ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS
March 11, 2003
3:23 p.m.

MEMBERS PRESENT

Representative Vic Kohring, Chair
Representative Mike Chenault, Vice Chair
Representative Hugh Fate
Representative Lesil McGuire
Representative Norman Rokeberg
Representative Harry Crawford
Representative Beth Kerttula

MEMBERS ABSENT

All members present

OTHER LEGISLATORS PRESENT

Representative Jim Holm

COMMITTEE CALENDAR

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 28
"An Act relating to adjustments to royalty reserved to the state to encourage otherwise uneconomic production of oil and gas; and providing for an effective date."

- MOVED CSSSHB 28(O&G) OUT OF COMMITTEE

PREVIOUS ACTION

BILL: HB 28
SHORT TITLE:OIL & GAS ROYALTY MODIFICATION
SPONSOR(S): REPRESENTATIVE(S)KOHRING, ROKEBERG

Jrn-Date	Jrn-Page		Action
01/21/03	0039	(H)	PREFILE RELEASED (1/10/03)
01/21/03	0039	(H)	READ THE FIRST TIME - REFERRALS
01/21/03	0039	(H)	O&G, RES, FIN
02/19/03	0246	(H)	SPONSOR SUBSTITUTE INTRODUCED
02/19/03	0246	(H)	READ THE FIRST TIME - REFERRALS
02/19/03	0246	(H)	O&G, RES, FIN

02/20/03	(H)	O&G AT 3:15 PM CAPITOL 124
02/20/03	(H)	Heard & Held
02/20/03	(H)	MINUTE(O&G)
03/11/03	(H)	O&G AT 3:15 PM CAPITOL 124

WITNESS REGISTER

MARK MYERS, Director
Division of Oil & Gas
Department of Natural Resources (DNR)
Anchorage, Alaska
POSITION STATEMENT: During hearing on SSHB 28, offered the division's and DNR's support for Conceptual Amendment 1 and concerns about Amendment 2; said the amended version is workable but not ideal; gave no official position from the administration.

ACTION NARRATIVE

TAPE 03-14, SIDE A
Number 0001

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at 3:23 p.m. Representatives Kohring, Chenault, Rokeberg, Fate, Crawford, and Kerttula were present at the call to order. Representative McGuire arrived shortly after the meeting began. Also present was Representative Holm.

HB 28-OIL & GAS ROYALTY MODIFICATION

Number 0049

CHAIR KOHRING announced that the committee would hear SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 28, "An Act relating to adjustments to royalty reserved to the state to encourage otherwise uneconomic production of oil and gas; and providing for an effective date."

CHAIR KOHRING, joint sponsor with Representative Rokeberg of SSHB 28, noted that substantial testimony had been heard at the hearing [on February 20, 2003].

Number 0093

CHAIR KOHRING offered a recap, noting that the intent of SSHB 28 is to spur development of marginal oil fields and to establish a more understandable and usable royalty-adjustment method for

fields that might otherwise prove uneconomical. It clarifies and simplifies the 1995 legislation that established the current royalty-reduction method, especially with regard to the role of the commissioner of the Department of Natural Resources (DNR), who, under the bill, will be given greater flexibility to negotiate deals that are more financially viable for drilling and exploration companies. Existing law is simply too burdensome and costly for industry, he suggested, and thus discourages the filing of drilling applications; as a result, oil is left in the ground that otherwise could be extracted to add to the state's economic base. Essentially, the bill extends the life of existing, uneconomical fields.

Number 0229

CHAIR KOHRING continued with his recap, offering his belief that [SSHB 28] protects the public interest by maintaining individuals' ability to comment on preliminary findings of the commissioner; it also maintains the legislature's involvement through the Joint Committee on Legislative Budget and Audit, which holds meetings year-round. Chair Kohring asserted that the public process isn't compromised by this bill. He also said Alaska needs to remain competitive in the global market by encouraging development of its oil and gas resources, and that he believes this legislation moves [the state] closer to that goal. He added that the bill is basically intended to jump-start drilling activity.

Number 0288

CHAIR KOHRING turned attention to the fiscal note [from the Division of Oil & Gas] for more than $30 million. He suggested representatives from the division could address it. He offered his belief, however, that the bill has essentially a zero [fiscal impact], because without development of these marginal fields, there won't be oil royalties going into the state treasury. Suggesting it's another way of looking at it, he added, "In my mind, the note reflects an amount of money the state wouldn't get if this bill simply didn't become law."

Number 0379

CHAIR KOHRING moved to adopt [Conceptual] Amendment 1, which read [original punctuation provided]:

> Delete all references to: **or portion of a field or pool**

REPRESENTATIVE CHENAULT objected for discussion purposes.

Number 0440

MARK MYERS, Director, Division of Oil & Gas, Department of Natural Resources, told members that the division and DNR support Conceptual Amendment 1. Calling attention to the scale in terms of size, he pointed out the inherent flexibility in using "field or pool" in customizing royalty relief. Pools are individual, separated reservoirs, whereas a field commonly consists of multiple pools. In this legislation, the state can grant royalty relief for a field producing through common facilities - multiple different reservoirs - and have a royalty reduction on an individual reservoir. That gives a lot of flexibility, since it isn't for the entire infrastructure related to [production] in that field, but can be tailored to a heavy-oil zone or a gas pool, for example, if it's separate from the main oil reservoir.

Number 0537

MR. MYERS explained that going to [a portion of a field or pool, as proposed in SSHB 28], brings up multiple problems, both administratively and, to his belief, in [terms] of purpose. Using an analogy of an oil field as a flying saucer with a thin edge, he explained that the thicker part - the middle of the field - will be developed first, since it is the only economical area to develop: it has the thickest accumulation of oil, and the wells have the highest rates of return and flow rates. As the field life continues - with more infrastructure built, including drilling pads - thinner and thinner parts of the field become economical.

MR. MYERS continued, noting that the natural evolution is to produce the thickest, best, most economical part first, and later on to produce the thinner edges of the field. He expressed concern, therefore, that at some point in time an operator could claim that only the "thickest part of the pie" was economical, and thus request royalty relief for the thinner edge.

Number 0631

MR. MYERS told members:

> Historically, what we've seen is, on the North Slope, Prudhoe Bay, originally, the economic limit was 100 feet of oil thickness, of oil column or net pay. That is now down to about 10 feet. So both as the field production moved on and also as technology changed, it became more and more economic, through a natural evolution of the oil field, to produce the thinner edges. So ... by using "parts of fields," an operator could always claim a royalty relief at any given point for part of the field: a small, isolated fault block within the field that might have thinner "pay" on, certainly, the fringe parts of the field.

MR. MYERS offered that at some point in the field life, only uneconomical oil will be left; that is when an incentive is desired. Reiterating that the fine scale of "[portion] of a field or pool" is problematic from both an administrative and an "intent" standpoint, he added, "I could even see cases where it might lead to improper reservoir management, where you actually don't produce the core part of the field first, or maximize production, because you're ... producing those areas where you get a royalty reduction." From an operational standpoint, he suggested, it doesn't make sense.

MR. MYERS pointed out another problem with the language [being deleted by Conceptual Amendment 1]: early in the life of a field, there isn't the data necessary about the fringe areas to determine whether they are economically viable. As a field is developed, however, more and more information is obtained, he said, "moving out to these peripheral areas of the field; then you can quantify the value of that."

Number 0772

REPRESENTATIVE KERTTULA indicated technological advances start to make areas economically viable that weren't previously. She asked Mr. Myers what the state would have lost in revenues if economic incentives had been granted when [the economic limit for oil] was 100 feet, rather than the 10 feet it is currently.

MR. MYERS replied:

> The only example that I know of on a royalty-relief case where you could have tested that was at Milne Point, ... prior to ConocoPhillips, when Conoco was originally operating the field [in] the 1980s, and they applied for royalty relief, I think, in [the]

'89-to-'90 timeframe. The state denied the application, but the analysis showed that if it would have been granted, it would have cost the state between $64 [million] and $120 million. But that was at Conoco's 20,000-barrel-per-day rate of production. Currently, the field produces nearly 50,000 barrels per day, without that royalty relief.

So, in this case, we could quantify about 128 million [dollars]. But, in reality, what we got was a new operator with additional capital to spend in the field that has really done a good job of developing it. So ... that is sort of the upside risk early in the life of ... the field, is in the $100 million-plus range. Later in the life of fields, near the end of production life, there's much better data to quantify, the risks are significantly lower, and the dollars involved ... can be significantly lower.

Number 0886

REPRESENTATIVE KERTTULA asked whether the bill is structured so this determination is only made at the end of the life of a field, or whether something may happen at the beginning. She noted that page 1 places some sidebars with regard to economic feasibility.

MR. MYERS responded:

I think ... there is a risk early in the life of the field, because ... you have uncertainty about the actual recoverable reserves, the changes in technology, future oil prices. On the other hand, the bill allows the flexibility to condition royalty relief, so that when conditions [change] there can be payback ... if it's deemed appropriate in the mechanism, or the royalty relief can end. So the bill does allow ... a lot of flexibility and discretion [to the] DNR commissioner to customize it. And I believe that was Representative Rokeberg's intent, there, ... to give those tools for flexibility so it could be managed in such a way ... to minimize the risk.

But there is risk early in the life of the field. You simply ... don't have the data to know; on the other hand, you risk the field, in some cases - and I can use a Badami-type-field example, where even though

> you're relatively early in the life of the field, it doesn't have very good economics, i.e., have sufficiency of data to know that it's a very challenged field. So there are cases at all ends of the spectrum. ... This is not an easy thing. That's why it takes a lot of detailed analysis. That's why the data requirements are here in the bill.

Number 1016

REPRESENTATIVE ROKEBERG, joint sponsor of SSHB 28, referred to discussion at the previous hearing about the judgment of then-Commissioner Harold Heinze in denying the Milne Point application from Conoco; he asked Mr. Myers whether the state would have foregone substantial income [if the application had been approved], and requested details.

MR. MYERS answered that it was for the heavy oil as well as the Kuparuk River formation, the main producing reservoir; it wasn't limited to heavy oil. Indicating DNR had reviewed the substantial technical data that was provided, he said Conoco did a good job, had identified a lot of additional reserves in the field, and had actually pioneered some of the heavy-oil work. However, Conoco determined that its internal economics were "more challenged," particular in relation to the higher tariffs the company was paying TAPS [the Trans-Alaska Pipeline System] and the Kuparuk pipeline. He added:

> When ... the state reviewed that application, ... the data showed what the state thought was a reasonable rate of return for the [operator] at the time. I think the operator saw a better economic fit with trading that for some property in the Gulf of Mexico; BP saw a good economic fit. But as far as the reserves and the technology, BP has done an excellent job in developing the field. The potential was clearly recognized by Conoco, which had [itself] done a good technological job in looking at those reserves.

Number 1157

REPRESENTATIVE ROKEBERG remarked that Mr. Myers had refreshed his memory. He asked whether the true reason for the original application [for royalty modification] was that Conoco wasn't a participant in TAPS and therefore would have had to "pay through the nose" compared with TAPS participants.

MR. MYERS replied:

> It certainly hurt their economics, although the state's analysis, and the determination, wasn't based on all those economics; it was based on [Conoco's] confidential, internal economics. ... I think the public-interest decision by Commissioner Heinze was also based on [the assumption that] ... little behavior modification was going to occur with Conoco. They weren't going to ... incrementally increase production in the field, even though they identified the reserves, by any significant amount.
>
> So ... one of the things, I think, with royalty reduction: if you give the royalty reduction, will the field produce longer? And we knew the reserves were there. So, would it enhance the production? Would ... investment pour back in the field to increase and create a win-win situation, a symmetrical situation where we gave up royalty relief and then received additional revenue? Conoco's case on that was pretty poor, in that it was business as usual. It was clear, even though the amount of dollars for the royalty reduction were substantial, [that] it was still less than $10 million per year, which wasn't sufficient money to allow them to invest ... more capital for enhanced oil recovery, which is one of the limitations, I truly think, the state has, again, with our royalty share being a [small] percentage of that.

Number 1292

MR. MYERS continued:

> The relief can help, and it particularly helps against the operating cost standard. But against the total investment in the field - which at that time, the royalty reduction had to be used against - it was relatively small, a small incremental change to the company that couldn't change the behavior. But even with all that said, the economic analysis showed that they made a reasonable rate of return, in the state's interpretation. And that's why the application was denied.

Number 1320

REPRESENTATIVE ROKEBERG offered his belief that Conoco had swapped interests with BP, which had a better position with regard to tariffs, and left Alaska because of an inability to do business here. He said it doesn't speak to this bill, but to access with regard to infrastructure, for example. He suggested [ConocoPhillips Alaska] is back only because of "international corporate deal making."

Number 1438

REPRESENTATIVE McGUIRE mentioned a concern expressed at the previous hearing [by Representative Rokeberg] about the concept beginning on page 2, line 5 - which refers to delineation to the satisfaction of the commissioner - with regard to whether the commissioner might "overdemand for a delineation about fields" and then never make a decision. She asked if that had been addressed.

Number 1545

CHAIR KOHRING asked Mr. Myers whether he had any concerns about that provision.

MR. MYERS replied:

> No, I don't. I think, actually, the sufficiency-of-data standard's important here early, particularly because that results ... in potential royalty reduction early in the life of the field. So you need to have an idea of the size of the reserves, the economics, the production. And we need to ... do a "due diligence" to be reasonably ... confident that we can either agree with their numbers or do some independent assessment of that. So ... it's always going to be a judgment as to the sufficiency of data, and it's a professional judgment. But ... early in the life of the field you're going to have a lot less data to work with.
>
> I think the bill has ... a real positive aspect [in that] it allows you to customize the relief ... to deal with some of those uncertainty issues. But you still fundamentally need to ... know whether your field is 200 million barrels or 400 million barrels recoverable, the gravity of the oil, ... the producibility, the net cost for producing that oil. So ... there is definitely a sufficiency-of-data

standard [and] that any prudent operator will have that data if they've sanctioned the project and ... are going ahead with development of that project. So, ... again, I think it's sort of ... self-policing. I guarantee you, the companies can't make those decisions ... on skinny data. They're spending hundreds of millions or billions of dollars, and they will have ... that sufficiency of data.

Number 1646

REPRESENTATIVE McGUIRE, again referring to her notes from the previous hearing, mentioned a concern about the appearance or reality of a guaranteed result in picking from a list of qualified consultants.

REPRESENTATIVE ROKEBERG requested that attention return to Conceptual Amendment 1.

REPRESENTATIVE CHENAULT removed his objection.

Number 1722

CHAIR KOHRING asked whether there was any further objection to adopting Conceptual Amendment 1. There being no objection, it was so ordered.

CHAIR KOHRING suggested that Representative Rokeberg's Amendment 2 should address Representative McGuire's concerns.

Number 1736

REPRESENTATIVE ROKEBERG moved to adopt Amendment 2, labeled 23-LS0177\D.3, Chenoweth, 3/11/03, which read:

Page 5, line 20, following "data;":

Insert "**the commissioner may require use of the services of an independent contractor if the commissioner determines that the estimated costs of the contractor's services do not exceed 10 percent of the estimated value of the royalty reduction to the lessee or lessees making application for it, except that the commissioner may require use of the services when the estimated costs of the services equal or exceed 10 percent of the estimated value of the royalty reduction with the applicant's agreement; if,**

under this paragraph, the commissioner requires payment for the services of an independent contractor,

CHAIR KOHRING objected for discussion purposes.

Number 1759

REPRESENTATIVE ROKEBERG said this is in the same area brought up by Representative McGuire. He pointed out that there is a difference in the view of the Division of Oil & Gas and his own view of the bill. He explained, "They've requested that the commissioner have the right here to make the selection of the consultant."

REPRESENTATIVE ROKEBERG told members that Amendment 2 really has to do with use of the services of an independent contractor. He offered for the record a three-page letter from Kevin Tabler of Union Oil Company of California (Unocal) dated March 7, 2003 [which also contained testimony by Unocal submitted on March 16, 1995, to the House Special Committee on Oil and Gas and on April 28, 1995, to the Senate Resources Standing Committee with regard to HB 207].

REPRESENTATIVE ROKEBERG told members the issue is that if the commissioner had full sway to select the contractor and to determine the relevant scope of work, [the commissioner] could ask the contractor to spend more money than the royalty relief would be worth. He suggested that might have happened with regard to the only application he was aware of under HB 207, the current law. Referring to Mr. Tabler's letter, Representative Rokeberg said the consultant cost something like $250,000, whereas the total benefit to Unocal was only about $600,000. He suggested a 5-to-1 ratio might be worthwhile, and mentioned high hurdle rates because of the higher level of risk. He suggested taking great care when drafting the statutes to try to make them reflect the real world.

Number 1950

REPRESENTATIVE ROKEBERG noted that Amendment 2 restricts the cost of these contracts, and that the commissioner can still determine the relevant scope of work to be performed. He asked: if the relevant scope to be demanded by the commissioner exceeds a valuation and there is no cost-benefit ratio here, why proceed with the application? He said the 10 percent admittedly is "an estimate of a reasonable number," and that although he wasn't "wed to that number," it has been recommended. He called it a

commonsense addition, suggesting that there could be a scenario wherein a commissioner demands that "you study this thing to death" and it costs more than it is worth.

REPRESENTATIVE ROKEBERG requested feedback from [Mr. Myers] on Amendment 2 and the relevant section of the bill, but again referred to Mr. Tabler's letter, page 2 in particular, about why Mr. Tabler believed this to be necessary.

Number 2060

MR. MYERS responded:

> I believe this amendment creates an on-off switch ... of whether or not the state can hire a contractor, not the expenses the contractors can [incur]. In other words, I don't believe, under this amendment, we could actually hire them unless we've demonstrated the 10 percent, which you won't know until you've hired the contractor. So ... I believe that ... probably isn't the intent, but, again, I don't see that as very workable in the sense it wouldn't allow us to hire the contractor at all.
>
> I'm sympathetic to the concern that the costs, with a contractor, ... can be quite expensive. ... I'd like to note, though, that on the Unocal case, the state did not hire a contractor, so Mr. Tabler must be referring to internal costs [incurred] ... by Unocal. Again, we had no contractor on board for that.

REPRESENTATIVES McGUIRE and ROKEBERG referred to the fact that Mr. Tabler's letter says Unocal hired its own consultant, Gaffney Cline.

Number 2116

MR. MYERS said that was for [Unocal's] internal analysis, not for reimbursable expenses to the department. "So, again, we handled that case internally," he said. He added that it's likely, for a field late in its life, that [the department] would have sufficient data and the costs in the contract would be less. On a larger field early in its life, however, the amount of analysis inevitably would be a lot more and the potential [royalty] reduction would be more. He said he is sympathetic to Representative Rokeberg's concern that [the state] not charge too much or do extensive analysis that isn't

necessary, and has some sympathy for the applicants if the costs are large for a contractor. If a royalty structure were designed with a payback or shut-off mechanism, however, it would be price-dependent, and estimating 10 percent of the relief wouldn't be an easy task, either.

MR. MYERS reiterated his two concerns. First, this sets up a situation whereby [the department] isn't allowed to hire a contractor unless it either demonstrates or estimates that the costs don't exceed 10 percent. And, second, it will be hard in some cases, depending on how the relief is structured, to actually quantify the value of that relief, because of using a sliding-scale mechanism, a price-sensitive mechanism, or a payback - all of which could be used under this.

Number 2198

REPRESENTATIVE ROKEBERG responded that he didn't entirely agree. He said he'd seen no evidence that the Division of Oil & Gas is reluctant to create fiscal notes with estimates with regard to potential oil revenues lost; he cited [this year's] HB 57 as an example. He disagreed with the characterization that this is an on-off switch, unless the desire is to use it as a mechanism to foil the attempt of the applicant.

REPRESENTATIVE ROKEBERG offered his belief that the language [in Amendment 2] is sufficient to provide flexibility, and that the 10 percent could be exceeded if the applicant gave consent. Noting that he'd worked on it for a couple of weeks, he said it seemed easier to try to set some quantifiable standard based on preliminary estimates of what could happen. He added, "This could be really problematic because the bill does provide for this to an undeveloped field." Suggesting that the word "estimates" is clear statutorily, he offered to modify the language if it could include the concept of "cost-benefit analysis of value engineering." He cautioned that great harm could result if two parties in a semi-adversarial situation were saying who could be used as consultants, what lists were to be chosen from, and so forth; he suggested that is a collateral issue about which there has been past disagreement.

Number 2332

MR. MYERS replied:

> If I have an ... initial application for this and I know I'm going to need a consultant, I'm ... probably

> going to hire the consultant on an hourly basis, based on how much analysis he's going to be doing. This says that I have to know what these costs are going to be ... ahead of time, prior to it, and have done enough analysis to know what the royalty relief is going to be worth, all of which ... would be preconditions for my authority ... to hire the contractor or to get a contract with him.
>
> So I'm stuck in the case of ... thinking, "How do I possibly, going into [an] application, know what data, (a), is available to me through the applicant, and, (b), what sort of analysis I'm going to need, and what that analysis is going to cost me." In addition, I don't know what the royalty relief is, because I'm first seeing this application cold, with a lot of data.
>
> So, under this scenario I'd have to work the data internally, extensively, [to the] point that I was comfortable enough that ... the 10-percent number would work, and then I could hire the consultant to work on those particular problems. That's going to cause a lot of internal analysis, a lot of delay ... in the work on the application.

MR. MYERS offered to work with Representative Rokeberg, reiterating that he understood and sympathized with the intent from the applicants' standpoint of wanting certainty that [DNR] won't use this as a mechanism to deny it; Mr. Myers said that clearly isn't the intent.

Number 2409

REPRESENTATIVE KERTTULA asked how many times this actually has been a problem that [DNR] has asked for [a consultant] and been told it would be too expensive.

MR. MYERS indicated that the times when DNR went through these analyses, it never hired an independent assessment. He said, "I do note, the Conoco case took a long time to do internally." He reiterated that if there is a lot of data late in the life of the field, this is not a difficult problem. Early in the life of the field, however, engineering analysis and technical, upfront analysis must be done. It really will vary, he added.

Number 2449

REPRESENTATIVE ROKEBERG replied to Representative Kerttula by referring to [AS 38.05.180(j)] and saying the provision that required the independent consultant was added in 1995 by HB 207; thus the commissioner [of DNR] under the Conoco scenario didn't have this mandate. He suggested that any hiring of consultants is "probably discretionary as to the commissioner on any other type of circumstance," but said only the Conoco application, to his knowledge, has done this in eight years. He added, "That's why we're doing this bill. The statute doesn't work now. We're trying to clean it up so it's workable and so it can have some impact and effect on our oil and gas production here in the state."

REPRESENTATIVE ROKEBERG indicated he could envision what Mr. Myers was thinking, although he didn't entirely agree. He did agree that in a new field, in particular, or where there isn't sufficient data, it can be extremely difficult to make some of these estimates, even with regard to the amount of royalty reduction. He suggested that both [he and Mr. Myers] agree with the need for some sideboards with regard to "value engineering" and how to accomplish that.

Number 2541

REPRESENTATIVE ROKEBERG requested, rather than holding the bill further, that the committee accept Amendment 2 in order to introduce the concept into the bill, but with the proviso that he'd work with Chair Kohring and the Division of Oil & Gas to try to make it workable.

MR. MYERS offered technical support.

Number 2583

REPRESENTATIVE KERTTULA objected, stating her preference for not including Amendment 2, which could be added on the House floor if necessary.

CHAIR KOHRING withdrew his own objection.

A roll call vote was taken. Representatives Rokeberg, Fate, McGuire, and Kohring voted in favor of Amendment 2. Representatives Crawford and Kerttula voted against it. Representative Chenault was absent for the vote. Therefore, Amendment 2 was adopted by a vote of 4-2.

The committee took an at-ease from 4:02 p.m. to 4:03 p.m.

Number 2624

REPRESENTATIVE ROKEBERG referred to Mr. Tabler's letter and conversations with Ken Boyd, Mr. Myers' counterpoint when the original legislation came before the House Special Committee on Oil and Gas eight years ago. With regard to paragraph (6) on page 5 of SSHB 28, Representative Rokeberg said it reads that the applicant pays for the services of an independent contractor selected from a list of qualified consultants provided by the commissioner. In existing law, by contrast, the commissioner selects the consultant and the applicant has to pay for it. He offered his belief, from past conversations, that Mr. Myers and his staff were in disagreement [with Representative Rokeberg] on this point.

REPRESENTATIVE ROKEBERG said he would "stick by this position because it's been reconfirmed by the testimony, in talking to various people ... in the industry that have ... gone through the situation, where I think that ultimately the companies paying for the contractor - who's going to be working under the direction of the commissioner - should be the one to select whoever they're going to be paying for." Calling it a "basic axiom of business," he also offered his understanding that relatively few companies would even qualify [for the list].

REPRESENTATIVE ROKEBERG noted that proposed language on page 5, lines 20-21, of SSHB 28 [which immediately follows the language inserted by Amendment 2], says, "**the commissioner shall determine the relevant scope of the work to be performed by the contractor**". He pointed out that [DNR] would use this information to evaluate the application. He said he saw no reason to change this, but acknowledged that Mr. Myers might feel otherwise.

Number 2776

REPRESENTATIVE CRAWFORD said it seems this will be a somewhat adversarial relationship between the contractor and the applicant, and that the most qualified contractor that the [commissioner] chooses might be unacceptable to the applicant because of being too tough an adversary. He asked the reasoning behind allowing the applicant to choose who the adversary is.

REPRESENTATIVE ROKEBERG replied that it is supposed to be an independent consultant - a gatherer of technical data and an

analyst. He suggested an adversarial relationship, if any, would be between the commissioner and the applicant. Characterizing this as a "pretty small business sphere," he remarked that if the commissioner told him to hire a particular person that he'd had a bad experience with, he wouldn't appreciate it. He offered that the commissioner has a say in the selection process by providing the list; the applicant selects [from] the list and pays for [the consultant]; the commissioner then gets to use the consultant.

Number 2890

REPRESENTATIVE FATE said it seems that allowing the contractor to assume the selection and to bypass the department removes the responsibility of the division and perhaps even some responsibility from the [Alaska Oil & Gas Conservation Commission (AOGCC)] when it comes to production. It is placed solely in the hands of the [applicant], he suggested, by allowing that person to select the consultant to do the very things specified in the bill. He asked whether his reading was correct.

Number 2955

REPRESENTATIVE ROKEBERG replied that perhaps Representative Fate was reading too much into it, since he didn't believe AOGCC had anything to do with it. He said it is an application made by the lessee to the commissioner of DNR. He added, "Frankly, the testimony I have is that the people in the industry believe that ... the commissioner and [the Division of Oil & Gas] should be able to do this in-house. They don't even need to hire a contractor." He pointed out that "may" is in the language; it is discretionary, therefore, driven by whether the commissioner believes there is a need for an independent consultant.

TAPE 03-14, SIDE B
Number 2974

REPRESENTATIVE ROKEBERG said the applicant pays for it, under the current statute or the bill. The question is who makes the shortlist and who gets to make the decision. He clarified, "I'm saying that the applicant should make the final decision because he's paying for it." He asked that Mr. Myers address the issue.

The committee took an at-ease at 4:11 p.m. that lasted a few seconds.

Number 2913

MR. MYERS told members:

> We can live with ... the amended version. Again, it's not ideal, but we understand Representative Rokeberg's concerns, and it's workable. I will say that we have a ... fairly small consulting community in Alaska. It's one thing to consider, that most of the work for that consulting community will come from the producers, of various sorts. So contractors have to be careful ... when they work for us that they don't hurt their other business opportunities out there.
>
> So, the more [autonomy] we have to select contractors, the better. Again, we would be looking for someone who's objective, someone that can maintain confidentiality, above all, because that's absolutely critical. ... We very seldom bring in contractors on detailed technical evaluations. ... One thing is funding, but the second thing is the ... concern over confidentiality of data. You are allowing them to see some very sensitive data, both from a sense of technical information, but also from commercial economic information on an individual company: information on their rates of return, information on the profitability of the field, et cetera. So this is a very, very sensitive analysis. And to that point, we can understand the companies' concern, but it's our concern as well. There's a liability for showing them that data and allowing them to use that data.

Number 2851

MR. MYERS continued:

> The quality of ... consultants varies widely, depending on their experience, their background. So all we want is to get ... a good, unbiased, qualified person - ... or people or firm - in there. And, again, one of the issues is, that's a pretty short list in Alaska. I'm not trying to defame anyone, but [this is] very specific, narrow, technical expertise, and there's only a limited market. So we have limited folks in-state. ... So chances are, our shortlist and a producer's shortlist would be very similar, but not identical.

> And, I think. the compatibility for us to work with folks - it's [nice] to know that ... they are high-quality [and that] I won't be spending all our staff time bringing someone up to speed in terms of training them to get them to the point they can do the analysis, and then that we can trust them, forward looking. So, ... again, from a selfish standpoint, we like to maintain the flexibility. But I understand Representative Rokeberg's concern, and ... we could work with it.

Number 2800

REPRESENTATIVE KERTTULA requested confirmation that the idea behind the contractor is someone who basically takes the division's place in order to provide the information so the commissioner can make a reasonable decision.

MR. MYERS responded:

> The way I understand it is, ... it won't be a broad-based, do-everything kind of consultant, necessarily. It may be ... specific aspects. There may be a question on recoverability of the reservoir, reserve estimates, in which case you might bring a reservoir engineer in. It may be an economic run, in which case you might want to bring ... an economics firm in to do it. ... There's seldom "one size fits all." If so, ... if we hire one of these all-encompassing firms, typically, the cost will be very expensive to the applicant, and that's ... not the intent here at all. So we'll probably narrow the focus, when we hire consultants, to specific issues where either our in-house expertise is not available in a timely manner or ... it's specific issues where it doesn't exist. So I see it as augmenting, ... not replacing, the division's analysis.

Number 2728

REPRESENTATIVE McGUIRE said she'd struggled with this issue and supports Representative Rokeberg's position. She offered an analogy from her childhood: when two kids fight over pieces of pie, the parents can resolve it by having one child cut the pieces and the other choose which piece he or she wants. Returning to the bill, she said this gives each an opportunity

to enter into the equation when both have a lot at stake, both from a proprietary point of view and from the desire to have the results be good.

REPRESENTATIVE McGUIRE said she'd originally been concerned about it, but likes how broad and general it is: a list is chosen, but there aren't limits on how many or where they are chosen from, for example. She suggested this gives [the commissioner of DNR] a great amount of power because of the unlikelihood of putting someone on the list without believing the person would protect confidentiality requirements and so forth. She also said she'd been concerned about the appearance of impropriety; given how much discretion there is in creating the list, however, Representative McGuire said she believes that giving [the applicant] the opportunity to pick [the contractor] - since the applicant is ultimately paying the bill - is probably a fair tradeoff.

Number 2649

REPRESENTATIVE CRAWFORD expressed concern about the timing of the "pick" because it seems there could be too much allegiance [by the contractor] to the applicant who made the final choice from the list that was put forward. He offered that it would be fairer if the applicant put together the shortlist and the commissioner selected the final contractor.

REPRESENTATIVE ROKEBERG said that's what current law says, which he doesn't like.

Number 2604

REPRESENTATIVE CRAWFORD remarked, "I think that our job here is to make sure that the state's interests are best protected. And ... I believe that if we change it to the way that Representative Rokeberg wants to, that ... the pendulum swings towards the side of the applicant."

REPRESENTATIVE ROKEBERG acknowledged that this can be contentious, with the applicant on one side and the commissioner and the state on the other. Noting that the independent contractor is intended to provide an independent voice, he agreed with Representative Crawford about the question of bias. He suggested, however, that the state should be able to do this in-house, and only use an independent contractor for something highly technical, if staff is tied up elsewhere, or if there is "a failure by DNR to be able to meet its requirements." He

asked why an applicant should be penalized by "giving the default benefit to the commissioner rather than to the applicant, when the commissioner should have done the job in the first place and ... it's going to cost the guy money."

Number 2507

REPRESENTATIVE CRAWFORD, noting that this is an honest disagreement, surmised that the reason for using an outside contractor was to enhance or speed up the process because the Division of Oil & Gas, from what he has been told, is shorthanded. This slows the process because the division doesn't have enough staff to handle these, he suggested. He again expressed concern that it could tend to bias the outside contractor who was chosen by the applicant. He reiterated his belief that the outside contractor should be chosen by the state, which is doing the hiring. "This is for the state's side of the argument," he added.

Number 2452

REPRESENTATIVE KERTTULA remarked, "They're asking for a huge break in some cases. ... It's to their benefit to be able to get someone that the commissioner feels confident of, and it's the state's responsibility." She said Representative Crawford's point was well taken. She asked Mr. Myers whether the administration supports the bill.

MR. MYERS said that to his knowledge, the administration hadn't taken a position on the bill.

REPRESENTATIVE KERTTULA asked what the positions of previous administrations have been on similar legislation.

MR. MYERS responded, "I think it's been recognized by previous administrations that we needed an effective royalty-reduction bill as a tool." He indicated the division was only providing technical support on the current legislation.

CHAIR KOHRING pointed out that the original legislation was signed into law by then-Governor Knowles.

REPRESENTATIVE ROKEBERG said HB 207 in 1995 was the centerpiece of the entire Knowles Administration, but that the Senate Finance Committee "screwed it up."

Number 2335

REPRESENTATIVE KERTTULA referred to the analysis on page 2 of the division's fiscal note, which says HB 28 opens the door to the possibility that every oil or gas reservoir would be eligible. She asked whether that stands.

MR. MYERS specified that with [Amendment 1, deleting "or portion of a field or pool"] it wouldn't stand. He added the following with regard to independent contractors:

> Our goal is not to have [an] independent contractor as an advocate for a state position. It's to do the technical analysis. Again, the state's not opposed ... to royalty reduction. We just want to make sure it meets the statutory requirements and we give the commissioner the ability to do the analysis. So, again, ... we're not hiring a law firm to advocate a position for us. We're [hiring] technical experts. We're just trying to get "the best" to verify the data and to do the proper analysis. That determination has to be made by the commissioner; it won't be made by the contractor.

Number 2271

REPRESENTATIVE CHENAULT moved to report SSHB 28 [as amended] out of committee with individual recommendations and the accompanying fiscal note(s). There being no objection, CSSSHB 28(O&G) was reported from the House Special Committee on Oil and Gas.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 4:29 p.m.