emphasized that at Prudhoe Bay it is highly unlikely the remedy chosen by the courts would be termination of leases. He added:

Again, it strikes me as ... at least hard to imagine that we would think that would be in our best interests, but it would be a situation [in] which we'd present arguments to the court, and it'd be up to the court to accept those arguments or choose some other

appropriate remedy, assuming, again, that the state could show a breach.

CHAIRMAN TORGERSON asked what would happen if [the state] showed it had another customer ready to go forward with some sort of high-volume usage, although not necessarily a pipeline, and the analysis by the producers was that it isn't economical. He said he would think the producers could certainly make a deal with that other person, and that if they refused to do so, the state would have a cause. He asked what Mr. Griffin thought.

MR. GRIFFIN answered:

Well, I guess my personal view is that a scenario in which we would think it'd be in the state's best interests to go forward with a project like that and the producers would not - and then the producers would not go the next step of trying to accommodate our interest in pursuing that proposal - would be somewhat unlikely. But I guess I acknowledge your "hypothetical," and I think that under the right circumstances you could, in fact, allege a breach and try and pursue some ... remedy there. ...

I think, to be fair to the producers, they - believe it or not - are interested in making money. And if you could make money off a proposal like that, they'd probably be interested.

Now, there may be a situation in which, for example, we don't think we need to make as much money as the producers feel they need to make. Well, then, then we're going to have a situation in which we're going to ask the producers to help us out on what to them would be money-losing proposition. But they say OK. So we enter into the arrangements and we have a situation in which we're selling gas at a price that is lower than the producers would be willing to accept on behalf of their shareholders.

Now, presumably the reason the producers would conclude that that price is too low is that they've got something else in mind. And so let's take the hypothetical further and say that what they've got in mind is a major gas sale. And then they'd build the gas project. And lo and behold, the price that they're getting is, in fact, much higher than the price we've committed to in our agreement with Netricity. ... We've created a rather unfortunate situation in which they are going to be, probably, a lot of hard feelings all

around, and the producers ... might feel that we might take it out on them because ... they weren't ... as forthcoming with us as they should have been in describing just how unprofitable this particular scheme was, or whatever. ...

What we generally try and do is find ways of aligning ourselves with ... the producers. And if we come to a point that we really want to do something and the producers really don't, ... we'll be talking a lot with them, and we may be talking a lot with you, as well. But we haven't reached that point yet. Netricity hasn't come forward with a proposal that is something that is detailed enough to justify the unqualified support of either the state or the producers.

CHAIRMAN TORGERSON responded:

Or me, as far as that goes. I'm not necessarily looking at Netricity, but there are other things out there. And I'm not saying either one of them are better. I'm not trying to give you names of different projects that may or may not be a little bit better. But the facts are, the producers sat on this for 27 years, haven't done much, and we have a lot of interest in moving this. And they're looking at a particular thing. And the question looms that if their project's uneconomical and they refuse to sell to somebody else, then what position are we in, in ... terminating the lease or doing other things?

MR. GRIFFIN replied, "Right. And with any luck, we won't have to face ... that particular scenario. But if we do, we do."

REPRESENTATIVE DAVIES followed up, specifying that he wasn't talking about the Netricity model, but a situation in which the state is willing to develop for a return on the investment that is considerably less than the companies might be willing to do it for. For example, a company could go through its "due diligence" and conclude that the return on investment at 10 percent is too low, and that a better return on the capital can be obtained elsewhere in the world, not even necessarily with gas; it would be a perfectly valid business decision. However, the state might be willing to build a pipeline and finance it for an investment return of 5 percent, and would see that as a perfectly valid investment because it would develop infrastructure and get gas to the citizens, for example. He asked, "Where are we then?" He also asked, "How do we get the gas?"

MR. GRIFFIN answered:

Well, we ask them for it. ... If they say no, I guess there are probably a number of hammers that the legislature could wield. The power to tax is the power to destroy; you've got the biggest hammer there is. And perhaps that's one reason why they are willing to talk to us, if that's really what we want to do. ... I suppose from their perspective, they'd look at it as ... if we want to hang ourselves, they'd sell us the rope. ...

As long as we're willing to pay for what we want, there's relatively little reason for them to say no, except, again, perhaps this fear of what's going to happen down the line. ... Let's take your example: We sell gas with the expectation of a 5 percent return on investment; they develop a gas project and are making 17.5 percent. Well, we're going to be paying ... for the gas that we overlifted to earn 5 percent with 17.5 percent gas. We're not going to be very happy about that. Or ... someone's going to make a deal today, and then ten years from now it's payback time, and the people who made the deal aren't going to be around. And the folks who are judging the deal ... are probably not going to be very happy. I think that sort of scenario makes the producers a little bit nervous.

I think they would like to be aligned with us on gas development projects. And alignment generally, I think, is what's contemplated in the leases and in the unit agreements. But I'd say we talk first; I think that will probably take care of it. And if it doesn't take care of it, I think that the state does have other options at its disposal, as unsavory as those options might be.

REPRESENTATIVE OGAN asked what happens if the "something else [that producers have] in mind" is to warehouse [the gas] another 27 years. He also asked whether that would give the state the legal ability to call it a breach of contract. He mentioned a paper written by Bob Bartlett at the Alaska constitutional convention about giving a property right to a corporation that will warehouse it until such time as the corporation sees fit to market it; Representative Ogan commented that it was prophetic.

MR. GRIFFIN responded, "I think from the companies' perspective, they would not warehouse gas ..."

REPRESENTATIVE OGAN interjected, "They have been."

MR. GRIFFIN replied:

That presumes that ... it would have been commercially reasonable to develop the gas before now. And I think that based on the work that we've done with our consultants, the work that the Department of Revenue has done, we could not conclude that it was unreasonable of them to not build a gas pipeline and enter a major gas sale before now.

Because a dollar today is worth a lot more than a dollar 27 years from now, I think that if these companies could profitably develop the gas today, ... that's what they would choose to do. I don't think, as a state, we would want them to develop the gas if it couldn't be done profitably. We want a royalty interest. We want there to be a slice of the pie that we can tax. That's how we benefit from these projects. ... The project would benefit us very little if, in fact, it was a money-losing proposition.

CHAIRMAN TORGERSON informed the committee that Mr. Jack Chenoweth [legal counsel from Legislative Legal Services] wouldn't testify that afternoon. He had asked Mr. Chenoweth and Mr. Griffin the same questions, he pointed out, but had also asked Mr. Chenoweth to respond to some questions he had asked FERC and the Washington, D.C., attorneys. However, Mr. Chenoweth had only responded to the latter questions. Therefore, Mr. Chenoweth's written responses to the FERC-related questions would be handed out at the following day's hearing.

MR. GRIFFIN turned attention to the next section. Question 1, along with the response, read:

#### IV. PRUDHOE BAY UNIT AMENDMENTS

1) Have there been changes in those agreements which affect the Producers' obligation to develop gas resources in Prudhoe Bay?

No. The producers have always had the obligation to develop Prudhoe Bay gas, assuming it is commercially reasonable to do so, and that obligation has not changed.

MR. GRIFFIN discussed question 2, which read, along with the response:

2) Were there any provisions in older versions of those agreements that were an impediment to gas development?

I assume you are referring here to the disparate ownership interests held by the working interest owners in the Oil Rim and Gas Cap of the Sadlerochit Reservoir in Prudhoe Bay. My understanding and belief is that these disparate ownership interests, and the agreements establishing these interests and the manner in which they would be operated, created no economic impediments to a major gas sale.

More specifically, the Department of Revenue analyzed this question at length and concluded that there were no provisions in those agreements that created an economic disincentive for any working interest owner at Prudhoe to develop a gas project capable of supporting a major gas sale. If such a project is economic, Revenue concluded that every working interest owner would have an incentive to participate in it.

It is nevertheless true that the source of each working interest owner's incentives varied, depending upon that owner's relative interests in the Oil Rim versus the Gas Cap. Speaking in very rough terms, a Gas Cap owner's incentives come primarily from the revenues generated by a major gas sale. An Oil Rim owner, however, derives many of its benefits another way: once there is a major gas sale, some of the costs of running the field are shifted from Oil Rim owners to Gas Cap owners. Nevertheless, at the end of the day, the incentives of these owners were aligned, even though their ownership interests were not. Of course, the analysis becomes complicated, because every working interest owner at Prudhoe owns interests in both the Oil Rim and the Gas Cap.

MR. GRIFFIN added that the cost-shifting happens under the agreements. Therefore, an oil rim owner also has an incentive to pursue a major gas sale. He concluded that the incentives are aligned, but the source of the incentives comes from different parts of the agreements.

MR. GRIFFIN turned attention to question 3, which read, along with the response:

3) Have those impediments been removed?

As indicated above, the claim that such impediments existed is not really accurate. The substantial realignment of interests at Prudhoe Bay has, however, greatly simplified the analysis. It has, moreover, created a situation where the economic incentives of the major producers are not only aligned, but also spring from exactly the same source.

MR. GRIFFIN added that the producers are all "looking at the picture the same way," which is a real benefit to the realignment, even though it didn't really change the economic question or answer.

MR. GRIFFIN addressed the fourth and final question, which read, along with the response:

4) If impediments remain, can the State terminate the leases unless the Producers agree to remove those impediments?

Again, we do not agree that the term "impediments" is accurate. To the extent that there were "misalignments" attributable to disparate ownership interests in the Gas Cap and the Oil Rim, those misalignments did not create an economic disincentive for a major gas sale. In addition, the Department of Natural Resources approved the disparate ownership interests between the Oil Rim and the Gas cap as part of the Prudhoe Bay Unit Agreement. It would not be appropriate to seek termination of the leases simply because the lessees have not completely realigned the interests that DNR previously approved.

REPRESENTATIVE OGAN turned to the issue of gas balancing and posed a hypothetical situation. There is no gas balancing agreement, and the three major producers are looking at a project. One wants it to go one way, but the other two prefer another way. He asked whether lack of a gas balancing agreement doesn't give that minority owner a "pocket veto," in essence, if that one owner doesn't agree to a route. He asked whether that could be used as leverage in negotiating with the other two, because if there is no gas balancing agreement, then the gas cannot be commercialized.

MR. GRIFFIN responded that a gas balancing arrangement is just one of a number of commercial arrangements that would have to take place among the working-interest owners. He added:

I don't think that the lack of a gas balancing agreement today would necessarily ...

**TAPE 01-10, SIDE B**

... inhibit commercial development if two out of three working-interest owners wanted to go their own way. I'm going to have to review the Prudhoe Bay Unit Operating Agreement again, but essentially ... there are balancing arrangements already in place among the working-interest owners. ... And it would probably be more appropriate ... for someone from the companies to answer this question. But I think that to the extent you're referring specifically to the existence of a gas balancing agreement - as I understand that term - that agreement may already exist in Article 39 of the Prudhoe Bay Unit Operating Agreement.

REPRESENTATIVE OGAN recalled that in testimony this year [before the House Special Committee on Oil and Gas] the companies said there isn't a gas balancing agreement. He again asked whether that could be used as leverage regarding the choice of a route if the three producers didn't agree.

MR. GRIFFIN replied:

I personally don't see how that could be used as a ... real lever in the discussions among the companies. ... The companies may have different views ... today about ... how particular aspects of gas development should be treated. But I think at the end of the day they're going to try and align themselves. ... I guess I just don't foresee the existence or lack thereof of a gas balancing agreement preventing them from ... getting together, because ultimately they will get together, one way or another.

REPRESENTATIVE OGAN remarked that he has talked directly with people who have been around the industry for a while, and who are directly involved with the "majors" who feel that that is a major factor. He said he was trying to determine Mr. Griffin's take on it, and whether he had firsthand knowledge.

MR. GRIFFIN specified that he didn't have firsthand knowledge.

SENATOR OLSON asked, "If there are changes in agreements - realizing that the district I represent is the North Slope - are there any significant negative effects to the local people up on the North Slope if some of these agreements are to be changed?"

MR. GRIFFIN replied:

The agreements I'm thinking of generally are the Prudhoe Bay Unit Agreement, the Prudhoe Bay Unit Operating Agreement, and perhaps the Point Thomson Unit Agreement and the Point Thomson Operating Agreement. ... I don't see that changes to any of those agreements should have negative effects on the people ... of the North Slope. Those changes will ... address the relative interests in each lease or participating area that the working-interest owners have. It'll be a shuffling of interests.

Of course, once a gas project is built, or ... as it's being built, ... there's going to be a number of effects on the people on the North Slope, and I'm not really prepared to address those effects.

CHAIRMAN TORGERSON asked whether Mr. Griffin's understanding is that the balancing agreements that were negotiated because of the ARCO-Phillips merger are public documents.

MR. GRIFFIN answered that he doesn't believe they are.

CHAIRMAN TORGERSON asked if Mr. Griffin would venture to guess why that is.

MR. GRIFFIN replied:

The reason I have them and they are not public is that I obtained them under the investigative powers of the attorney general, as part of the merger investigation. And there are fairly strict confidentiality requirements that attach to investigations like that. ... As a rule, private companies don't share their commercial negotiations and ... their commercial arrangements publicly.

CHAIRMAN TORGERSON expressed his understanding that the legislature has a request in, from Mr. Jack Chenoweth, for copies. He stated:

Initially we were told it was confidential, and then were told later that they'd get us one Xeroxed copy of it so that we could review those ... as to how they may affect the old agreements versus the new ones, because, quite honestly, this is like a mysterious document out there that nobody wants to talk about. ...

I can't tell you if the state's interests were protected or not, and neither can you, apparently, because you've ... conflicted yourself out by saying

[they're] confidential. So ... if you obtained them that way, I'm assuming you can't speak about them or what's in them to any degree .... I think it's important that our Legislative Legal [Services] review those documents, which I understand are six volumes, versus the Prudhoe Bay Unit Agreement was one volume, and that was negotiated however many years ago. ... I can't believe it's the same information and nothing's changed .... I believe we do have a request in, to get those documents.

MR. GRIFFIN replied, "I think you should review those. I was under the impression that the legislature had, in fact, been privy to some of that information during the merger, but perhaps I'm wrong."

CHAIRMAN TORGERSON responded:

Well, they probably were, but the people on that committee were conflicted out also. They signed a confidentiality agreement that lasts beyond life. ... Whoever drafted that one was a dandy, but I wouldn't [sign] it myself because it would just [prevent] you from being able to discuss it ... in any event, at any time, in any case, the way I read the thing. ... But I'm not looking for that to be presented to this committee in a confidential form, because I won't do that. I don't think it needs to be confidential, or nothing that I [am] going to review is going to be confidential, from my point of view.

REPRESENTATIVE DAVIES said to Mr. Griffin:

In answer to one of the questions earlier, you said that the state's interest - I think ... you were talking about alignment with the industry ... and that our interest was, I took you to be saying, entirely within our ability to tax and to get severance taxes and royalties off the development of the gas. ...

I wanted to ask you to broaden the consideration to lower energy costs for citizens if gas were available, and the possible development of petrochemical industries and those kinds of things, and how do we balance those interests of the State of Alaska with the severance taxes and royalties. Clearly, there are scenarios where ... it would be in our collective interest to ... have a lower wellhead value and have the gas produced, because of these other benefits. ...

What's the calculation that we do to make that decision?

MR. GRIFFIN answered:

That's a good question. I didn't mean to suggest that ... the legislature's only power in this regard applied to its tax regime. ... I was speaking in terms of ... what the appropriate mechanism is ... in which to accomplish particular objectives, and what the objectives are, I think, as a policy choice that's given to the legislature. And I think you can certainly make tradeoffs between wellhead value and other interests - gas to local communities and the like.

Again, I was just suggesting that you don't want to try and accomplish those objectives by changing the terms of the leases that the state has with the producers. You want to pick other mechanisms for accomplishing those objectives, and there may be many different ways of accomplishing those objectives. ... There may be ways in which we take our royalty in kind and devote it to ... the interests you've described, or we create tax incentives for certain types of conduct that accomplish the legislature's goals. I think it is up to you to come up with what the appropriate goals are, and then there are a number of different ways, probably, to accomplish those goals.

Personally, though, in any sort of tradeoff like that, ... I don't like trading wellhead value unless someone can show me that ... when you add the benefits of the jobs and the benefits of the local gas use, that you come out with greater economic benefit than you would get from just taking that wellhead value and paying for the gas or paying for the jobs yourself. So ... we want to be careful, when we start trading wellhead value for something, to make sure that we actually get what we're paying for.

CHAIRMAN TORGERSON thanked Mr. Griffin and asked whether there were further questions; none were offered.

CHAIRMAN TORGERSON called an at-ease at 4:47 p.m. He called the meeting back to order at 5:03 p.m.

Gas Pipeline Office

CHAIRMAN TORGERSON reminded members that although Mr. Bill Britt had given a lengthy presentation at the July committee meeting, he had been invited to update the committee on the status of the memorandums of understanding (MOUs) with the producers and Foothills Pipe Lines, as well as anything else that may be going on with the [Gas] Pipeline Office.

MR. WILLIAM G. BRITT, JR., State Pipeline Coordinator, Department of Natural Resources, came forward, noting that he was tasked by Administrative Order 187 with setting up the office that will be responsible for permitting natural gas pipelines to move North Slope gas to market, and for overseeing construction of pipelines. He offered a list of activities and accomplishments [in committee packets]. The first section read [original punctuation and capitalization provided]:

Gas Pipeline Office  
Activities and Accomplishments

Project Proponent Relations

- 1 We began work planning with Foothills Pipe Lines on July 26. Follow-up will occur on August 16 and 17.
- 2 Work planning with the producers' consortium will begin on August 23.
- 3 DFG [Department of Fish and Game] approved the producers' consultants' fish collection permit.
- 4 Meetings have occurred with representatives of El Paso, Williams, and Anadarko.

MR. BRITT turned attention to the second portion of the list, which read:

Federal Relations

- 5 BLM [Bureau of Land Management] assigned a liaison to the GPO [Gas Pipeline Office]. Discussions are underway with MMS [Minerals Management Service] for assignment of a liaison.
- 6 The GPC [Gas Pipeline Coordinator] and BLM liaison to GPO were briefed on DOI/DOE/FERC cooperative efforts on August 9.
- 7 Travel to DC [by Mr. Britt] is tentatively scheduled for mid-September to attend the North American Natural Gas Forum and to coordinate with FERC and DOE staff.

MR. BRITT explained that the liaison assigned by BLM is an engineer with a petroleum pipeline background. He also noted that there is an ongoing relationship with MMS in the State Pipeline Coordinator's office because of the "Liberty project."

He reported that the Gas Pipeline Coordinator is himself, and said DOI/DOE/FERC refers to a task force among the [U.S.] Department of the Interior, the Department of Energy, and FERC, formed pursuant to the President's energy policy to figure out how to cooperate on a variety of issues including a gas pipeline. He pointed out that in his travels to Washington, D.C., he plans to have staff-level interactions with both FERC and the Department of Energy; at that point, he will have relationships going with all of the major federal agencies that he believes the state needs to cooperate with.

MR. BRITT addressed the next portion of the list, which read:

#### Legislative Relations

- 8 The GPC provided testimony at the Joint Committee on Natural Gas Pipelines on July 17 and August 14.
- 9 The GPC and the DFG and DEC [Department of Environmental Conservation] liaisons to the GPO provided testimony at the Alaska Highway Natural Gas Policy Council on August 2.

MR. BRITT turned attention to the next portion, which read:

#### Media Relations

- 10 The GPC was interviewed by the Journal of Commerce on July 19.
- 11 The GPC was interviewed by Petroleum News Alaska on July 27.

MR. BRITT commented, "Fortunately, I believe, we have not received a great deal of media relations, so we've been able to concentrate on other things. A couple of folks have picked up on the opening of the office and the signing of the reimbursement MOUs, and so I've conducted a couple of interviews."

MR. BRITT turned attention to the next portion, which read:

#### Financial

- 12 LB&A [Legislative Budget and Audit Committee] approval for the Chairman [Therriault] to release funds to DNR occurred on July 17. Commissioner Pourchot received Senator Therriault's letter approving the first expenditures of general funds on July 18.
- 13 The reimbursement MOU with Foothills Pipe Lines was signed on July 18.
- 14 The reimbursement MOU with the producers was signed on August 1.

15 RSA forms for state agencies were completed the week of July 30. Detailed attachments have been completed for DEC and DFG.

16 Collocation codes have been established for all GPO agencies.

MR. BRITT clarified that the state agencies mentioned above regarding RSA forms are the other agencies that will be participants in the Gas Pipeline Office. The accounting functions have been set up with those agencies to track the money and make sure everything stays straight.

MR. BRITT turned attention to staffing, noting that the GPO has begun to staff up, although it is still relatively small in numbers. That portion of the list read:

#### GPO Staffing

17 Liaisons from DEC and DFG have been hired and are on the job.

18 The DFG Design and Permitting Coordinator has been hired and is on the job.

19 The DFG Field Inspection and Compliance Coordinator has been hired and is on the job.

20 Recruitment for DFG Habitat Biologists III is underway.

21 Recruitment for the DOT [Department of Transportation and Public Facilities] liaison should begin soon.

22 Recruitment for the DGC [Division of Governmental Coordination] liaison should begin soon.

23 The GPO Administrative Manager has been hired and will begin work soon.

24 Recruitment for the Deputy GPC is underway. Display ads ran in Anchorage, Fairbanks, and Juneau papers last weekend.

25 Two Assistant Attorneys General have been assigned to assist the GPO on an as-needed basis.

26

MR. BRITT concluded by informing members that the GPO moved into its temporary offices in the Atwood Building on August 10 and will be there for the next four and a half months or so.

CHAIRMAN TORGERSON said he has been hearing rumors that the producers may have reduced their scope of work. He asked whether there is any truth to that.

MR. BRITT answered that he hadn't heard that, and hadn't seen much evidence of it, so he didn't know.

REPRESENTATIVE OGAN expressed concern with the appropriation that was approved, saying it creates new divisions of bureaus. Once this work is done, he asked, are these positions going to go away? He acknowledged that Mr. Britt couldn't speak for other portions of the administration, but asked whether these people are being told they are going to work themselves out of a job, for example.

MR. BRITT replied:

The Gas Pipeline Office has always been viewed as an entity with a sunset clause. And the administrative order speaks to it, and I believe, and I've said it out loud: The Gas Pipeline Office's purpose in life is to permit the project and to oversee construction; when a gas pipeline is operational, it will return to the Joint Pipeline Office, which is where the rest of the operational pipelines exist, and that's exactly where it should go.

REPRESENTATIVE OGAN asked, "What if it takes another 27 years? Will you be coming to the legislature next year for an appropriation, and the year after, and the year after?"

MR. BRITT answered, "I'll stop somewhere before 27 years. ... At the point that the majority of our funding is not through reimbursement, I would expect the patience with the Gas Pipeline Office to wear fairly thin, fairly fast."

REPRESENTATIVE FATE asked why there must be a new hire for the Alaska Department of Fish and Game habitat biologist, rather than recruiting someone interdepartmentally.

MR. BRITT responded that the liaison came from within the Alaska Department of Fish and Game. He added that he believes both those positions were filled by people from within the Alaska Department of Fish and Game; they are new positions because that department's resources were such that it couldn't simply move a position from another program and short-hand that other program. Mr. Britt offered his belief that the DEC liaison, recruited from outside of state government, may be the only current GPO employee who wasn't already a state employee at the time of accepting a position there.

CHAIRMAN TORGERSON reminded members that at the last meeting he'd raised concern about the administration's and the legislature's going down parallel courses and not talking much to each other. He noted that right before coming to Fairbanks, he'd received a letter from Commissioner Pourchot saying he wants to work with the legislature and this committee; Commissioner Pourchot had

also asked Chairman Torgerson for suggestions on how he might communicate better. Chairman Torgerson asked Mr. Britt whether he does weekly updates for the public, for example, and whether he could include the committee.

MR. BRITT answered:

I'm not doing that right now, Senator Torgerson, but I'm at the point where the activities are such that a weekly update wouldn't be too short and boring. So it's probably time to begin preparing periodic updates for a variety of folks, and I'd be happy to include you on the list.

CHAIRMAN TORGERSON replied that he appreciated that, but wasn't quite sure what the best way to interact would be. He said information is not free-flowing, and that needs to be addressed. Whether it is what Mr. Britt proposed for every office, he indicated, he wasn't sure, but he suggested that wouldn't be too time-consuming.

MR. BRITT responded:

No, I don't think so. My expectation was, with the general funds from LB&A, that I would be in as frequent a contact with Senator Therriault as he wished to be briefed on what was going on and how the money was being spent. And I would certainly offer the same thing to you or any other member of this committee. If you ever would like a status report on any of these topics or anything else within the Gas Pipeline Office, please give me a call.

CHAIRMAN TORGERSON asked whether there were further questions or comments; none were offered. He thanked Mr. Britt for the update.

#### Testimony - North Slope Borough Assembly

MR. MIKE AAMODT, Member, North Slope Borough Assembly, North Slope Borough, came forward to testify as follows:

My name is Mike Aamodt. I've lived on the North Slope for 29 years, and I've been on the North Slope Borough Assembly for 14 years. I am currently the Assembly vice-president.

Thank you for the opportunity to address the Joint Committee on Natural Gas Pipelines. For more than a quarter of a century, the people of the North Slope

have played an active role in Alaska's oil and gas development. Ever since the first oil flowed from Prudhoe Bay, North Slope residents have worked in partnership with the state and the industry to expedite development and at the same time protect the land and wildlife that feed the people that I am married into and form the spiritual core of Inupiat culture.

We believe natural gas development is the next logical step in the North Slope resource extraction. We salute the legislature and the governor for firm support of a highway route in delivering gas to market. The highway route makes a lot of sense because it increases the potential for in-state use of gas. This can help to create new industries along the route and keep communities viable, especially in rural areas where energy costs are so high.

Most important to residents of the North Slope Borough is that the highway route makes the best environmental sense. By using the existing pipeline corridor instead of the ice-choked Beaufort Sea, the highway route minimizes damage to the land and the risk to the wildlife. From our perspective, putting a pipe out in the Beaufort Sea is just asking for trouble.

When the Alaska Highway Natural Gas Policy Council held a hearing in Barrow a few weeks ago, many whaling captains and elders showed up to tell the committee about the current and wind-driven forces of ice that they've seen out in the ocean. It's going to take more than a few feet of ocean floor to protect the pipeline in the Beaufort Sea. That's why the North Slope Borough, the Alaska Eskimo Whaling Commission, the whaling captains association, and other local organizations have expressed opposition to the over-the-top route.

In the short term, any summer construction activity will disrupt the bowhead whale migration around Kaktovik, Nuiqsut and Barrow. This is unacceptable. In the overall scheme of things, three small communities are probably meaningless when the cost savings of the northern route is considered. But for the people dependent on that resource, the loss is beyond value.

Apart from the concern over where the pipeline goes, there is also the political and economic question of how to make it happen. The North Slope Borough took an

early interest in the possibility of public-sector involvement in financing the gas line.

As a member of the Alaska Gasline Port Authority, we explored finance options as mechanisms for lowering the effective cost to industry and maximizing the return to the state and communities all over Alaska. The port authority has sponsored some good discussion and has brought consultants with relevant expertise to the state.

However, now that your committee and the governor's gas policy council have commenced hearings, the borough believes it should defer to both groups and wait for the results of these hearings.

The North Slope Borough will remain open to all development scenarios under consideration, including the port authority. We also want to see the results of industry efforts through the Consortium Group and the Sponsor Group.

We feel so strongly about [this] that the North Slope Borough Assembly has passed resolution 44-2001 to put our position on the record. That resolution says, in part: ...

1. The North Slope Assembly supports the administration's current efforts to use borough participation in the port authority as one means of encouraging the development of North Slope natural gas resources;
2. The Assembly believes it is in the borough's best interests for the port authority, at the present time, not to expand its role until other development strategies are fully explored; and
3. The Assembly supports the administration's continued effort to take into account the entire political picture and pursue ... and support the natural gas development strategy which will best protect the borough's tax base and method of taxation, and ensure the continued vitality of the economic and political structure of the North Slope Borough.

I need to make one comment about resource revenues. We have been approached by the producers and asked to consider support for the over-the-top route. While we are predisposed not to grant that request, we are getting such mixed messages from the legislature that it's hard to tell where the greater danger lies.

It is fitting that our testimony is given in Fairbanks, because on the one hand, the legislature wants us to join in promotion of the highway route so that Fairbanks and other parts of the Interior can benefit, but at the same time the North Slope Borough is under intense and very pointed attack from Fairbanks legislative leaders over our method of resource taxation and our ability to issue bonds. That is not exactly the kind of gesture you make to a development partner.

In the meantime, our interests and concerns remain constant. We support the statewide effort to develop our natural gas resources. We strongly favor transportation down the existing pipeline corridor and the Alaska Highway. This is consistent with our preference for onshore development, instead of taking unnecessary risks out in the unstable icepack of the Beaufort Sea. Also, it will ... occur largely within the existing resource development area, which helps to confine the impacts to our land and wildlife. Finally, gas development will help to sustain the state and local revenue stream.

After all, we are partners in resource development, and the borough looks forward to working together with you for the good of Alaska. We look forward to the results of your work in this committee and to the continued partnership in the reasonable development of the resources we've been blessed with. We are all in this together, and through mutual respect, we can achieve the goals of all Alaskans.

MR. AAMODT concluded by saying that is the report from the borough's administration and the assembly. It may not represent his own feelings completely, but represents the group.

REPRESENTATIVE OGAN inquired about Mr. Aamodt's comment about receiving mixed messages from the legislature. He remarked that he doesn't believe there has been any mixed message from the legislature about the route.

MR. AAMODT responded:

The mixed messages I'm referring to are attacks on our taxing authority and our ability to sell bonds. It's becoming a little bit difficult to sustain our way of existence with the way the legislature has come at us in the past. I don't think that's going to continue, though.

CHAIRMAN TORGERSON thanked Mr. Aamodt for his testimony.

REPRESENTATIVE JOULE commented that with the effort to open the Arctic National Wildlife Refuge (ANWR) [to development], he would like to thank the people of the North Slope for their active role in that endeavor. He concluded, "It's greatly appreciated, because we are being partners in a lot of ways."

CHAIRMAN TORGERSON agreed with Representative Joule and related a story about being in Washington, D.C., mentioning two women who had done an excellent job of lobbying on behalf of opening ANWR.

#### Alaska Highway Natural Gas Policy Council

MR. JIM SAMPSON, Co-Chair, Alaska Highway Natural Gas Policy Council, came forward to provide an update, noting that the other co-chair is Mr. Frank Brown. He informed members that with him were Mr. Charlie Cole, who chairs the council's Federal/International Action subcommittee, and Mr. Ken Freeman, special assistant to the governor, who also provides staff to the council.

MR. SAMPSON reported that since the last time the council came before the committee, it has continued public hearings throughout the state on the issue of a gas pipeline. Public hearings have been held in Barrow (July 19) and Juneau (August 2), and the final meeting is scheduled in Valdez (August 23).

MR. SAMPSON reported that the council's subcommittees continue to meet, looking at issues important to the commercialization of Alaska's natural gas. Those efforts are led by five subcommittee chairs: Mr. Cole chairs the Federal/International Action group; Mr. Bill Corbus heads the State Pipeline Ownership and Tax Structure group; Mr. Mike Navarre heads the Alaska Hire/Buy/Build group; Ms. Peg Tileston leads the Environmental Considerations group; and Mr. Ken Thompson leads the Access for In-State Gas Use and Future Opportunities group.

MR. SAMPSON expressed hope that in the next four or five weeks, subcommittee chairs will start putting on paper their recommendations on issues they've been discussing in subcommittee. It is hoped that the first draft of the council's

report will be completed between the first and middle of October, with a final report to the governor by November 30. Mr. Sampson deferred to Mr. Cole to discuss issues relating to his subcommittee.

MR. CHARLES E. COLE, Chair, Federal-International Subcommittee, Alaska Highway Natural Gas Policy Council, informed members that the meeting in Barrow was "very successful." From that hearing, the council learned of the intense opposition to a pipeline route across the Beaufort Sea. He noted that he had encouraged the administration to transcribe that testimony so that it will be available for anyone who wishes to look at it. He added, "It was dramatic and telling."

MR. COLE reported that he'd arranged a meeting of his subcommittee at which Mr. John Katz and Mr. Bob Loeffler testified; he'd recorded that testimony and had it transcribed [copy in packets.] Important was testimony from Mr. Katz and Mr. Loeffler about [draft] legislation provided to U.S. Senator Murkowski and perhaps other members of the U.S. Senate from the producers. [That draft legislation, dated July 19, 2001, and titled "Alaska Natural Gas Pipeline Act of 2001, is also included in committee packets.]

MR. COLE further reported that when [Mr. Katz and Mr. Loeffler] were asked whether the proposed legislation is route-neutral, they said no, in their view. He suggested that committee members may want to use that transcribed testimony to further their interrogation of Mr. Katz and Mr. Loeffler at the following day's hearing. [He noted that Ms. Esther Wunnicke's name was misspelled in the transcript, and that Representative Ethan Berkowitz was inadvertently referred to as the Speaker.]

MR. COLE also noted that discussed was the effect of the treaty between the United States and Canada regarding the ANGTS [Alaska Natural Gas Transportation System] route; he indicated the views of Mr. Katz and Mr. Loeffler on that are contained in the transcript as well.

MR. COLE informed members that at his suggestion, Mr. Rigdon Boykin had drafted another version of federal legislation [provided in packets] that proposes to just amend [the Alaska Natural Gas Transportation Act of 1976 (ANGTA)] to clear up problems it poses to a highway route now. By contrast, the producers' legislation is designed to favor a Beaufort Sea route. Mr. Cole concluded by emphasizing the need to cooperate and by offering any information that the council is able to generate.

MR. COLE noted that he had comments to make on other testimony as well. He recalled about ten years ago [when he himself was

attorney general] that he and Commissioner Harold Heinz [of DNR] looked at the producers' implied obligation to develop the gas at Prudhoe Bay; the principal consideration they talked about was whether that gas was needed economically to further the extraction of oil from Prudhoe Bay. He remarked, "Well, it raised such a hue and cry when we even mentioned that we were looking at it, that for some reason or other the whole subject was dropped."

MR. COLE suggested it might be good for the legislature to look aggressively at the implied obligation to develop, "because I have the sense, to the extent that that obligation exists, that ... a lessee of oil and gas leases ought not to be able to defer the development of those reserves essentially in perpetuity until the lessee concludes, 'Well, I've got a bonanza here now, and it's time to do something,' and to remain sort of silent up until that time." He said there must be a lot of law on that point, and an able legal scholar might be helpful to this committee in looking at those cases. He added, "If you find ... they pass the 'red face' test, then you can write that letter and say, 'Hey, ... it's time ... to put up or shut up or say goodbye.' And that's pretty bold talk, but, ... it's gone on for years and years, and something has to happen."

MR. COLE also commented that as he looks at the statutes and what happens with respect to Alaska's oil lands, so often one runs across this confidentiality; many times, citizens of this state just can't find out what's going on with respect to their prized reserves. [Not on the tape but recorded in the log notes was that he believes the best government is when the people have full knowledge of what is going on with their resources.]

**TAPE 01-11, SIDE A**

MR. KEN FREEMAN, Special Assistant, Gasline & Business Development, Office of the Governor, told members:

One of the interesting things we learned in Southeast Alaska, actually, is how much Southeast sees the potential benefits from a highway project as well. We heard from the cities of Haines and Skagway, in particular, who see themselves as a very important link in terms of moving people and materials up Lynn Canal and into Canada. ... They're taking this very seriously in terms of maybe even potentially expanding the facilities at their docks.

We also heard from the Juneau Chamber of Commerce and Southeast Conference on even Juneau's perception, hopefully, that they would even have some economic

benefits also of materials and people moving up Lynn Canal. And interestingly enough, ... we've talked about potential linking of other opportunities in Anchorage and Valdez off an Alaska Highway project; Haines also sees an opportunity for itself to have an LNG [liquefied natural gas] facility.

Bill Corbus's committee met all day yesterday - the state ownership and tax structure committee - and I think he's making some good progress and wants to interface with this group as much as possible, in terms of how he starts to formulate some of his recommendations.

And lastly, I just wanted to mention: I think the last meeting we discussed a trip we made to Austin, Texas, a couple of the gas policy council members; we met with their division of lands, learned a little bit about how Texas takes its gas, in kind versus in value. They take about half their gas in kind, and about half the time make more money on it than they would in value. We've invited an individual up from Texas to join us September 17th, and we'd like to make him available to you if you have an interest in that.

MR. SAMPSON commended Chairman Torgerson and the committee for the leadership role in the legislature on the issue of oil and gas, noting that there will be a lot of expertise. He also commended members for going to Canada, saying he believes it will be worthwhile. He said the council looks forward to continuing to work with the committee as it finalizes its report to the governor.

CHAIRMAN TORGERSON thanked council members for their comments, noting that Mr. Bill Corbus had called him and invited him to the meeting; however, he was in Fairbanks, so it didn't work out. He added, "We are going to exchange data and information back and forth." He noted that Commissioner Condon would go through some of that at the following day's hearing. Furthermore, the administration has made Mr. Pedro van Meurs available to the committee, beginning with a teleconference on the 18th between mainly Mr. Van Meurs and Chairman Torgerson, "setting down the groundwork on where we're going to go on the severance taxes and some of the other things." He added, "Most everything that I do, if not all of it, I want to make public." He offered to interact in any way possible with the council.

CHAIRMAN TORGERSON asked whether there were further comments; none were offered.

Public Testimony

CHAIRMAN TORGERSON announced that the committee would hear further public testimony.

KEITH HAND, Fairbanks Natural Gas, came forward to testify, noting that Fairbanks Natural Gas is a certificated utility. He explained that there is, indeed, natural gas in Fairbanks, with LNG being trucked up from Cook Inlet. He said Fairbanks Natural Gas has been widely accepted with enthusiasm from a lot of people in the community; he mostly supports the committee's worthwhile efforts, and would offer statements that he believes to be common and generally representative of most residents of Fairbanks and the Interior.

MR. HAND referred to gas available for Alaskans, not only for heat but also for electricity. He reported that the local utility, Golden Valley Electric Association (GVEA), obtains a substantial amount of its power from "Cook Inlet gas, ... the intertie." Future ancillary industries are very important to the Interior, he said, and are being studied by a plethora of entities; he cited Williams [Companies] and El Paso [Energy Corporation] as two.

MR. HAND brought up a second point: availability at an equitable price via netback pricing, tariffs, and perhaps royalty gas tagged for in-state use; he suggested those might be solutions to dampen any price spikes caused by Lower 48 energy crises.

MR. HAND encouraged infrastructure development prior to when a gas line becomes available to the people. If a pipeline comes through town and there is no infrastructure to support it, there will be no benefit from that pipeline for several years. Just as the pipeline will demand a high amount of "labor and brains" to build it, so, too, will the infrastructure require that expertise in pipeline capabilities. He concluded by saying the following:

I'd just like to leave you with the goal to unite and conquer. Currently, there are three government entities ... focusing on the pipeline: ... yourselves, ... the governor's policy council, and the ... three mayors of Valdez, North Slope, and Fairbanks - powerful mayors - have also had their own group in the [Alaska Gasline] Port Authority; of course, they have ... kind of a different agenda. But obviously these three groups should have the common goal of the top three points I've identified. And these government entities really should stand together, I believe, provide a united front with one another, and one strong voice championing the best interests of the State of Alaska,

its communities, and its residents, because everyone should be sharing the same goals [rather than] having three weaker voices and three different groups to approach .... Each time, it seems a bit redundant, and I think if everyone pooled their interests, it'd be a better product, a faster result, and a stronger group.

CHAIRMAN TORGERSON thanked Mr. Hand and asked if there were questions; none were offered. He then asked whether anyone else wished to testify; there was no response. He closed the public testimony.

CHAIRMAN TORGERSON reminded members that there was a reception sponsored by the Fairbanks North Star Borough and the Fairbanks Chamber of Commerce that evening at 6 p.m.

CHAIRMAN TORGERSON thanked participants and adjourned the meeting at 5:46 p.m.