

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

April 6, 2013

1:06 p.m.

MEMBERS PRESENT

Representative Eric Feige, Co-Chair
Representative Dan Saddler, Co-Chair
Representative Peggy Wilson, Vice Chair
Representative Mike Hawker
Representative Craig Johnson
Representative Kurt Olson
Representative Paul Seaton
Representative Geran Tarr
Representative Chris Tuck

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

HOUSE BILL NO. 163

"An Act prohibiting a person from burning certain materials in a solid fuel burning device; relating to solid fuel burning device emission standards; and relating to prohibitions on the burning of solid fuels."

- HEARD AND HELD

HOUSE BILL NO. 198

"An Act relating to the primary period of an oil and gas or gas only lease and the extension of a lease; relating to terms to be included in an oil and gas or gas only lease; relating to rental for an oil and gas or gas only lease; and providing for an effective date."

- MOVED HB 198 OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

BILL: HB 163

SHORT TITLE: REGULATION OF SOLID FUEL BURNING DEVICES

SPONSOR(S): REPRESENTATIVE(S) T.WILSON

03/11/13 (H) READ THE FIRST TIME - REFERRALS

03/11/13 (H) CRA, RES
03/21/13 (H) CRA AT 8:00 AM BARNES 124
03/21/13 (H) Moved Out of Committee
03/21/13 (H) MINUTE(CRA)
03/22/13 (H) CRA RPT 5DP
03/22/13 (H) DP: FOSTER, REINBOLD, DRUMMOND, LEDOUX,
NAGEAK
04/06/13 (H) RES AT 1:00 PM BARNES 124

BILL: HB 198

SHORT TITLE: OIL AND GAS AND GAS ONLY LEASES

SPONSOR(S): LABOR & COMMERCE

04/02/13 (H) READ THE FIRST TIME - REFERRALS
04/02/13 (H) RES
04/06/13 (H) RES AT 1:00 PM BARNES 124

WITNESS REGISTER

REPRESENTATIVE T. WILSON
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: As the prime sponsor, introduced HB 163.

KONRAD JACKSON, Staff
Representative Kurt Olson
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Introduced HB 198, on behalf of the sponsor of HB 198, the House Labor and Commerce Standing Committee, Representative Kurt Olson, Chair.

WILLIAM C. BARRON, Director
Division of Oil & Gas
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: Provided a PowerPoint presentation to review the provisions of HB 198.

LISA PARKER, Manager
Government Relations
Apache Alaska Corporation (Apache)
Soldotna, Alaska

POSITION STATEMENT: Testified in general support of HB 198.

ACTION NARRATIVE

[1:06:16 PM](#)

CO-CHAIR ERIC FEIGE called the House Resources Standing Committee meeting to order at 1:06 p.m. Representatives Seaton, Hawker, Tarr, P. Wilson, Olson, Saddler, and Feige were present at the call to order. Representatives Johnson and Tuck arrived as the meeting was in progress.

HB 163-REGULATION OF SOLID FUEL BURNING DEVICES

1:06:40 PM

CO-CHAIR FEIGE announced that the first order of business would be HOUSE BILL NO. 163, "An Act prohibiting a person from burning certain materials in a solid fuel burning device; relating to solid fuel burning device emission standards; and relating to prohibitions on the burning of solid fuels."

1:06:53 PM

REPRESENTATIVE T. WILSON, Alaska State Legislature, paraphrased from the following sponsor statement [original punctuation provided]:

This bill would establish a new emission standard for solid fuel burning devices within the EPA designated 2.5 nonattainment areas by allowing only the cleanest burning devices to be sold at local retail stores. Those who have a solid fuel device currently installed are grandfathered under the new emission standard and would not need to convert their device.

Currently, a PM 2.5 nonattainment area has been designated by the U.S. Environmental Protection Agency within the Fairbanks North Star Borough. During the winter months, air quality status can reach unhealthy levels for many of the people who reside within the nonattainment area. This was especially true this last winter when the average temperate between November and December was minus 40 degrees.

This bill ensures the most efficient EPA certified appliances are installed as homeowners naturally upgrade their units, saving Alaskans money by reducing the cost of space heat. Additionally, by installing the best technology, air quality at a neighborhood and regional level will also improve. This is important

for the overall health of the communities and for achieving federal attainment with EPA.

Finally, HB 163 guarantees an individual's right to use a solid fuel burning device in accordance with their budget and local and state law. The consequences of not reaching EPA PM 2.5 attainment status stretch beyond health concerns. If attainment is not reached by 2014, the EPA could sanction the state of Alaska by withholding Federal highway funds within the non-attainment area, which ranges from the City of Fairbanks to the City of North Pole and the outlying areas. It is not the entire Fairbanks North Star Borough but is the populated area. It also would include Ft. Wainwright. This would prevent many of Alaska's roads and transportation infrastructure from being constructed or upgraded. This bill is a proactive bill and will hopefully prevent additional communities from becoming a PM 2.5 nonattainment area.

[1:09:20 PM](#)

REPRESENTATIVE T. WILSON indicated she originally considered making the bill apply statewide, however, since then she made several changes to the bill. Perhaps if the community had been more proactive it might not be in a non-attainment area now, she said. The EPA certified wood stoves are rated up to 7.5 grams per hour. Due to temperature inversion issues, the EPA and Fairbanks North Star Borough (FNSB) do not think the community can meet attainment without specifying cleaner burning stoves, such as ones that rated at 2.5 grams per hour.

REPRESENTATIVE T. WILSON explained that the interpretation of the EPA's standards related to British Thermal Units (BTUs) indicated none of the wood stoves would have qualified, which was not the intent of the bill. Additionally, the DEC will address by regulation any stoves over 200,000 BTUs, which are more the commercial size. She said the intent of this bill is to provide relief for her community. In fact, she hoped that a natural gas project will move forward, which will ultimately solve the air quality problem.

[1:10:44 PM](#)

CO-CHAIR SADDLER moved to adopt the proposed committee substitute (CS) for HB 163, Version 28-LS0248\R, Nauman, 4/4/13,

as the working document. There being no objection, Version R was adopted as the working document.

CO-CHAIR SADDLER asked how much of the non-attainment issues were the result of tar emissions versus emissions from a wood stove or other stove.

REPRESENTATIVE T. WILSON indicated that over 50 percent of the air quality issue is attributed to burning solid fuel from wood stoves.

[1:11:32 PM](#)

REPRESENTATIVE HAWKER asked whether the sponsor is comfortable with the standards on [page 2, lines 10-31, and page 3, lines 1-2], subsection (c)]. He further asked whether the sponsor is comfortable that the department will have time to adopt the regulations.

REPRESENTATIVE T. WILSON answered yes; that at this point these standards will work the best for Fairbanks. She remarked that the coal burners within the FNSB are exempt. She emphasized that the community is not seeking a whole new test model. Instead, she would like regulations to be clearly set so companies bringing in any device not currently certified by the EPA will have the ability to have the device tested, submit the results, and receive approval or denial.

[1:12:48 PM](#)

REPRESENTATIVE HAWKER remarked that she has hit on the key. He offered his belief the one of the areas that will be most impacted by the bill is the Fairbanks area. He said, "If you are comfortable with it, I'm comfortable with it."

REPRESENTATIVE T. WILSON clarified that another community, Juneau, "is on the edge." She stated that Juneau represents a smaller area and while it does not fall in the EPA's non-attainment area for air quality, it does fall in the next stage. She hoped one outcome will be that companies will manufacture cleaner-burning stoves.

REPRESENTATIVE HAWKER said he appreciated her bringing the bill forward.

[1:13:26 PM](#)

REPRESENTATIVE P. WILSON understood the sponsor will be working with the DEC in the next several months and if necessary would bring additional changes forward next year.

REPRESENTATIVE T. WILSON agreed. She said that she will be working with the community, the DEC, and the dealers on the air quality issue. She stated that her overreaching goal and intent is not to do harm.

[1:14:08 PM](#)

REPRESENTATIVE TARR suggested the sponsor could also work with the Department of Health and Social Services. She understood that high rates of asthma currently exist in Fairbanks due to particulate matter. She expressed concern that burning fuel and other materials such as plastics which emit toxic fumes is also related to asthma and other health conditions.

REPRESENTATIVE T. WILSON answered that the list of items not to burn is already addressed in regulation. She highlighted that the asthma problem in Fairbanks is more closely related to burning of "greener" wood, which doesn't combust to the fullest extent. In fact, the temperature inversion holds all particulates at the ground level. Further, at extreme low temperatures the problem has been exacerbated [since people burn more wood]. She anticipated one outcome of the bill is that people automatically will look for cleaner burning stoves.

[1:16:11 PM](#)

CO-CHAIR SADDLER asked whether stoves already in stores' inventory that do not meet the standards will pose a problem for retailers.

REPRESENTATIVE T. WILSON answered that issue will be worked on with DEC [as part of the interim work on the bill]. She envisioned that a list will be sent to DEC so the department is informed on store inventories; however, she understood the stoves would be sold outside the non-attainment area. She acknowledged that one of her goals is to hold companies harmless.

[1:16:53 PM](#)

CO-CHAIR SADDLER asked how much more expensive a high-performance, high-efficiency low-particulate emitting stove is as compared to one with a lesser emission standard.

REPRESENTATIVE T. WILSON responded that the cost ranges from \$100 to \$200 or more for high-efficiency stoves, which is not related to emissions as much as the stoves' appearance since features such as glass or curlicues cost more. In fact, most of the high-efficiency stoves contain a catalyst, which is the mechanism that makes the stoves cleaner burning, she said.

1:17:38 PM

REPRESENTATIVE SEATON referred to background information in members' packets entitled, "EPA Certified Wood Stoves." He understood the EPA maintains a list of 1988 accredited laboratory tested stoves. He asked whether the 1988 standard has not been replaced by a new standard. He further asked whether the 2.5 grams per hour for each 200,000 BTUs of heat output represents a new "Alaska-only standard" or if the EPA has another designation.

REPRESENTATIVE T. WILSON responded that 1988 is the year in which certification of all stoves began, which ranges from .4 to 7.5 grams per hour. A few years ago Washington [state] had the same issue and instead of banning stoves, their agencies approached the issue by lowering the amount of emissions. She had hoped the EPA would impose the emissions standards, similar to how car emissions are regulated, by requiring catalytic convertors to reduce emissions. However, she did not want to wait for the EPA to act, so the aforementioned standard would only apply to the non-attainment area in Alaska. Additionally, as sponsor, she will consider adding a sunset provision so once attainment is reached the statutes would no longer apply.

1:19:18 PM

REPRESENTATIVE SEATON understood the EPA performs the certification so the state will not need to do the testing; instead, it will be done by the EPA laboratory. He wondered if stickers or some type of plaque would be applied to stoves to indicate the particulate emissions.

REPRESENTATIVE T. WILSON responded that this would apply to wood stoves and qualified solid fuel burners, but coal burners will be exempt. The DEC would set up the equivalent standard related to the EPA, by regulation, for testing by certain laboratories. She stated that the FNSB currently will test any units not currently certified or not qualified by the EPA, at the owner's expense.

1:20:45 PM

CO-CHAIR FEIGE understood that catalytic converters help burn the contents more completely and cuts down on the particulate emissions. He asked whether it is possible to retrofit older stoves with some type of in-stack catalytic converter.

REPRESENTATIVE T. WILSON stated that some testing is currently happening, especially for outdoor boilers. She stated, for example, that the Tok School has a [catalytic converter] in one of its bigger units. She highlighted that while it works best job when the stove is burning hot, it's a little harder to control with wood stoves as opposed to furnaces. Typically, people get the stove started then turn it down while they are at work. The catalytic converter will make the stoves burn cleaner and longer. She pointed out that most of the non-catalytic stoves emit 4.5 grams of particulates or higher.

REPRESENTATIVE T. WILSON compared the process as being similar to the Inspection and Maintenance (IM) program some communities had in place. What ultimately happened was that car manufacturers were forced to make their products cleaner and as older cars wore out and were replaced by newer ones [with catalytic converters], the carbon dioxide emission issue subsided. She offered her belief that it may take combined efforts from states to request EPA offer testing. Currently, the EPA tests units in a big warehouse with certain types of wood, but not under cold temperatures. She expressed doubt that the actual performance outcome would be the same in sub-zero temperatures.

1:23:15 PM

REPRESENTATIVE TARR asked whether the committee previously considered a bill to provide loans for wood-burning stoves and if that aspect will also help private homeowners to meet the new standards.

REPRESENTATIVE T. WILSON asked whether she was referring to HB 35, which would allow people to change out any type of furnace to a more efficient type. She explained that under HB 35, a person could not exchange the home heating system for a manual wood stove, but a person could put in an automated system.

1:24:07 PM

CO-CHAIR SADDLER asked whether this bill would bar other second class cities and municipalities from imposing either more rigorous or more lenient standards. He was uncertain of the impact the bill will have on emissions. He referred to [DCED Fiscal note 1 dated 3/22/13] which read, "It would limit all municipalities from adopting a particulate air contamination emission standard for solid fuel burning devices other than the standard adopted by regulation by the state."

REPRESENTATIVE T. WILSON stated the fiscal note he referred to is a fiscal note which refers to the original bill and will be updated to reflect the proposed committee substitute. She anticipated the updated fiscal note would be a zero fiscal note. She pointed out the original fiscal note was based on a statewide impact and required the DCED to perform the testing.

[1:24:59 PM](#)

CO-CHAIR SADDLER asked whether this bill will assist in delaying the EPA's implementation of any sanctions or would result in any loss of highway funds.

REPRESENTATIVE T. WILSON answered that the state is required to have a state implementation plan and this will fit within the plan. The more ways in which the state can demonstrate to the EPA that the state is attempting to meet the standards can help the state receive an extension to meet the standards. She offered her belief that the EPA realizes it will take a different type of fuel, primarily gas, before the FNSB can meet the air quality standards. However, as long as the state is making progress in lowering the emissions, the EPA has been willing to work with the state. Additionally, the EPA's air quality standards will impact the military bases since the military must take into account the non-attainment area when considering transporting troops into the Fairbanks area.

[1:26:20 PM](#)

CO-CHAIR FEIGE indicated Representative T. Wilson has another hearing to attend. He asked to hold HB 163 over.

[1:26:34 PM](#)

REPRESENTATIVE SEATON referred to page 3, line 10, to subsection (e), which read, "A state or local authority may not adopt the particulate air containment emission standard for solid fuel burning devices other than the standard adopted by regulations

under (c) of this section." He asked whether this statewide requirement is necessary in this bill since the program is limited to the non-attainment area.

REPRESENTATIVE T. WILSON understood that is already state law and is not something added.

[HB 163 was held over.]

HB 198-OIL AND GAS AND GAS ONLY LEASES

[1:27:28 PM](#)

CO-CHAIR FEIGE announced that the next order of business would be HOUSE BILL NO. 198, "An Act relating to the primary period of an oil and gas or gas only lease and the extension of a lease; relating to terms to be included in an oil and gas or gas only lease; relating to rental for an oil and gas or gas only lease; and providing for an effective date."

[1:27:49 PM](#)

KONRAD JACKSON, Staff, Representative Kurt Olson, Alaska State Legislature, on behalf of the House Labor and Commerce Committee, Representative Kurt Olson, Chair, stated that HB 198 relates to the primary period of an oil and gas lease or gas only lease. Currently under AS 38.05.180 (m), oil and gas leases may be extended automatically (1) if and for so long as oil or gas is produced in paying quantities from the leased area, or (2) if the lease is committed to a unit approved by the Commissioner of the Department of Natural Resources (DNR).

MR. JACKSON said bill would amend AS 38.05.180 (m) to provide the Commissioner of the Department of Natural Resources (DNR) or his/her designee the discretion to grant a one-time lease extension to the primary period of the oil and gas lease or gas only lease. The total time of the extension is not to exceed ten (10) years.

[1:29:04 PM](#)

MR. JACKSON stated that Section 2 of HB 198 would allow the DNR to establish conditions for the lease extension, including that if a lease extension is granted, the annual rental rate per acre shall increase up to \$250 per acre per year for the final three years of the term. However, the commissioner has the discretion

to reduce this increased rental rate if it is determined that a lessee has exercised reasonable diligence in exploring and developing the lease during the primary term.

MR. JACKSON indicated that Section 4 provides transition language for leases which will be expiring close to the effective date of the bill. The intent is to ensure all lessees have an opportunity to apply for the extension.

MR. JACKSON characterized the bill as a "win-win" for the state, for explorers and producers, who are close to being able to begin production or exploration, but need a little more time.

[1:30:48 PM](#)

WILLIAM C. BARRON, Director, Division of Oil & Gas, Department of Natural Resources (DOR), began his presentation by stating that currently no one has the authority to extend short-term oil and gas leases beyond the primary lease terms. He characterized this as a real gap in terms of DNR's policy.

[1:31:26 PM](#)

REPRESENTATIVE P. WILSON asked whether there is any reason why leases cannot be extended or if this represents an accidental loophole.

MR. BARRON responded that he believed it was an oversight. The division has the statutory authority to lease up to 10 years but no less than 5 years. Thus over time the division has considered 5, 7, or 10-year terms and conditions in an effort to motivate exploration [slide 2]. The downside to the plan is that it takes time to mobilize, shoot, interpret, and re-interpret the seismic information, plus get a drilling rig under contract can take five years. He suggested that a five-year lease term on the East side of Cook Inlet, with existing road infrastructure and longer drilling seasons might tend to work better.

[1:33:06 PM](#)

MR. BARRON said it was recognized that some lessees were diligently conducting work but running out of time. These lessees brought to the division unit applications that were not fully fleshed out. Thus it was necessary for the division to process units rather than allow companies to perform exploration drilling to prove the hydrocarbon rather than work off a

potential hydrocarbon. He described this as being a key difference.

MR. BARRON emphasized that this is not about "warehousing." Instead, this is about companies who have been diligent about doing their work. For example, some companies with five-year leases have been working for four years or longer and working their leases hard. This bill represents an opportunity for these companies to pursue one or two more years [slide 2]. However, this bill does not issue an automatic extension and interested companies would have to petition the department and provide details on the work done, money spent the discoveries, and current plans. At that juncture, it would become a bit of a negotiation since the lease is a contract. Secondly, this statute would also allow the division to renegotiate contractual terms, which is essentially an option. Options come at a premium, so this will be the first time the division can actually hold discussions and dictate the necessity for the drilling program, with hard and fast work commitments made under the contract extension.

[1:35:22 PM](#)

MR. BARRON referred to the \$250 per acre rental rate [in Section 2] that Mr. Jackson previously mentioned, which represents the lease terms issued within the last several years. He said the industry has indicated that seven-year leases are good, since most of the work could be done within seven years; however, three extra years would be better. Currently, the fees increase for leases in which work has not yet been done. He said that the industry has been really good at making business decisions so the division will give them an opportunity to make additional business decisions. Additionally, the commissioner has the ability to reduce the rental rate if work has been done.

MR. BARRON said he was unsure whether the division would ever use the \$250 rental figure. For example, if a producer had a five-year lease and the division granted the lessee a full five-year extension, the division would be building yearly thresholds. In the event the lessee did not meet the first annual requirement, perhaps the lease would expire. Therefore, even though the \$250 per acre rental rate is an option, he did not anticipate the division would routinely use it.

MR. BARRON pointed out the real key will be the ability to have work commitments. Under the bill, this would be the first time

the division could "lean into the companies" and get work programs established.

[1:37:03 PM](#)

MR. BARRON offered to quantify the problem the bill will address. He referred to slide 3, entitled "Northern Alaska Lease Distribution" which depicts a collection of data, by column, for the number of companies and leases in the Foothills area and North Slope area that will expire in the next 2 years, 2-5 years, and over 5 years. He characterized it as a mix of companies, which changes over time.

MR. BARRON stated that Repsol [E&P USA, Inc.] (Repsol) is a "big" player, and AVCG, LLC is right behind them. Repsol was not at the original lease sale, but acquired the leases through a business arrangement with Armstrong Oil and Gas, Inc. This is the type of company that became very aggressive with its drilling activities and mobilization. He indicated this is the type of company the division would want to encourage and reward with this type of extension opportunity.

[1:38:28 PM](#)

REPRESENTATIVE HAWKER acknowledged Repsol as a great example. He recalled previous testimony that the division seeks to have latitude to extend leases for someone who had been diligent over the primary term. He wanted to make certain that the intent is for this bill to cover someone who held a successor interest since these lessees did not have the ability to be diligent over the primary term. Thus the successor interest would need to be willing to adhere to additional requirements as a condition of the extension.

MR. BARRON responded that is clearly the intent. He explained that when someone buys into an oil and gas lease, they enter into a contract with the state and effectively "step into the shoes" of the other company. If they stepped in with only one year of the lease remaining, it would be very difficult to make substantial activities. Granted, that would be a difficult call, since the company is aware at the outset it only has one year. Thus, the company must "really get after the program" or risk "a very blunt no." Naturally, companies will be aware of the short time remaining so if the companies are not ready to proceed, it would likely be their preference to let the lease expire and pick it up in the next lease sale. Again, Repsol came in with a short window and worked aggressively and

diligently with the state to get its work program moving forward. He reiterated that someone stepping into the lease would be treated the same as someone who originally had the lease.

[1:40:44 PM](#)

REPRESENTATIVE P. WILSON asked for clarification on the process. She asked what happens when a five-year oil and gas lease runs out. She further asked whether an unsuccessful oil and gas lease will go back to the state or if the company is successful, if oil production is the next step.

MR. BARRON first explained what happens if a company fails to finish working its lease within the lease timeframe. He said that the company can relinquish the property, which is returned to the state for the next lease sale. The company has an opportunity to pick up the lease again or a competitor could lease it. He said the division recognizes this as a problem since substantial work may have been done under the initial lease and the original company has the best knowledge and understanding of the geology, as well as having the work plan laid out. Thus it's in the state's best interest to give them another year or two to complete the work that is already started.

[1:42:00 PM](#)

REPRESENTATIVE P. WILSON asked who owns the geographical information.

MR. BARRON answered that information is held by the company. He said that seismic information is typically released to the state, but it is held in confidence.

CO-CHAIR FEIGE remarked one exception is if the company acquired the geographical information under exploration credits.

MR. BARRON answered that is correct. In the event the company acquired the information under the exploration tax credit regime, the state would receive the information.

[1:42:42 PM](#)

MR. BARRON next turned to the success path. In the event a company was successful and was able to perform due diligence, and drill wells, and was successful, would apply for a unit

application from the division. The company would unitize the area it felt was productive and all the leases associated with the unit will be held so long as the unit is in state. "They get to keep the land after that," he said.

CO-CHAIR FEIGE understood that is the case so long as the unit is producing.

MR. BARRON answered that is correct.

[1:43:15 PM](#)

CO-CHAIR SADDLER asked whether the extra rental rate per acre, increasing from \$25 to \$250, which could be pretty expensive, might jeopardize the economics such that it might not be affordable to continue even if the company desired to do so.

MR. BARRON allowed that would be a possibility, but the division's intent is to have the ability to increase rents as an option; however, it doesn't necessarily mean the division would impose the additional rental fees.

CO-CHAIR SADDLER asked whether the division could charge fees up to the \$250 limit.

MR. BARRON answered yes, that process is part of the negotiations with the lessee. Additionally, one of the pieces is also performance bonding. For example, the division may require a \$10 million bond if the cost to drill the well is \$10 million. If the company doesn't perform, the state would keep the bond, but in the event the company performs, the state would release the bond.

MR. BARRON clarified that this represents the division's attempt to have companies obtain some "skin in the game" and commit to the state work activities that the lessee intends to perform on state land in a timely manner.

[1:44:27 PM](#)

MR. BARRON, again, said that while the \$250 per acre rental rate may seem extreme, it would likely be the last option the state would use. In fact, if the company has been performing substantial work, the \$250 increase would not be issued by the commissioner. He emphasized that the entire point of the additional fee is if the work isn't being done, that the state is placing a value on the land.

CO-CHAIR FEIGE remarked that it is a "nudge."

MR. BARRON said that is exactly right. While in theory, the rental fee increase provision is in the bill, it's highly unlikely that the state would get to that specific point.

[1:45:12 PM](#)

MR. BARRON turned to the slide depicting Cook Inlet Lease Distribution [slide 5]. He pointed out the slide represents the major companies operating in the Cook Inlet. Again, this represents a mix, with clearly Apache Alaska Corporation (Apache) leading, since that company has picked up considerable acreage. In fact, the company has been very aggressive. He cautioned that the lease extension in the bill is not to allow companies an opportunity to "shoot seismic." While he said he isn't pointing any fingers, there is a great deal of push to get as much seismic shot as possible. However, keep in mind, companies do not have to own leases to shoot seismic. Instead, companies can obtain a land use permit from the state to "shoot seismic."

[1:46:18 PM](#)

CO-CHAIR SADDLER asked whether the number of leases and the acreage covered by the leases are based on the same proportion.

MR. BARRON answered relatively so, especially in the Cook Inlet. But, in general, the division's leases are three miles by three miles. He offered a "quick rule of thumb" to interpret the acreage depicted on the slide. He referred to first column with 88 leases in total, that the aforementioned proportion of three miles by three miles could be multiplied to arrive at the approximately total acreage.

[1:47:04 PM](#)

REPRESENTATIVE SEATON understood that the seismic was held up for Apache. He asked whether any allowance is made for delays in permitting.

MR. BARRON answered that the intent is decisions will be made on a case-by-case basis. The company would need to provide details on the work planned and any barriers encountered. He anticipated that companies will likely come in with bundles, such as packet A, B, and C. Thus the leases may be in a

grouping on the North Slope from west to east. He envisioned the division would grant extensions for packet A based on specific work programs. However, the company may not have performed any work on leases in packet C so the division would not grant an extension. Again, this would be discretionary and is part of the dialogue, he said.

[1:48:48 PM](#)

MR. BARRON turned to slide 6, entitled, "What are the benefits of HB 198?" He noted that companies are aware the short-term leases are somewhat problematic, which the division is trying to solve with this bill. The goal of this bill will be to afford lessees holding short-term leases an opportunity to finish up. In essence, this would benefit the state since it would require a work program, plus the division believes this bill will increase the probability of bringing leases to production, which clearly will benefit the state.

[1:49:29 PM](#)

REPRESENTATIVE HAWKER asked whether it will be beneficial to the state as a law of general application that would apply to both the northern and southern part of the state.

MR. BARRON answered yes. He said the bill would affect future leasing programs, regardless of where the areawide leasing is located. He predicted the overall effect of HB 198 will be to allow the state to manage its oil and gas leases at a much higher level.

[1:50:13 PM](#)

REPRESENTATIVE HAWKER inquired how Mr. Barron would respond to critics that this would open up a secondary market in lease futures where companies can hang on to the lease for the purpose of "flipping it" to an adjacent holder or someone else once the work is done.

MR. BARRON remarked that is an interesting question. He anticipated a company who has been diligent in performing work will not likely be in a position to "flip it." He surmised that the secondary market may not be there, but there may be added value. Besides, if the secondary party has more financial ability than the first lessee, it would represent an advantage to the state since the secondary party would bring the strength of the ability to complete the work and bring the unit under

production. However, operators who originally bought the lease might be deemed as speculators, probably haven't been performing any work on the leased land. Therefore it would be difficult for the speculators to jump the division's first hurdle, which is to identify any work performed.

[1:51:46 PM](#)

MR. BARRON acknowledged that the secondary market exists and it is a robust market. Clearly, that is evident by the work already done in Cook Inlet. For example, the aforementioned Repsol lease is indicative of a secondary lease market. He said [secondary leases] represent one piece of the industry which does bring value.

REPRESENTATIVE HAWKER agreed. He was unsure whether it was a desirable outcome to allow companies to buy up leased land, perform very little work and then "flip it" to an incredibly competent qualified new operator. In doing so, it will allow the new operator the ability to operate for five years without the lease reverting to the state, which would [effectively bypass] the competitive bidding process.

MR. BARRON responded that this is the reason the lease extension is a one-time extension and the timeframe is not locked into five years. In fact, the extension may only span one or two years. He emphasized that this process is clearly identified as a one-time extension with the time and work program to be determined by the department.

REPRESENTATIVE HAWKER related a scenario in which an operator bought a lease, but did not perform work and the lease is almost expired. If the lease can be "flipped" to a company with expertise to work it, it would essentially be a subsidy for the value of the lease. Moreover, it would provide an intrinsic value to a company who has otherwise failed completely in its obligations to invest and develop on the leased property.

MR. BARRON answered the department would not likely grant an extension in the aforementioned instance since no work had been done by the first lessee.

REPRESENTATIVE HAWKER wondered whether the committee ought to fine-tune the process. He said this is the reason he didn't pursue a similar bill early in the legislative session.

[1:54:45 PM](#)

CO-CHAIR FEIGE surmised the risk of obtaining an extension would be taken up by the second purchaser. He suggested the risk would increase significantly as the end term of the first lease approached. He observed that the better option for the original lessee would be to "flip it" fairly quickly to allow time for significant work to be accomplished by the second lessee. He offered his belief that the leases were mostly competitive bids.

MR. BARRON clarified the original oil and gas leases are all competitive bid leases.

CO-CHAIR FEIGE pointed out the department really does not have any control over the high bidder. He suggested this bill could result in more highly capitalized companies buying leases and performing more work than the original lessee. In brief, he said this would let the market decide.

MR. BARRON answered yes.

[1:55:55 PM](#)

REPRESENTATIVE P. WILSON asked for the reason the lease would not automatically revert back to the state. She wondered why the state would not revoke a lease if a company was not actively working the lease.

MR. BARRON responded that the primary lease term is a contract between the state and the company which gives the lessee the exclusive right to operate on the land for the primary term. Currently, the state does not impose work obligations during the primary term, he advised. Thus a company can obtain the land under the current 10-year lease terms and could hold it. Incidentally, that's the reason the division added the \$250 per acre rental increase provision for the last three years of the lease. He predicted this change will encourage companies to make wise business choices.

[1:56:55 PM](#)

REPRESENTATIVE P. WILSON asked for clarification on lease sales between companies noting the company [selling the lease] would likely make a profit.

MR. BARRON answered yes. He characterized the transaction as being a business arrangement between two independent parties. For example, party "A" owns the lease, party "B" wants to own

the lease or part of the lease. The companies would enter into a private negotiation, finalize the deal, and present it to the division as a lease modification to reflect the new owner. Hence the state would not have any dialogue associated with the process since it is an independent land transaction.

[1:57:54 PM](#)

REPRESENTATIVE SEATON remarked that companies are often recruited to come to Alaska and drill by the lessee. In fact, this type of mechanism has brought a number of companies to the state, such as Repsol and Armstrong. He said he is less concerned about companies selling their leases since it means the lessee had to convince another company to buy the lease. He expressed support for the lease extension provision, which he characterized as being similar to Norway's requirement for work commitments. Ultimately this will be beneficial in Alaska in terms of production, he said.

REPRESENTATIVE SEATON referred to page 2, lines 10-29, to the language "automatic extensions" which is deleted. He asked for clarification on the effect since the language on page 2, line 14 allows for automatic extensions, [which seems contradictory].

MR. BARRON responded that automatic extensions will occur, but will be limited to instances in which the property is committed to a unit or is under current production.

REPRESENTATIVE SEATON questioned whether the language in the bill is referenced correctly.

[2:01:16 PM](#)

CO-CHAIR FEIGE said it seems as though the "automatic extension" language was moved from line 10 to line 14.

REPRESENTATIVE SEATON again referred again to page 2, line 10-29. He argued that removing the language "automatic extensions" would eliminate automatic extensions. The bill would set up the condition that if the lease is not automatically extended, the other provisions will occur; however, the ability to offer "automatic extensions" has been removed.

MR. BARRON remarked that the division and the sponsor are comfortable with the language, which read [original punctuation provided]:

An oil and gas lease **or gas only lease** shall be **extended beyond its primary term** [AUTOMATICALLY EXTENDED] if, **at the end of the primary term, oil or gas is produced in paying quantities from the lease** and for so long thereafter as oil or gas is produced in paying quantities from the lease or if the lease is committed to a unit approved by the commissioner.

MR. BARRON indicated the aforementioned language provides a clear way to indicate the lease is extended as long as it is committed to a unit or is producing.

CO-CHAIR FEIGE reinforced that the language does read "shall be extended."

[2:02:51 PM](#)

REPRESENTATIVE TUCK suggested rather than saying "automatically extended" it could read, "extended beyond its primary term," which means the same thing.

[MR. BARRON nodded yes.]

CO-CHAIR FEIGE concurred that "shall be extended" and "if oil or gas is produced in paying quantities" [seems to cover this].

REPRESENTATIVE SEATON maintained his concern is for the sponsor to review the language related to automatic extensions to be certain it functions as intended.

CO-CHAIR FEIGE offered his belief that the essence of the "automatically extended" is maintained in the proposed language.

[2:03:28 PM](#)

CO-CHAIR SADDLER asked whether this bill is likely to change the division's policy on lease terms or if the department will use the five or seven year leases to encourage companies or if the leases would automatically be 10-year leases.

MR. BARRON answered that the division really prefers 10-year leases, which are called "seven plus three" leases. This allows the division to grant a 10-year lease, but retain the potential elevation in rental rates in years 8-10 to encourage work to be completed in the seventh year, which fits in well with good business practices. However, the "seven plus three" leases are

not eligible for any extension since the division does not go beyond ten-year leases.

[2:04:30 PM](#)

CO-CHAIR SADDLER asked whether the leases are considered seven-year leases.

MR. BARRON answered no; that the oil and gas leases are 10-year leases. The division refers to them as seven-year leases since the first seven years fall under the low-rental rates.

CO-CHAIR SADDLER remarked that the "seven plus three" leases would be similar to balloon payments.

[2:04:49 PM](#)

MR. BARRON said this bill would clearly give the division the ability to manage its land over the next five years on lease sales that were originally five-year and seven-year leases. Additionally, HB 198 would give the division the ability to manage the land as short-term leases in the event that the division decides to let additional five-year or seven-year leases.

[2:05:21 PM](#)

CO-CHAIR SADDLER asked whether it would be a fair assessment to state that the division does not offer any more five-year leases.

MR. BARRON answered yes.

CO-CHAIR SADDLER clarified the aforementioned scenario would be more of an escalator than a balloon payment.

[MR. BARRON nodded yes.]

CO-CHAIR FEIGE commented that the division has built the "nudge" into the current 10-year leases.

MR. BARRON answered yes.

[2:05:37 PM](#)

REPRESENTATIVE OLSON said he had shared Representative Hawker's concerns at the time the bill was drafted. He emphasized that

he, too, did not want the bill to be used to "warehouse" significant acreage. He offered his belief that HB 198 will meet those needs, is a good bill, and he encouraged members to support it.

2:06:30 PM

REPRESENTATIVE P. WILSON asked why work agreements are not included in the initial leases.

MR. BARRON replied that the division is not statutorily allowed to do so.

MR. BARRON explained that Norway expends considerable funds to build consortiums and gain seismic information, which is made public to companies interested in leases - prior to any leases being issued. However, in the U.S. that doesn't happen so at the time of the lease, U.S. companies really don't know what resource is "underneath them." For that reason, it isn't reasonable for the state to impose work programs on exploration areas. He characterized it as being considered "an unfair hurdle" and he thought industry would step away from it. In fact, Alaska would be the sole state to impose that type of requirement.

2:08:04 PM

REPRESENTATIVE P. WILSON understood that Norway hires companies to perform the seismic work.

MR. BARRON answered yes. In essence, it is an expense to the country and to the consortium. He pointed out that Norway's tracts are sometimes "20-by-20 mile" or "30-by-30 mile" areas whereas Alaska's leases are "3-by-3 mile" tracts. He described the comparison as being "two ends of the spectrum."

2:08:44 PM

REPRESENTATIVE SEATON commented that Norway performs 2D seismic, with the work commitment within three years and Norway performs 3D seismic to further identify the resource. He asked for clarification on the usefulness of having an open-ended unit since the company really doesn't have to produce it.

MR. BARRON answered that typically, unit agreements have five-year or 10-year timeframes, with automatic expirations if production doesn't happen. He recalled only one major unit in

the Cook Inlet without production; however, drilling has been aggressively performed. He indicated it is generally not a big issue since most units have moved forward. In fact, the division is "dogged" in its efforts to have units formed based on proven hydrocarbons, not on potential hydrocarbons - even though that is in regulations. Thus the division can form a unit based on potential; however, the division drives hard to have the well drilled and the resource to be proven. Basically, that would represent the point at which the division would form units, not before. As a rule, the division insists on a known hydrocarbon resources. In conclusion, he said that it's not in anyone's best interest to not produce since the company has already incurred the expenses and is paying rental fees on leases. Finally, the company will enjoy the asset base as soon as the production is on-line.

[2:11:48 PM](#)

REPRESENTATIVE SEATON referred to [page 2] lines 12-13, which read, " ... **the lease** and for so long thereafter as oil or gas is produced in paying quantities from the lease or if the lease is committed to a unit approved by the commissioner." He recalled a Kenai Peninsula lease that was held for the West Eagle unit. He asked whether the division has been able to secure work commitments.

MR. BARRON answered that the time of unitization is the point when the work agreement is imposed.

[2:12:49 PM](#)

CO-CHAIR FEIGE recalled the division offers leases other than oil and gas leases. He asked whether other lease programs could also benefit from this method.

MR. BARRON responded that it is possible. However, the only other lease program the division engages in is for geothermal leases. He reported this program hasn't grown very much and represents a small part of the overall lease programs. Certainly, this bill clearly targets oil and gas leases.

[2:13:25 PM](#)

CO-CHAIR FEIGE inferred that while the division has other lease programs the utility of extensions doesn't apply at this time.

MR. BARRON said that is correct.

[2:13:38 PM](#)

CO-CHAIR SADDLER asked whether many companies use land use permits to perform seismic in an area, but do not buy a lease.

MR. BARRON answered not so much anymore. He recalled that companies used to go out and "shoot seismic on spec" and in fact, there are still seismic companies that sell their seismic information. However, he did not necessarily think oil and gas companies would do so. Instead, oil and gas companies will buy the "spec seismic" for future lease sales.

[2:14:28 PM](#)

CO-CHAIR SADDLER asked for the biggest delay in the process from leasing to exploration and production.

MR. BARRON said clearly, the first process is to acquire seismic information and as diligent as some companies are, they have encountered hurdles for federal permits to operate on federal land. Clearly, that effort poses a hurdle, he said. The more complicated the geographical area, the more time it takes to process 3D seismic, and to reprocess, stack, and reanalyze the data. Certainly, it can take several years to process since a company would not want to drill a well in the wrong spot.

MR. BARRON added that securing a location to drill or to mobilizing a rig can create hurdles in some areas. Granted, if the unit is a good prospect, companies can find rigs and bring them into the state.

MR. BARRON said beyond that would be permitting delays or ensuring all the permits are in place. He characterized this as being is a "time value of money" discussion. He pointed out another limiting factor is the winter season on the North Slope, which essentially allows three months to drill. To illustrate this, he asked members to consider that a 10-year lease program with only three months per year of drilling time actually translates to about four years.

[2:16:52 PM](#)

CO-CHAIR SADDLER recalled some problems one company experienced to "shoot seismic" along the borders of the Kenai National Wildlife Refuge. He asked whether this illustrates some of the permitting delays that can happen.

MR. BARRON answered that the U.S. Fish & Wildlife Service is allowing seismic activities to take place on Native inholdings in the Kenai National Wildlife Refuge, but only to the border of the inholdings and the activity cannot cross the boundaries outside of the Native inholdings lands. He predicted this could be a "crippling event," in terms of the ability to acquire "good seismic" information. In particular, truncating where companies can put their receivers has been detrimental. He described the process to accomplish activities on federal land as being onerous.

MR. BARRON said, then again, issues with respect to endangered species habitats also must be managed through federal organizations and rightfully so. However, unreasonably withholding permission to conduct that type of work presents a real burden for companies, he said.

MR. BARRON pointed out that Shell has been held up for many years by lawsuits. In any case, no matter how well the state handles permitting reform, the ability for parties to stop activities through legal action remains, which is clearly within their rights.

[2:18:58 PM](#)

CO-CHAIR FEIGE inquired whether there are provisions in the standard lease agreements that if a delay happens, the lease is extended. For example, he asked whether the lease that is delayed due to Beluga whales could be extended.

MR. BARRON answered no.

[2:19:25 PM](#)

REPRESENTATIVE P. WILSON asked whether there is any possibility of allowing for permanent roads on state lands in some areas.

MR. BARRON said he is an unabashed supporter of Roads to Resources (R2R). He strongly suggested the state should investigate this further. He offered his belief the west Cook Inlet is another area that the state should investigate building permanent roads. He pointed out that each year ice roads are built on the Alpine, Badami, and Point Thomson units on the North Slope since the development is roadless development. However, if a permanent road had been built to the Badami unit it could have resulted in less expensive exploration by using

short ice roads off of the permanent road. He characterized the Alpine unit as a great development; however, from Kuparak to Alpine represents another gap without roads, which is an impediment to exploration. Similarly, there is a marked difference between the east and west sides of Cook Inlet. After all one side has roads and the other does not have roads. In fact, he identified the lack of infrastructure as being an impediment. He highlighted the importance of being able to move people and equipment quickly, which makes all the difference in the world to operators. He pointed out this has been demonstrated by the robust development in North Dakota, Oklahoma, Colorado, Texas, Ohio, and California. He attributed the difference between the development in the aforementioned Lower 48 states and Alaska as being due to a lack of general infrastructure.

[2:22:17 PM](#)

CO-CHAIR FEIGE concurred with the difficulties of operating with ice roads.

MR. BARRON mentioned several areas in the state that also pose difficulties to access, such as the Umiat oil field due to the terrain.

[2:22:54 PM](#)

REPRESENTATIVE OLSON asked whether it is possible to put the fiscal note at zero.

MR. BARRON replied that a zero fiscal note would be a good idea. Initially, the division debated whether it would fall within its own ability to budget and at the time he was uncertain so he submitted an indeterminate fiscal note; however, he now believes the zero fiscal note would be fine.

[2:23:34 PM](#)

REPRESENTATIVE SEATON recalled previously discussing permanent roads. He asked whether any statutory requirement needs to be changed or if it the decision to build permanent roads is based on the department's policy.

MR. BARRON said he believed that is correct. He said he did not think it was a statutory provision, but the areawide best interest finding (BIF) contains a provision that exploration be conducted on ice roads and ice paths.

[2:24:24 PM](#)

REPRESENTATIVE SEATON recalled the previous discussions on permanent roads. He expressed the committee's frustration since it would like to advance main corridor roads that make sense for other development. He wanted to make sure the DNR is aware this this committee believes the policy and finding should be revisited; however, he understood the decision rests with the administration. Still, he encouraged the department to move forward. Again, he said this committee has held hearings and determined that the committee and legislature is very receptive to the DNR revising its BIF's policy to allow main corridor roads to be built. He recalled the legislature funding \$70 million for a gravel road to Mount Spurr. In essence, the department needs to revise its BIF. He offered his belief the committee has done all it can do to encourage the department to move in that direction. At some point, it's up to the department to reanalyze the policy, he said.

[2:27:24 PM](#)

REPRESENTATIVE P. WILSON asked whether the department will consider changes to the policy or if not, to outline reasons not to change the policy.

MR. BARRON responded that to begin with, one of the division's roles is as the "protector" of state land. He said by definition the nature of exploration should be temporary. Since developing a permanent road will impact the land forever, it seems premature to build a road until the resource is known. Therefore, the best way to build roads for exploration is to build ice roads. He characterized the division's policy as being based on environmental protections. The division doesn't want roads to be built to "nowhere." Currently, the state has co-sponsored ice roads to Badami every year for drilling activities. Once again, Point Thomson has been under consideration, which is just further down the ice road from the Badami unit. He reiterated the department's concern, such that nature of exploration potentially results in a "scar" on the land for no value. However, once an area is known to have ongoing development, such as the Badami unit, the state should make a hard push for road access; however, it should not do so during the exploration phase. In short, he said there's good reason for the [policy].

[2:29:28 PM](#)

REPRESENTATIVE P. WILSON asked how many permanent roads exist on the North Slope.

MR. BARRON directed attention to the map on the committee room wall that depicts the North Slope, which identifies all the roads.

REPRESENTATIVE P. WILSON asked whether those are permanent roads.

MR. BARRON answered yes. In fact, the infrastructure in the existing fields has been robust, but once away from the area is not. For example, Great Bear Petroleum has acquired and performed exploration work using existing gravel pads right off the highway, rather than to build an ice road via a waiver granted by the division.

MR. BARRON, with respect to the fiscal note, said that it will be zero fiscal note, given the balance between leases to be returned versus activity associated, which also includes the value of the work programs. Thus the revenue to the state would be zero, he concluded.

[2:31:21 PM](#)

CO-CHAIR FEIGE opened public testimony on HB 198.

[2:31:45 PM](#)

LISA PARKER, Manager, Government Relations, Apache Alaska Corporation (Apache), paraphrased from written testimony, as follows [original punctuation provided]:

Thank you for the opportunity to comment on [HB] 198, which would allow the Commissioner of the Department of Natural Resources to extend the term of oil and gas leases or gas only leases beyond the original primary term. This legislation will offer an alternative to last minute rushes to create units, propose placement of rigs or other lease saving operations that would allow an operator to hold its oil and gas lease. The DNR has seen this done on a repeated basis using valuable time while the company continues to hold the unit or oil and gas lease while requesting further extensions with no actual work being performed.

2:32:36 PM

MS. PARKER continued to read from written testimony [original punctuation provided]:

Apache Alaska Corporation (Apache) is, in general, supportive of this legislation. As a new operator in Alaska we have acquired a significant amount of acreage which has leases that will expire before we are able to complete our seismic exploration activities, which help us delineate what, if any potential oil or gas resources are under our leases.

Since entering Cook Inlet in 2010, Apache has been aggressive in exploration and development efforts. Apache has and continues to find new and innovative ways to conduct seismic so as to create only the slightest disturbance while gathering good quality data. We have employed a cutting-edge technology that, in 2012, resulted in acquiring over 200,000 acres of seismic data within the Cook Inlet basin. There is still a lot of work left to do and, in working with the Department, Apache is hopeful that it will have the opportunity to continue its 3D seismic program to better identify the potential of the Cook Inlet Basin.

2:33:39 PM

MS. PARKER mentioned Apache set its first well in the fall 2012 in Cook Inlet. She recommended two changes to the bill. First, she suggested deleting the requirement for a performance bond. Second, she suggested changing the \$250 per acre bond to not exceed 150 percent of the rate for the preceding year of the lease term.

MS. PARKER said in closing, Apache urges support for HB 198. She remarked that John Hendrix, General Manager, Apache Corporation, has stated on numerous occasions that "Apache does not sit on its assets." She indicated that Apache would like the opportunity to bring their leases into production and to do this the company needs to delineate its assets before beginning exploration efforts. She indicted this is one reason the company has worked with Representative Olson, the House Labor and Commerce Standing Committee, and the administration on this issue.

[2:34:47 PM](#)

CO-CHAIR FEIGE, after first determining no one else wished to testify, closed public testimony on HB 198.

[2:35:06 PM](#)

CO-CHAIR SADDLER offered his support for the bill. He said he thought the bill will provide the division with a flexible tool to encourage production as well as offer flexible terms for each circumstance. Given the imperatives to quickly produce new sources of natural gas for all of Alaska, this bill makes sense and is a good idea.

CO-CHAIR FEIGE offered his support for the bill. He stated that this bill will allow the state to standardize its lease periods and provide adequate time to all entities interested in producing oil and gas, which generates tax revenues for the state. He offered his belief that it puts the interest of the state and companies in greater alignment. Moreover, it takes leases that could potentially expire and potentially languish before re-leasing, which will allow work started in good faith to continue and can result in more production for more of the state's lands sooner, all of which supports the state's goal with respect to more production.

[2:36:25 PM](#)

REPRESENTATIVE HAWKER made a motion to adopt a zero fiscal note. There being no objection, the committee adopted a zero fiscal note.

REPRESENTATIVE TUCK said he supported the bill. He further said that it's in the state's best interest to obtain production from its leases and to allow the companies more time to get to production. He characterized it as a win-win situation for all parties. He also thought the 10-year lease maximum was a good thing.

REPRESENTATIVE TARR said she supported the bill. She liked that the bill enforces the concept of the duty to produce, plus the "seven plus three leases" of flexibility will give the state more authority to ensure that work is being done.

[2:37:46 PM](#)

REPRESENTATIVE P. WILSON moved to report HB 198 out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, HB 198 was reported from the committee.

[2:38:29 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 2:40 p.m.