

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

May 19, 2003

10:35 p.m.

MEMBERS PRESENT

Senator Scott Ogan, Chair
Senator Thomas Wagoner, Vice Chair
Senator Fred Dyson
Senator Ben Stevens
Senator Ralph Seekins

MEMBERS ABSENT

Senator Kim Elton
Senator Georgianna Lincoln

COMMITTEE CALENDAR

HOUSE BILL NO. 283

"An Act relating to limitations on coal leases."

MOVED HB 283 OUT OF COMMITTEE

CS FOR HOUSE BILL NO. 24(JUD)

"An Act relating to intergovernmental agreements with the federal government regarding management of fish or game in the state."

MOVED CSHB 24(JUD) OUT OF COMMITTEE

CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 28(FIN)

"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 CS SSHB 28(FIN) OUT OF COMMITTEE

PREVIOUS ACTION

HB 283 - See Resources minutes dated 5/16/03 and 5/18/03.

HB 24 - See State Affairs minutes dated 5/17/03 and Resources minutes dated 5/18/03.

HB 28 - No previous action to record.

WITNESS REGISTER

Representative Bruce Weyhrauch
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Sponsor of HB 24

Mr. Steve White
Assistant Attorney General
Department of Law
PO Box 110300
Juneau, AK 99811-0300
POSITION STATEMENT: Told members HB 24 will not affect existing agreements

Mr. Ron Somerville
Advisor to the House & Senate Majority
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Answered questions about HB 24

Representative Norm Rokeberg
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Co-sponsor of HB 28

Representative Vic Kohring
Alaska State Capitol
Juneau, AK 99801-1182
POSITION STATEMENT: Co-sponsor of HB 28

Mr. Ken Boyd
Alaska Oil and Gas Association (AOGA)
121 West Fireweed Lane
Anchorage, Alaska 99503
POSITION STATEMENT: Supports CS SSHB 28(FIN)

Mr. Kevin Banks
Division of Oil and Gas
Department of Natural Resources
550 W. 7th Ave. Ste 800
Anchorage AK 99501-3560
POSITION STATEMENT: Answered questions about CS SSHB 28(FIN)

Mr. Mark Myers, Director
Division of Oil and Gas
Department of Natural Resources
550 W. 7th Ave. Ste 800
Anchorage AK 99501-3560

POSITION STATEMENT: Answered questions about CS SSHB 28(FIN)

Mr. Kevin Tabler
Manager, Land and Govt. Affairs
Union Oil Company of California (Unocal)
909 W. 9th Ave
Anchorage, Alaska 99501

POSITION STATEMENT: Supports CS SSHB 28(FIN)

ACTION NARRATIVE

TAPE 03-49, SIDE A

CHAIR SCOTT OGAN called the Senate Resources Standing Committee meeting to order at 10:35 a.m. Senators Wagoner, Stevens, Dyson and Chair Ogan were present. The committee took up HB 283.

HB 283-ACREAGE FOR COAL LEASES

CHAIR OGAN informed members that at the last hearing on this legislation, he was concerned about coal leases overlaying traditional oil and gas leases because coal is available in areas that are also available for areawide leasing for oil and gas in the Tyonek Basin. He noted the language on page 1, line 11, reads, "The coal deposits in the land covered by the application shall be temporarily set aside" therefore the coal leases will not affect deep hole oil and gas leases. He said he discussed the matter with Division of Oil and Gas staff and learned that a company with a coal lease can exploit the shallow gas for either production or safety reasons. He said his concerns have been addressed.

SENATOR WAGONER moved HB 283 from committee with individual recommendations and its attached zero fiscal note.

CHAIR OGAN announced that all members were present except Senators Lincoln and Elton. He then announced that without objection, HB 283 moved from committee.

CHAIR OGAN announced an at-ease. Upon reconvening, the committee took up HB 24.

CSHB 24(JUD)-AGREEMENTS ON MANAGEMENT OF FISH AND GAME

REPRESENTATIVE BRUCE WEYHRAUCH, sponsor of HB 24, told members HB 24 follows on the heels of legislation introduced by Chair Ogan that said the state will in no way cooperate or spend funds on the Glacier Bay lawsuit. He explained that in the early

1980s, in the Alaska Wildlife Alliance versus Jensen case, the District Court of Alaska and the Ninth Circuit Court indicated that ANILCA did not prohibit commercial fishing in Glacier Bay but that the National Park Service could prohibit it by regulation. Thereafter, the National Park Service began a process of promulgating regulations to prohibit and restrict commercial fishing in Glacier Bay National Park. Senator Ted Stevens then introduced legislation, which Congress adopted, that said commercial fishing should be closed in certain areas of the park and restricted to those who have a lifetime access permit for the tanner, halibut and salmon troll fisheries. That is the status of fishing in Glacier Bay now. Congress also established a compensation program related to those closures and restrictions. Senator Frank Murkowski then introduced legislation, S 501, which Congress adopted, that said the State of Alaska and the National Park Service shall enter into co-management agreements on the management of commercial fisheries in the outside waters of Glacier Bay National Park.

REPRESENTATIVE WEYHRAUCH told members HB 24 was originally introduced to prohibit the State of Alaska from entering into any co-management agreement with the federal government or a sovereign entity. If it did enter into those agreements, the legislature would have to review the agreements. During the hearings in the House, it became apparent that certain co-management agreements between the federal and state governments benefit the State of Alaska, such as the management of bowhead whales or waterfowl, so the House did not want to prohibit or require legislative review of all co-management agreements. CSHB 24(JUD) now says the State of Alaska may not enter into an agreement that cedes jurisdiction to the federal government. He stated:

You do not want to have any state...public servant or bureaucrat, having a co-management agreement with the federal government that cedes jurisdiction by contract, which we can't do by Constitution or statute. And, tactically, the reason you want to do that is because eventually if the federal government says we have management jurisdiction over this resource, and you agreed to that in a contract, then that may undermine any argument that says no, federal government, you don't have management jurisdiction over our resources - the State of Alaska does. So, by passing this statute, tactically, you can say if there were a co-management agreement and it ceded jurisdiction of management over a fishery, it would

have been void as against public policy of the State of Alaska. And I think that's, sort of as a tactical reason, why this was introduced, to prohibit by contract what we can't do by statute or regulation, the secession of our management and jurisdiction of our resources to the federal government.

CHAIR OGAN said he toured the Situk River in Yakutat a few years ago, an area with some conflicts. A federal permit is required to float a state river. He said he got an earful from the locals in the area and had to hold his tongue while the federal officials were checking everyone's permits. He asked if this legislation will deal with that problem.

REPRESENTATIVE WEYHRAUCH said it would if the State of Alaska and the National Park Service said the federal government has jurisdiction to manage the [riverbed] on behalf of the state or if [the state] cedes jurisdiction of fish and game management on that river. It is narrow on those issues. It arguably could address the co-management agreement between the National Park Service and the state if the state, by management agreement or a memorandum of understanding, says it will give the federal government the authority to do so, whether or not that is allowable under the Alaska Constitution. He said the legislation is intended to make any admission by the state void if the federal government intends to use it against the state later in court.

CHAIR OGAN asked a representative of the Department of Law to comment on the legislation and describe its application "in the field."

MR. STEVE WHITE, Assistant Attorney General, Department of Law (DOL), told members he talked to staff at the Alaska Department of Fish and Game (ADF&G) who could not identify any agreements this legislation would apply to at this time. HB 24 would be preventive for future agreements. He said as Representative Weyhrauch said, the intent is not to interfere with the state's interaction with the federal government on cooperative management that does not give away the state's authority in any manner. For example, the state cooperates with the federal government to implement fishery management plans under the North Pacific Fisheries Management Council and it shares research information for subsistence management on federal lands. The state and federal governments also have agreements involving migratory waterfowl. In those situations, the state cooperates with the federal government, which was given the authority by

Congress through the Supremacy Clause, to regulate in those areas. The state assists to make sure its interests are involved.

MR. WHITE said if ADF&G attempted to give away the state's management authority, the contract would be subject to being voided by the courts because it would be outside of the state's authority to do so.

CHAIR OGAN said he begs to differ that no existing agreements have given away authority. He said a recent ruling by the federal subsistence board for subsistence fishing for rainbow trout in western Alaska is egregious, according to some biologists. He also referred to the 20 halibut per day subsistence catch established by the federal subsistence board. He said he is concerned that while the state might not technically be ceding its authority, the federal subsistence board does not have a mandate to manage for sustained yield. Therefore, the state is allowing the federal government to manage its resources in state waters and submerged lands by doing nothing, which is ceding by default.

SENATOR SEEKINS asked if the state has cooperative agreements with the federal government for the management of fish for any purpose within the navigable streams or within three miles of the coastline of the state at this time.

MR. WHITE said he is personally not aware of any. He noted that Mr. Williams of ADF&G was shaking his head "no."

SENATOR SEEKINS asked, if the federal government claims it has management authority over fish for subsistence uses in the Yukon River, whether ADF&G recognizes that claim and enters into a co-management agreement.

MR. WHITE said the situation on subsistence is very difficult because the federal government has management authority over some navigable waters but not all.

SENATOR SEEKINS said in the Totemoff case, the Alaska Supreme Court said that is not true.

MR. WHITE agreed.

SENATOR SEEKINS asked if Mr. White is saying the Totemoff case is tolled so that the state can have these agreements.

MR. WHITE replied, "No. The Ninth Circuit ruled contrary to the state supreme court on the Totemoff case."

SENATOR SEEKINS disagreed. He said the Totemoff case was never brought to the Ninth Circuit Court. The Alaska Supreme Court said, in the Totemoff case, that the State of Alaska did not have to recognize the federal claims.

CHAIR OGAN clarified the decision said that is the situation unless the case goes to the U.S. Supreme Court.

SENATOR SEEKINS again asked if the state is now involved in any co-management agreements in violation of the Totemoff decision made by the Alaska Supreme Court.

MR. WHITE said he does not believe the state has any agreements along those lines. ADF&G is closely watching the federal government's exertion over subsistence management and, if the federal government goes beyond what ANILCA allows, the state would challenge.

SENATOR SEEKINS said that is his concern. He again asked if the state is complying, via contract, or spending any money to assist the federal government to exert management authority over fish on the state's submerged lands.

MR. WHITE said he does not believe the state has any formal agreements. He said the state shares research and comments on proposals, such as the subsistence halibut fishery. He said ADF&G objected to a recent proposal before the federal subsistence board to allow for customary trade. He told members to the extent the federal subsistence board is taking action, ADF&G is commenting to protect the state's interests but it has not entered into any agreements to assist the federal board.

CHAIR OGAN stated, "I'd like to add a comment. I can't resist taking the bait. You said they were just watching it and the department just sat back and watched while the feds undermine the sovereign rights of our state to manage our resources and the Governor rolled over - the last Governor rolled over and, in my opinion, violated his oath in the process...."

SENATOR SEEKINS said he was just curious whether any existing contracts would violate HB 24, if it is enacted.

MR. WHITE again said no existing contracts would.

SENATOR WAGONER asked Representative Weyhrauch whether the lifetime permits in Glacier Bay include the halibut fishery and whether they are transferable or restricted to the current owners. He questioned whether [Congress] made a withdrawal so that the state will never again be able to go into Glacier Bay and harvest its resources.

REPRESENTATIVE WEYHRAUCH said the congressional action means that no more commercial fishing operations will take place in Glacier Bay. Sport fishing, charter fishing, cruise ships, kayaking and hiking, among other activities, will be allowed in Glacier Bay.

SENATOR BEN STEVENS said he believes the permit holders were compensated as well.

REPRESENTATIVE WEYHRAUCH told members that \$23 million was awarded to people who made claims for compensation under the portion of the congressional act that closed and restricted commercial fishing in Glacier Bay. Those commercial fishermen who received lifetime access permits may or may not have received compensation; they could have applied. Some lifetime access permit holders applied but were denied either initially or because they initially obtained money but were then reversed to zero on appeal because the National Park Service tinkered with the numbers for the compensation program.

SENATOR BEN STEVENS stated, "If the federal government had a clause like this in their law, the FMPs [Fisheries Management Plans] and North Pacific and civil co-management agreements that we manage for the feds now would not be able to exist."

REPRESENTATIVE WEYHRAUCH said outside of the three-mile boundaries, those could still exist, particularly for the crab FMP in the Bering Sea. The State of Alaska and federal government could still enter into those co-management agreements because that is a federally managed resource. The intent of HB 24 is to address state waters and to say if a co-management agreement cedes management or jurisdiction unauthorized by statute or the Alaska Constitution, an agreement could not be made by contract.

SENATOR BEN STEVENS said if the table was turned and the federal government could not cede management authority to the state, the state could not enter into a management agreement with the federal government.

REPRESENTATIVE WEYHRAUCH said the state could enter into an agreement with the federal government if the State of Alaska had a claim over the management and jurisdiction by constitutional right. That jurisdiction would exist no matter what the management agreement said. The jurisdiction and management, whether federal or state, still exist. If the state has a claim on the management and jurisdiction over those fishing rights under law, it could not give those away by contract.

SENATOR BEN STEVENS asked if the state could not give away management by contract.

REPRESENTATIVE WEYHRAUCH replied:

It can't give it away - it can't say we give you the right to have management and jurisdiction of our resources by contract because if that was prohibited by Constitution or statute, the state couldn't give it away by contract. The state couldn't cede that jurisdiction by contract what it can't cede now by law or Constitution. So, by entering into a co-management agreement, or - if you want to call it a co-management agreement - an agreement with the federal government of federal fisheries, the state isn't ceding any jurisdiction over those fishery resources because the state by Constitution doesn't have jurisdiction over those resources. It's a federal resource.

SENATOR BEN STEVENS said he was suggesting a role reversal so the federal government could not cede its authority to manage to the state. The state manages federal resources, in certain instances, but the state would not be able to cede to them.

REPRESENTATIVE WEYHRAUCH said the state could allow the federal government to manage the resource in the state. CSHB 24(JUD) would prohibit any assertion that the state has given up its management and jurisdiction over those resources by contract. If the state has a dispute with the federal government over who has the right, the federal government could not claim it in court via the contract. The contract cannot override the state's plenary ability to manage and have jurisdiction over the resources and nothing by contract diminishes the legal argument.

SENATOR SEEKINS said he believes Representative Weyhrauch's argument parallels a decision in an early 1990s case named New York State versus United States of America. That decision basically said a sovereign cannot realign the boundary between

these sovereigns by agreement. It would have to be done by constitutional amendment.

REPRESENTATIVE WEYHRAUCH added, "Or to say that we have the legal authority to do that - nothing diminishes that."

SENATOR SEEKINS agreed and said CSHB 24(JUD) is a restatement of that decision. He said he likes that approach because it is also consistent with the Dinkum Sands case. He asked if the State of Alaska is involved in a [U.S.] Supreme Court case right now on the ownership of the submerged lands in Glacier Bay.

REPRESENTATIVE WEYHRAUCH said that case is Alaska versus United States, which is a quiet title action filed in the U.S. Supreme Court.

SENATOR SEEKINS asked if CSHB 24(JUD) merely says that no agreement the state enters into affects its sovereign control.

REPRESENTATIVE WEYHRAUCH said that is correct. He noted that Mr. Somerville has provided him with several examples of how it works with the federal fisheries.

SENATOR SEEKINS maintained that CSHB 24(JUD) will not prevent the state from entering into a contract with the federal government. It just allows the federal government to manage if it has the manpower and will but it retains ownership by the state.

CHAIR OGAN said his concern in the past has been that the state has been terribly inconsistent with assertion of sovereignty on navigable waters. He commented:

We're saying on one hand we want to assert sovereignty in Glacier Bay because we all agree on that one. But, losing by default by not appealing to the Supreme Court, we gave up sovereignty of the rest of the submerged lands - it's a pretty schizophrenic state position and set a terrible precedent and it's probably one of the reasons we're here now.

SENATOR BEN STEVENS pointed out that the reference to AS 16.20.010, on page 2, line 5, relates to legislative recognition of a state game refuge. [Section 1] says the state has jurisdiction over all fish and game in the state except in those areas where it has assented to federal control but the state has

not assented to control of fish and game in Glacier Bay National Park.

REPRESENTATIVE WEYHRAUCH asked that Mr. Somerville address some of the federal issues that Senator Stevens raised.

MR. RON SOMERVILLE, advisor on natural resource issues to the House and Senate Majorities, told members that the state has concurrent jurisdiction but it can adopt regulations within the regulations adopted by the federal agencies related to marine mammals, waterfowl, and halibut. In other cases, such as federal jurisdiction beyond the state's waters, the federal agencies delegate authority to manage those areas; they do not cede that authority to the state. The federal government allows the state to manage halibut under the treaty, but it has not ceded authority to the state.

CHAIR OGAN remarked, "In other words, we roll over but not without kicking a little bit."

MR. SOMERVILLE said that is one way of putting it but, in some cases, such as with marine mammals, the state is preempted so anything it gets at the preemption process the federal government can delegate back to the state.

SENATOR SEEKINS asked if the supremacy clause overrides the state in the management of fish and game in state waters.

REPRESENTATIVE WEYHRAUCH said the State of Alaska came into the Union with the promise that it would be on an equal footing with other states. That was affirmed in a Utah lands case before the U.S. Supreme Court. The state was in a constant battle with the federal government to assert that it should be on equal footing with the other states and colonies and that Alaska should have control and management over its submerged lands and waters at statehood. That has been a defining moment in the state's history and the dispute will continue of who should control, own, manage and have use of lands in the state. He said he cannot answer Senator Seekins' question but he is very concerned about the issue. He repeated that the intent of the legislation is to make it clear that no agent of the state, who is not an elected official, or through constitutional and statutory amendment, is allowed to diminish our ability to claim management and jurisdiction of our resources.

CHAIR OGAN commented that the state not only gained control of submerged lands [at statehood] but it also gained title to those

submerged lands. The equal footing provision was specifically included in the Statehood Act: the quitclaim of title to submerged lands and with it the right to control not only the lands but the water columns and fish and game in it.

REPRESENTATIVE WEYHRAUCH clarified that title case is before the U.S. Supreme Court's master at this time.

CHAIR OGAN stated, "But the goofy ruling of the Ninth Circuit saying the reserved water rights doctrine - because this molecule of water ran across federal lands somehow gets them to control all of the fishing downstream, is what the last Governor dropped the ball on."

SENATOR SEEKINS asked if the Statehood Act provided that the State of Alaska was the beneficiary of the 1953 Submerged Lands Act in equal footing with all other states.

REPRESENTATIVE WEYHRAUCH said he could not answer that question.

SENATOR SEEKINS said it is his understanding that it did.

SENATOR BEN STEVENS asked why AS 16.20.010 is referenced on page 2 since it has no definition of management.

SENATOR SEEKINS pointed out the words, "added by Sec. 1 of this Act." follow.

SENATOR BEN STEVENS said his point is that the language [in Section 1] is restricted to AS 16.20.010, which pertains only to Glacier Bay.

REPRESENTATIVE WEYHRAUCH said he continually queried George Utermohle, who drafted the legislation, about Sec. 2. Mr. Utermohle said Sec. 2 was necessary as a transitory provision for existing agreements and was "phase-out" language to put the agencies on notice. He said the "meat" of the legislation is Sec.1, which addresses management.

SENATOR BEN STEVENS said the way he reads the bill, subsection (c) only applies to AS 16.20.010.

REPRESENTATIVE WEYHRAUCH said that is correct.

SENATOR BEN STEVENS said then all of the talk about other fish and game on state lands does not apply because AS 16.20.010 applies only to Glacier Bay National Park, bird and national

wildlife refuges or navigable waters within or adjoining the park and preserve.

REPRESENTATIVE WEYHRAUCH replied:

...what happened in this committee is exactly the dynamic that happened in House Judiciary, where people wanted to make it very broad and the discussion got very broad and philosophical and you bring in every agency and every agreement. But the intent of this bill was to deal with the co-management agreements in Glacier Bay National Park and S 501 by Senator Frank Murkowski, which required co-management agreements between the state and federal government.

MR. SOMERVILLE said Senator Stevens is correct in that the sponsor's intent was to cover Glacier Bay and the mandatory co-management agreements. The request of the House committee to expand it to include all state lands and waters should have been placed in a separate section.

SENATOR BEN STEVENS said that is what he was trying to clarify.

REPRESENTATIVE WEYHRAUCH told members that the [House] committees wanted to make the bill apply to every agreement with every agency. However, that would have made the bill unwieldy and could have harmed some of the potentially beneficial ministerial contracts the state has entered into. He said the focus was on Glacier Bay because of S 501, which mandated co-management agreements with the state. He believes the Alaska Department of Fish and Game should never cede management jurisdiction that might somehow decrease the state's ability to defend it later in court.

SENATOR DYSON said he appreciates the sponsor's efforts and believes the legislation is narrowly aimed and well crafted. He said his last comment characterized the feelings of legislators in that they would all like to expand the legislation but it is inappropriate to do so at this time. He then moved CSHB 24(JUD) out of committee with individual recommendations and its zero fiscal note.

CHAIR OGAN announced that without objection, the motion carried. He then announced an at-ease.

CS SSHB 28(FIN)-OIL & GAS ROYALTY MODIFICATION

REPRESENTATIVE NORM ROKEBERG, co-sponsor of HB 28, told members that HB 28 is a "tune-up" of AS 38.05.180(j). That section of statute pertains to royalty modifications of marginal fields. In 1995, the new Governor brought forth this legislation as a major centerpiece of his Administration to try to increase oil production in Alaska. That bill was crafted in such a way that it created impossible barriers for it to work. During that nine-year period, no grants of royalty reduction have been granted by the state. This bill modifies that statutory section to remove some of those barriers and it simplifies the language. He directed members' attention to the language on page 2, beginning on line 24. That particular language embodies, in one paragraph, the discretionary ability of the commissioner to grant a royalty modification under the terms set forward in it. It deletes language that indicates that if a royalty modification is granted, the state would have to ultimately recover. The intent was to increase oil exploration but it required that the state recover its money even though it was reopening a dry hole by royalty reductions. He said the provisions of the bill became almost unintelligible.

TAPE 03-49, SIDE B

REPRESENTATIVE ROKEBERG said HB 28 removes that language and provides for a sliding scale royalty to be determined by the commissioner who, under the Constitution, must act in the best interest of the state. It provides that relevant factors be taken into consideration, such as a change in the price of oil and gas, in production rates, production ultimate recovery, development costs and operating costs. Therefore, if the price of oil increases, the state's share will increase on a sliding scale basis. It contains other provisions that remove some of the oversight. He said the Administration supports the legislation.

CHAIR OGAN said he instantly recognized this legislation from his participation on the House Oil and Gas Committee years ago. He asked if there has been any use of the statute.

REPRESENTATIVE ROKEBERG said there was one application from Unocal that did not go through. Although the public believes the legislature gave big incentives to the oil industry, the North Star modification was the only thing that occurred. He pointed out that other specific royalty bills targeted certain fields, particularly in the Cook Inlet area, that had to be enacted because the statute did not work.

11:30 a.m.

REPRESENTATIVE VIC KOHRING, co-sponsor of HB 28, told members the sliding scale would likely be between 3 and 12.5 percent. The general royalty rate has been 12.5 percent. The commissioner is granted discretion to determine the rate. The commissioner can make that decision based on an in-house evaluation, or through an independent contractor. The evaluation will consider operating costs, field recovery, production rate and volume.

REPRESENTATIVE ROKEBERG commented that the fiscal note indicates program receipts at \$150,000. He stated:

I caution you - it's just program receipts because of the requirement of a maximum ceiling on any applicant where they can hire a third party consultant. Actually, I think the fiscal note's not correct. It should be a zero fiscal note. Only if there's an application would there be any program receipts generated. So I just wanted to point that out. This bill is not going to cost the state anything - only in foregone royalties that we wouldn't perhaps get otherwise if they're bringing a shut-in well back on production.

MR. KEN BOYD, an oil and gas consultant, said he was testifying on behalf of the Alaska Oil and Gas Association (AOGA). He stated support for CS SSHB 28(FIN) and said he participated with Representative Rokeberg and Senator Ogan and a cast of hundreds seven or eight years ago who worked on the existing law. He said the current royalty reduction statute is awkwardly worded and very difficult to implement.

SENATOR SEEKINS asked if a model already exists for the sliding scale or whether this bill will give the commissioner the discretion to set a sliding scale for each particular field.

REPRESENTATIVE KOHRING said it is his understanding this bill gives the commissioner that discretion. He deferred to Mr. Myers for an answer about an existing model.

SENATOR SEEKINS asked if a cap exists for the state's overall agreement with an oil company or whether there is a seller price.

MR. KEVIN BANKS, Division of Oil and Gas, Department of Natural Resources (DNR) said, regarding whether a model exists, DNR uses

fairly standard discount cash-flow models. DNR would more than likely tailor a sliding scale royalty provision to the specifics of each applicant. He said he can't say the bill contains a cap. DNR could conceivably trade a 12.5 percent royalty for a royalty modification that would allow for some sliding scale that could exceed, in rare instances, the 12.5 percent rate. However, that would depend upon the kind of project and the unknowns at the time of application.

SENATOR SEEKINS asked if the oil companies will pay more during the "boon" years.

CHAIR OGAN said as memory serves him, he believes there was an upside in the original legislation.

MR. BANKS said the original HB 207 contained some complicated language that directed the commissioner to develop a system that would pick up on the upside. Unfortunately, it was written so that it removed any projected royalty modification benefits to the applicant. In CS SSHB 28(FIN), the commissioner can negotiate an upside but is not required to do so. He said he can think of cases where a sliding scale between 3 and 12.5 percent would provide sufficient incentive to get production on line. The state's reward for giving up some of its royalty on the front end would be to get more production out of the prospect.

CHAIR OGAN said subsection (3) on line 24, page 2, seems to be the key to the legislation. It says "sliding scale royalty or other mechanism" so it provides broad latitude. He added that it provides for an increase or decrease and asked if it gives that discretion to the commissioner.

MR. BANKS said that is correct.

SENATOR BEN STEVENS asked if this legislation prevents or allows the commissioner to make rate adjustments to specific platforms [in Cook Inlet] without coming to the legislature for legislation.

REPRESENTATIVE KOHRING said the answer is yes but this legislation does not apply to platforms. He noted that SB 185 pertains to platform royalty reduction and differs from this legislation. He explained that the intent of CS SSHB 28(JUD) is to encourage the industry to develop three types of fields because they are not profitable: new fields, existing fields, or mothballed fields.

SENATOR BEN STEVENS said if this legislation is not enacted, separate pieces of legislation would be brought forward, such as SB 185, asking for royalty rate reductions for specific fields. He said instead, CS SSHB 28(JUD) defers all legislative authority for rate reductions to the commissioner.

REPRESENTATIVE KOHRING said that is correct, for marginal fields only. He said the legislation is not specific to certain fields; it applies to any field in the state considered to be unprofitable. He said the commissioner will determine whether a field is profitable after doing an analysis of each field.

SENATOR BEN STEVENS asked Mr. Myers to describe what kinds of fields fall under those three categories.

MR. MARK MYERS, Director of the Division of Oil and Gas, DNR, told members this bill amends an existing royalty reduction statute. It does not create a new program; it fixes some problems in the existing statute. That statute was modified but the last set of modifications created unintended consequences that were problematic. CS SSHB 28(JUD) applies in three situations: to new fields that are not economic where reducing the state's royalty share would make the field go; to fields in a later stage of production where operating costs exceed the value of production; and to fields that have been physically shut in so there is no production flowing. Reducing the royalty would change the economics sufficiently to start up production of the field again. This bill gives broad authority to the commissioner to set terms to recapture upside.

MR. MYERS said once a field is in development, a few things might improve its economics - operating costs remain the same but an increase in oil prices creates a dramatic increase in profits. Under this bill, rising oil prices can be structured into the royalty rates. Second, if production itself increases, which is only likely in a new field, the state needs a mechanism to capture the upside as more data comes in. This bill allows for all of the adjustments by giving the commissioner a lot of flexibility. However, the agreements still require legislative approval. He said an example of a field that is not yet in production would be the small field at Umiat; a field that is producing but is close to shut-in is Badami, which is currently producing about 1400 barrels per day. He said SB 185, the platform bill, addresses a unique set of circumstances in Cook Inlet where some fields are late in life with a 30-year production history. DNR was comfortable with the data about that area and did not feel it needed a mechanism to recover the

upside. That legislation contains a customized approach for Cook Inlet platforms that do not require this same process. The advantage of that approach is to retain the infrastructure in Cook Inlet.

SENATOR WAGONER asked how CS SSHB 28(FIN) will apply to abandoned oil wells.

MR. MYERS said they could fall under all three categories, because of the term "field or pool." A deeper reservoir of oil under a shallow gas reservoir could be a separate reservoir. Depending on whether that gas had been produced before by field or pool, it could qualify under any of the three categories. He said the operator would have to justify that the economics did not support operation without the royalty reduction. He explained that the process for approving the royalty reductions would be a little different. The preliminary decision would be submitted to the legislature during the public comment period, however the legislature does not vote to approve royalty reduction under this bill.

SENATOR BEN STEVENS asked if that provision is in Section 8.

MR. MYERS said that is correct.

CHAIR OGAN pointed out there is a \$150,000 cap on the amount that can be paid by the lessees and asked whether that reflects program receipts. He also asked if that amount is appropriate or whether it will cost DNR more than \$150,000 to administer.

MR. MYERS said that money would come from the applicants so there should be no additional cost to the state if the program receipts are authorized. He said that amount was negotiated with the sponsor and he cannot say whether it is totally adequate. In the past, all of the royalty reduction requests have been handled internally. DNR recognizes that a lot of analysis will have to be done on new fields, where little data is available. DNR believes \$150,000 is an adequate amount.

CHAIR OGAN asked what fields this might apply to. He noted a bill just passed the Senate that deals with severance tax breaks for certain wells. He questioned how the two pieces of legislation dovetail and whether CS SSHB 28(FIN) is targeted toward heavy oil.

MR. MYERS said it is targeted at any producing field. He said fields go through various stages. At a field's end stage, the

operator and the state must determine when it becomes uneconomic. He said royalty reductions are truly effective at the very tail end of declining production. He expects this legislation to eventually apply to all fields in the state. He pointed out in the other cases, DNR will have to look at the individual economics of each field. He said with heavy oil, as the technology changes, the economics have vastly improved. DNR would have to take a serious look at the detailed economics, the engineering and the reservoir. He indicated the heavy oil reserves are just being tapped now and are in their initial stages of production. He pointed out the exploration incentive is specifically crafted to not include wells within units that are producing or any units that have a plan of development.

SENATOR DYSON asked if anyone is opposed to CS SSHB 28(FIN).

MR. MYERS said he is not aware of anyone.

REPRESENTATIVE KOHRING said he was not aware of anyone either. The bill had three committee referrals in the House and he did not recall any negative testimony.

CHAIR OGAN noted this bill is extensive and he has some angst about the short timeframe for study. He asked Mr. Myers if he is aware of any flaws that committee members' may not be aware of.

MR. MYERS said he believes the bill improves the process. Although compromises are made in every bill, he believes the compromises are balanced and that the interests of the state are well protected.

SENATOR WAGONER asked if Swanson River has any royalty incentives right now.

MR. MYERS said he believes Swanson River is primarily a federal unit.

SENATOR BEN STEVENS noted that Mr. Myers said that application is determined on the end of life determination of the field, which he believes is a trigger to the possibility of a royalty reduction. He expressed concern that any operator could say a field is at the end of production life. He asked how DNR would determine whether a field is at end of life.

MR. MYERS said this bill allows those royalty reductions to occur at any stage of a field's life but, to determine the true economics of a field takes a lot of work and is more difficult

the further it is from the end of field because later in the field life there are more well and seismic data and production profiles. He said the calculation is very technical, which is why the fiscal note contains funds for outside experts.

CHAIR OGAN asked why the language on page 2, lines 5-9, is being deleted. He stated:

I remember we had a lot of discussion with the bill that originally passed about delineation of the oil and gas field or pool and, instead of delineating it to allow the commissioner to conduct an analysis and make the findings required by the subsection, we're eliminating - we're just letting them delineate to the satisfaction of the commissioner and it doesn't say anything about findings. Why are we doing that?

MR. MYERS said they wanted the delineation to be done on a technical basis. Representative Rokeberg was concerned about the level of legislative input and cleaning up the cumbersome nature of the mechanism. He said the original royalty reduction required two years of production. There was a push at that time, primarily by BP, to allow a reduction before production start-up. BP then asked for the royalty reduction. However, the reality is that some production is necessary to determine the economics of the field. The legislature at that time said as long as the reservoir was delineated, it was willing to grant a royalty reduction. He said this bill establishes the necessary level of data and who gets to decide whether a reservoir has been sufficiently delineated.

CHAIR OGAN said the bill contains no sunset data or requirement to report to the legislature.

MR. MYERS clarified that the commissioner's preliminary decision will be presented to the legislature. The House amended the bill to provide the legislature with access to confidential data.

REPRESENTATIVE VIC KOHRING said regarding the potential Permanent Fund earnings that this bill will generate, this bill essentially deals with three fields. Two are not producing anything at all. One way to look at the economics is that the state could get 12.5 percent of nothing, or 3 or 7 percent of something, by virtue of the sliding scale.

CHAIR OGAN asked if there is as much known heavy oil on the North Slope as has already been discovered.

MR. MYERS said that is correct but the recoverability of that heavy oil will be much lower, probably 10 to 15 percent.

MR. KEVIN TABLER, Manager of Land and Government Affairs for Unocal, stated support for CS SSHB 28(FIN). He said it is a substantial improvement to the 1995 legislation, in that it provides clarification and predictability for an applicant.

CHAIR OGAN asked Mr. Tabler if Unocal applied for a royalty reduction but did not complete the process.

MR. TABLER said Unocal pulled out after 18 months and a significant amount of cost.

CHAIR OGAN commented this bill is extensive, however the policy decision to allow royalty reduction was already made by the legislature.

SENATOR WAGONER moved CS SSHB 28(FIN) from committee with individual recommendations and its attached fiscal note.

CHAIR OGAN announced that without objection, the motion carried. He then recessed the meeting to the call of the Chair at 12:10 p.m.

On May 20, 2003, at 6:21 p.m., CHAIR OGAN reconvened the meeting for the purpose of announcing that the committee meeting was adjourned.