

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

May 7, 2003
8:10 a.m.

MEMBERS PRESENT

Representative Hugh Fate, Chair
Representative Carl Gatto
Representative Cheryll Heinze
Representative Bob Lynn
Representative Carl Morgan
Representative Kelly Wolf
Representative David Guttenberg
Representative Beth Kerttula

MEMBERS ABSENT

Representative Beverly Masek, Vice Chair

COMMITTEE CALENDAR

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 198

"An Act providing for a reduction of royalty on certain oil produced from Cook Inlet submerged land."

- MOVED CSSH B 198(O&G) OUT OF COMMITTEE

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 CSSH B 28(RES) OUT OF COMMITTEE

CS FOR SENATE BILL NO. 151(L&C)

"An Act relating to the regulation of natural gas pipelines under the Pipeline Act; and providing for an effective date."

- MOVED CSSB 151(L&C) OUT OF COMMITTEE

HOUSE BILL NO. 246

"An Act relating to the limitation on upland acreage that a person may take or hold under oil and gas leases; and providing for an effective date."

- SCHEDULED BUT NOT HEARD

HOUSE BILL NO. 267

"An Act relating to the Alaska Railroad; authorizing the Alaska Railroad Corporation to provide financing for the acquisition, construction, improvement, maintenance, equipping, or operation of facilities for the transportation of natural gas resources within and outside the state by others; authorizing the Alaska Railroad Corporation to issue bonds to finance those facilities; and providing for an effective date."

- BILL HEARING POSTPONED [See 1:40 p.m. minutes for this date]

HOUSE BILL NO. 277

"An Act relating to the powers of the Regulatory Commission of Alaska in regard to intrastate pipeline transportation services and pipeline facilities, to the rate of interest for funds to be paid by pipeline shippers or carriers at the end of a suspension of tariff filing, and to the prospective application of increased standards on regulated pipeline utilities; allowing the commission to accept rates set in conformity with a settlement agreement between the state and one or more pipeline carriers and to enforce the terms of a settlement agreement in regard to intrastate rates; and providing for an effective date."

- BILL HEARING POSTPONED [See 1:40 p.m. minutes for this date]

CONFIRMATION HEARINGS

Board of Fisheries

Floyd F. Bouse, D.D.S. - Fairbanks
Robert (Ed) Dersham - Anchor Point

- CONFIRMATION HEARINGS POSTPONED [See 1:40 p.m. minutes for this date]

PREVIOUS ACTION

BILL: HB 198

SHORT TITLE: ROYALTY REDUCTION ON CERTAIN OIL

SPONSOR(S): REPRESENTATIVE(S) KOHRING

Jrn-Date	Jrn-Page		Action
03/17/03	0560	(H)	READ THE FIRST TIME -

			REFERRALS
03/17/03	0560	(H)	O&G, RES, FIN
03/26/03	0654	(H)	COSPONSOR(S): CHENAULT
04/03/03		(H)	O&G AT 3:15 PM CAPITOL 124
04/03/03		(H)	-- Meeting Canceled --
04/10/03		(H)	O&G AT 3:15 PM CAPITOL 124
04/10/03		(H)	-- Meeting Canceled --
04/24/03	1093	(H)	SPONSOR SUBSTITUTE INTRODUCED
04/24/03	1093	(H)	READ THE FIRST TIME -
			REFERRALS
04/24/03	1093	(H)	O&G, RES, FIN
04/24/03		(H)	O&G AT 3:15 PM CAPITOL 124
04/24/03		(H)	Moved CSSSHB 198(O&G) Out of Committee
04/24/03		(H)	MINUTE(O&G)
04/25/03	1138	(H)	COSPONSOR(S): HOLM, MCGUIRE
04/28/03	1154	(H)	O&G RPT CS(O&G) 6DP
04/28/03	1154	(H)	DP: HOLM, FATE, CRAWFORD, KERTTULA,
04/28/03	1154	(H)	MCGUIRE, KOHRING
04/28/03	1155	(H)	FN1: (DNR)
05/02/03		(H)	RES AT 1:00 PM CAPITOL 124
05/02/03		(H)	-- Meeting Canceled --
05/05/03		(H)	RES AT 1:00 PM CAPITOL 124
05/05/03		(H)	Scheduled But Not Heard
05/06/03		(H)	RES AT 0:00 AM CAPITOL 124
05/06/03		(H)	Scheduled But Not Heard
05/07/03		(H)	RES AT 8:00 AM CAPITOL 124

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
03/11/03		(H)	Moved CSSSHB 28(O&G) Out of

			Committee
03/11/03		(H)	MINUTE(O&G)
03/14/03	0536	(H)	O&G RPT CS(O&G) 6DP 1AM
03/14/03	0536	(H)	DP: CHENAULT, MCGUIRE, ROKEBERG,
03/14/03	0536	(H)	CRAWFORD, FATE, KOHRING; AM: KERTTULA
03/14/03	0537	(H)	FN1: ZERO(DNR)
04/30/03		(H)	RES AT 1:00 PM CAPITOL 124
04/30/03		(H)	<Bill Hearing Postponed to Fri. 5/2>
05/02/03		(H)	RES AT 1:00 PM CAPITOL 124
05/02/03		(H)	-- Meeting Canceled --
05/05/03		(H)	RES AT 1:00 PM CAPITOL 124
05/05/03		(H)	Scheduled But Not Heard
05/06/03		(H)	RES AT 0:00 AM CAPITOL 124
05/06/03		(H)	Scheduled But Not Heard
05/07/03		(H)	RES AT 8:00 AM CAPITOL 124

BILL: SB 151

SHORT TITLE:REGULATION OF NATURAL GAS PIPELINES

SPONSOR(S): SENATOR(S) WAGONER

Jrn-Date	Jrn-Page		Action
03/20/03	0550	(S)	READ THE FIRST TIME - REFERRALS
03/20/03	0550	(S)	L&C, RES
03/27/03		(S)	L&C AT 1:30 PM BELTZ 211
03/27/03		(S)	Heard & Held
03/27/03		(S)	MINUTE(L&C)
03/27/03		(H)	MINUTE(O&G)
04/01/03		(S)	L&C AT 1:30 PM BELTZ 211
04/01/03		(S)	Moved CSSB 151(L&C) Out of Committee
04/01/03		(S)	MINUTE(L&C)
04/02/03	0663	(S)	L&C RPT CS 5DP NEW TITLE
04/02/03	0664	(S)	DP: BUNDE, DAVIS, FRENCH,
04/02/03	0664	(S)	SEEKINS, STEVENS G
04/02/03	0664	(S)	FN1: INDETERMINATE(DNR) CORRECTED
04/02/03	0664	(S)	FN2: ZERO(CED)
04/14/03		(S)	RES AT 3:30 PM BUTROVICH 205
04/14/03		(S)	Heard & Held
04/14/03		(S)	MINUTE(RES)
04/16/03		(S)	RES AT 3:30 PM BUTROVICH 205
04/16/03		(S)	Moved CSSB 151(L&C) Out of Committee

04/16/03		(S)	MINUTE(RES)
04/17/03	0891	(S)	RES RPT CS(L&C) 4DP 3NR
04/17/03	0891	(S)	NR: OGAN, ELTON, LINCOLN;
04/17/03	0891	(S)	DP: SEEKINS, STEVENS B, WAGONER, DYSON
04/17/03	0891	(S)	FN1: INDETERMINATE(DNR)
04/17/03	0891	(S)	FN2: ZERO(CED)
04/25/03	0971	(S)	RULES TO CALENDAR 4/25/2003
04/25/03	0971	(S)	READ THE SECOND TIME
04/25/03	0971	(S)	L&C CS ADOPTED UNAN CONSENT
04/25/03	0971	(S)	ADVANCED TO THIRD READING 4/28 CALENDAR
04/28/03	1012	(S)	READ THE THIRD TIME CSSB 151(L&C)
04/28/03	1013	(S)	PASSED Y19 N- E1
04/28/03	1013	(S)	EFFECTIVE DATE(S) SAME AS PASSAGE
04/28/03	1015	(S)	TRANSMITTED TO (H)
04/28/03	1015	(S)	VERSION: CSSB 151(L&C)
04/29/03	1177	(H)	READ THE FIRST TIME - REFERRALS
04/29/03	1177	(H)	RES
05/05/03		(H)	RES AT 1:00 PM CAPITOL 124
05/05/03		(H)	<Bill Hearing Postponed to 05/07/03>
05/07/03		(H)	RES AT 8:00 AM CAPITOL 124

WITNESS REGISTER

REPRESENTATIVE VIC KOHRING
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Testified as sponsor of SSHB 198 and as one of the sponsors of SSHB 28.

GARY CARLSON, Senior Vice President
Forest Oil Corporation
Anchorage, Alaska

POSITION STATEMENT: Testified on SSHB 198, focusing on the benefits of maintaining the infrastructure in Cook Inlet; said the bill provides a way for the state to make a difference.

MARK MYERS, Director
Division of Oil & Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions about SSHB 28.

REPRESENTATIVE NORMAN ROKEBERG

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as one of the sponsors of SSBH 28.

KEVIN BANKS

Division of Oil & Gas

Department of Natural Resources

Anchorage, Alaska

POSITION STATEMENT: During hearing on SSBH 28, answered question relating to Amendment 1 to Version U.

SENATOR THOMAS WAGONER

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as sponsor of SB 151.

ACTION NARRATIVE

TAPE 03-37, SIDE A

Number 0001

CHAIR HUGH FATE called the House Resources Standing Committee meeting, which had been recessed on May 5, back to order at 8:10 a.m. Representatives Fate, Heinze, Morgan, and Wolf were present at the call to order. Representatives Gatto, Lynn, Guttenberg, and Kerttula arrived as the meeting was in progress.

HB 198-ROYALTY REDUCTION ON CERTAIN OIL

CHAIR FATE announced that the first order of business would be SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 198, "An Act providing for a reduction of royalty on certain oil produced from Cook Inlet submerged land." [Before the committee was CSSSHB 198(O&G).]

Number 0089

REPRESENTATIVE VIC KOHRING, Alaska State Legislature, sponsor, explained that this bill is intended to help prevent offshore oil platforms in Cook Inlet from shutting down. Rapidly reaching the end of their economic lives, the platforms were built mostly in the 1960s; two of the thirteen rigs have suspended production because they no longer break even. He offered his belief that it isn't in the state's best interest to

abandon these fields, because of the negative economic effects that would occur mostly on the Kenai Peninsula.

REPRESENTATIVE KOHRING noted that the bill reduces the royalty rate paid to the state, on a sliding scale. Two primary categories encompass two different groups of offshore platforms that will benefit from this legislation: Dolly, Grayling, King Salmon, Steelhead [and Monopod], which are wells with high overhead; and Granite Point, Anna, Bruce, Baker, Dillon, [XTO.A, and XTO.C], which have lower operating costs. He told members that without this bill, the state eventually will receive zero in royalty income because there will be no production and the state will be receiving 12.5 percent of nothing. With passage of the bill, however, the state can receive between 5.5 percent and 12.5 percent of something, since it encourages owners of the platforms to continue with production.

Number 0365

REPRESENTATIVE KOHRING called attention to the fiscal note [prepared by Mark Myers of the Division of Oil & Gas, Department of Natural Resources (DNR)]. Representative Kohring said the estimated \$600,000 is a relatively modest amount that the state would lose because production isn't high for the rigs; Mr. Myers could address that and details about the sliding-scale system. Representative Kohring said the trade-off for the \$600,000 lost from the state treasury will be hundreds of jobs involved with running these oil rigs; millions of dollars spent on goods and services, mostly on the Kenai Peninsula; and continuation of property-tax revenues to local governments there that provide for roads, schools, and public safety.

REPRESENTATIVE KOHRING highlighted the expensive infrastructure. If the lives of the platforms can be extended through this legislation, the owners may be able to use that infrastructure to further develop the [oil] fields by using directional drilling techniques. Instead of shutting down, being mothballed, and eventually being towed away, these rigs could be kept in place as a base for future drilling. He closed by offering his belief that the legislation is relatively urgent.

Number 0573

GARY CARLSON, Senior Vice President, Forest Oil Corporation, noting that he has been a major investor in Cook Inlet in the past five years, told members:

My testimony on this bill will focus on the maintenance of critical and scarce infrastructure associated with the mature oil fields in the Cook Inlet. The platforms, associated pipelines, and related onshore facilities ... represent irreplaceable infrastructure which may facilitate the exploration, discovery, and development of as yet undiscovered reserves if their useful lives can be extended. Any delay in abandoning and decommissioning of this infrastructure will provide opportunities to the industry to develop smaller-scale oil and gas prospects that won't stand the economics if new infrastructure needed to be developed.

As mature fields approach their economic life, the operators need to get creative and manage ... costs carefully, ... including managing their vendors and their contractors to share in these efforts. And I believe it is appropriate for the state to step in as a partner also. This bill would provide a way for the state to make a difference.

Keeping the current Cook Inlet oil fields on line a few more years will maintain good jobs, provide local taxes, and [provide] the possibility of new development. And it could easily exceed the anticipated future shortfall in state revenues resulting from the reduced state royalty. I want to commend the bill sponsors and the Department of Natural Resources for their foresight in supporting this bill.

Number 0722

REPRESENTATIVE HEINZE said she thinks this is a good bill, but inquired about the 14 months' extension and the economic feasibility for companies that keep these platforms going.

MR. CARLSON answered that the length of time to keep a platform producing, depending upon the decline rates and who analyzes the data, could be one to three years. Knowing the royalty rates would help a company plan, keep the facilities on line another year or two, and stay above the red line. He suggested that the operators of the platforms can plan the decommissioning much better [if the bill passes], which should delay shutting down.

Number 0842

CHAIR FATE asked whether the cost of maintaining the platforms after their useful production life will offset revenues made before they are shut down, especially if those platforms aren't utilized in the near future.

MR. CARLSON explained that the cost of shutting in the platforms without abandoning them will be tremendously different for each facility. He offered his belief that some have been operated in the red for a short time prior to being shut in because of that cost. Once they've been decommissioned to where they can be left intact without abandoning them, the cost of maintaining the platforms is relatively low.

CHAIR FATE suggested that even if the cost is low, paying that cost over 10 years, for example, without [operating the platform] will begin to erode the profit made in the 14 months it was kept alive. He asked whether it would be worth it, other than extending jobs and the local economy for those 14 months.

MR. CARLSON answered:

It's difficult to say if that's the case. And I appreciate the question ... that the amount of additional revenue that would come to the operator as a result of this could be marginal at best. I think it's the spirit of what the state is trying to do here ... that's critical. And as ... [an] operator in the inlet that ... is looking at exploring for new oil and gas, the fact that that facility - even if it's been shut in two or three years - ... [is] there, it's possible for us to bring the field on and maybe pipe the oil to this idle platform. And at that point, ... the value of that facility comes back to the operator or, if not the operator, somebody that's out there like Forest Oil [Corporation], where we would pay for access ... to the infrastructure. So there's ... those unknowns out there that I think offer more ... opportunities than the actual savings, ... in equivalent of ... the 750-barrel-a-day platforms, ... [a] savings of roughly 50 barrels a day.

Number 1063

CHAIR FATE asked whether those platforms, even if shut in, might help facilitate smaller fields or exploration around the vicinity; he mentioned possible lateral drilling.

MR. CARLSON answered in the affirmative.

The committee took an at-ease from 8:25 a.m. to 8:27 a.m.

Number 1142

REPRESENTATIVE HEINZE moved to report [CSSSHB 198(O&G)] out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSSSHB 198(O&G) was reported from the House Special Committee on Oil and Gas.

HB 28-OIL & GAS ROYALTY MODIFICATION

[Contains discussion of SSHB 198]

Number 1170

CHAIR FATE announced that the next order of business would be 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." [The bill was sponsored by Representatives Kohring and Rokeberg. Before the committee was CSSSHB 28(O&G); in packets was a new proposed committee substitute (CS), Version U.]

Number 1196

REPRESENTATIVE VIC KOHRING, Alaska State Legislature, one of the sponsors, noted that he chairs the House Special Committee on Oil and Gas. He explained that SSHB 28 is an "incentive bill" that provides for royalty reduction. The intent of the legislation is to spur development in what are considered marginal fields, which are prospective fields where there is no facility that is drilling already; where there is an existing facility producing oil that may be close to being uneconomical; or where the facility is mothballed and shut in, not producing because the lease owners feel they aren't making money. He specified that the intent is to provide a royalty break for oil and gas for marginal fields anywhere in Alaska.

CHAIR FATE requested a motion to adopt the proposed CS before Representative Kohring continued.

Number 1290

REPRESENTATIVE LYNN moved to adopt the proposed CS, Version 23-LS0177\U, Chenoweth, 4/30/03, as a work draft. [No objection was stated, and Version U was treated as adopted.]

The committee took an at-ease from 8:28 a.m. to 8:31 a.m. to distribute copies of Version U.

REPRESENTATIVE LYNN announced that he needed to go to another meeting, but was generally in support of this bill.

The committee took a brief at-ease.

Number 1491

REPRESENTATIVE KOHRING continued, advising members that he would incorporate Version U during his presentation. He said 1995 legislation had enacted the current royalty-reduction system for these marginal fields, but clarification and simplification are needed. The intent is to create a more understandable, flexible royalty-adjustment method that is more simplified with respect to the procedure and paperwork, and to give authority to the Department of Natural Resources (DNR) commissioner to make decisions relating to royalty reduction, to encourage development of these marginal fields. Hence this gives the [DNR] commissioner the tools to negotiate with drilling and exploration companies to make both oil and gas production financially viable. He explained, "We feel that the existing law is simply too burdensome and costly for the industry and thus discourages filing of drilling applications."

REPRESENTATIVE KOHRING reminded members that the state's royalty share usually is 12.5 percent, but sometimes as high as 20 percent, depending on the field. Royalty reduction under SSHB 28 will depend on changes in oil prices, fuel recovery, production rates and volumes, and development and operating costs. He said the new rate will be set at the discretion of the commissioner, who will evaluate each project independently and then decide the rate; it could be as low as about 3 percent and perhaps as high as 12.5 percent.

Number 1661

REPRESENTATIVE KOHRING emphasized a key part of the legislation: the decision by the commissioner as to whether a field is profitable will be based on an evaluation done either internally by DNR's Division of Oil & Gas or through an independent contract, if the applicant wants to expedite the process and so

chooses. Criteria regarding whether the fields are economically viable include the hydrocarbon potential and costs associated with drilling [and] production. The commissioner will decide whether it's justifiable to grant a royalty reduction and, if so, at what rate. If the study shows the field as uneconomic, then the commissioner can structure a royalty rate that will improve the field's profitability.

REPRESENTATIVE KOHRING informed members that the standards of the contract and who [the contractor] will be are to be determined by DNR. Although he'd heard there are few [potential contractors], he expressed confidence that they are competent and qualified, and said he'd discussed this with Division of Oil & Gas personnel. If the evaluation is done internally, unless there are unusual circumstances, there won't be any cost to the applicant that would have to be reimbursed to the state. But if it's done through an independent contract, the applicant must pay the state a reimbursement fee not to exceed \$150,000.

REPRESENTATIVE KOHRING explained that if the commissioner hires an independent contractor, the current royalty-reduction statute exempts the hiring process from the state's normal competitive bidding process. This provides the applicant with some certainty about who will do the professional evaluation, and it will expedite the commissioner's decision. He asserted that the public process is protected with this legislation because the public has access and the ability to comment on the commissioner's preliminary findings. Furthermore, SSHB 28 retains legislative involvement through the Joint Committee on Legislative Budget and Audit, which meets year-round and through which detailed audits can be requested to examine individual applications and royalty adjustments that are granted.

REPRESENTATIVE KOHRING offered his expectation that SSHB 28 will result in more oil being produced and not left in the ground. He said he believes Alaska needs to remain competitive in the global market by encouraging development of oil and gas, and that this legislation moves the state closer to that goal. He noted that Representative Rokeberg had sponsored similar legislation in the past and was the impetus behind SSHB 28.

Number 1893

CHAIR FATE asked about provisions for increasing the royalty if improvements in technology make a field less marginal and more productive.

REPRESENTATIVE KOHRING deferred to Mr. Myers.

Number 1939

MARK MYERS, Director, Division of Oil & Gas, Department of Natural Resources, responded:

The bill ... gives the commissioner broad latitude to structure the royalty reduction and actually have the choice, under this bill, to either try, on the upside, to recover some of the ... royalty reduction, structuring it that way, or not to. And it depends on the individual circumstances. So the bottom line is, the commissioner can structure the royalty, if prices go up and the field's more economic, to recover it or to change and raise the royalty back up to what it was, which are ... likely mechanisms. ...

It's hard to individualize ... the specific mechanism because ... royalty reduction under this bill can come under fields that [have] just been delineated, and you don't have a lot of geologic information yet - you have enough to know that it's developable, but you don't fully have the wells drilled; you don't fully have an understanding of the size and shape of the accumulation. So in that [case] ... you'd have a rough idea, but not real accurate numbers. And in that case, it takes a lot more scrutiny to do the analysis and you would want to condition the royalty with a lot more upside protection.

Conversely, very late in the life of the field you'll have a lot of data, you'll have lots of wells, you'll have good seismic data, you'll have a good production history and [know the] decline of the field. And you'll be able ... to be a lot more precise ... on the royalty production. You may not need as many caveats to protect the upside.

So it all depends on ... the individual data set available [for] the field, the economics of the field, the oil price, obviously. So ... there are a lot of abilities in this bill to customize the royalty reduction and protect the state ... on the upside.

Number 2029

REPRESENTATIVE NORMAN ROKEBERG, Alaska State Legislature, one of the sponsors, agreed with Mr. Myers, noting that page 2, lines 24-28, [paragraph] (3), is the key to this legislation. He pointed out that the sliding scale is a key element of the bill and read from the paragraph, which states:

(3) shall provide for an increase or decrease or other modification of the state's royalty share by a sliding scale royalty or other mechanism that shall be based on a change in the price of oil or gas and may also be based on other relevant factors such as a change in production rate, projected ultimate recovery, development costs, and operating costs

REPRESENTATIVE ROKEBERG said there is an upside that should be anticipated under any kind of agreement entered into; that was the fundamental basis of the 1995 changes proposed in HB 207.

Number 2111

REPRESENTATIVE GUTTENBERG asked whether Mr. Myers had said the royalty reduction could be given before the field went into production or before the geological structure was understood.

MR. MYERS directed attention to page 2, line 5, sub-subparagraph (i), which talks about a field that has been sufficiently delineated to the satisfaction of the commissioner. He said there must be some "reasonable geologic information," but that for a field not yet in production there is a higher level of uncertainty. There will be test data, but not necessarily representative of the entire field. He elaborated:

So there's a substantial amount of uncertainty, but you do believe you have captured the range of possible oil and gas that's in the field. But ... as you get more data, the range of uncertainty decreases. So the commissioner has to make a decision without [its being] sufficiently delineated, and ... that's a real important ... issue. He's not going to know he's right or not - that's why the conditioning that Representative Rokeberg talks about in these early stages are important; that's why the ability of the state to get an outside consultant to look at engineering data as well becomes really critical.

So ... in those cases where you have a reasonable amount of information but not a huge amount of

certainty, you really want to be careful on how you condition it to capture the upside again ... as development of the field goes. Typically, oil and gas fields increase in their ultimate recoverable reserves due to changes in technology ... and due to capturing the upside. That's ... historically, if you look at all our major fields, with the exception of fields like Badami, in which case ... there was more downside than upside.

So, generally, the upside's larger than initially calculated, and the state needs to be keenly aware of that when they model it. That's not to say there aren't other cases where it goes the other way, or the uncertainty. So I guess [the] long and short is, the applications under that section, under "delineated but not yet in production field," are the most challenging, ... 'cause you have less information. But you can still do it, particularly if you condition, as Representative Rokeberg suggested, in the other section.

Number 2259

REPRESENTATIVE GUTTENBERG asked, in that scenario, whether it would be prudent for developers to say, at a certain point in their exploration, that they would stop looking and didn't have enough data, in order to get the royalty reduction.

MR. MYERS responded that, first, it's been learned from royalty reduction in other scenarios that other factors involving profitability of the field generally outweigh the royalty reduction; external factors such as fluctuations in the price of oil and uncertainty about the size of the reservoir dominate a company's discussions in terms of whether or not to develop. Thus he opined that only development at the margins can be affected in most cases.

MR. MYERS said, second, there is definitely some risk, which is why it needs to be structured. He explained:

We independently review the data. We have the seismic data; we look at the well data. Will an applicant try to leverage this? Possibly. But, again, you would condition such a royalty reduction as production increases or as reserve base increases or as price changes - a sliding scale. So we would capture that.

And probably, in many of these cases, ... we would ask for an increase in royalty to offset any decrease in royalty earlier on, again, to balance that. So it's a delicate balance.

You have to be very diligent to ... do a good technical evaluation to protect the interest. There's clearly a desire by the operator to pay as little royalty as possible; that's ... only nature. We are a cost ... to the structure. It's our job, in terms of our technical analysis, to make sure we get our fair share, and that if we do structure a deal that we do recover any royalty [relief] that was granted that was not appropriate. ...

Number 2385

MR. MYERS said the other big factor that no one controls is price, a big [determinant] in how the evaluation is done with regard to whether royalty reduction is justified economically. Noting that generally most mechanisms under royalty reduction would take price into consideration, he said:

I guess where this is useful, in cases where the field size is "on the bubble" in terms of whether it's economic or not and the price is depressed for a while, this would provide ... a little bit of certainty ... that they might be able to go ahead with development and improve their economics slightly. ... That's the kind of issues ... we play with here.

This is very difficult, ... very tough stuff to do. It takes really detailed analysis; we don't take it lightly. And ... the history of this is, we have denied applications under this when we haven't seen it as appropriate or in the public interest, under the previous [AS 38.05.]180(j) and (p).

Number 2440

REPRESENTATIVE HEINZE offered her understanding that the commissioner is bound by law to act in the state's best interests and has the right to set the royalty at the time of a lease sale. She asked whether the commissioner can reduce it only through this bill.

MR. MYERS said that's correct, but there are other conditions under which royalty might be reduced. For example, some fields in Cook Inlet are affected by [SSHB] 198, heard during this meeting; there are other mechanisms, but those are site-specific. With regard to SSHB 28, he said it truly is designed to be customized royalty relief for each field, based on its individual economic criteria.

REPRESENTATIVE ROKEBERG pointed out that this is statewide in application, whereas most of the other bills have specifically targeted a particular basin, area, or circumstance. He said this portion of the statute is the central, historic, long-term statutory authority for any modification, and that the other bills are additions to it.

Number 2530

CHAIR FATE surmised that SSHB 28 will induce exploration in areas that are marginal or where little data has been obtained from previous exploration, even though the geology may indicate a high potential. He opined that the ability to recapture a previously reduced royalty if a field becomes highly productive bodes well for this legislation. He suggested this might be a good device for the Nenana basin in his own region, for example.

Number 2577

REPRESENTATIVE GUTTENBERG asked whether this bill is universal enough to cover all oil and gas situations in the state.

REPRESENTATIVE ROKEBERG replied that he wouldn't go so far as to say that. He characterized this as the root or foundation, with general applicability, but offered his belief that there should be other, targeted types of programs. He cited [SSHB 198] as an example that deals with the actual production equipment and is unique to Cook Inlet and its declining production in certain older fields. He indicated SSHB 28 is intended to look at older fields, but could have general applicability as an incentive to drill. He explained that the language passed in 1995 had become unworkable and that the intention is to straighten that out.

CHAIR FATE announced that he was closing public testimony.

Number 2741

CHAIR FATE drew attention to Amendment 1, which read [original punctuation provided]:

Insert new section after (6):

(7) may, with the mutual consent of the lessee or lessees making application for the royalty reduction under (1)(B) or (1)(C) of this subsection, request payment for the services of an independent contractor, selected from a list of qualified consultants to evaluate hydrocarbon development, production, transportation, and economics by the commissioner to assist the commissioner in evaluating the application and financial and technical data; if, under this paragraph, the commissioner requires payment for the services of an independent contractor, the total cost of the services that may be paid for by the lessee or lessees may not exceed \$150,000 for each application, and the commissioner shall determine the relevant scope of the work to be performed by the contractor; selection of an independent contractor under this paragraph is not subject to AS 36.30;

REPRESENTATIVE ROKEBERG noted that it goes on page 5, line 24, and also should say "renumber accordingly".

Number 2821

REPRESENTATIVE GUTTENBERG moved to adopt Amendment 1.

CHAIR FATE asked whether there was an objection.

REPRESENTATIVE GUTTENBERG said just for discussion purposes. He asked whether anything covers a conflict of interest for an independent contractor for this evaluation, who would most likely have ties to the industry or considerable contractual relationships with such entities.

Number 2863

REPRESENTATIVE ROKEBERG agreed that the number of firms with this expertise is limited. He said the issue of who gets to select whom had been an arm-wrestling match of sorts between him and the division for a prior draft of the bill, and that he'd deferred to the division "to give them a little more sway in terms of the selection of who was going to be doing it, notwithstanding the fact that the applicant still pays the freight."

MR. MYERS added:

We want to be sure that the qualified consultant ... isn't biased. Generally, they work for a large number of folks in the industry because there's ... certainly not enough government work up here to support contractors. And you clearly want a qualified one that has good experience with the industry. That said, ... we've worked with contractors before; they've been good. We have a confidentiality agreement, obviously, with them, and we've seen a pretty good professional relationship.

The other thing is, the decision will still be made by the commissioner. ... This isn't "we just farmed this ... analysis out." We will ask them specific questions, evaluate, and maybe ask a question on the seismic on the upside. It may be a question on the cost of facility construction and auditing, ... looking at what data: "Take a look; give us an expert opinion on the financial data submitted by the applicant."

So, generally, when we use a contractor - and we never have for a royalty reduction, but it's anticipated we would be using one - we would target specific questions and their specific qualifications.

TAPE 03-37, SIDE B

Number 2965

MR. MYERS mentioned unbiased information and the intention to "trust but verify." He also offered his experience that the high-quality contractors have been able to compartmentalize their work "between folks" and are ethical. He concluded by saying he thinks the system is workable, and emphasized that the commissioner has the say in the selection process, although the applicant has a partial say as well. He added:

I think in most cases we probably won't hire [an independent contractor]. It's primarily in two cases. One, the workload is so high that we physically can't ... do the work in a timely manner, so the applicant may ... want to hire somebody to help us with some of the analysis.

Secondly, in the case of the delineated cases ... we talked about, there is a tremendous amount of upside work to do in order to craft something or to fully understand the economics of the field to the best we can with a limited data set. At that point, ... you can't rely on production forecasts, production history; you've got to look at the "what ifs." The scenarios become very broad ... early in the life of the field, [for example] ... the price of oil you have to forecast or risk over a long period of time in order to craft something. So there is just a tremendous amount of work in the early ... life of a field. To that case, we would be targeting them to do a bunch of the modeling, probably, for us. But, again, ultimately, that modeling would have to be compiled and looked at heavily by our commercial section.

MR. MYERS deferred to Kevin Banks for further comment.

Number 2878

KEVIN BANKS, Division of Oil & Gas, Department of Natural Resources, indicated Amendment 1 is a companion to paragraph (6), wherein if the commissioner decides an evaluation is needed, he/she can require that an independent contractor be hired and paid for by the applicant, up to \$150,000. He said [paragraph (7), proposed by Amendment 1] would provide the option "to have an independent contractor hired and, with the consent of the applicant, have the applicant contribute to ... paying for it." Mr. Banks related the experience that in-house evaluations take a lot of time away from regular work, and said he believes the ability to hire an independent contractor will "serve the process" and expedite the applicant's application.

Number 2817

REPRESENTATIVE KERTTULA asked for verification of her understanding that under previous bill versions the commissioner could require the payment, whereas this would change it so payment could be requested with mutual consent.

MR. MYERS answered:

Under the cases where the royalty reduction is for a field already in production and for shut-in production, it'd have to be mutual agreement. For a

case where it's delineated but not yet in production, the commissioner has the sole discretion. That was, again, I think, part of this arm-wrestling match that Representative Rokeberg referred to. And we looked at it practically, and ... in these later cases we believe we have sufficient technical expertise to do the work. ...

I think there was some concern by AOGA [Alaska Oil and Gas Association] and some other folks of the cost, potentially, that could be incurred there. We tried to assure them that we're not likely to have high costs on those types of applications. They wanted assurance that they would have some say ... in the application. So we balanced [it], to say that "if we both agree to it." So ... it seemed like a reasonable compromise, recognizing that in cases of royalty-reduction requests previously under those two types of royalty reduction, we have not ... used an independent contractor.

Number 2729

REPRESENTATIVE KERTTULA requested clarification on the two types of royalty reduction he'd mentioned.

MR. MYERS specified that the three cases are on page 2, lines 5-12. The "sufficiently delineated" case has the most uncertainty in all aspects: clearly, there is a lot of work and modeling to be done, and no production in those fields. The second case is that oil or gas production for the field wouldn't be economically feasible: there has been production for a while but the economics are no longer sufficient and the operator wants to "shut in." Royalty reduction might extend that. The third case is when it has already been shut in and the desire is to bring it back on line. There is a lot more data involved in those decisions. He said it is sort of like the discussion for [SSHB 198], where the production decline can be tracked and there are delineated reservoirs. It still would be a lot of work, but there would be a better data set and less uncertainty. Thus the department would have reasonable confidence of being able to do it without the independent contractor, although the contractor would clearly speed up the process.

REPRESENTATIVE ROKEBERG noted that (1)(A), starting on page 1, line 13, is new fields; (1)(B), starting on page 2, line 13, is existing fields; and (1)(C), starting on page 2, line 18, is

shut-in fields. He said that's why there are slight distinctions about different types of conditions.

Number 2629

REPRESENTATIVE GUTTENBERG removed his objection.

CHAIR FATE announced that there was no objection and that Amendment 1 was adopted.

REPRESENTATIVE KERTTULA referred to the top of page 5 and expressed concern about taking out the sections regarding confidentiality and producing the information to the legislature. She said she doesn't care whether the legislature approves it or not, but asked whether there are other avenues for legislators to get this information if they sign confidentiality agreements.

MR. MYERS deferred to Mr. Banks, but said [the Joint Committee on Legislative Budget and Audit] has a role in the review, if requested.

REPRESENTATIVE ROKEBERG brought attention to page 7, line 5 [paragraph (8)].

REPRESENTATIVE KERTTULA acknowledged that, but said she wanted certainty that legislators, if they sign confidentiality agreements, can somehow get access to the information.

Number 2550

MR. BANKS referred to the language pointed out by Representative Rokeberg on page 7, and said he believes there are other avenues available, "with a specific confidentiality waiver, that the legislature can see the information that's been presented to us." He added, "My concern only is that in striking out the section on page 5, that there might be some kind of legislative intent to erase that, but ... I don't know the answer to that question."

REPRESENTATIVE KERTTULA surmised that it was Representative Rokeberg's intention not to wipe out the legislature's right to receive confidential information, but only to remove the [role of the Joint Committee on Legislative Budget and Audit].

REPRESENTATIVE ROKEBERG said that's correct. Noting that in 1995 it became much too cumbersome, he referred to the review by

the [Joint Committee on Legislative Budget and Audit] and to page 7, line 18 [paragraph (9)]. He said the findings and [determination] still are specifically directed by statute to be delivered to the legislature for review. He offered his experience, specifically relating to the Northstar case, that whoever chairs that particular committee can request a confidential executive session if the information is proprietary, if there is a need to go to that extent. He said the legislative purview is still very much a part of this [under Version U], but isn't as cumbersome as it was before with respect to the governor and so forth.

Number 2420

REPRESENTATIVE KERTTULA emphasized that she wants to be positive that the legislature isn't giving up any right of access to confidential information. She said she knows that isn't the intent, but she would double check with Mr. Banks later and then clear it up with the [sponsors]. She clarified that she had no problem with the intent to streamline the approval system.

REPRESENTATIVE ROKEBERG referred to page 7, lines 12-17, which deleted language [in paragraph (8)] and which read:

[IF, UNDER (6)(B) OF THIS SUBSECTION, THE FINANCIAL AND TECHNICAL DATA MUST BE KEPT CONFIDENTIAL AT THE REQUEST OF A LESSEE OR LESSEES MAKING APPLICATION FOR THE ROYALTY MODIFICATION, THE COMMISSIONER MAY APPEAR BEFORE THE COMMITTEE IN EXECUTIVE SESSION;]

He said, "I think that's just assumed. ... Deleting that particular section doesn't mean it can't be done."

REPRESENTATIVE KERTTULA again acknowledged the intention, but reiterated that she would talk to Mr. Banks and then return to the sponsors.

Number 2358

REPRESENTATIVE KERTTULA referred to page 4, line 15, noting that it removes a line that says the royalty modification is not assignable [without the prior written approval of the commissioner]. She asked whether the bill allows it to be assignable without the prior written approval of the commissioner or not.

MR. MYERS replied that he believes removing that language does do that.

REPRESENTATIVE KERTTULA asked what Mr. Myers thinks about that.

MR. MYERS said he thinks one of the important things is that the commissioner really look at the issue and the value of the assignability as part of the royalty reduction, and that it not be assignable if the commissioner thinks it's inappropriate.

Number 2316

REPRESENTATIVE ROKEBERG explained that it had been removed at his request because he believed it would cloud or restrict the alienability of any leasehold assets a company might have.

REPRESENTATIVE KERTTULA said she wasn't sure she agreed, but could deal with that issue later.

Number 2281

REPRESENTATIVE HEINZE moved to report CS for SSHB 28, Version 23-LS0177\U, Chenoweth, 4/30/03, as amended, out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, CSSSHB 28(RES) was reported from the House Resources Standing Committee.

[There was an announcement that the previously recessed meeting was being adjourned and that the May 7 meeting was beginning, with a quorum present. However, these minutes treat it as one meeting, which is how it was scheduled.]

SB 151-REGULATION OF NATURAL GAS PIPELINES

[Contains discussion of HB 204, the companion bill]

Number 2160

CHAIR FATE announced the final order of business, CS FOR SENATE BILL NO. 151(L&C), "An Act relating to the regulation of natural gas pipelines under the Pipeline Act; and providing for an effective date."

Number 2155

SENATOR THOMAS WAGONER, Alaska State Legislature, sponsor, noted that SB 151 is a companion bill to HB 204, which this committee

had heard recently. He said the only change in the Senate Labor and Commerce Standing Committee was the addition of an immediate effective date.

CHAIR FATE asked whether there were any questions. [None were offered.]

Number 2091

REPRESENTATIVE KERTTULA moved [to report CSSB 151(L&C) out of committee with individual recommendations and the accompanying fiscal notes]. There being no objection, CSSB 151(L&C) was reported from the House Resources Standing Committee.

ADJOURNMENT

The House Resources Standing Committee was recessed at 9:21 a.m. to a call of the chair. [The meeting was reconvened at 1:40 p.m.; see 1:40 p.m. minutes for this date.]