

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

January 25, 2007

5:03 p.m.

MEMBERS PRESENT

Representative Kurt Olson, Vice Chair
Representative Nancy Dahlstrom
Representative Jay Ramras
Representative Ralph Samuels
Representative Mike Doogan
Representative Scott Kawasaki

MEMBERS ABSENT

Representative Vic Kohring, Chair

OTHER LEGISLATORS PRESENT

Representative Lindsey Holmes
Representative Anna Fairclough
Representative Bob Buch

COMMITTEE CALENDAR

PRESENTATION: DIVISION OF OIL AND GAS

-HEARD

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

KEVIN BANKS, Acting Director
Central Office
Division of Oil & Gas
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: Gave the presentation on the Division of Oil & Gas.

BOB SWENSON, Director
Central Office
Geological & Geophysical Surveys (DGGS)

Department of Natural Resources (DNR)
Fairbanks, Alaska

POSITION STATEMENT: Provided comments and responded to questions during the presentation on the Division of Oil & Gas.

ACTION NARRATIVE

VICE CHAIR KURT OLSON, acting as Chair, called the House Special Committee on Oil & Gas meeting to order at [5:03:32 PM](#). Representatives Olson, Samuels, Ramras, Doogan, and Kawasaki were present at the call to order. Representative Dahlstrom arrived as the meeting was in progress. Representatives Holmes, Fairclough, and Buch were also in attendance.

Presentation: Division of Oil and Gas

VICE CHAIR OLSON announced that the only order of business would be the presentation by the Division of Oil & Gas.

[5:04:37 PM](#)

KEVIN BANKS, Acting Director, Central Office, Division of Oil & Gas, Department of Natural Resources (DNR), after noting the information available in member's packets, explained that the Division of Oil & Gas is instructed by the Alaska State Constitution to develop resources for the maximum benefit of all Alaskans. The division will do the following: encourage exploration and development of Alaska's oil and gas resources; maximize revenue from oil and gas production; and maximize the benefits of development and production which can lead to jobs, new industry, and expansion of commercial and service businesses. However, he continued, sometimes these purposes conflict as efforts to maximum revenue may be seen to discourage development because the division is pressing for revenue over and above the incentives the industry would like. The benefits of jobs and of industrial and economic growth must be balanced against what the state can offer to change the revenue stream.

MR. BANKS pointed out that Alaska is the fourth largest oil producer in the state and has a very important role in the North American energy market; 25 percent of domestic production and 10-12 percent of the U.S. consumption of oil comes from Alaska, and Alaska's reserves represent an enormous percentage of undeveloped domestic reserves. The division is the manager of these resources. Other organizations in North America in a similar position are: Minerals Management Service [an agency of the U.S. Department of the Interior] and the Canadian

government. For that reason the division needs to manage Alaska's lands proactively, with responsibility, and with a focus on maximizing the benefits for all Alaskans.

MR. BANKS referred to the state's revenue for 2006 (FY06), totaling \$2.4 billion from the land resources, with about \$600 million going to the permanent fund and \$1.8 billion contributed to the general fund (GF); taxes totaled \$1.9 billion for the same period. He pointed out the Department of Revenue (DOR) has forecasted that for next year tax revenues will total \$2.8 billion as a result of the production profits tax (PPT), adding that the estimation of revenue from production taxes now includes variables such as: tax credits, industry expenditures, and the response of new development from incentives.

MR. BANKS stated the division is responsible for "a somewhat more predictable and perhaps less volatile stream of revenue." Referring to page 5 of the packet, he reviewed the revenue picture from royalties, rents, bonuses, and oil and gas settlements, and noted that high prices have mitigated the decline in production. In regard to the royalty in-kind (RIK) program, Mr. Banks said about 60 percent of the royalty oil, nearly 40 million barrels, was sold to Flint Hills Resources. Historically, the sale of royalty oil was less and this means the percentages are increasing as the flow of oil continues to decline; therefore, meeting the requirements of the contract with Flint Hills Resources will take a larger percentage of royalty oil.

[5:15:09 PM](#)

MR. BANKS described the organization at the division as similar to an oil and gas exploration and production company. He noted that his staff have extensive experience in the industry and are interested in working for his department because of the challenges and career opportunities. Staff includes experienced geologists, geophysicists, and other geotechnical scientists with backgrounds in oil and gas exploration.

MR. BANKS explained that the leasing and permitting section of the division raised almost \$40 million in bonuses and is now running land lease sales. Included in these leases are: Beaufort Sea, North Slope Foothills, Cook Inlet, and Alaska Peninsula Bristol Bay. Leases are offered on a routine basis. The unit administration section begins work after the lease is offered, when the division brings together lease owners to encourage development of resources, protects the relative rights

of the owners, and encourages the economic and physical development of resources. The Royalty Accounting section makes sure that money is accounted for and deposited correctly, and the Audit Section has been returned to the division so it can conduct its own audits and catch up on the backlog of audits of royalty revenues. Also, the royalty valuation mechanisms are governed by royalty settlement agreements that are a consequence of the North Slope royalty dispute with the Amerada Hess Corporation. Bi-lateral agreements are held with each major North Slope producer regarding calculation of royalty value, and the Commercial Section works with the Audit Section to validate those numbers and ensure that Alaska gets fair value for the royalty. Mr. Banks described the Commercial Section as small, and staffed with employees who are experienced in economics and who have the intention to find commercial opportunities when they arise.

Mr. BANKS spoke of issues on the table: the North Slope gas pipeline, the Point Thompson Unit, the Petroleum Systems Integrity Office, the ongoing audits, and the re-evaluation of royalty value. Longer term issues are: the oil decline, access to lands, and fostering development. The division must outreach to new producers, make land available, manage leased land effectively, and make sure leaseholders begin production of resources. Lastly, [is the issue of] facility access. The division will search for commercial solutions wherein independent producers who need facilities can make fair and equitable commercial deals with those who own facilities, and develop oil fields in an efficient and cost-effective way.

[5:24:18 PM](#)

REPRESENTATIVE RAMRAS asked what kind of new activity from large or small producers has been spurred by the PPT since the end of June.

MR. BANKS said: "I think it is too soon to tell ... [there has been] a real bump-up of activity in both the North Slope and in the Cook Inlet, ... but I think that was more a consequence of higher oil prices and also some limited supply of other opportunities." He added that the division has analyzed PPT with respect to royalty modification applications and the gas line.

REPRESENTATIVE RAMRAS asked if the new development is by ConocoPhillips Alaska Inc., and BP Exploration, or by the small

producers and independent drillers which PPT was meant to attract.

MR. BANKS replied ConocoPhillips Alaska Inc., and BP Exploration (Alaska) Inc., have roles in new development. However, much of the new exploration activity on state land is by independents, such as the Pioneer Natural Resources development of the Ooguruk site.

[5:27:24 PM](#)

REPRESENTATIVE RAMRAS commented that Ooguruk is already a known site and so he would like the division to provide the names of new companies and outline activities that have been stimulated since PPT was passed. He went on to say:

When we open up the envelope on March 31st, if the right sum of money isn't there, does the division have a plan immediately to introduce to the legislature ... [that will] remedy the potential for big oil to have gamed us through the PPT? Do we have an estimate of the deferred maintenance for BP Exploration (Alaska) Inc., not only to rehabilitate the inline transmission lines up North, but also their global and North American reputation?

[5:29:03 PM](#)

MR. BANKS referred to the situation which will occur on March 31, 2007, and said that the division is: "not working on a potential solution to that problem. ... The Department of Revenue will want to monitor what is going to be happening." Mr. Banks concluded by saying the role of the division is to make sure the royalty from the existing players is paid, and to offer assistance to the Department of Revenue (DOR) regarding how investment credits are spent. He said: "The full story of PPT will be hard to tell."

VICE CHAIR OLSEN stated the DOR may be asked to assist in answering questions about the impact of the PPT. He also asked about activity in the Nenana Basin.

MR. BANKS said the exploration license for Nenana Basin was offered to Andex Resources and there has been very little activity; the division would like to further respond to this question in writing.

5:32:10 PM

VICE CHAIR OLSON asked about the negative impact in Cook Inlet as a result of the recent Regulatory Commission of Alaska (RCA) decision.

MR. BANKS remarked that the division has been tasked by the governor to examine the market for Cook Inlet gas. The market has begun to coalesce with liquefied natural gas (LNG) exports, and contracts expiring, so now there is demand for supplies of gas. He opined that the historical prices for consumers in the Cook Inlet were not high enough to bring in new gas supplies.

REPRESENTATIVE DOOGAN questioned why his gas bill has doubled but is not [at] a high enough price to support new exploration.

MR. BANKS explained that the price to the consumer is the result of historical contracts that have been indexed to oil. Because the price of oil has risen in the past several years, the increase is now being reflected in the contracts. Newer contracts are driven by the price of gas in the Lower 48 as measured by the Henry Hub pricing point in Louisiana, which reflects what the market is for Gulf of Mexico gas. Reasonable prices for gas with oil at \$20.00 per barrel can now be seen. If new supplies are set at a price commensurate to what the old contracts are generating, for example, \$7.50 per natural cubic foot (NCF) for the consumer in Anchorage, then the price might be enough. Although prices are low in the Rockies and Alberta, there is a lot of development there. Something must change in the new contracts to tie gas prices to something different. Mr. Banks added, Cook Inlet gas was found in the search for oil, so there was some logic in setting the price of gas to the price of oil; now the price of gas must be set to the price of gas elsewhere because the target is gas.

5:38:08 PM

BOB SWENSON, Director, Division of Geological & Geophysical Surveys (DGGS), Department of Natural Resources (DNR), recalled that two wells were drilled in the Nenana Basin in the 1980s with some indication of hydrocarbons and limited seismic data, and an exploration license was granted to Andex Resources with a work commitment to shoot additional seismic data. The Basin is geologically complex and the structures, the trap, that the hydrocarbons are reservoired in are complex. Mr. Swenson opined that after further seismic data was done, Andex Resources decided not to drill the planned well and is still analyzing

data to determine if reserves are large enough to warrant a well.

VICE CHAIR OLSON asked about the results from the two test wells in the Red Dog Mine area.

[5:40:55 PM](#)

MR. SWENSON said he did not have information regarding the shale gas wells from the mine, but will provide that information to the committee. Mr. Swenson commented, regarding Cook Inlet, that any given market is better with a continuous, rather than a swing, demand. Producers want to produce continuously through time; demand in the Basin in the wintertime is three times the demand in the summertime, so it will spur exploration, but the market is relatively limited.

REPRESENTATIVE RAMRAS referred again to the Nenana Basin and the governor's direction to DNR to find energy and get it to the communities that need it. Andex Resources also has leases in the Gulf of Mexico and so is not very motivated to explore Alaska. Representative Ramras asked:

What specific steps [is the division]... going to take to energize Andex, ... to change the economy for 90,000 people in the interior of Alaska?

[5:45:04 PM](#)

MR. SWENSON stated that the DNR is looking for energy resources across the state. The cost of diesel is causing problems for all the villages and many communities. Work has been done around the state to understand what sources are available, but the compilation in any given area has not been done, so this inventory will enable each area to understand the geologically related resources, coal, geothermal energy, shallow natural gas, coal bed methane (CBM), and renewable fuels. He stated DNR is working with the Alaska Energy Authority (AEA) to get data and also include [data from] the Division of Forestry regarding all biomass; the plan is to end up with a map of the state with layers of each resource-including wind, hydro, all the renewable resources and coal-and including the economics of each resource.

MR. SWENSON referred back to the Nenana Basin, and noted there is certain potential there and exploration licensing is a way to spur exploration. There was very little money, but work commitments were given, and after the work commitment is done,

the developer can pare down to a specific area and go to lease on the smaller prospect. The first work commitment on the Nenana Basin was satisfied and the next work commitment is a well. Each company has baseline economics which are related to the trillion cubic feet (TCF) range in a certain size of field. For the future of the Nenana Basin, exploration licensing is a good way to go. He further explained that the Andex Resources seismic data is not available to the state, but the state can gather additional data in order to understand the potential for the Nenana Basin and then make that data public to attract developers.

[5:49:57 PM](#)

REPRESENTATIVE RAMRAS stated that the economics of the Fairbanks market will never justify interest, but the governor charged the DNR and the legislature with providing energy to all of the state. He further asked about a plan that will deliver gas to a community 50 miles away from the Nenana Basin, and will further support ENSTAR Natural Gas Company's interest in moving gas. Andex Resources, an out-of state entity, has not acted.

REPRESENTATIVE SAMUELS asked how much how much of the proposed \$150 million [budget cut] will the division absorb.

[5:53:13 PM](#)

MR. SWENSON said he did not know the answer, but stated he did know that Commissioner Rutherford has suggested that she is interested in eliminating programs to cut the budget, but those programs have not been identified.

MR. BANKS, in conclusion, introduced division staff.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 5:56 p.m.