

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 28, 2012

3:32 p.m.

MEMBERS PRESENT

Senator Joe Paskvan, Co-Chair
Senator Thomas Wagoner, Co-Chair
Senator Bill Wielechowski, Vice Chair
Senator Bert Stedman
Senator Lesil McGuire
Senator Hollis French

MEMBERS ABSENT

Senator Gary Stevens

OTHER LEGISLATORS PRESENT

Senator Cathy Giessel
Senator John Coghill

COMMITTEE CALENDAR

SENATE BILL NO. 145

"An Act providing for a credit against the oil and gas production tax for costs incurred in drilling certain oil or natural gas exploration wells in the Nenana Basin."

- HEARD AND HELD

SENATE BILL NO. 215

"An Act requiring the Alaska Gasline Development Corporation to construct a natural gas pipeline to deliver Cook Inlet natural gas to Fairbanks and other communities between Cook Inlet and Fairbanks that do not have access to a natural gas pipeline."

- SCHEDULED BUT NOT HEARD

SENATE BILL NO. 219

"An Act relating to the Alaska Land Act, including certain lease, sale, and other disposal of state land and materials; relating to production royalties from miners; relating to rights to use state water; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 145

SHORT TITLE: OIL/GAS PRODUCTION TAX CREDITS: NENANA

SPONSOR(s): SENATOR(s) WAGONER, COGHILL

01/17/12 (S) PREFILE RELEASED 1/6/12
01/17/12 (S) READ THE FIRST TIME - REFERRALS
01/17/12 (S) RES, FIN
03/28/12 (S) RES AT 3:30 PM BUTROVICH 205

BILL: SB 219

SHORT TITLE: DISPOSALS OF STATE RESOURCES

SPONSOR(s): RULES BY REQUEST OF THE GOVERNOR

02/29/12 (S) READ THE FIRST TIME - REFERRALS
02/29/12 (S) RES, FIN
03/28/12 (S) RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

MARGARET DOWLING, Staff
Senator Tom Wagoner
Alaska State Legislature
Juneau, AK

POSITION STATEMENT: Commented on SB 145 for the sponsor.

JAMES MERY, Senior Vice President
Lands and Natural Resources
Doyon, Limited
Fairbanks, AK

POSITION STATEMENT: Supported SB 145.

LANCE MILLER, Vice President
Resources
NANA Regional Corporation
Kotzebue, AK

POSITION STATEMENT: Supported SB 145.

ELIZABETH HENSLEY, Corporate and Public Policy Liaison
NANA Regional Corporation
Kotzebue, AK

POSITION STATEMENT: Supported SB 145.

ED FOGELS, Deputy Commissioner
Department of Natural Resources (DNR)
Juneau, AK

POSITION STATEMENT: Presented SB 219 to the committee for the administration.

WYN MENEFEE, Chief of Operations
Division of Mining, Land and Water
Department of Natural Resources (DNR)
Anchorage, AK

POSITION STATEMENT: Helped present SB 219 to the committee on for the administration.

ACTION NARRATIVE

[3:32:27 PM](#)

CO-CHAIR TOM WAGONER called the Senate Resources Standing Committee meeting to order at 3:32 p.m. Present at the call to order were Senators French, Stevens, McGuire, Co-Chair Paskvan and Co-Chair Wagoner.

SB 145-OIL/GAS PRODUCTION TAX CREDITS: NENANA

[3:32:41 PM](#)

CO-CHAIR WAGONER announced consideration of SB 145.

CO-CHAIR PASKVAN moved to bring CSSB 145(), version 27-LS1078\I, before the committee for discussion purposes.

CO-CHAIR WAGONER objected for discussion purposes.

[3:33:33 PM](#)

SENATOR WIELECHOWSKI joined the committee.

[3:33:40 PM](#)

At ease from 3:33 to 3:34 p.m.

[3:34:34 PM](#)

CO-CHAIR WAGONER asked for the motion to be restated.

CO-CHAIR PASKVAN moved to bring CSSB 145(), version 27-LS1078\D, before the committee for purposes of discussion.

CO-CHAIR WAGONER objected for discussion purposes.

[3:35:09 PM](#)

MARGARET DOWLING, staff to Senator Tom Wagoner, said SB 145 is a companion to HB 276, which has had six hearings in the House Resource Committee and currently resides in House Finance. She said SB 145 initially intended to provide tax credits that would

be meaningful enough to attract exploration in some of the remote areas of the state identified by the Department of Natural Resources (DNR) as potential for holding hydrocarbons. The areas are so remote that it is hard to attract investors. Another feature about these areas is that they are within an approximate range of populated areas that are struggling with fuel costs and unreliable resources. For example, Fairbanks spent \$660 million on space heat at about \$4.20/gallon and has an average kilowatt-hour of about 23 cents and it has been struggling for many years to come into compliance with EPA air quality standards. In Cooper Bay, the city administrator said that people are pulling boards off buildings for heating purposes.

CO-CHAIR WAGONER noted Senator Giessel and Senator Coghill in the audience.

MS. DOWLING said that the Nenana Basin is just 50 miles north of Fairbanks and has already had some exploration seismic and drilling; it has a potential for gas and possibly oil. So after extensive consultation with the Department of Revenue (DOR) and the Department of Natural Resources (DNR) and other communities interested in the concept, the bill was expanded to include exploration drilling in other basins. That is what is in the CS, which was also expanded to include seismic.

She said the original intent of the bill guided the conversation: to serve Alaskans not only to increase production for exports but also to promote exploration for oil and gas resources in the frontier basins where there is a potential for serving local and regional use.

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MS. DOWLING said they always kept the state's public policy in mind to balance risk with the potential for some return for that investment.

She said Version D includes the six geographical areas for exploration identified by DNR as having potential for discovery of hydrocarbons within proximity to existing communities. With the addition of these areas it also increased the cost of the bill. To address that they limited the number of credits and the value; so, as the bill stands today there are four total wells anywhere in those areas and no more than two wells in any one area.

The tax credits are for 80 percent of the total exploration expenditures for work performed or \$22.5 million, whichever is less. She pointed out that it's 15 percent more than is currently available under existing statute. The total maximum credit is \$90 million. It only applies to work performed after 2012 and will expire in 2016 like other AS 43.55.025 credits. The tax credit is not stackable with other credits either under this section or AS 43.55.023.

To ensure the investment is warranted and projects are sound, Ms. Dowling said some prequalification criteria by DNR were built in - for instance: well location, proximity to a community in need of energy resources, proximity to infrastructure and technical aspects like whether there is seismic mapping or data sufficient to identify a particular trap.

MS. DOWLING said to guarantee return on investment the state concurred that more data would be a positive return. More geophysical data will assist current and future explorers and attract new investment and development to the state, which leads to the potential of building infrastructure, and increasing production, tax revenue and royalties. Therefore, seismic was added because, in addition to data from exploration drilling, seismic will yield additional information from some of the unexplored remote areas. They allowed credits for a total of four projects with no more than one seismic project in any one of the areas and a 75 percent credit for total exploration expenditures or \$7.5 million, whichever is less. This is 10 percent more than existing statute. The total maximum potential credit is \$30 million. The seismic project has similar pre-qualifications as the well drilling.

Because the focus was on getting more information for the state and for public use, she said they added data on private land to the existing requirement for all seismic and drilling exploration data on state land be turned over to the state, but in addition, if someone wants a credit on private land, they must obtain written consent from the owner to disclose the data to DNR. Additionally, the confidentiality period for seismic changes from 10 years (in current statute) down to 2 years.

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MS. DOWLING said the final consideration in these conversations was about what happens if an explorer is successful - and he's in the middle of nowhere with very little infrastructure (for instance) and would be subject to North Slope tax rates. So they came up with a maximum seven-year, 4 percent credit on gross

production following commencement of commercial production. After the seven years, the tax rate reverts back to existing statute. This tax break doesn't apply to North Slope oil or gas, not to royalty gas and oil, not to Cook Inlet gas or oil and not to gas used in the state. The bill gives no breaks on royalty, corporate income tax or property tax.

She said it does provide explorers willing to take the risk to explore in these remote areas some predictability seven years out. That will help them in getting financing for their infrastructure and other costs associated with working in these remote frontier areas.

SENATOR STEVENS said it seemed to him that it would be advantageous to have all six areas explored and he was sorry to hear it was reduced to four. Which four and wouldn't it be a better idea to get all six?

MS. DOWLING replied that the original concept of the six areas was proposed by DNR and in contemplating how many wells should be allowed a credit the cost to the state became sizeable. It was a public policy decision on the House side working with the agencies to limit it to four.

SENATOR WIELECHOWSKI said he appreciated her work on this. He asked if this credit is stackable with other deductions.

MS. DOWLING deferred to the Department of Revenue (DOR).

CO-CHAIR WAGONER said he would ask the department after other presenters.

SENATOR WIELECHOWSKI said Senator Wagoner's jack up rig bill had a provision that required a successful company to repay 50 percent of its credits and asked if this bill had a similar provision.

MS. DOWLING replied that was part of the original bill, but it became less attractive because depending on the value invested it would put a company in the position of choosing between existing credits and this credit based on speculation about the future for production. It was decided to simplify and add just a small percentage over what is available in the existing credits to make the future a little more predictable.

SENATOR WIELECHOWSKI said he has no problem with this for local needs, but he was concerned about protecting the state treasury

if there is a large find (which they all hope for) especially for the seven years. The typical decline curve for an oil field is that it peaks within the first couple years and then spikes down dramatically.

MS. DOWLING responded that issue had been discussed and the timeframe for extending the credit is a policy question for this body to decide. They used seven years to provide predictability to explorers so they could get financing in exchange for their risk in exploring in remote areas. The sponsors of the bill were looking for ways to provide more predictability to the companies.

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CO-CHAIR WAGONER said this started out as a bill getting gas to Fairbanks the fastest way possible. All of a sudden the need is throughout the state and it's hard to argue against the other needs. The bill matured and grew, but it has tight enough controls that it won't get out of hand. He explained that the Cook Inlet Stampede bill was crafted in the later part of a session by rolling it into another bill and they didn't think through the credits, because right now if a company drills to the depth they have to to get those credits, they have to decide on taking the 65 percent credit or the drilling credits for the exploration - and that \$25 million if they have producible gas or oil all of a sudden becomes \$12.5 million. He thought the 65 percent credit was more doable than drilling credits, because in Cook Inlet they were trying to get more than one person to come in with jack up rigs, and that was successful.

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JAMES MERY, Senior Vice President, Lands and Natural Resources, Doyon, Limited, said he had worked with Doyon for a little over 30 years. He said that Doyon, Limited, is one of the Alaska Native Claims Settlement Act regional corporations and is resided in Fairbanks; it has over 18,000 shareholders and is the largest private landowner in Alaska owning over 12.5 million acres. They have a number of operating businesses and employ several thousand people here and "outside." Most of their flagship organizations operate in the oil field and remote services sector of Alaska businesses.

MR. MERY said he would give them a background on how the natural resources segment of Doyon operates, because it feeds directly into the importance of the two major pieces of the bill. Basically, Doyon doesn't do anything with traditional lands, but they have areas for development purposes in hard rock mining and

oil and gas. Their business model is like a junior mining company; they are not a development company or producer. They are an explorer; they generate ideas about not just their own lands but about nearby state lands. Nenana is a good example of that. They gather market and geological data and assemble it into an acreage package. They acquire as much heritage data as possible; some of it is in the public domain that they might have to pay a lot of money for. Then they begin to explore doing everything from surface studies to air and ground geophysics such as seismic and gravity. Then they do some drilling for hydrocarbons and hard minerals.

MR. MERY said Doyon is very different from most of the companies that talk to the legislature. They are about as Alaskan as you can get with many shareholders living here. Two of the communities are close by the Nenana Basin, in particular, and all over the Yukon Flats. These people need jobs and opportunities. Doyon's home office is in Fairbanks and many of their subsidiary offices are in Anchorage; many are successful oil field services. They pay a lot of dividends to shareholders and all that money stays in the state.

MR. MERY said he thought Doyon had more reasons to make these areas work than other companies - meaning no disrespect. But they can't do this on their own; they need help from the state, which they have been getting via the credits that are truly appreciated; but they need help from industry, too. Even on the North Slope companies partner up to spread the risk; Doyon has to do the same thing.

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He showed maps of the Interior basins that were relatively close to some infrastructure, some relatively close to the TAPS (the Nenana Basin is one). He said Doyon has an exploration license with the state on almost 500,000 acres at Nenana and that license expires this year. They have to take leases if they are going to move forward and start paying rentals to the state - which will happen later this year.

MR. MERY said they had been the operator of this project only since 2010. They have other partners, a company in Denver called Rampart, Arctic Slope Regional Corporation, Usibelli Coal Mining, and Cedar Creek (from Minnesota), but they are the only ones left exploring. Everyone else has lost interest in the project and they are the only one (along with the state) that is funding an 125 mile seismic program that is going on right now on the northern Nenana Basin.

He said these basins, and Nenana in particular, have seen work in the past. The big companies have been there as early as the 60s, but more recently in the 80s. Some work has been done on oil (not gas), but these companies left when their business models changed in the mid-80s when the price of oil crashed. Doyon started there as a gas-for-Fairbanks project, but is not there today because of the chaos in the natural gas markets in Alaska, in particular, because of small lines versus big lines issues. And Doyon thinks natural gas will be transported down to Fairbanks in an LNG-type project by truck. That project does "gut the economics" of a natural gas project at Nenana because there just wouldn't be enough left after bringing it down by LNG and moving it to the big industrial users.

Fortunately, when they drilled their well there a couple of years ago, even though it wasn't commercial, Mr. Mery said they saw a very active petroleum system and excellent oil source rocks and that has encouraged them to "soldier on." He said they expect to find gas there and hopefully find a way to put it to some productive use.

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He said the Yukon Flats has three Nenana Basins with similar geology. Some work was done by the major companies a few years ago and Doyon picked it up and ran with it doing extensive geochemical surveys in the light bed sediments. Light oil is pervasive throughout in micro-seeps and shows a lot of promise. But they are at a point where they need help. They get a lot of push back - not on the geology so much as what happens if they find something and because of the lack of infrastructure and the high cost of entry into Alaska. So, the two pieces of this bill address a lot of this market push back with a boost to the tax rate on the exploration side for a limited period of time.

CO-CHAIR PASKVAN asked what would lead him to conclude it's better to go with the structure under SB 145 at 80 percent versus the current system at 65 percent.

MR. MERY answered through Doyon's own experiences with costs both in drilling and in seismic they have figured it would be far more beneficial than the .025 credits, but not farther away from the grid.

CO-CHAIR PASKVAN asked because Doyon is so close to roads already in Nenana if 65 percent would be better for that region.

MR. MERY replied it's possible, but not absolutely.

CO-CHAIR PASKVAN asked what this structure does for a company like Doyon on the back end.

MR. MERY replied that it's not what it does for them so much as that it helps them find other companies outside that aren't here and bring them up. New entrants have the perception of complexity and progressivity and they get scared. Even people who understand what they are getting into will have to hire lawyers and accountants for a month or two to figure out what their tax will be. The flat rate is simple and easy to understand for a company's critical period of capital recovery. He said they are not targeting huge companies, but the "wildcatters."

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LANCE MILLER, Vice President, Resources, NANA Regional Corporation, Kotzebue, said their specific area of interest is the Kotzebue Basin and part of the Selawik Basin. It is a Cook Inlet-size basin, about 380 miles by 80 miles, much of it going off-shore into the Chukchi Sea, but their focus is onshore. He said Doyon had been pioneering the way looking for investors, but NANA's story has been mainly minerals from that region.

He said in 2010, according to Export Council Alaska data, 25 percent of the exports from Alaska were due to Red Dog zinc alone. On an average year about 23 ships take ore to smelters in Canada, Europe and Asia. "So, we actually do export from the region and have that capability."

SENATOR STEVENS asked if the exports were in volume or dollar value.

MR. MILLER replied in dollar value.

SENATOR WIELECHOWSKI asked if that excluded oil.

MR. MILLER replied yes. The NANA Basin had two stratigraphic wells drilled in 1974 about 60 miles apart. In those days a lot of the majors would actually just drill the wells to look at the stratigraphy rather than try to hit the hot prospects, because they have the longer term view and do more research than an independent might. There are about 1500 miles of 2-D seismic work. Since receiving data in the mid-90s, NANA has been compiling it and has an agreement with a petroleum independent out of California to market it.

He said in the early 2000s they went to all the majors and better known companies and while people know it geologically, it's overshadowed by Prudhoe and Cook Inlet. So, it really is a new game: for minerals it's the juniors and for oil and gas it's the independents that might take the risk on some of the challenging basins.

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MR. MILLER said their work has identified about nine significant geologic targets for hydrocarbon accumulation, basically structural and stratigraphic traps.

CO-CHAIR PASKVAN asked if he is talking oil, gas or both.

MR. MILLER said that's a good question; it's often viewed as a gas basin, but a lot of the recent work shows potential for oil. They won't know until they drill, but the hydrocarbon system could lend itself to oil as well.

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CO-CHAIR PASKVAN asked what he would do if he found significant gas. How do you market it? Where does it go?

MR. MILLER answered first they hope for a discovery of significance. But it would go to the local markets: villages like Kotzebue and the Red Dog. They have been working with a company for exporting LNG to Asia that is paying a higher price for natural gas the US is. All are possibilities and it depends on the size.

CO-CHAIR PASKVAN said when they talk about export potential they always hear about ports and asked what their capacity is.

MR. MILLER answered that everything has been looked at from Red Dog to Cape Blossom to Nome to a further south pipeline. The shipping season at Red Dog is July to late-October basically depending on insurance for ice shipping.

SENATOR WIELECHOWSKI said he assumed most of the gas would go to Red Dog because it uses an enormous amount of power.

MR. MILLER replied about 15 - 20 megawatts.

SENATOR WIELECHOWSKI asked what would happen if they find oil.

MR. MILLER replied that would be a great game changer and it's not that far to get over to TAPS. But he emphasized it would be purely wildcat prospectivity. Incidentally, he said the term "wildcat" came from early 1900s in Texas and guys took a flyer out away from the known fields; and people just said they are just going out where the wild cats roam.

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SENATOR STEVENS remembered Standard Oil was in the Port Moller area in 1912 and asked if there has been any exploration development in this area.

MR. MILLER replied that the two red dots represented SoCal or Chevron wells from 1974. One went down to 8400 ft. and one to about 6300 ft. and they were looking at the geology and not targeting high prospectivity targets. This is when one of the first deals was done between an Alaska Native Corporation and an oil company in Alaska.

He wanted to mention that the frontier basins are getting more attention now from explorers and in the past they had been overshadowed by the North Slope in terms of size and infrastructure in that it has a road and you can get things.

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A rig located in their area would be close to tide water, but the rig would probably be captured there for a year. The Kotzebue Basin has geologic risks, which is why some of these incentives are helpful. The incentives on the front end and the simple tax rate on the back end would really help attract the needed risk capital. With the remoteness of the state, projects often necessitate being large. So, a worst case of success might be where you find gas and there is enough for local use but not enough to make it economic.

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ELIZABETH HENSLEY, Corporate and Public Policy Liaison, NANA Regional Corporation, related that this bill is a priority for NANA and the Northwest Arctic leadership team, which consists of NANA, the Northwest Arctic Borough, the Northwest Arctic Borough school District and Maniilak Association (provides health care throughout the region).

She said "The Cost of Energy in Northwest Alaska" said that the average cost of one gallon of gas is \$7.92 and Kobuk pays the highest rate at \$10.46 per gallon. Buckland pays the lowest at just \$6.25 per gallon. The average price for a kilowatt hour of

diesel generated electricity is \$.68; the residents at Shungnak pay the highest at \$.92 per kilowatt hour and Kotzebue residents pay the lowest at \$.41 kilowatt. She heard that people in Juneau pay \$.11 1/2 per kilowatt. She said the average per capita income in northwestern Alaska is \$21,000 per year, which is \$10,000 below the rest of the state according to the 2010 census, and 20 percent of the population is living below the poverty level. Yet residents in Northwest Alaska are paying really high costs for energy. If this bill passes, it would be very helpful in incenting exploration for oil and gas in the region, which could help offset the really high cost of energy for citizens who need to heat their homes and businesses as well as for other development projects in the region.

SENATOR WIELECHOWSKI asked if she would support an amendment that allows for this to apply to gas and oil used for local needs as opposed to export.

MS. HENSLEY said she would have to talk about that with her leadership and asked what his concern is with exports.

SENATOR WIELECHOWSKI replied the bill originally started out as a way to supply low cost energy to local communities, which he supports, but it has expanded greatly. His concern is protecting the state's treasury and, if there is a big find of a couple of billion barrels of oil, exporting while ensuring local needs are met.

MS. HENSLEY replied that she would be interested in discussing that, but NANA supports the bill as written at this time.

CO-CHAIR WAGONER said he would hold SB 145 in committee.

SB 219-DISPOSALS OF STATE RESOURCES

[4:25:53 PM](#)

CO-CHAIR WAGONER announced SB 219 [Rules by request of the Governor] to be up for consideration.

[4:26:09 PM](#)

ED FOGELS, Deputy Commissioner, Department of Natural Resources (DNR), asked that the DNR chief of operations join him.

[4:26:23 PM](#)

WYN MENEFEE, Chief of Operations, Division of Mining, Land and Water, Department of Natural Resources (DNR), introduced himself.

MR. FOGELS said he would give some broader background to where this bill came from and then would turn it over to Mr. Menefee to go into the details. He said the governor asked all state agencies to take a look at their permitting processes to see if they could be made more efficient. They worked with five principle focuses.

CO-CHAIR PASKVAN moved to bring SB 219, version A, before the committee for purposes of discussion.

CO-CHAIR WAGONER objected for discussion purposes.

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MR. FOGELS said this bill is about streamlining the individual permits that each agency issues; enhancing coordination amongst all the state agencies and the state and federal agencies; gathering public input, which they have doing over the last six to eight months; looking for ways to better for collaboration with federal permitting agencies that are key to getting any projected permitted these days; and getting the jump on new activities that they don't have good permitting expertise on like shale oil, underground coal gasification, geothermal, wind et cetera.

He said SB 219 makes individual agencies' permitting processes work together better. The Division of Mining, Land and Water at this time last year had a fairly significant backlog of about 2500 permits and authorizations and the legislature gave them additional resources to work on those. With those resources came the promise that money and people alone may not be solution; it would come with the fundamental way of doing business and that is what the division has been working on for the last year. A new director, Brent Goodrum, has an eye toward organizational efficiency and the backlog has been knocked down by about 21 percent already this year.

MR. FOGELS said one of the major things they have been doing within the division is looking at the statutes that guide the permitting and it has come up with significant ways to make them work better for Alaskans. SB 219 doesn't make earth shattering changes, but rather small changes that cumulatively will have a big impact on how they do business. It will make some authorizations go quicker and free up resources within the division so more staff can be devoted to the permitting work at hand. As a result the permitting system will run a lot smoother and faster.

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MR. MENEFEЕ said when they talk about land leases it's for things like lodges, commercial facilities and fish processing plants not oil and gas. A provision in statute has a threshold of when they can go "negotiated" versus "competitive" and negotiated leases is a shorter process; you can negotiate directly with the individual without competition. Since 1984 the threshold for a direct negotiation is a \$5,000 lease and for a period less than 10 years. They are asking for an increase up to \$10,000 and he said that would affect just a couple of leases a year.

More substantially, Mr. Menefee said they would like to get more competitive category leases under negotiated leases, because right now they have to spend an extra 30 days and publish an auction brochure for the competitive category and that is charged to the applicant. It's just extra time and money that shouldn't be expended if no one is competing for it. They would like to find out if anybody is interested through their public notice process on disposals of interest decisions and if nobody is, they would like to go straight to the negotiated category. These issues were in sections 5 and 6 of the bill.

SENATOR WIELECHOWSKI asked him to describe the process for a lease renewal (section 6).

MR. MENEFEЕ replied that leases can be a maximum of 55 years long, although often they are 25 to 30 years and a lease renewal must go through the full best interest process again. The revision in the bill would give the department the discretion to renew it. That means the process would be shortened and it would be an administrative decision rather than the full preliminary and final finding. It would still get public notice and have an appeal option. The department would still see if there is competitive interest, but once that has been ascertained and if the lessee is in good standing the lease could be renegotiated. It just shaves time off.

CO-CHAIR PASKVAN asked what percentage of the state's leases is for 55 years.

MR. MENEFEЕ answered not many; some of the leases done in the 60s and 70s are 55-year leases and they are just starting to come up. It doesn't mandate that you have to renew for the full term, you just can't exceed the initial term. They have found there are enough changes going on in land that they feel much

more comfortable with a 25 to 30 year lease depending on what is being built.

SENATOR STEVENS asked how many leases would be affected.

MR. MENEFEER replied the division processes about 10 leases a year and gets applications for about 14 to 20 a year (that's where the backlog comes from). He couldn't predict the amount of leases that would actually hit the renewal, because it depends on whether people are still doing what they started out doing and how many want to continue. But about five leases a year could move from the competitive to direct negotiated category.

CO-CHAIR PASKVAN asked what type of operation is going in a 55-year lease.

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MR. MENEFEER said he didn't have an exact example, but lodges were done with longer lease terms in earlier times.

SENATOR FRENCH asked if Alyeska Ski Resort leases its land from the state.

MR. MENEFEER replied Alyeska is a recreational development lease through the state; there is only one recreational facility under that statute and it is Alyeska. Examples of some other ones are a Princess Lodge, fish processing plants, large docks like Juneau's Jacobson Dock as well as submerged lands and uplands where larger development is being put in.

CO-CHAIR PASKVAN asked the total number of leases and the ranges of operations one might see.

MR. MENEFEER replied that a large scale lease would be a gas processing plant that was completely separate; for instance the proposed Dead Horse LNG processing plant to Fairbanks Natural Gas or for a smaller project a guide service putting in something more than a just a camp like a structure with foundation for a mess hall that will last longer than five years.

[4:45:33 PM](#)

CO-CHAIR WAGONER asked for list of lease samples, large to small.

[4:45:53 PM](#)

MR. MENEFEЕ said he would certainly get those for him and moved to sections 10, 11, 14 15 that separate timber sales from material sales. Statutes were intertwined and a little bit confusing; so they left the timber sale statutes (sections 10 and 11) the same, but pulled out all the material sale parts and put them into sections 14 and 15.

Changes were made to the process of material sales that save time and money. Typically, when someone applies for a new site it will take 130 - 160 days. If somebody wants to come into the same area, they are still going to have to go through the same process; so they are proposing creating a material site disposal area of about 15 acres. The point is that the material will be exhausted and subsequent sales would not be publicly noticed or have new decisions. You would just write the contracts for them. They do 30-50 material sales a year and this would save a lot of time and some costs.

The same materials section also deals with a couple of other changes that have cost savings for the applicant dealing with appraisals. He explained that these areas sell for appraised fair market value and an appraisal actually has to be done to get that. Those run about \$5,000 per appraisal. They want to use the representative regional sales price which they have developed by comparing the property to private markets to find out what the cost of in situ material is and if someone wants to challenge that and do their own appraisal, they are welcome to do that, too.

MR. MENEFEЕ said they also added language about the low appraised fair market value sales for material that is in the state's interest to get out of a river, for instance, where excess material is causing flooding that the state would have to spend money on preparing roads, bridges and emergency response, like in Seward where the river bed is higher than the surrounding land.

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He said point 4 of the briefing paper was about temporary water use authorizations in section 21 of the bill. The department currently believes it has the authority under current statute to issue a temporary water use authorization for a period up to five years. If a business continues to need that same water source, they can issue another one for another five years after that. This makes it clearer in statute that they really can, because there have been some water right challenges. Temporary water use authorizations are used by industry all over Alaska

and are revocable, he said, but a water right stays with the land forever.

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CO-CHAIR PASKVAN said point 1 of the briefing paper says that change doesn't apply to oil and gas leases and asked if point 4 temporary water use authorizations are used on the North Slope as compared to water rights.

MR. MENEFEЕ clarified that oil and gas leases have a separate authorization, but people use the temporary water use authorizations for getting water from lakes, streams and sometimes chipped ice to make ice roads going out on the North Slope. Some actually get water rights if they have a well that is going to be producing for a long time.

CO-CHAIR PASKVAN asked if the state has a developing problem with water interests on the North Slope either through a water use authorization or a water right.

MR. MENEFEЕ replied that this bill isn't about water shortages, just about the process of doing a second authorization. And yes, some areas on the North Slope have less water available especially in the foothills. If you build an ice road there, you will have to haul water from a further distance which is more expensive.

CO-CHAIR PASKVAN said the temporary water use authorizations are for five years and he didn't want to create a system that excludes independents or the "new kids on the block."

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MR. MENEFEЕ replied that the department takes other uses into account when it reviews the temporary water use authorizations. Also, they are revocable and modifiable.

SENATOR FRENCH commented that they do hundreds of these.

MR. MENEFEЕ replied that was correct.

SENATOR FRENCH asked if there is any limit to the number of times that a temporary water use authorization can be renewed.

MR. MENEFEЕ replied no; each time you reach the five-year cycle he would have to re-review other uses before issuing it again. He would take into account if the company was a "good actor" and abiding by the terms of its permit.

SENATOR FRENCH asked if each authorization is noticed.

MR. MENEFEER replied that it's agency noticed but not publicly noticed; he added that statute does not require public notice.

SENATOR FRENCH asked if there is no public comment or right of appeal.

MR. MENEFEER replied yes there is the right of appeal. They were recently challenged on it and the court upheld going without public notice on these. Some people have asked how they would know they have a right of appeal if it's not noticed and that's a catch-22 situation.

SENATOR FRENCH said it's hard to imagine the circumstances under which they would be aware of the decision.

MR. MENEFEER replied that temporary water use authorizations rarely come by themselves. If it's on state land it has some other authorization from the state going. For instance, Golden Valley is going to do a wind energy project at Eva Creek; they are going to need a water authorization to keep the dust down on the road as they build it. That is all noticed.

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SENATOR FRENCH said he was thinking of the shale oil development explosion on the North Slope and many companies could be competing for what is fairly scarce ground water available year-round. He asked how many times an authorization gets renewed before it becomes a permanent water right.

MR. MENEFEER replied, "There is no more permanent water right." If someone is going to invest in shale oil in an area where they know there is limited water, it's probably in their best interest to get a water right immediately versus a temporary water use authorization, because that would exclude all others that come subsequently.

SENATOR FRENCH said he guessed that would be a far more exacting procedure.

MR. MENEFEER agreed.

SENATOR WIELECHOWSKI asked the standard of review on appeal if someone has a temporary water use permit and the commissioner

decides he wants to grant a new one and someone says, "Hey, what about me?"

MR. MENEFEЕ replied statutes and regulations guide the appeal process.

SENATOR WIELECHOWSKI asked the standard of review by the court or the reviewing entity.

MR. MENEFEЕ answered the reviewing entity is actually the commissioner of the reviews under appeal. Once he makes a decision to uphold the decision the staff made or not, at that point an individual has 30 days to appeal to Superior Court.

SENATOR WIELECHOWSKI said he was concerned that someone gets the temporary water use authorization, there's no public process for renewing it and the commissioner just decides to renew it; then there is an appeal. If it is about abuse of discretion it's virtually impossible to overturn. So you essentially turn the temporary water use authorization into a de facto permanent water right.

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CO-CHAIR PASKVAN said he was reminded of an AOGCC hearing within the last year that investigated Pioneer's difficulty in getting water from ConocoPhillips. Was that because there was a limited access to water or a water rights issue? He wanted to know if the state is facing a water shortage on the North Slope and if so, they need to know what permitting processes or interests the system provides.

MR. MENEFEЕ replied there is no general water shortage on the North Slope and he would get the details of the Alaska Oil and Gas Conservation Commission (AOGCC) hearing.

CO-CHAIR WAGONER said once they start fracing with water, the practice is recycling the same water; so there isn't that big of a demand except initially.

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MR. MENEFEЕ discussed the sealed bid procedure in sections 1-4 and 7-9. He said the Department of Law helped discover a lot of inconsistency about public auctions and sealed bids and they tried to make them consistent so it's clear they can use cry option or sealed bid if they choose.

Point 6 in sections 18 and 19 are the public notice requirements for when they do public disposals of interest (38.05.945 public noticing). It spells out the choices and who they have to notify: things like statewide distribution newspapers and local newspapers and posting in a conspicuous place locally. The one part they are de-emphasizing is the posting of legal notices in the newspapers that refer back to the public notice website by phasing it out over five years. The issue is that the applicant has to pay for all of this and a typical ad costs \$300 to \$900.

Point 7 deals with mining royalty in section 12. They found that miners who are only making \$10,000 in gross income in a year don't pay royalty, because they can deduct their rental rate and the cost of extracting the material; and because mining royalty is paid off of net income, they don't end up paying any. They found the threshold is right around \$10,000 or about 6 oz. of gold, not a lot of production. So they are saying save the paper work and audit and just exempt them. The idea is to do the exemption for the areas where the state is not getting revenue anyway.

SENATOR FRENCH asked if this superseded Senator Wagoner's bill on small gravel pit operators.

MR. MENEFEЕ replied this measure is specifically aimed toward mining royalty on locatable minerals like gems, gold, diamonds, platinum and silver.

SENATOR FRENCH asked the definition of small operations.

MR. MENEFEЕ replied it's essentially a value of \$10,000 or less, but the reason they didn't put that figure in is because the prices of materials change so much that it wouldn't make sense. The value would have to be addressed by regulation.

SENATOR FRENCH said that's on the gross.

MR. MENEFEЕ agreed.

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The next issue this bill addresses is it allows mining royalty to be filed on a fiscal year basis rather than the calendar year. Minors already have to file their federal income tax in a fiscal year and having to switch over to the calendar year for filing royalty is an accounting challenge.

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MR. MENEFEЕ said point 9, section 13 in the bill, talks about submerged mining leases and Nome that has a gold rush going on is the only one with them. Current law says when it comes to the end of a lease (10-20 years), if somebody is still producing minerals in paying quantities, they get one-year extensions. But knowing you have only one year of authorization is not good business sense. So, if they are still producing in paying quantities and making royalty revenue payments to the state, and they have sufficient land to continue their operations, the department can make a judgmental call how far out to issue another lease and that can't exceed the terms of the initial lease.

MR. MENEFEЕ said these changes were small, but incrementally and cumulatively they would make a difference in time and money for both the state and the applicant; they would also help in reducing the backlog.

CO-CHAIR WAGONER said, "Whatever we can do to decrease that backlog and keep it from building again, we're interested in." Finding no further questions, he thanked them for presenting the bill to the committee.

[SB 219 was held in committee.]

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CO-CHAIR WAGONER adjourned the Senate Resources Standing Committee meeting at 5:10 p.m.