

**ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS**

January 17, 2006

5:07 p.m.

MEMBERS PRESENT

Representative Lesil McGuire
Representative Norman Rokeberg
Representative Ralph Samuels
Representative Nancy Dahlstrom
Representative Berta Gardner
Representative David Guttenberg

MEMBERS ABSENT

Representative Vic Kohring, Chair

OTHER MEMBERS PRESENT

Representative Kurt Olson
Representative Jim Holm
Representative Mike Kelly

COMMITTEE CALENDAR

OVERVIEW FROM DEPARTMENT OF NATURAL RESOURCES - DIVISION OF OIL
& GAS

- HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

BILL VAN DYKE, Acting Director
Division of Oil & Gas (DOG)
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: Presented an overview from the Division of
Oil & Gas, Department of Natural Resources.

ACTION NARRATIVE

REPRESENTATIVE RALPH SAMUELS, acting as Chair, called the House Special Committee on Oil and Gas meeting to order at [5:07:44 PM](#). Representatives McGuire, Samuels, Dahlstrom, Gardner, and Guttenberg were present at the call to order. Representative Rokeberg arrived as the meeting was in progress. Also in attendance were Representatives Olson, Holm, and Kelly.

OVERVIEW FROM DEPARTMENT OF NATURAL RESOURCES - DIVISION OF OIL & GAS

[5:07:57 PM](#)

REPRESENTATIVE SAMUELS announced that the first order of business would be an overview from the Division of Oil & Gas, Department of Natural Resources.

[5:08:32 PM](#)

BILL VAN DYKE, Acting Director, Division of Oil & Gas (DOG), Department of Natural Resources (DNR), announced that he would be referring to the handout entitled "Alaska Oil and Gas Activities". Slide 2, the state revenue pie, displayed petroleum revenue sources for the fiscal year (FY) 2005. He stated that for FY 2005, the non-petroleum unrestricted revenue was 11 percent. Royalties, bonuses, rents, and settlements totaled \$1.9 [million]. Royalties to the Permanent Fund totaled nearly 500 million dollars. Referring to slide 3, fiscal year oil and gas revenue from state lands for fiscal years 1990-2005, he explained that FY 2005 is the highest because of the rise in commodity prices. The state is still benefiting from those commodity prices this FY [2006].

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REPRESENTATIVE GUTTENBERG, referring to slide 3, asked for clarification of the monetary amounts of the oil and gas settlements.

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MR. VAN DYKE answered, "A couple million dollars, primarily from royalty audits and settlements," adding that it's nothing like the early 1990s, when there were major royalty settlements.

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REPRESENTATIVE SAMUELS inquired as to whether it was possible to get a similar graph that accounts for inflation.

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MR. VAN DYKE confirmed that the DOG would be able to convert it to whatever "dollars" the committee requests. For example, 1990 "dollars."

[5:12:12 PM](#)

MR. VAN DYKE, referring to slide 4, described the organization "links" of the DOG. The division takes a "team approach" in accomplishing their mission, and also utilizes the Department of Law (DOL) and the Division of Geological and Geophysical Surveys (DGGS).

[5:12:51 PM](#)

MR. VAN DYKE, referring to slide 5, described some of the DOG's continuing projects, which range from the sciences, to audits, to accounting, to commercial land, as well as to recruitment. Currently in the oil and gas industry, hiring is competitive and the state has lost employees to other oil and gas companies.

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REPRESENTATIVE ROKEBERG, referring to the continuing project of crafting new, 10-year best interest findings for the state's lease sales, beginning in 2007, asked if 2007 was the tenure date for the areawide leasing program.

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MR. VAN DYKE confirmed that through the areawide leasing program, the DOG is able to do a "best interest" finding, which can last up to 10 years. It is refreshed each year, but the DOG doesn't have to go through the entire finding process again. He informed the committee that the 10-year "sunset dates" are starting to "roll up", beginning in 2007.

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REPRESENTATIVE ROKEBERG requested that Mr. Van Dyke discuss the status of the governor's change in the production tax last year. He also asked whether there are ongoing negotiations with the various companies.

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MR. VAN DYKE asked if Representative Rokeberg was referring to the "aggregation at Prudhoe Bay."

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REPRESENTATIVE ROKEBERG added that the economic limit factor (ELF) for the production tax applicability to the satellite field was changed.

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MR. VAN DYKE informed Representative Rokeberg that he is not involved in the negotiation. He then offered his understanding that some appeals have been filed in the Department of Revenue (DOR).

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MR. VAN DYKE, referring to slide 6, informed the committee that with the upcoming gasoline and the increase in workload, the DOG received some supplemental funding about a year and a half ago. The money runs out at the end of this fiscal year. If the state doesn't get the money replenished, and the DOG is asking for general fund money to replace what is now supplemental, the DOG will lose about 13 people, which is about 15 percent of the DOG staff. He opined, "Now's not the time to take a 15 percent cut in oil and gas activity."

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MR. VAN DYKE, referring to slides 7 and 8 and division highlights, said that in calendar year 2005, the state collected over \$2 billion in rents, royalties, and settlements. Currently, there are approximately 1,200 active oil and gas leases, covering approximately 4 million acres and generating approximately \$6 million in rental income. Audits focus mainly on transportation costs, most of which are marine transportation costs, compared to pipeline transportation costs. Audit employees also deal with the net profit share leases. The state has an active royalty settlement "re-open" process, as a result of the royalty settlement agreements the state entered into in the 1990s and this process allows either party to re-open parts of the deal when [oil and gas] conditions change. He added that this process works well for both sides.

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REPRESENTATIVE SAMUELS referred to ongoing arbitration, and commented, "I assume that we haven't received any of the [\$]26 million yet."

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MR. VAN DYKE informed the committee that it will take a total of three to four years to complete the [arbitration] process. He explained that the state has already won the first part of the arbitration process regarding destination value for the oil, and that the second part, as yet unresolved pertains to marine transportation. The state has made an offer and similarly, ExxonMobil has made an offer. Whoever wins, transportation costs are going to rise, which means the state's revenue will decrease.

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REPRESENTATIVE SAMUELS inquired about the \$997 million from royalty in-kind (RIK) sales and whether it was sold in-state.

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MR. VAN DYKE responded that it was all sold locally to Flint Hills. Currently the state doesn't have an oil contract with Tesoro Alaska Company, or with any other oil purchasers. The unit staff is "real busy" as a result of the new entrants coming in. He stated that leases change hands as companies interested in one area decide to sell out and purchase leases elsewhere. There are over 1,000 assignments of interest annually. In regard to royalty accounting, the state has more pools online, more production for more pools, more players, more "working interest" owners, and over 20,000 royalty transactions per year.

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REPRESENTATIVE GUTTENBERG asked where the production reports are generated.

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MR. VAN DYKE informed the committee that most of the DOG's reports come from the sales meters and from there the oil is allocated back to the individual leases. The volumes are

recorded at the Lease Automated Custody Transfer (LACT) meters, and the operator reports the volumes. He stated that the owners of the leases pay the royalty, not the operator of the field. He reported that the state's lease sale program is "alive and well", and that the DOG has five sales per year. There is a sale scheduled for March 1st, with the sale terms having been announced last week.

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REPRESENTATIVE ROKEBERG inquired as to whether the state has changed any of the terms for the new North Slope areawide sale.

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MR. VAN DYKE confirmed that the state did; the state shortened some of the primary terms in some areas, but not in the most remote areas. For some of the areas closer in, the state shortened the primary term for the lease from seven years to five years. In addition, in some of those areas, the state increased the royalty from 12.5 percent to 16.66 percent. The shorter lease term recognizes that there is better access today than there was in the past, thus it's easier to begin drilling. The royalty increase is a reflection of today's commodity prices. He opined that the commodity prices will remain.

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REPRESENTATIVE ROKEBERG asked if the DOG analyzed the potential impacts of the adjustments on development.

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MR. VAN DYKE informed the committee that the DOG has done some analysis, particularly on relatively smaller pools. The analysis looked at the changes in commodity prices, which is the "real driver". He opined that the rates set by the state are "very reasonable", and considerably lower, as are Alaska's primary lease terms.

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MR. VAN DYKE stated that the DOG's resource evaluation staff has conducted a lot of work for the Alaska Peninsula lease sale, including distributing information to new entrants. The DOG is continuing to do the same for the North Slope sale. He stated that the more information the DOG generates on their website and

in public reports, the more interest there will be in the oil and gas leasing program. The DOG issued its first gas storage lease in the Cook Inlet area a couple of months ago and currently has another lease being processed. The gas storage lease industry is critical to meeting the gas demand in Cook Inlet in the winter.

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MR. VAN DYKE, referring to slide 9, explained royalty settlement "re-openers" as an arbitration process. Two sides are able to agree on a change to a royalty settlement agreement voluntarily, but if they aren't able to come to an agreement, they enter into an arbitration. He added, "That's where we are right now with ExxonMobil."

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MR. VAN DYKE, referring to slide 10, described the incremental North Slope oil production. He said that the "big pools" - Prudhoe Bay, Kuparuk, Endicott - are in decline. A lot of the state's new production is going to come from smaller, newer pools, expansions from the older pools, infield drilling, and viscous oil pools.

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MR. VAN DYKE, referring to slide 11 and historic and projected oil production from 1976-2002, stated that the production trend on the North Slope is most likely in a slow, steady decline. Unless, however, a major field is discovered, which would still require a lot of new development, wells, and investment in projects.

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REPRESENTATIVE GUTTENBERG inquired as to how far out the production curve would continue, and if it would continue down to the "bottom" or "level out."

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MR. VAN DYKE explained that it would depend on numerous factors, two being the price of oil and the cost to transport the oil to the "market." As long as the Trans-Alaska Pipeline System (TAPS) tariff remains reasonable, and the marine transportation costs don't skyrocket, there's no reason that the TAPS rate

can't decrease substantially from where it is today. In addition, there's no reason that tankers can't continue to take oil to the west coast. He said that operating costs need to stay in line on the North Slope. As long as money is being generated on the North Slope at that wellhead, companies are going to continue to produce oil; with the strategic reconfiguration of the TAPS tariff, companies will be in business on the North Slope for a long time to come.

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REPRESENTATIVE ROKEBERG inquired as to whether the DOR made a presentation to the House Finance Committee. He asked, "What were the production figures for the upcoming years?" In addition, Representative Rokeberg asked Mr. Van Dyke if he had any input [in that presentation].

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MR. VAN DYKE confirmed that the DOG worked with the DOR to put together the volume forecast, which is included in the DOR's source book.

MR. VAN DYKE, in response to questions from Representative Rokeberg, said that the volume forecast is in the FY 2007 budget. He opined that the figures are "pretty reasonable", with approximately 850 million of barrels per day.

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MR. VAN DYKE, referring to slide 12 and oil and gas incentives, explained the various ways to approach royalty reduction. There's currently a preliminary decision for Pioneer Unit's project, Oooguruk on the North Slope, which is offshore west of Kuparuk. The DOG is currently taking comments on the preliminary decision. It would be the first formal royalty modification under AS 38.05.180(j) for a field that has yet to produce. He said that there's also a program in Cook Inlet, a more mechanical program, which is based on production rates from platforms. The royalty mechanically "stair-steps" down as production from the platforms decline below a certain level. The numbers are where they need to be in order to keep the platforms alive.

MR. VAN DYKE explained that while royalty reduction is one incentive, there are also a couple exploration incentive credit programs. Under "AS 41 credits", when a company applies for a

credit and earns the credit, its well data becomes public in two years. A company can't hold the data confidential, and on the seismic, geophysical side, the commissioner has the authority to show the geophysical data to other parties interested in seeing it. As a result, companies are hesitant to use the exploration incentive credit under the "AS 41 program," which sunsets in 2007. He said that the state also has a discovery royalty program in Cook Inlet that is "alive and well."

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MR. VAN DYKE, referring to slide 13, stated that the tax incentive program is "where the action is these days", both in Cook Inlet and on the North Slope. The tax incentive program sunsets in 2007. He opined that the program is "working well", noting that the sunset was extended for areas south of the North Slope, but not for the North Slope. He informed the committee that there are companies that have exploration plans beyond 2007 that would like to see the program continued. There have been credits of about \$14 million granted thus far.

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REPRESENTATIVE SAMUELS, referring to slide 12, asked what the state is getting out of the deal if it is paying for up to 25 percent of the drilling costs.

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MR. VAN DYKE explained that if the production tax is "zeroed out", the state would still be entitled to property taxes, and local boroughs may or may not get "first dibs" on the property tax revenue. The state would get the income tax as well as the revenue sharing on the royalty. For example, with the National Petroleum Reserve-Alaska (NPR-A), the state receives 50 percent revenue sharing on the royalty, whereas on most other federal lands, the state receives 90 percent revenue sharing.

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REPRESENTATIVE ROKEBERG stated that there seems to be an issue about how much the state realizes, from a 50 percent position in NPR-A, from federally generated royalties. The North Slope Borough has an impact statement to the "tune of" [\$]5.8 million, and the amount available is [\$]4.5 million; the North Slope Borough has been impacted to a greater degree, and any revenue for this calendar year is "zero" to the State of Alaska.

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MR. VAN DYKE said that he wouldn't disagree with Representative Rokeberg's "accounting". The other benefit for the incentive program, and one of the primary reasons it was instituted, is that if the DNR grants a credit under "AS 41", the state is able to see the information from a "well on federal land", or a "well on private land" standpoint. It's part of the trade for granting the incentive credit; the state wouldn't see either the data the geophysical data or the well data otherwise.

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MR. VAN DYKE, in response to Representative Rokeberg's question, clarified that AS 38.05.180 has been "on the books for a good 15 years" and that the tax incentives listed on slide 13 are the more recently adopted credits.

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REPRESENTATIVE ROKEBERG asked if the "frontier" area is 10 miles.

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MR. VAN DYKE clarified, "20 miles, 20 and 40." Referring to slide 14, he opined that the State of Alaska areawide oil and gas lease sales program is "doing well." The state has the same five competitive lease sales every year. The DOG delayed the North Slope and Beaufort Sea sale from October to March 1st because it wanted to have the Alaska Peninsula sale by itself in attempt to highlight the sale and garner more interest. Also, the state is currently trying to decide whether to keep that schedule. He opined that the size of the leases and the terms seem to work "okay." By law, the primary term has to be somewhere between five and ten years, but it's the commissioner's call. The commissioner also sets the royalty rate, with the minimum rate being 12.5 percent.

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MR. VAN DYKE, referring to slide 15, discussed the competitive lease sale areas and their sizes in comparison to other states. For example, part of the North Slope basin is about the size of Kansas, and the Cook Inlet basin is about the size of New Jersey.

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MR. VAN DYKE, referred to slide 16, which he said displayed the Alaska Peninsula lease sale. In terms of oil and gas, the Alaska Peninsula is a remote area. There is no recent/modern seismic information, so it's "high risk" from a geology and geophysics standpoint. He said that the state needs to work on generating more information for potential bidders.

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MR. VAN DYKE, referring to slide 17, described the exploration licensing program. The program is for areas where there aren't competitive oil and gas lease sales. One can't apply for an exploration license on the North Slope around Prudhoe Bay or in the middle of Cook Inlet. He said that there's a program where one can apply for an area up to 500,000 acres. It's not a competitive lease-type process, rather one bids a work commitment, which is how much money one is going to spend to do fieldwork, collect seismic information, and drill wells. One has an exclusive right for the license area. There is a license area near Nenana and licenses in the upper Susitna area.

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REPRESENTATIVE GUTTENBERG, in regard to the Nenana Basin, asked what's scheduled to occur this winter.

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MR. VAN DYKE answered that Andex Resources LLC is trying to get financing together to get a well drilled. Forest Oil Corporation in the Susitna area is "shooting seismic" this winter. He said that there was a license area near Glennallen and a well was drilled. An aspect of the program is that one can convert part or all of one's license area to conventional oil and gas leases, and the license holders in that area chose to convert part of their license area to conventional oil and gas leases. The DOG has two proposed licenses for which it's currently working on best interest findings - one near Healy and one near Holitna. For the licensing program, the DOG has to do a site-specific best interest finding for each individual license application.

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MR. VAN DYKE, referred to slide 18 regarding North Slope oil and gas activities and discoveries. He said that in the legacy field, there's certainly a lot of "well work" occurring.

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REPRESENTATIVE GUTTENBERG asked if there have been any requests for leases in the Umiat area.

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MR. VAN DYKE confirmed that there are a "few" leases on state land in the Umiat area. It's right in between the NPR-A and state lands boundary. The Arctic Slope region also has some mineral rights in that area, and there's a company that's been promoting that area for the last couple of years; so there's some leases in that area. In the legacy fields - Kuparuk, Prudhoe Bay, and Endicott - there is a lot of well work occurring right now, especially with the high commodity prices. In addition, there are a lot of expansions in the newer fields. In regard to exploration, he mentioned that there aren't as many wells being drilled as the state would like to see, and that the new entrants on the North Slope have done "pretty well" the last couple of years.

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MR. VAN DYKE, referring to slide 19 and North Slope development activities, stated that there is well work and development of some of the viscous oil reservoirs in Prudhoe Bay. With respect to Pioneer Unit and Kerr-McGee, he said that if they do get their projects sanctioned, there will be two new operators on the North Slope.

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MR. VAN DYKE, referring to slide 20 and Cook Inlet oil and gas activities and discoveries, stated that in regard to natural gas, the gas business is "good" in Cook Inlet; gas exploration is continuing and there are quite a few companies that are active. For the most part, there is on-shore activity/on-shore exploration. In regard to oil, Mr. Van Dyke is "a little more worried" because there is limited oil exploration. There are only one [or 2] wells targeting oil prospects on-shore; there are oil prospects off-shore, but they require a "jack-up rig" that comes from outside to explore in Cook Inlet, and that is a costly process. He added, "It costs about as much to bring a

rig into Cook Inlet and then to return it as it does to actually go out and drill the well," and commented that production of oil in Cook Inlet is declining.

[5:55:14 PM](#)

MR. VAN DYKE, referring to slide 21, listed some of the more recent wells on the North Slope, in Cook Inlet, and in the Copper River Basin. On the North Slope, Kerr-McGee was active last year as was Pioneer Unit, but both were partners in the wells, not the operators. ConocoPhillips is still "very active" on the North Slope, more towards the west and towards NPR-A.

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REPRESENTATIVE SAMUELS requested a list by company of exploration wells drilled in the past 10 years, on the North Slope.

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MR. VAN DYKE confirmed that he would provide that to the committee.

REPRESENTATIVE ROKEBERG suggested that Mr. Van Dyke create a similar list regarding Cook Inlet.

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MR. VAN DYKE, referring to slide 22, discussed the number of exploration wells per year. The DOG has been working on making information readily available for the public, in order to increase the number of exploration wells per year.

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MR. VAN DYKE, referring to slide 23, listed the recent new units on the North Slope: Whiskey Gulch-Brooks Range, Rock Flour-ENI, Jacob's Ladder-Anadarko, Cronus-ConocoPhillips, and NE Storms-Pioneer Unit.

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MR. VAN DYKE, in response to a question from Representative Rokeberg, informed the committee that Brooks Range is a company that Ken Thompson, a former ARCO president is involved in. Referring to slide 24, regarding units, participating areas, and

unit actions per year, Mr. Van Dyke stated that there has been an increase in unit actions per year. As oil and gas development expands in Alaska, the demand for timely unit decisions and evaluations by the division continues to increase.

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MR. VAN DYKE, referring to slide 25, an excerpt from the DOG's budget, explained the division's contribution to the mission of the DNR.

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REPRESENTATIVE ROKEBERG, stating that he was looking at the "recent new units", asked whether there's a level of discovery before unitizing.

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MR. VAN DYKE confirmed that there are no discoveries in those units to date, and informed the committee that one can unitize ahead of a discovery.

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REPRESENTATIVE SAMUELS announced that Dan Seamont from the Alaska Oil and Gas Conservation Commission (AOGCC) was online if anyone had any questions to ask him.

[6:01:21 PM](#)

MR. VAN DYKE, referring to slide one of the handout entitled "Oil and Gas Permitting", said that one needs a permit from the DOG if one is operating on a state lease. In addition, one needs a "plan of operations" approval from the DOG, as well as approvals from other state, federal, and/or local agencies. The number of permits required is dependent on the location, habitat impacted, animals/species present, operation time of year, and the scope of the project. The DOG also issues geophysical exploration permits and miscellaneous land use permits. However, one doesn't need an oil and gas lease to collect seismic information, and an oil and gas lease doesn't give one exclusive use of the surface.

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MR. VAN DYKE, referring to slide two, explained that the division has a public comment period, and that if one is in a coastal zone, a public comment period is also available during the coastal consistency review. Not every application is treated the same, but they all receive some form of public notice. When the DOG's authorizations are issued, they include some sort of mitigation measures. The DOG's leases have some stipulations and mitigation measures, while the permits have additional stipulations and mitigation measures. Furthermore, the DOG requires bonding for activities on state land.

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MR. VAN DYKE, referring to slide number 3, informed the committee that the DOG's permitting application process is not "new age". The division has testing of on-line permit applications scheduled, and is hoping to have them online within the next year.

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MR. VAN DYKE, referring to slide four, listed some of the permits that may be required by entities other than the DOG. He said that it would be difficult to write general permits and/or areawide permits, because they're so location-specific and so project-specific. However, there are general permits for exploration, ice roads, and seismic surveys.

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REPRESENTATIVE ROKEBERG expressed his concern about the changing of the annual lease sale dates.

MR. VAN DYKE stated that the issue is currently being discussed with the commissioner.

REPRESENTATIVE ROKEBERG asked if the DOG has talked to industry representatives to see what their concerns would be.

[6:08:41 PM](#)

MR. VAN DYKE stated that the division is aware that the North Slope and Cook Inlet sales are currently the premier sales, adding "Alaska Peninsula hopefully will one day be there too."

REPRESENTATIVE ROKEBERG commented that the DOG has been good at nominating land in the past.

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REPRESENTATIVE KURT OLSON, Alaska State Legislature, asked if there has been any movement on Point Thompson.

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MR. VAN DYKE acknowledged that Point Thompson is one of key fields involved in the gasline negotiation, but the timeline has been delayed until May 2006.

6:10:10 PM

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 6:10 p.m.