

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS
Anchorage, Alaska
November 21, 2005
1:10 p.m.

MEMBERS PRESENT

Representative Vic Kohring, Chair
Representative Nancy Dahlstrom
Representative Lesil McGuire (via teleconference)
Representative Norman Rokeberg
Representative Berta Gardner
Representative Beth Kerttula (via teleconference)

MEMBERS ABSENT

Representative Ralph Samuels

OTHER LEGISLATORS PRESENT

Representative Mike Chenault (via teleconference)
Representative David Guttenberg (via teleconference)
Representative Mike Hawker
Representative Peggy Wilson

COMMITTEE CALENDAR

DISCUSSION REGARDING INDEPENDENT OIL AND GAS COMPANIES IN ALASKA

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

MARK HANLEY, Manager
Public Affairs for Alaska
Anadarko Petroleum Corporation
Anchorage, Alaska

POSITION STATEMENT: Testified in support of incentives for oil production in Alaska.

KEN SHEFFIELD, President
Pioneer Natural Resources Alaska, Inc.

Anchorage, Alaska

POSITION STATEMENT: Testified in support of incentives for oil production in Alaska.

ARLEN EHM, Geological Consultant

Anchorage, Alaska

POSITION STATEMENT: Testified in support of incentives for small-sized oil companies in Alaska.

KEN BOYD, Oil and Gas Consultant

Anchorage, Alaska

POSITION STATEMENT: Testified on the subject of incentives for oil production in Alaska.

MARK MYERS, Former Director

Division of Oil and Gas

Department of Natural Resources

POSITION STATEMENT: Testified on the subject of incentives for oil production in Alaska.

DAVID BOELENS, Vice President

Alaska Operations

Aurora Power Resources Inc.; Aurora Gas, LLC; Aurora Well Service; and Shirleyville Enterprises LLC

Anchorage, Alaska

POSITION STATEMENT: Testified regarding laws affecting independent oil companies in Alaska.

DAN DONKEL

Anchorage, Alaska

POSITION STATEMENT: Testified in support of incentives for independent oil companies in Alaska.

PAUL CRAIG, Owner

Trading Bay Energy Corporation

Anchorage, Alaska

POSITION STATEMENT: Testified on the bonding difficulties for independent oil companies in Alaska.

DAVE LAPPI, President

Lapp Resources

Anchorage, Alaska

POSITION STATEMENT: Testified in support of incentives for small oil companies in Alaska.

JIM WHITE

Alaskan Crude Corporation

Anchorage, Alaska

POSITION STATEMENT: Testified that the oil industry is over-regulated in Alaska.

ACTION NARRATIVE

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at [1:10:15 PM](#). Representatives Kohring, Gardner, Rokeberg and Dahlstrom were present at the call to order. Representatives McGuire (via teleconference) and Kerttula arrived as the meeting was in progress.

DISCUSSION REGARDING INDEPENDENT OIL AND GAS COMPANIES IN ALASKA

CHAIR KOHRING relayed that the committee would be seeking ideas and recommendations from independent oil and gas companies regarding how the state can spur development and make it easier for them to operate in the state. He said that he is frustrated by the fact that the state is not developing its resources as aggressively as he thinks it should. Although Alaska has the greatest potential of all the states, currently there are only four wells being drilled, he said. He said the ideas and recommendations offered during this meeting could potentially engender forthcoming legislation.

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MARK HANLEY, Manager, Public Affairs, Alaska Region, Anadarko Petroleum Corporation (Anadarko), after mentioning that he would be referring to a PowerPoint presentation, said that generally the system is working. There have been a lot of new companies showing up in Alaska over the last five or six years, he remarked, such as "Armstrong," "British Gas," Devon [Energy Production Company, L.P], "ENI," Petro-Canada [Alaska Inc,], "Pioneer," "Shell," "Talisman," Ultrastar Exploration LLC, and others. Therefore, he surmised, the things currently being done are actually having the desired impact. On the issue of wells being dug, he noted, it takes longer in Alaska - perhaps even as long as 10 years - from "first thought" to actual production. Therefore, the price of oil right now doesn't matter as much as what the price will be between the years 2015 and 2030. Mr. Hanley, referring to his PowerPoint presentation, went on to describe some of Anadarko's financial and operational aspects.

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MR. HANLEY relayed that Anadarko tends to look for larger anchor fields, which are larger, stand-alone facility fields and tend to be farther away from existing infrastructure. Such fields tend to be higher-risk/higher-reward operations, he said. New companies provide competition, partner opportunities and educational opportunities, he stated. Referring to his PowerPoint presentation, he said "independents" are important because of the tremendous amount of resources in Alaska, although accessing those resources does come with challenges, such as high costs, long "lead times," and limited infrastructure relative to other places.

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MR. HANLEY explained that companies need stable taxes, reasonable regulations and access to infrastructure and acreage. With regard to acreage access, he suggested that current state and federal programs are working well and should be continued. With regard to the issue of regulations, he said that although there has been lot of progress made in recent years to the regulatory process, there is always room for further improvement; he mentioned a couple of recent regulatory changes which have assisted what he characterized as "North Slope orientated" companies. Regarding stable taxes, he remarked that Alaska has had such for some time and opined that this has attracted companies. In fact, he added, the five-year incentive program on the North Slope that was adopted a few years ago has influenced the decision-making process of companies like Anadarko.

MR. HANLEY pointed out that the results of any incentive program won't be seen in the first [few years] of implementation, and therefore the state should consider extending current incentives for another five years, beyond July 2007. He explained that the incentives are necessary because one can't predict what the price of oil will be in 10 years; therefore, incentives such as those for upfront exploration are helpful in convincing companies to start drilling now. Mr. Hanley offered his understanding that there has been talk of rewriting North Slope tax structures as the gasline negotiations continue. This is of concern because it creates uncertainty. He reminded the committee that the issues for independents aren't necessarily the same as for the existing players on the North Slope.

MR. HANLEY then turned to infrastructure access, which has been an issue for some time. Currently, the access on the oil pipeline is good. The concern for Anadarko, he related, is in

relation to the rates. Anadarko is currently before the Federal Energy Regulatory Commission (FERC) with a challenge to the interstate tariffs, which Anadarko believes is as much as \$1.70 a barrel too high. That can have a fairly significant impact on exploration economics, he opined. Mr. Hanley said that a gasline is needed because it will, with proper access, encourage and accelerate gas and oil exploration. Mr. Hanley concluded by acknowledging that although some may not view [gasline negotiations] moving as aggressively as some would like, one must keep in mind Alaska's unique circumstances. He predicted that there will be an increase in the number of wells.

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REPRESENTATIVE ROKEBERG inquired as to whether there is a timeframe with regard to restructuring the taxes.

MR. HANLEY answered that [Anadarko] has expressed its preference for 60-90 days. He emphasized that it will be much more complicated than the open season regulations. Thirty days is a short time for evaluation, he opined. In further response to Representative Rokeberg, Mr. Hanley confirmed that Anadarko does business in areas with varying tax structures. He offered to get back to the committee with additional data.

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REPRESENTATIVE ROKEBERG inquired as to the recommendations Mr. Hanley would give to the governor in regard to the contracts in play at this time.

MR. HANLEY related his belief that [Anadarko and other independents] have educated the governor's staff regarding fair access at a reasonable price. In further response to Representative Rokeberg, Mr. Hanley opined that it would be beneficial for there to be additional contractual provisions beyond those of FERC. For example, although there is facilities access, not all facilities are regulated by FERC. Knowing the rules of the game before investing is important, he opined. He highlighted that the negotiations are complicated, and therefore as much time as possible is necessary to review the contract.

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CHAIR KOHRING thanked Anadarko for its investment in Alaska. He then offered to work with Mr. Hanley on an extension of the tax incentives currently in place.

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KEN SHEFFIELD, President, Pioneer Natural Resources Alaska, Inc., (Pioneer), began by informing the committee that Pioneer began its investment in Alaska in early 2003 with the drilling of three exploration wells in the Beaufort Sea. In 2003, Pioneer significantly expanded its acreage position and then opened an office in Anchorage in 2004. Pioneer now employs 22 people in Alaska, he said. In 2004 Pioneer concluded exploration agreements with ConocoPhillips Alaska, Inc. (ConocoPhillips) and Anadarko across a vast portion of the National Petroleum Reserve-Alaska (NPR-A) and has assembled a substantial portfolio with an interest in more than 1.6 million gross acres across the North Slope. More recently, Pioneer acquired a 10 percent working interest with the option to acquire an additional 40 percent interest and possibly succeed ConocoPhillips as the operator of the cosmopolitan unit in the Cook Inlet.

MR. SHEFFIELD opined that for independent companies such as Pioneer the challenges to building a business in Alaska are formidable. First, the remaining North Slope resources are nothing like the original fields on the North Slope. Second, the North Slope is one of the highest cost areas in the world regarding capital, lease operating and transportation. Third, the North Slope projects have comparatively long cycle times. For instance, the time between purchasing a lease to drilling/selling oil takes from 5-10 years. Finally, the largest challenge of independents on the North Slope is uncertainty. Mr. Sheffield said: "To be successful, we must properly assess and make provision for a number of uncertainties related to future oil and gas prices, current and potential future fiscal policy, regulatory processes, and access to infrastructure, not to mention exploration risk." The long cycle times for Alaska projects require investments to be made against a long-term view for oil and gas prices. Although the current price is over \$50 a barrel, he said that the 10-year average weighted price is less than \$25 a barrel. Due to the cumulative effect of all the costs, the long time between investment and cash flow, and the odds of finding a discovery large enough to justify new infrastructure, it's difficult for many of the remote exploration areas on the North Slope to project acceptable full-cycle returns. In 2003 the state initiated exploration incentives which encouraged Pioneer and others to invest more significantly in infrastructure-challenged areas such as NPR-A. Mr. Sheffield opined that the state should

consider the effectiveness of the existing program and extend the credits beyond the current expiration of July 2007.

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MR. SHEFFIELD pointed out that for exploration nearer existing infrastructure, facility access and commercial terms aren't known with a high degree of certainty. Furthermore, the impact of third-party production into existing facilities is significant and complex. Currently, Pioneer is engaged with the Kuparuk River Unit owners in cooperative negotiations to access facilities to process production from the proposed Oooguruk development. Mr. Sheffield opined that the state must provide a stable and competitive environment for new investors. Moreover, the state needs to ensure that any future changes to tax policy don't adversely impact the resources that independents are working to commercialize. Although the state has made improvements in its regulatory process, permitting remains complex and time consuming, he said. Therefore, the state should look to the Alaska Oil and Gas Association (AOGA) and the permitting methodologies of other states for additional streamlining opportunities.

MR. SHEFFIELD stated that although Pioneer currently has no oil production, it envisions the establishment of a core producing area by 2010. Pioneer is facing major investment decisions over the next few years, including a sanction decision on the Oooguruk development project. Mr. Sheffield concluded:

Alaska needs billions of dollars of new investment required to find and develop fields to maintain production near current levels. Large independents have global portfolios with the ability to shift investment to areas with the best return and lowest risk. Higher commodity prices are opening up significant lower risk resource plays in the Lower 48. As decision makers in Alaska focus on the future, my hope is that they will stay informed, recognize the cyclical nature of oil prices and make decisions in light of what is best for the long-term future of the state, growing new supplies of oil and gas, and keeping Alaska competitive for investment.

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REPRESENTATIVE ROKEBERG asked if Pioneer has tracked the various areas in regard to the credit benefits.

MR. SHEFFIELD answered that to date the vast majority of Pioneer's investments have been in NPR-A. At this point, the majority of Pioneer's investments in the Central North Slope haven't met the requirements to receive the credits. However, Pioneer does have future investments that will likely meet the credit requirements.

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CHAIR KOHRING recalled Mr. Sheffield's comments on the complicated nature of permitting, and encouraged Mr. Sheffield to share specific ideas he has with the committee. Chair Kohring then turned attention to coal bed methane and asked whether Mr. Sheffield believes the regulations for the coal bed methane industry are onerous and should be modified.

MR. SHEFFIELD said that he wasn't familiar with the details of the coal bed methane regulations. He explained that Pioneer came into that process late and its decision to relinquish its acreage were primarily technical. However, he noted that the uncertainty of the regulatory process also influenced Pioneer's decision.

CHAIR KOHRING said that he would be happy to entertain any suggested changes necessary if Pioneer again becomes interested in coal bed methane exploration.

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ARLEN EHM, Geological Consultant, relayed his background, including his Bachelor and Masters degrees in geology. He noted that he has been involved in exploration in Alaska for over 40 years. He further noted that over the last 29 years he has been a geological consultant with clients including federal and state departments as well as individuals. Mr. Ehm said that he would restrict his remarks to how to attract and encourage independent oil and gas companies to invest, explore, and do business in Alaska. He said the term independent "is often used to differentiate those companies that are vertically integrated, usually the majors, from those that are not so integrated, usually smaller companies of an size. This vertical integration refers to the company being involved with all phases of the oil and gas industry, including acquisition, exploration, production, processing, transportation, and marketing. Since size isn't necessarily a factor ... large non-integrated companies often refer to themselves as independent companies.

For the purposes of my testimony I do not include companies the size of Anadarko, Pioneer, Kerr-McGee, Marathon as independents whether or not they are vertically integrated."

MR. EHM related his understanding that the purpose of the hearing was to address the concerns of small companies, which he referred to as the true independents. He said that the larger companies can and do solve problems by "throwing money at the problem." However, independents don't have the resources for such resolution. He said that his testimony would also relate to potential operators who may be considering coming to Alaska. He clarified that he doesn't include lease brokers as independent operators - they are in the business of acquiring and brokering leases, not operating. He stated that he has encouraged about 25 independent companies to come to Alaska, and nearly all declined in order to avoid the risk and expense of exploring in Alaska. He said that high potential is not incentive enough to come. Companies are not interested in Alaska because of high entry costs, high operating costs, high risk, permitting problems, excessive bureaucracy, excessive environmental constraints, remote exploration targets, long lead times, seasonal operation restrictions, lack of infrastructure, and seasonal access. High entry and operating costs and high risk are not problems that the state can or should address, he said, however, if the policies of the state cause these factors to increase, the state should then correct its policies. Mr. Ehm emphasized that he is vehemently opposed to anything remotely suggesting state funding.

MR. EHM then turned to permitting problems and said entities interested in operating in Alaska have reason to be concerned. He then related examples of permitting problems in which he was involved. He also related that each agency has regulations that must be followed, although he has been told that agencies have discretionary powers superseding the regulations. He recalled that a few years ago he spoke at a conference during which he called for an ad hoc panel to evaluate all permitting regulations. Although the proposal received a round of applause, no such panel has ever been assembled. Some permit reform is taking place, but it's woefully inadequate, he said. Governor Murkowski requested that Mr. Ehm compile a report with regard to the problems he encountered while permitting several wells for a client. His report included suggestions to appoint a working body of knowledgeable individuals charged with cataloging all existing regulations impacting the acquisition of oil and gas drilling and production permits. He said the working body would develop the following: a unified, integrated

information gathering system covering all agencies to avoid duplication; consistent forms available for applicants to file on line; an accessible system for retrieval by all of the agencies; and creation of review boards of knowledgeable specialists who can write and rewrite regulations as necessary. Mr. Ehm identified the largest problem as the coastal zone questionnaire/form, of which only a fraction of the questions actually apply to oil and gas operations. This form needs to be simplified as to purpose, he stated. He opined that oil and gas operations could and should be covered by two pages rather than the nine pages that are currently used.

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MR. EHM said there should be considerably more information and cooperation exchanged between the agencies to avoid excessive bureaucracy. He said that the environmental community will always be a force, and "by its very nature Alaska seems to be their playground." He said the industry has to comply with laws that environmentalists have promulgated, but he said the state could be more active in supporting exploration for the extraction of oil and gas resources. Remaining access issues, which were mentioned earlier, are of concern [for independents] as well. However, the state only has varying degree of control over some of them. He discussed some of the difficulties with regard to the lead-time between a lease sale and drilling/exploration. He also discussed the lack of infrastructure as well as seasonal operation restrictions. The problems of remote exploration are exacerbated by the state, he said, because regulations require operators to remove roads if the wells accessed by the roads are not successful.

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MR. EHM concluded by opining that the state can attract and encourage independent companies to come to Alaska by implementing the aforementioned suggestions. He said larger companies will come to Alaska without any additional incentives. He then suggested that the state establish economic incentives for companies below a specified minimum size, such as lowering the state royalty for the initial production as well as lowering severance and property taxes. He reminded the committee that the independents are the ones that fill in gaps after the major [larger] companies have left.

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MR. EHM, in response to Representative Wilson, indicated that he would provide the letter he wrote to the governor.

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REPRESENTATIVE ROKEBERG expressed his concern with the problems Mr. Ehm has had with the bureaucracy and suggested that anyone being hassled by bureaucracy should bring it to the attention of the legislature. He acknowledged that the legislature can't change the regulations without passing another statute.

CHAIR KOHRING echoed Representative Rokeberg's comments.

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KEN BOYD, Oil and Gas Consultant, informed the committee that he is a former director of the Division of Oil & Gas and a consultant to EnCana Oil and Gas, Inc. (EnCana). He explained that EnCana, upon arriving in Alaska, looked much like Anadarko, such that it was well capitalized and knowledgeable. EnCana immediately partnered with Anadarko to purchase gas leases in the Foothills and became involved with the McCovey well, although it wasn't successful. Mr. Boyd opined that EnCana had the same goals and needs as outlined by Mr. Hanley. With regard to why EnCana left, Mr. Boyd said it was simply a corporate decision to become an unconventional oil company that had no relation to Alaska.

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MR. BOYD recalled 10 years ago when [oil and gas discussions] always included the same needs of stable taxes, reasonable permitting and access to land. He said access to land isn't of such concern anymore. The state's leasing program 10 years ago was done on a nomination basis and was messy, and from that came legislation implementing areawide leasing. The area leasing worked and continues to work today. Therefore, he suggested areawide permitting. The state now leases in five different areas, which are fairly distinct in regard to geology and permitting. He reminded the committee of the creation of the best interest findings [with regard to the areawide leasing option]. Every year DNR goes out for substantial new information, which requires mitigating the change alone. He questioned why such a process wouldn't work for permitting because it allows one to think over the matter while starting with a core understanding that has been learned over time.

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REPRESENTATIVE ROKEBERG asked if Mr. Boyd believes that access issues for areawide leasing and exploration licensing have been solved for the wildcat areas.

MR. BOYD replied yes, adding that exploration licensing fills in the gaps where there is no leasing. He opined that the exploration licensing program has resulted in a well in the Copper River Basin and perhaps some wells to come in the Nenana Basin, which, he argued, wouldn't have been drilled under the old program.

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REPRESENTATIVE ROKEBERG asked Mr. Boyd's opinion of the exploration investment credits in NPR-A.

MR. BOYD said he believes that exploration credits and other incentives can work, although they work mostly for smaller companies and only for projects on the margin. "I don't think it will cause a dumb well to become a good well," he stated. He expressed the need for incentives to be carefully crafted and said that Alaska will never drill as many wells as Alberta.

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REPRESENTATIVE ROKEBERG recalled that when Mr. Boyd was the director of the Division of Oil & Gas, he had to administer net profit share leases. He asked whether Mr. Boyd believes the concept of frontloading investment payback is beneficial and should be looked at.

MR. BOYD said he does not know what has been proposed, but that net profit share leasing isn't a good system.

CHAIR KOHRING expressed interest in obtaining further details from Mr. Boyd regarding how an areawide permitting system could be established.

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MARK MYERS, Former Director, Division of Oil and Gas, Department of Natural Resources, said the state has a real opportunity to develop a stronger, diversified industry base. After working on the aforementioned for five years with the state, he said a level playing field is critical, and part of the government's

role should be to ensure the playing field is fair. Therefore, the regulated utilities and pipelines need effective regulation that is well thought out, well designed, and fairly implemented. Because of the remoteness of many of the river basins, access to infrastructure is critical. The state can continue to review building critical infrastructure, such as the proposed road from the Arctic National Wildlife Refuge (ANWR) to Point Thompson. Furthermore, once infrastructure is created, the value of that to everyone is visible. Therefore, key infrastructure nodes can be facilitated by government, although they ultimately require industrial development. The aforementioned is apparent in NPR-A's alpine development.

MR. MYERS opined that the state needs to negotiate fairly with companies; although once commitments are made the companies must be held to them, particularly in regard to explorers. As the basin has more competition, the state should hold firm to its commitments to turn over that land quicker.

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MR. MYERS said facility access is another major issue. He explained that nearer infrastructure plays would be best developed by using existing capacity and facilities. To achieve the aforementioned, commercial agreements between all parties is necessary. To date, explorers haven't been successful in obtaining that commercial access. He highlighted that the problem with commercial access is not uncommon, although other areas such as the North Sea have addressed the issue. The legislature, he opined, will have to become involved to reach a resolution with commercial access. He highlighted that the good news is [that resolving the commercial access problem] would be a win-win situation such that a handsome rate of return could be paid to the existing facility owners while the state would enjoy more production, accelerated development, and less environmental impact.

MR. MYERS noted his agreement with Mr. Boyd that it's appropriate to do anything that can be done to streamline permitting without minimizing its importance. However, the state does need to take care when it changes major policies like oil and severance taxes as it effects different operators differently, and therefore the dialogue should be public for everyone involved to respond. He acknowledged the difficulty to do so when political goals are involved. Mr. Myers pointed out that with more exotic state ownership structures there are significant questions if the state is a competitor with the

companies it's trying to attract. With regard to incentive programs, he suggested reviewing those that have been effective in generating the intended behavior in order to determine which programs to retain and remove. Mr. Myers said he is proud of some of the incentives passed by the legislature, such as those on the automatic royalty reduction on the platforms. With regard to new incentives, he encouraged the legislature to review what will impact the [targeted] behavior. He stressed the need to hold the administration to what the legislature intended with the laws that it passes. Mr. Myers identified the royalty reduction program as one that's working as intended. In conclusion, he urged the committee not to reinvent the wheel, not to shortcut the public process, and to know the intended consequences of a proposed incentive.

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CHAIR KOHRING turned attention to seismic information accumulated by seismic banks and asked if that information could be shared with companies interested in evaluating formations to determine the potential for oil and gas.

MR. MYERS answered that generally seismic data is acquired by companies to sell it to specific parties, or it's done on a specific request by a company or a consortium of companies. Under state statute that data stays confidential forever, although well information is made public after a certain time. He acknowledged that the timeframe the information is confidential must be long enough that the commercial value and proprietary nature of it is preserved. He opined that after perhaps 10-20 years, [the seismic data] should be made public. He noted that in a few cases some seismic data is made public. For entities that take advantage of the 40 percent incentive credit, the data becomes public after 10 years. Mr. Myers related his belief that it would greatly enhance the viability of new entrants if the older data were made publicly available.

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CHAIR KOHRING thanked Mr. Myers for his work with the legislature over the years.

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REPRESENTATIVE ROKEBERG agreed that the legislature should review what it has passed and determine what's working. He

asked how the legislature would do that. He further asked if the legislature should hire consultants to perform a review.

MR. MYERS reminded the committee that during budgetary review the agencies go through the missions and measures process. That process could be required to include evaluation of the amount of money spent, the number of wells drilled and the number of new discoveries. He agreed that the Division of Oil & Gas or the Department of Revenue could check its work. He recalled that the division did review many of the incentives and that data could've been shared with the legislature, although it takes time and an individual in the legislature to review it. Therefore, he recommended that the legislature retain an oil and gas consultant to perform the aforementioned. In the short-term, he suggested requesting that the agency do so every five or so years. In further response to Representative Rokeberg, Mr. Myers explained that the royalty reduction under [AS 38.05.180(j)] allows [the incentive to be in place] before production, which provides DNR flexibility and allows the upside to be captured. Mr. Myers specified that he is aware of two outstanding applications.

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REPRESENTATIVE ROKEBERG asked if the legislature should review its boilerplate language in the state's leases.

MR. MYERS said he believes there is a requirement, although not in the primary term of the lease. Therefore, in eligible jurisdictions, a drilling commitment is required after the fifth year. One approach, he said, is leases could be conditioned to require either drilling or relinquishment on an earlier date. Another approach, he said, is that after a lease reaches its primary term, "we" form units and commit a drilling. At that point, the department has historically required a specified number of wells to be drilled within a specified time. He opined that the aforementioned commitments become the basis of a stronger drilling commitment such that failure to meet [those commitments] means the relinquishment of the acreage and sometimes reimbursement to the state for what the state lost by not releasing it. Point Thompson is an example of a lease with such a requirement for this winter. That requirement has been stayed, and therefore the state missed the opportunity to have a critical well drilled. If the state allows that, the division can no longer negotiate those commitments and feel confident that those commitments will be held. If there's a political way to undo it, the commitments are meaningless, he stated.

Therefore, there should be very good reasons for changing such commitments. He then expressed the need for the government to fairly and consistently manage its commitments. He said independent companies either drill or relinquish, and typically the major companies will honor the commitment or relinquish the acreage and pay it back. But once the state "starts interfering with that natural process, then there's really no ability for the state to enforce any of its negotiated provisions."

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DAVID BOELENS, Aurora Power, Aurora Gas LLC, Aurora Well Service, Shirleyville Enterprises LLC, informed the committee that "we" have five existing producing gas fields on the west side of Cook Inlet. There have been quite a few successes and some disappointments since arriving in Alaska in 2000. Mr. Boelens said that he doesn't really view other independents as competition because Alaska is a very tough environment. Many issues and challenges have arisen with regard to operating in Cook Inlet, some of which have already been mentioned, such as access to existing pipeline infrastructure, the need for new infrastructure, fiscal stability, royalty and tax valuation, regulatory and permitting, contractor support, and the need for incentives focused on Cook Inlet gas issues. Access to existing pipelines and infrastructure in Cook Inlet is critical, he opined. He noted that there has been some progress on pipeline issues with the Regulatory Commission of Alaska. He added that there needs to be economical ways to get to the pipelines if the state is going to attract new independent operators to Cook Inlet.

MR. BOELENS highlighted that on the west side of Cook Inlet there are no bridges, and everything has to be brought in on landing craft or flown in. Mr. Boelens said that "we" have ended up in the position of re-opening and building roads, building bridges, extending power lines or setting generators, and other things that wouldn't have to be done in other parts of the country. Therefore, he suggested that the state could review having some role in development, like bridges and roads, on the west side of Cook Inlet. Furthermore, much of the lands that have been developed in the Cook Inlet are either offshore or around the coast, where putting a runway, for instance, couldn't be done today. He said surrounding game refuge regulations and winter sea ice can restrict activity, making operations in the Cook Inlet costly.

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MR. BOELENS agreed with earlier testimony regarding the need for fiscal stability and [consistent] rules. He requested not changing the rules to accommodate North Slope operations without considering the impacts to Cook Inlet operations. With regard to royalty and taxation for independents, Mr. Boelens noted that there is the prevailing value trap, which specifies that the royalty and taxation is going to be paid on the prevailing value, which is the average of a series of utility contracts. However, the larger producers tend to have those utility contracts, and thus new producers can't get the contracts and have to find someone that needs gas, or they must sell gas to an entity that already has a contract. That can sharply reduce the selling price, he noted. He said, "if it's an arm's length deal between the producer and whoever they're selling the gas to, that should be good enough for taxation, and the state did fix that in the case of Agrium. The new contracts with Agrium were at the value that it was cut; it's not at the average of Chugach's electric or ENSTAR's or anybody else's contract, as far as what they're going to pay the royalty taxes on."

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REPRESENTATIVE ROKEBERG related his understanding then that the royalty and taxes are being paid based on other values, not the actual cost of the sale of the transaction.

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MR. BOELENS agreed. He said regulatory and permitting have gotten better; however, he related his experience in installing a power line and "it was an eye-opener." He said his company did the wetland assessment, the coastal zone management process and the storm water plan, which made permitting expenses about one third of the total \$125,000 project cost. He mentioned spacing exceptions and acknowledged that state employees are merely enforcing the regulations, however he questioned whether they always make sense. With regard to utility contracts, he said, new companies have the issue of what they're going to do with their gas. Therefore, it's a big issue for new entrants to discover a situation in which there are no unmet requirements because the utilities have dedicated 100 percent to the existing producers. He related that prospectors love the geology of Cook Inlet until the question arises regarding how one will sell the gas. Although he acknowledged that Agrium will buy gas, but the future of Agrium is unclear. "So there's some real uncertainty

here having utilities with all these unmet requirements met," he said.

MR. BOELENS, in response to Representative Rokeberg's question about unmet requirements, said, "ENSTAR has signed these tiered contracts where Unocal will supply the gas and Marathon will supply the gas."

REPRESENTATIVE ROKEBERG surmised then that there's no market for future reserves that may be discovered if ENSTAR is the only buyer.

MR. BOELENS concurred, adding that his concern is that there is no set-aside on these utility contracts for another producer.

REPRESENTATIVE ROKEBERG asked if set asides are typical in other jurisdictions.

MR. BOELENS pointed out that normally the market wouldn't be stranded; "You find your gas, you put it in the system, and off it goes." Furthermore, he pointed out there isn't a critical mass with regard to good support contractors, as in the Lower 48, but the legislature probably can't address that.

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MR. BOELENS, turning attention to incentives, informed the committee that [Aurora Gas] has drilled eight new wells, five side tracts and "three non-rig work-over interventions," spending about \$38.6 million. Two of the eight wells have been dry, he said, and if the dry wells were the first ones drilled, the company would not be in Alaska today. There aren't incentives for small producers to mitigate a situation like that and to want to remain or enter Cook Inlet. He noted that he didn't want a give-away program, so he questioned how incentives could be structured.

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REPRESENTATIVE ROKEBERG addressed the lack of incentives, and said he thought the legislature passed a Cook Inlet credit.

MR. BOELENS said his company was able to take advantage of the seismic credit, but there is no incentive for drilling the wells, and he believes the company is not eligible for anything "when you consider where we operate."

REPRESENTATIVE ROKEBERG said that he believes the incentives have been specific to certain prospects or for lower capacity.

MR. BOELENS noted that his company's Nicolai Creek field qualified for a royalty reduction.

REPRESENTATIVE ROKEBERG said he believed that the legislature passed a facilities tax credit for gas "about three years ago." He asked if that helped for delivering the gas from the well site to the distribution system.

MR. BOELENS replied no.

REPRESENTATIVE ROKEBERG recalled that Marathon "was quite involved in that," and he thought it had broader applications.

MR. BOELENS said his company has talked about allowing a producer of coal bed methane "to come over the top of what we've got and work out a deal to access pipelines and compressors ... we're happy to see them come."

REPRESENTATIVE ROKEBERG asked if his company has encountered coal.

MR. BOELENS said yes, and coal is a big drilling hazard, "in fact Beluga coal fields overlie a lot of the stuff that we're doing."

REPRESENTATIVE ROKEBERG asked what kind of incentives would help his company operate and would invite competition.

MR. BOELENS said he would like to see a program to support rural bridges and roads, as well as a reasonable incentive for well-drilling costs to mitigate risk. He said he did not know exactly what that incentive would look like.

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REPRESENTATIVE CHENAULT asked if Aurora Gas LLC looked at House Bill 61, regarding an income tax credit.

MR. BOELENS answered that it depends on how a company is structured; it doesn't help a limited liability company.

The committee took an at-ease from 3:04 p.m. to 3:06 p.m.

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DAN DONKEL said he would like improvements in attracting independent oil and gas exploration in Alaska. He noted that he has over 20 years of experience in the oil and gas business. He said he has witnessed dramatic improvements in Alaska over the past years due to excellent laws that were recently passed. He said Alaska is heading in the right direction, and every Alaskan should be grateful to the legislature for the following: an increase in acreage limitation, the reduction of state-wide royalties, tax credits, the Alaska Stranded Gas Development Act, areawide lease sales, shallow gas leasing, the economic limit factor, exploration incentive credits, and discovery royalties for Cook Inlet. He opined that it was not an easy task for the legislature to "accomplish all these great achievements." He stated that the legislature needs promotional and education materials to promote those incentives. He suggested funds to create publications; "It doesn't cost that much, and we can use recycled paper." He said if independent producers become aware of the welcome mat that Alaska has put out, the state would see an increase in the average daily rig count, "like we have in Texas."

MR. DONKEL stated that there is much more room for improvement as evidenced by Alaska having only one percent of what Texas has in terms of drilling rigs. Only seven rigs are active in Alaska, he noted, and with four million acres of leases, there is only one well for every million acres. He said Alaska needs more wells. He said if Alaska builds the gasline, "they will come." If Alaska makes regulations that inspire people to drill and risk capital, "I think we can make for a better Alaska."

CHAIR KOHRING said he likes that comment, "Tear down that wall, reminiscent of Ronald Reagan."

MR. DONKEL said the state needs to tear down the wall of only seven rigs versus the 600 rigs in Texas. He said at the Resource Development Council, he asked the question of Exxon, ConocoPhillips Alaska, Inc., and British Petroleum, and only Anadarko responded. Anadarko said it will never happen, but Mr. Donkel said he disagreed because Alaska is 2 1/2 times as large as Texas. But he said Alaska is dead last in the number of rigs of all oil-drilling states, and "this is a sure sign that the rules and policies are out of sink with the rest of the nation, and need to be revised and improved upon."

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MR. DONKEL said he has been in court during all his years in Alaska due to "unreasonable, discriminatory, and unlawful acts by state agencies." He noted that the Department of Natural Resource and its Division of Gas violated his right to own oil and gas leases in the Cook Inlet. He said the Redoubt Shoal oil field was taken away from him, and the actions of DNR were unforgivable, and caused his company to be dissolved. He discussed his altercations and court actions with state agencies, and said "this isn't the sort of incentives that independent risk takers, or anyone else, find welcoming when they consider coming to Alaska."

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MR. DONKEL related another court case illustrating the difficulty in operating in Alaska, "even with all the great laws that this legislature has passed in recent years." He said the problem is that the state owns 99 percent of Alaska, and "if we have a dispute with our landlord, they are our judge, jury and executioner." He noted that DNR was separated from the Alaska Oil and Gas Conservation Commission (AOGCC), but the same law firm still represents both. The 11th amendment of the Constitution guarantees sovereignty, he said. He told the committee that he came to Alaska in 1986 as oil prices were crashing and was the only one buying leases. "I bought 100,000 acres. Formed an oil company. Living the American dream," he said. People asked him why he never drilled, and he said that the rules changed. He spoke of a former judge who heard a DNR director say that DNR can do anything it wants to small oil companies and they can't do a "damn thing about it." He said his company, Danco, got "beat up pretty badly," but that he dissolved the company and didn't go bankrupt. Now his clients get royalty checks every month, he noted, because he never gives up. He said it is time for change.

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MR. DONKEL said Alaska should consider Kansas as a self-insured state, and the untouched oil spill contingency fund proves that we have don't have "renegades coming up here and making a mess." He suggested eliminating every single bonding requirements in the state. He said the state could "back it up with the 470 fund. That way you will see massive amount of people coming to Alaska." He said if anyone spills oil, other oil companies will "tar and feather and run out [that operator] of town themselves. You won't have to do it." The state doesn't need the bonding requirements, he added, as well as the oil spill contingency

plan which kills competition. He said, "We should have the right to trial de novo" because the state owns 99% of all the land and shouldn't be judge and jury. "Absolute power corrupts absolutely," he said, and the governor appoints the oil and gas commissioners, the attorney general and others. He said if Alaska could double its "rig count" it could double the size of the Alaska Permanent Fund check. He said Alaska should elect the Attorney General, and should consider creating an Alaska version of the Texas railroad commission, and have all oil and gas agencies under one roof with an elected three-person commission. Oil is a major source of income for the state, he said, so the state should spend the money to "make the best system of justice money can buy." He said what works in Texas can work in Alaska. He said he does not know one person in Alaska who is actually producing a well. Mr. Donkel asked how a stripper well could produce four or five barrels a day when a \$1.2 million bond is required. He said he has hope and faith in this committee. He said the Alaska capital should be moved to Pt. McKenzie so it will be closer to him. Mr. Donkel offered to help the committee in its mission to achieve a better Alaska. And he said the state needs to produce more oil for the good of the country.

[Due to technical difficulties, the transmission stopped at 3:32 p.m.]

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PAUL CRAIG, Owner, Trading Bay Energy Corporation, said he would like to testify on bonding, but noted that there are six areas that need area-wide permitting, because there is a large difference between onshore and offshore drilling in Cook Inlet. He said he has gone through the permitting process for three wells in 1996. In that process he had to pay \$1 million in bonds to DEC for oil spill contingencies, \$100,000 to AOGCC, and \$10,000 to DNR, he stated. He said he quickly discovered that no one sells those bonds in Alaska, "even if I had the cash to put a million dollars up as security for the bond, bonding companies weren't very interested in issuing me that financial instrument for fear that by doing so they would not just be responsible for the million dollars that I've already posted, but that putting their name on the line may put them in the path of much greater financial responsibility if there were another disaster such as the Exxon Valdez."

MR. CRAIG said that in 1996, he researched bonding requirements for a single well around North America, and Kansas only required

a "cement bond" at the top of the well, or a \$0 bond. Oklahoma had the highest at \$55,000. He said the average bond requirement was \$13,950, and he figured that Alaska requirements were 76 standard deviations from the mean. "It's crazy," he said, "there is not justification for that." Oil spills do not occur with properly equipped exploratory wells, but with transportation and production, he opined. He said independents have no interest in "tying up a million dollars capital ... when they could be drilling two, three, four wells in the lower 48 with that capital and generating revenue from it." He noted that it is not an issue for larger companies. If the state wants smaller companies to come, changes need to be made, he stated. On a positive note, he said, after 12 years of effort, one of the two companies he owns will be drilling the Hannah prospect. He said things are possible when partnering with other small entities. He said that laws have improved but only 1-2 percent of the changes that need to be made, have been made.

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CHAIR KOHRING said he looked forward to discussing bonding.

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REPRESENTATIVE ROKEBERG asked Mr. Craig if he had to put up actual cash.

MR. CRAIG said that unlike insurance, bonds need an asset to back it up. He said with a liquid asset, companies would consider giving him a bond. "Obviously people are getting these bonds somehow and meeting their bonding requirements," he said.

REPRESENTATIVE ROKEBERG asked Mr. Craig if he was aware that bonds have been issued by insurance underwriters in Alaska.

MR. CRAIG said that back in 1996 he was not assured that he could acquire a bond even if he had a \$1 million asset to post, but he guessed that if he had \$1 million cash, he could get the bond, but he could probably do something more profitable with the money. Bonding is a large barrier to small companies, he said. In his Hannah prospect, he is the minority interest-working partner, and by partnering with Aurora he can get the project done. He can "slip around" the \$1 million requirement because he won't be drilling through oil.

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DAVE LAPPI, President, Lapp Resources, Inc., said he will discuss disincentives for small companies in Alaska, including land access, permitting, bonding, and regulation of production. He said that land is accessible and available for lease, but smaller companies need lower prices. The bidding process is not suited to small independents, he said, and he proposed reducing the minimum bid in exchange for a shorter lease term. He also suggested allowing exploration license applications year round instead of only in April to encourage more exploration and development. He said Alaska should reinstitute the shallow gas leasing program, with controls in populated areas to mitigate some of the impacts. He said the program would result in commercial production in areas that are not served by gas pipelines or are running short of gas, like the Cook Inlet Basin. He said he thinks the permitting process needs to be streamlined further with a set of standard pre-approved applications. He also suggested eliminating air quality permits for individual drill sites, and instead permit the drilling rig, not the drill site. He said the rig could have an annual I/M test like cars do now. The air quality permits can be very expensive if DEC decides to require computer modeling of the air quality around the rig site, he added. He noted that the state gets billions of dollars in various production taxes on oil and gas each year, and it should consider underwriting some of the costs and self-bond the risks associated with exploratory drilling. He said actual spill statistics prove that most of the risk of a large spill is from transportation and production of oil. He said that the regulation of production needs to be fair and impartial regarding leasing, exploration and drilling. Very few companies will come if the perception is that Alaska favors large companies over small companies, he said. He concluded that improvements be made and, "the measure of success would be that individual Alaskans actually have working interest in oil and gas producing assets of their own."

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CHAIR KOHRING asked Mr. Craig to elaborate on his suggestion of a streamlined permitting process.

MR. LAPPI said a standard drilling application approved speedily at a low cost would be good. He said the shallow gas leasing program is good, and if others have problems with the impacts of the program, he said he thinks there are ways to mitigate them. The leasing program should not be based on competitive bid but on "application first in, first served."

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REPRESENTATIVE ROKEBERG asked about Mr. Craig's review of the "the most recent rewrite, making shallow gas part of an exploration license."

MR. LAPPI said he has not seen that proposal.

REPRESENTATIVE ROKEBERG said the legislature adopted it about two years ago.

MR. LAPPI said he is not familiar with it.

REPRESENTATIVE ROKEBERG said it relies, in large part, on DNR's regulatory scheme which was being promulgated.

MR. LAPPI said that as part of the shallow gas leasing program there were changes that defined a shallow gas well as one that was drilled for gas at less than 3,000 feet, "and I don't think that those provisions were changed when the legislature abolished the shallow gas leasing program."

REPRESENTATIVE ROKEBERG told Mr. Craig to take a look at it.

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JIM WHITE, Alaskan Crude, informed the committee that crude has been produced and sold in Alaska for almost 100 years. He knows of no Alaskan that is producing or selling crude, and his friends in Oklahoma and Texas "think it is an atrocious circumstance." He said that it is a systemic problem and without change there will be another 100 years without an Alaskan producing crude in the state. The bulk of this wealth leaves the state, he said, and this should be the most important thing the legislature should address in the next session. The state disallowed the landowner from owning their minerals since 1958.

CHAIR KOHRING said that those that he has served with in the legislature have been friendly toward the industry.

MR. WHITE said, "If you were to pick a state and a plan to limit competition for a country or an area, you got the perfect road map." He said Alaska has been producing oil for decades and a person could count the producers on one or two hands. To change the roadmap, he said, "You need to gut the regulation and go back and take a look at all these issues."

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REPRESENTATIVE ROKEBERG asked about a distinction between a 500-barrel prospect, and how one could determine that without seismic data.

MR. WHITE answered that often a fairly accurate guess can be made from previous drilling in the area. He said he is getting ready to re-enter a well that was drilled in 1985 and closed in 1986 and has enough information to guess the well's potential output. To re-enter requires a six-month, \$70,000 contingency plan process, and it is outrageous, he opined.

REPRESENTATIVE ROKEBERG said it makes it difficult to define it.

MR. WHITE said there are ways to make reasonable projections.

REPRESENTATIVE ROKEBERG said with Mr. Donkel's suggested self-insurance, a producer would not have that limitation.

MR. WHITE said, "Before that tanker run into that rock and spilled all that oil down there, I'm having a hard time connecting what's relevant between the tanker running into a rock and me drilling a well." He said he has no knowledge of a well blowing out in all the years of Alaska oil production, "that hadn't been cleaned up by the guy that blew it out."

4:06:00 PM

REPRESENTATIVE ROKEBERG said that was because there is a regulatory requirement to clean it up.

MR. WHITE said he knows if he doesn't build a well according to industry practices and state rules, the state can shut the production down and impose a fine. He said the state has "absolute overkill in policing wells."

REPRESENTATIVE ROKEBERG said he doesn't disagree, but the public's perception is that the government is going to protect the environment on one hand and encourage development on the other. He asked how to design a statute to do that.

MR. WHITE asked what problems the state had prior to current rules.

REPRESENTATIVE ROKEBERG said there wasn't the political pressure to keep the environment clean.

MR. WHITE said the environment was clean and problems didn't happen. If they did happen, he continued, operators would lose their bonds and they would be out of business.

REPRESENTATIVE ROKEBERG said the state needs to design statute to avoid a fly-by-night entity "with no recourse, no balance sheet, and walking out the door after he mucks up the drill site."

MR. WHITE said that there is an arduous set of circumstances to comply with prior to permitting, and the AOGCC polices the industry.

REPRESENTATIVE ROKEBERG expressed concern about a potential fly-by-night LLC, and stressed that the state needed to limit bureaucracy at the same time as protecting the public interest.

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MR. WHITE said a fly-by-night person would not have the finances to drill a well. He discussed the ability of a "home-grown Alaskan" entering the oil business and keeping the wealth within the state. He suggested that Alaska will become a ghost town if Alaskans are kept from getting into the oil business.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at [4:15:28 PM](#).