

HOUSE FINANCE COMMITTEE  
January 22, 2008  
1:35 P.M.

CALL TO ORDER

Co-Chair Meyer called the House Finance Committee meeting to order at [1:35:35 PM](#).

MEMBERS PRESENT

Representative Mike Chenault, Co-Chair  
Representative Kevin Meyer, Co-Chair  
Representative Bill Stoltze, Vice-Chair  
Representative Harry Crawford  
Representative Les Gara  
Representative Mike Hawker  
Representative Reggie Joule  
Representative Mike Kelly  
Representative Mary Nelson  
Representative Bill Thomas Jr.

MEMBERS ABSENT

Representative Richard Foster

ALSO PRESENT

Kevin Banks, Acting Director, Division of Oil & Gas,  
Department of Natural Resources

GENERAL SUBJECT(S):

The following overview was taken in log note format. Handouts will be on file with the House Finance Committee through the 25th Legislative Session, contact 465-6814. After the 25th Legislative Session they will be available through the Legislative Library at 465-3808.

^PRESENTATION: OIL AND GAS ACTIVITIES

<b>TIME</b>	<b>SPEAKER</b>	<b>DISCUSSION</b>
<a href="#">1:36:20 PM</a>	Co-Chair Meyer	Convened the House Finance Committee in order to take testimony from Kevin Banks, Director, Division of Oil & Gas, Department of Natural Resources on the statewide oil and gas activities.
<a href="#">1:36:36 PM</a>	KEVIN BANKS, ACTING DIRECTOR, DIVISION OF OIL & GAS,	Provided members with a handout - "State of Alaska, Division of Oil and Gas, Oil and Gas Activities". (Copy on File). He provided an overview of current North Slope & Cook Inlet

	DEPARTMENT OF NATURAL RESOURCES	investments.
<a href="#">1:37:20 PM</a>	Mr. Banks	Referenced Page 29, the North Slope Oil and Gas Activity from 2006-2008. Pink boxes represent activity presently occurring: Chevron, White Hills Program, Renaissance Umiat proposed drilling and seismic program, and the Anadarko-Petro-Canada, Bubik/chandler drilling program. He pointed out that the highlighted programs (15 of them) are intended for drilling over the next two years.
<a href="#">1:39:51 PM</a>	Mr. Banks	Continued, the Renaissance Umiat proposes a winter trail south of the Dalton Highway for drilling into a National Petroleum Reserve-Alaska (NPRA) oil prospect. The Anadarko-Petro project is strictly gas. There has been previous exploration in the others.
<a href="#">1:40:33 PM</a>	Mr. Banks	Indicated that there are new drilling techniques. Chevron has stepped into a delineation program. The delineation stage of the process is as important as the actual exploration and could be more costly, requiring more drilling. There are greater potentials for failure as the oil does not flow as well with other development situations.
<a href="#">1:42:05 PM</a>	Mr. Banks	Mentioned the activities on the North Slope and how the new tax bill affects them. He indicated it is too soon to determine how it affects new investments; they are a deductible cost. The Colville River unit is an exploration well, intended to be moving forward in February, 2008. The Kuparuk River (KRU) project for ConocoPhillips is advancing, as is the West Sak Trader Bluff reservoir. They have drilled eight development wells in the Tarn reservoir with the KRU, resulting in application for an expansion of the Tarn Area.
<a href="#">1:44:14 PM</a>	Mr. Banks	The Department anticipates good results from the Ooguruk Unit. Production is anticipated within the next six months. A facility access agreement with the owners is close to being reached.
<a href="#">1:45:07 PM</a>	Mr. Banks	Referenced Page 33, which indicates the Anadarko reentering the Jacob's Ladder

		Well Unit during the winter drilling season with a deviated hole to the Lisburne drilling target. The Brooks Range Petroleum company is a prospect, which is north of Prudhoe Bay. There have been concerns with facility access.
<a href="#">1:46:12 PM</a>	Mr. Banks	Indicated that ENI, an oil Italian company last year, drilled Rock Flour 2 and 3 wells and the Maggiore well. ENI is the operator for the Nikaitchuq project, which was rewarded a royalty modification that lowered the lease rate to 5% when the prices dropped to \$42 dollars. The project will rely on its own standalone facility, delivering oil directly to the Kuparuk pipeline.
<a href="#">1:47:43 PM</a>	Mr. Banks	Addressed NPRA activities. The federal government has not yet conducted a second lease sale. Companies will then need to formalize those land positions to be able advance exploration programs.
<a href="#">1:48:33 PM</a>	Representative Crawford	Inquired about the royalty adjustment effect on the Permanent Fund rate. Mr. Banks explained that if it falls to 5%, then 25% of that 5% would move directly to the Permanent Fund. The Fund will share that reduction.
	Representative Crawford	Understood that under the Petroleum Production Tax (PPT), indicated that any lease expenses paid to the owner of a facility, would be required to count as income. He questioned if that should be repealed. Mr. Banks explained the impact of a net tax on the facility sharing agreement, caused by revenue or income paid by the company wanting access. That amount would count against the revenue for the PPT taxes. The margins could grow before facility sharing, increasing the facility production tax. The Department did not realize that there are "hold-harmless" arrangements and as a consequence, the company entering makes the owner "whole" in the arrangement. By isolating revenue of the facility owner, the problems could be solved.
<a href="#">1:52:36 PM</a>	Co-Chair Chenault	Asked the difference of offering a royalty reduction versus a tax reduction.

		Mr. Banks replied that the royalty modification is a tool available to the Department and the applicant. The Department evaluates the project, using the most recent tax statutes in which the applicant must provide a clear showing that the royalty reduction is efficient and effective, changing the economics of the project. The royalty modification can lead to a change of behavior.
<a href="#">1:55:17 PM</a>	Co-Chair Chenault	worried that a royalty reduction could reduce the Permanent Fund amount. Mr. Banks suggested that it would vary depending on each case and involves economic scrutiny. That applicant information can be daunting.
<a href="#">1:56:37 PM</a>	Representative Gara	Asked if it was essential that the project be clear and economic. Mr. Banks said it was. Representative Gara encouraged consideration is made for switching to a tax relief system.
<a href="#">1:57:34 PM</a>	Representative Hawker	Voiced confusion with regard to the royalty relief, which lessens the government take. During Special Session, there was discussion framing the Administration's perspective that higher tax rates create a more attractive investment climate. He questioned the change in philosophy to reduce the rate, encouraging investment. Mr. Banks explained that decision had been based on the date provided by the applicants and the downside risk affecting applicant's behavior. At high prices, the project is economic at the existing lease rate. The full lease rate is 12.5%-16 2/3%. The proposed is triggered above the \$42 dollars, at which the lease rate will drop to 5%. The plan targets one aspect and one set of outcomes in the evaluation.
<a href="#">2:01:24 PM</a>	Representative Hawker	Asked if it would be "universally applicable". Mr. Banks did not know. He added that the project is unique and involves many wells. Representative Hawker noted that when prices decline, the arrangement would not be economically beneficial to the government. He asked if there were a

		normalization of oil prices, would there be more requests by the Department for royalty relief applications. Mr. Banks thought that was a possibility. Representative Hawker stressed that statement contradicts testimony taken during the Special Session.
<a href="#">2:03:46 PM</a>	Representative Gara	Pointed out that the cost of facilities access was higher than anticipated, questioning if it could be addressed through the explorer royalty relief without changing statute. Mr. Banks responded that changing the royalty rate (between 12.5% and 5%) would be addressed on a case by case base.
<a href="#">2:05:12 PM</a>	Representative Gara	Recalled testimony regarding the higher rate, the more attractive the investment is and questioned why consideration had been made to reduce royalty. The higher the tax rate, the more the applicant gets to deduct. Mr. Banks interjected that if that was not enough, royalty relief could be an option.
<a href="#">2:06:52 PM</a>	Mr. Banks	Addressed activity in the Cook Inlet. In the Beluga River Unit, ConocoPhillips conducted a seismic survey determining that the area is a gas prospect. There was an agreement between the State and ConocoPhillips for the LNG license. In that agreement, ConocoPhillips and Marathon will drill at the Beluga River and Ninichik Unit. Marathon has also made a commitment to drill three wells at the Kenai gas fields. Both companies have agreed to sell seismic data for others coming in for exploration prospects and are addressing unmet needs of the local utilities.
<a href="#">2:09:47 PM</a>	Mr. Banks	There is a plan for exploration in the North Alexander-Escioeta project, decisions made independently. Not having a jack-up-rig is a major impediment for the off-shore development in Cook Inlet. Those costs can not be bore by a single well, requiring a multi year program. Mr. Banks pointed out that Armstrong gas, North Fork Unit was moving ahead with a second well being drilled.

		The Aurora Gas/Nicolai Creek Unit is currently active.
<a href="#">2:11:55 PM</a>	Mr. Banks	Continued, Pages 25 & 26, indicate the status of exploration licenses in the Interior noting the status reports on licensing in the Interior. The Nenana Basin was licensed by Andex Resources and is looking for new partners for that prospect. The Healy Coal Bed license has been receiving support from local government, being transferred to the Pacific Energy. Currently, there are two new applications for Crooked Creek-Circle and Houston-Willow licensing. The licenses will be awarded based on the size of a work commitment. During the work, the area is explored and then converted to an oil and gas lease.
<a href="#">2:13:52 PM</a>	Mr. Banks	Addressed commercial concerns and the knowledge of the Department's resource evaluation staff experience in oil and gas. The New Petroleum Systems Integrity Office (PSIO) developed a monitoring program. PSIO is moved to the North Slopes when incidents occur needing coordination. The Division anticipates requesting reservoir modeling performance.
<a href="#">2:16:42 PM</a>	Mr. Banks	Spoke about the gas produced on the North Slope minimizing oil lose and how gas in Prudhoe Bay might contribute to other units, while attempting to optimize projects for the use of natural gas. The timing issues are important to the Division of Oil and Gas.
<a href="#">2:17:36 PM</a>	Co-Chair Chenault	Inquired if reservoir modeling would be a one time issue. Mr. Banks responded that the initial request was for \$3 million with a total of \$10 million dollars; a major portion of that is related to paying consultants to design and build. He did not anticipate requesting \$3 million every year. Co-Chair Chenault worried about the request becoming an operating expense; presently, it is listed under "other funds". Co-Chair Chenault referenced Cook

		<p>Inlet, Marathon drilling in the areas of Beaver Creek/Wolf Lake. He assumed that gas injection wells into Swanson River field area were needed during colder times of the year. He questioned the efficiency of the project.</p> <p>Co-Chair Chenault mentioned the LNG license extension proposed by the Administration and worried about the amount of movement that has appeared on the concerns. A unique feature is backing the gas out as performed by ConocoPhillips.</p> <p>He acknowledged that many issues remain on the table, yet applauded the movement taken by certain companies.</p>
<a href="#">2:23:03 PM</a>	Co-Chair Meyer	<p>Voiced concerns regarding wildlife placed on the endangered species list and how that could affect work on the North Slope.</p> <p>Mr. Banks agreed that proposals affecting the Beluga whale were of a particular concern. It might affect an entire area boundary between the Outer Continental Shelf and the Susitna River. He reiterated that it is a concern of the Department.</p> <p>He anticipated that polar bears would not be affected by oil and gas drilling activities contributing to loss of their habitat. The Continental Shelf area plays a significant role in the vitality of the industry in Alaska.</p>
<a href="#">2:25:44 PM</a>	Co-Chair Meyer	<p>Inquired if the Administration was attempting to protect those areas while at the same time, addressing the species concerns.</p> <p>Mr. Banks attempted to provide the best information available when responding to each major species designation; the Administration plans to take an aggressive position when responding to federal government designations.</p>
<a href="#">2:27:01 PM</a>	Representative Joule	<p>Commented that the beluga population was increasing.</p> <p>Mr. Banks understood that was correct, however, pointed out there remains concern. Representative Joule said that he had spotted some young grey belugas during the recent summer months, which was unusual.</p>
<a href="#">2:28:18 PM</a>	Vice-Chair	<p>Commented on a hearing in the Homer</p>

	Stoltze	area with the federal government to discuss the issues.
<a href="#">2:29:10 PM</a>	Co-Chair Meyer	Inquired about oil and gas activity in the Nenana area. Mr. Banks advised that Shell Oil had acquired leases south of the "sweet spot" in the off-shore North Aleutian basin. There exists potential gas in that small and isolated area. The last lease sale in the Peninsula area was in Spring 2007 and it received one bid. There will be another one soon. There is now a licensing in the Nenana area, however, it is speculative to explore in that region.
<a href="#">2:31:46 PM</a>	Co-Chair Meyer	Recalled that the first oil discovered in Alaska was in Yakutat. Mr. Banks reported that the first was in the Copper Mine in Endicott and did not know of any current activity there.
<a href="#">2:32:22 PM</a>	Co-Chair Meyer	Asked if the Division was satisfied with the current activity on the North Slope. Mr. Banks made clear that there had been more activity in 2007 than anticipated is anticipated in 2008. The programs are expensive with a process that involves an exploration phase, delineation, & pre-development phase. All of which, involve a large expenditure of money. It has been advantageous for the NRPA to have the net tax system in place.
<a href="#">2:34:48 PM</a>	Co-Chair Meyer	<u>ADJOURNMENT</u>  The meeting was adjourned at 2:36 PM

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