

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 10, 2021

3:36 p.m.

MEMBERS PRESENT

Senator Joshua Revak, Chair
Senator Peter Micciche, Vice Chair
Senator Gary Stevens
Senator Natasha von Imhof
Senator Jesse Kiehl
Senator Scott Kawasaki

MEMBERS ABSENT

Senator Click Bishop

COMMITTEE CALENDAR

SENATE BILL NO. 61

"An Act authorizing the commissioner of natural resources to modify a net profit share lease."

- HEARD & HELD

SENATE BILL NO. 62

"An Act relating to surface use restrictions for oil and gas leases; relating to gas leases in Kachemak Bay; relating to the renewable energy grant fund; and providing for an effective date."

- HEARD & HELD

PREVIOUS COMMITTEE ACTION

BILL: SB 61

SHORT TITLE: OIL/GAS LEASE: DNR MODIFY NET PROFIT SHARE

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

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|----------|-----|---------------------------------|
| 01/29/21 | (S) | READ THE FIRST TIME - REFERRALS |
| 01/29/21 | (S) | RES, FIN |
| 02/10/21 | (S) | RES AT 3:30 PM BUTROVICH 205 |
| 02/10/21 | (S) | Heard & Held |
| 02/10/21 | (S) | MINUTE(RES) |
| 03/10/21 | (S) | RES AT 3:30 PM BUTROVICH 205 |

BILL: SB 62

SHORT TITLE: GAS LEASES; RENEWABLE ENERGY GRANT FUND

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/29/21 (S) READ THE FIRST TIME - REFERRALS
01/29/21 (S) RES, FIN
03/10/21 (S) RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

JHONNY MEZA, Commercial Manager
Division of Oil and Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions regarding SB 61.

RYAN FITZPATRICK, Commercial Analyst
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions regarding SB 61.

KARA MORIARTY, President and CEO
Alaska Oil and Gas Association
Anchorage, Alaska

POSITION STATEMENT: Testified in support of SB 61.

HALEY PAINE, Deputy Director
Division of Oil and Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Provided an overview of SB 62.

ACTION NARRATIVE

3:36:05 PM

CHAIR JOSHUA REVAK called the Senate Resources Standing Committee meeting to order at 3:36 p.m. Present at the call to order were Senators Stevens, Kiehl, Kawasaki, von Imhof, and Chair Revak. Senator Micciche arrived during the course of the meeting.

SB 61-OIL/GAS LEASE: DNR MODIFY NET PROFIT SHARE

3:36:51 PM

CHAIR REVAK announced the consideration of SENATE BILL NO. 61 "An Act authorizing the commissioner of natural resources to modify a net profit share lease."

He asked Mr. Meza and Mr. Fitzpatrick to provide a recap of SB 61 and an overview of their response to questions the committee asked during the first hearing.

[3:37:47 PM](#)

JHONNY MEZA, Commercial Manager, Division of Oil and Gas, Department of Natural Resources, Anchorage, Alaska, stated the information the department provided related to the three cases for which the department granted royalty modification.

He explained there were eight applications for royalty modification: two were denied, three were withdrawn by the applicants, and the department approved the remaining three applications. For the approved applications, the department issued recent findings, received public comments, and gave a presentation to the Legislative Budget and Audit Committee (LB&A).

MR. MEZA noted the department included additional information in their email response letter to the committee regarding the production that came from the royalty modification as well as revenues to the state as resource owner, specifically royalty and net profit share where applicable.

CHAIR REVAK asked Mr. Fitzpatrick if he had anything to add.

[3:40:02 PM](#)

RYAN FITZPATRICK, Commercial Analyst, Department of Natural Resources, Anchorage, Alaska, stated Mr. Meza covered the information that DNR provided to the committee.

CHAIR REVAK asked why it would benefit the State of Alaska to modify royalty or net profit share leases.

MR. FITZPATRICK replied the intent of the bill is to encourage development of resources would otherwise be stranded. He noted Chair Revak mentioned royalties and explained that current Alaska statute allows the DNR commissioner to modify royalty rates under three different scenarios: 1) to encourage new production from a field or pool that has not previously been produced, 2) to extend the life of existing production in the event that per barrel costs are increasing, or 3) to restore ceased production in a pool or field that is shut-in.

MR. FITZPATRICK explained that SB 61 primarily would do two things. First it would allow for a fourth condition for royalty modification, or for potential modification of net profit shares in the event that a field is producing but additional capital investments is required to increase marginal production. The scenarios would include additional drilling, drilling pads, and enhanced oil recovery. If those projects were not economic on a standalone basis but could be made economic through royalty or net profit share modification, it would encourage additional investment and production.

He said the second objective of SB 61 is to allow the modification of net profit shares under the same regime as royalty modification as currently allowed in statutes. That would be one of the three bases that the department already discussed, or potentially the fourth additional basis that the bill would add.

[3:43:30 PM](#)

CHAIR REVAK noted he mentioned enhanced recovery efforts and asked him to confirm that as an oilfield produces over time, oil recovery becomes harder and more expensive.

MR. FITZPATRICK answered yes, an oilfield over its life generally sees a decline in production. It is a common feature seen in North Slope oil fields and oilfields throughout the world. Initial production is high, but reservoirs drop over time. There are methods that producers can use to either slow oil production decline or temporarily increase production by injecting water or gas, polymer flooding, and a whole host of arrays that can be used.

CHAIR REVAK asked him to confirm that DNR's position is that current oilfield development will become uneconomical and that is the reason for the legislation.

MR. FITZPATRICK answered yes. He explained over time, any oilfield can potentially become uneconomic as seen throughout the world where oilfields producing over long periods of time eventually decline and no longer provide adequate revenues to meet operating expenditures and other financial commitments. Hypothetically, as oilfield production declines the modification of royalty rates and net profit share rates could extend the life of the oilfield a couple of years with increased revenues rather than the oilfield shutting down.

MR. FITZPATRICK summarized that the department believes the bill could help to increase production over time from certain fields that might otherwise be economically disadvantaged.

3:47:03 PM

SENATOR STEVENS expressed interest in knowing how often the department approves or denies modified lease requests. He noted the statement that there were eight royalty modification requests. He asked how often requests occur and does the department approve or deny a lot more requests.

MR. FITZPATRICK explained the figures that Mr. Meza shared pertain to when the statute was first enacted in 1995. DNR has had eight applications for royalty modifications from 1995 to present. These requests do not occur annually and involve a lot of review work.

CHAIR REVAK noted that the three modified applications were substantially lucrative to the state. He asked him to walk through the internal processes when somebody applies for a lease modification.

MR. FITZPATRICK explained that royalty modification is generally reviewed by the Commercial Section within the Division of Oil and Gas. The review process varies depending on whether the application is for larger or smaller oilfields, or larger or smaller operators, but it is always in depth. The last oilfield the department reviewed took approximately 10-11 months.

MR. FITZPATRICK detailed when the department reviews the application, there is generally a back and forth with the applicant to get all the information. If it is not forthcoming, the department can deny modification due to lack of information.

MR. FITZPATRICK said the department has statutory authority to require or request an applicant pay for consultant fees to aid the department in its application review. Those consultants would provide expertise that the department may not have in-house such as reservoir engineering, accountants, or financial industry members that might have expertise in financial review.

3:52:04 PM

MR. FITZPATRICK explained that once the applicant information is received, the department does its own evaluation and economic modeling. The primary evaluation objective is to determine whether the application meets the statutory requirements for royalty modification that were mentioned earlier. Each of the

three scenarios potentially has subparts that each application would have to meet.

MR FITZPATRICK said one of the primary considerations is that when the legislature passed the statute in 1995 to allow for royalty modification, one of its features is a heightened burden of proof that an application must meet for royalty modification eligibility. That is clear and substantial evidence.

MR. FITZPATRICK detailed once the applicant review is finished, the Commercial Section briefs the Division of Oil and Gas and the DNR commissioner to determine whether there is additional review work for the division to conclude the application process; at that point, DNR would prepare and publish a best interest finding that includes a public comment period, an offer to LB&A for a hearing on the royalty modification, the best interest finding draft, and comments from the DNR commissioner. After the public comment period closes, the department must consider all public and legislative comments to incorporate and publish in its final best interest finding.

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CHAIR REVAK noted the application process includes oversight by the public and LB&A, and only three out of eight applications have been approved. He asked Messrs. Meza and Fitzpatrick why the department is now asking for a modification, noting oilfield throughput has drastically decreased over the past few decades.

MR. MEZA replied he is correct in referencing that the declining production from the state's producing fields may create a possibility that some of those pools may become uneconomic. One of the main goals with the proposed bill is that modifying the royalty rates, or the net profit share rate for the net profit share leases, can prevent declining oilfield production from abandonment and perhaps ensure continuing production and revenue to the state. SB 61 provides the DNR commissioner with another lever to modify parameters to encourage continuous or additional incremental production versus shutting down wells due to economic disadvantages.

CHAIR REVAK noted the committee has strictly heard from the department on SB 61. He asked the Alaska Oil and Gas Association (AOGA) to provide their input.

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KARA MORIARTY, President and CEO, Alaska Oil and Gas Association, Anchorage, Alaska, testified in support of SB 61.

She explained AOGA is the professional trade association that represents the majority of explorers, producers, refineries, and pipeline company in Alaska.

She said 2020 was an unprecedented year for the oil and gas industry. Even with COVID-19, the industry also experienced a pre-pandemic price war, and then the whole world turned upside down about a year ago from COVID-19. For the first time since Prudhoe Bay production started, drilling on the North Slope virtually stopped. There were no drilling rigs in Prudhoe Bay for the first time in history and the sector lost thousands of jobs.

She noted while oil prices are rising and production in Alaska has largely rebounded to where production was before COVID-19, there are still effects from 2020. While the proposed legislation is not a new concept to allow for potential [net profit share lease] (NPSL) modifications, the timing for the legislation might be right because the state needs to do whatever it can to make sure the state's oilfields are economic and its fiscal regime remains competitive. SB 61 provides an additional regulatory tool in the state's toolbox to incentivize and grow production.

MS. MORIARTY said she thinks Mr. Fitzpatrick did a nice job discussing how modifying current royalty rates for oil and gas leases is not easy. Modification does not happen overnight. There is very much a rigorous standard of proof, the economics absolutely have to warrant a change, and modification has to be in the best interest of the state. Allowing NPSL to go through the same type of process could be a very necessary and effective tool for providing flexibility in managing different cost structures, market dynamics, and project economics.

MS. MORIARTY stated AOGA sees SB 61 as an additional tool to use on a case-by-case basis. It provides the option for DNR to work with the industry on any particular development.

She summarized AOGA wants to see as much production as possible because it is good for the state, economy, jobs, and all Alaskans.

[4:02:18 PM](#)

CHAIR REVAK opened public testimony on SB 61; finding none, he closed public testimony.

[4:02:43 PM](#)

CHAIR REVAK held SB 61 in committee.

SB 62-GAS LEASES; RENEWABLE ENERGY GRANT FUND

[4:02:48 PM](#)

CHAIR REVAK announced the consideration of SENATE BILL NO. 62, "An Act relating to surface use restrictions for oil and gas leases; relating to gas leases in Kachemak Bay; relating to the renewable energy grant fund; and providing for an effective date."

[4:03:20 PM](#)

HALEY PAINE, Deputy Director, Division of Oil and Gas, Department of Natural Resources, Anchorage, Alaska, explained her presentation will provide the committee with an overview of SB 62 including its purpose, any potential challenges if not permitted, and a sectional analysis.

[4:03:52 PM](#)

MS. PAINE referenced slide 2 and stated the purpose of SB 62 is to allow the Division of Oil and Gas to lease and capture revenue from state-owned resources underlying lands restricted to surface. The bill does not open Kachemak Bay or any other closed area to surface development, the bill simply aims only to capture royalty revenue from geology drained through adjacent development on nearby unrestricted lands. With the use of modern drilling technologies, oil and gas may be safely developed from adjacent lands with no impact to the surface of the restricted areas, to include the offshore.

MS. PAINE stated that the primary benefit of SB 62 is increased state revenue. Lands with surface-use restrictions can still provide revenue in the form of lease sale bids, annual rental payments, and royalties if made available for subsurface-only development. The state will be able to protect the land using established regulatory methods while still maximizing the economic recovery of its resources.

MS. PAINE turned to slide 3 and said the main concern is the mechanism for collecting royalties if unleased land is drained from wells on adjacent leases where the state does not realize royalty payment and possible diminished revenue. For instance, the wellhead may be located on private land; this may prevent the state from realizing the royalty revenue unless the remedy is sought through [Alaska Oil and Gas Conservation Commission] (AOGCC) for correlative rights.

She explained leasing is the standard mechanism for establishing a contractual relationship between the state and the developer. The state exercises its authority through the lease for mitigation measures compliance. The state also requires the sharing of drilling and reservoir data, data integral to the state understanding the extent of its resources.

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MS. PAINE said bill Section 2 addresses the subject area. The bill seeks to allow gas-only leasing of the subject area while maintaining the surface use restrictions that are currently in place. The offshore state lands in Township 5 South, Range 15 West are shown both within the context of the Greater Cook Inlet with more detail in addition to a closeup of the subject area illustrated in the blue-hashmark region.

MS. PAINE detailed the subject area is adjacent to active development on the Kenai Peninsula, including the Seaview Unit which was recently approved by the division in October 2020. The Cosmopolitan Unit to the north—depicted in olive color—are all being developed from the onshore Hansen pad—located on private land—about halfway up the unit along the coastline. The Cosmopolitan Unit provides an example of successful access of offshore resources without impacting the surface-use of the waters.

SENATOR STEVENS asked how far the pipelines reach out into Kachemak Bay.

MS. PAINE replied they are all accessed from the Hansen pad for the Cosmopolitan Unit but she would follow up with the actual distance to the wellbore.

SENATOR STEVENS said he assumed pipelines are able to extend farther and farther from shore.

MS. PAINE answered yes, modern drilling technologies continue to improve for safely accessing resources. The distance from shore would depend on the variety of factors including the pool depth within the geology—noting current examples. The blue-hash subject area should be well within current technologies for access via unrestricted surface land.

[4:09:30 PM](#)

MS. PAINE provided the following sectional analysis for SB 62:

Section 1 - Amends AS 38.05 to add a new section, AS 38.05.176 to specify that a statute restricting the surface use of an oil and gas or gas-only lease area does not also restrict drilling of the subsurface of that leased area from an adjacent leased area not subject to restrictions on surface use, unless specifically provided.

Section 2 - Amends AS 38.03.184(b) to acknowledge the exemption (created by Section 3 of this bill) to the statute prohibiting the Department of Natural Resources or any other state agency from issuing leases for oil exploration or development on state owned land and waters in and around Kachemak Bay and extending to the three-mile offshore limit of state ownership.

Section 3 - Amends AS 38.04.184 by adding a new subsection (h) specifically authorizing the director of the Division of Oil and Gas to offer gas-only leases in an area adjacent to Kachemak Bay - specifically, within Township 5 South, Range 15 West, Seward Meridian, Alaska. Such leases would carry no right to use the surface of the land and would allow only natural gas exploration or production drilling from adjacent leased lands.

Section 4 - Amends AS 42.45.045(b) to allow the legislature to appropriate to the Renewable Energy Grant Fund the state's rentals, royalties, royalty sale proceeds and net profit shares generated pursuant to oil and gas, or gas-only leases issued pursuant to AS 38.05.180(f) and (g), as well as such revenue generated by gas-only leases issued pursuant to AS 38.05.184(h) (authorized by Section 3 of this bill). Such appropriations would occur after the required deposit of any such revenue to the Alaska Permanent Fund required under art. IX, sec. 15 of the Alaska Constitution.

Section 5 - Amends AS 45.45.045(c) requiring investments funds to be managed by the Department of Revenue, which shall be the fiduciary of the fund under AS 37.10.071.

Section 6 - Provides an immediate effective date.

[4:12:48 PM](#)

SENATOR STEVENS noted Senator Micciche passed him a note saying, "We are talking about extending out to 7.5 miles." He asked if drilling from shore eliminates the need for the big platform sites in the ocean.

MS. PAINE answered that [drilling from shore] may not be a full replacement for any offshore development. Locations would depend on where the resource is accessed. Locations primarily in the Upper Cook Inlet are not near shore reach. SB 62 is looking to direct specific leasing areas that are close enough for safe and modern drilling technology to access from adjacent unrestricted surface land.

SENATOR STEVENS remarked that drilling from shore seems like a great goal.

[4:14:26 PM](#)

SENATOR KIEHL noted the focus on the Kachemak Bay area and asked if the bill would apply to subsurface leases on all state land with a surface restriction. For example, a critical habitat area like in Gustavus, a state park, or a piece of state land that has a private lease for a lodge.

MS. PAINE replied the intention of SB 62 is to provide a general framework that would allow for specific designations in the future should there be a specific lease-by-application (LBA) that closes or restricts that. Consideration will always depend on whether the state has the mineral estate and whether it can be safely accessed from a nearby piece of unrestricted state land. At this time, the bill is only contemplating the access of the subject area.

SENATOR KIEHL asked her to confirm that the bill applies everywhere, not just the Kachemak Bay area.

MS. PAINE answered yes, the bill is looking at addressing future surface-use restrictions that may be imposed. At this time, the Kachemak Bay oil and gas closure is a very unique location in terms of its authorization through statute and the bill would create the opening in case there are future opportunities.

[4:16:27 PM](#)

SENATOR VON IMHOF read the following from slide 3:

If unleased land is drained from wells on adjacent leases, royalties may not be paid to the state or that revenue could be diminished.

She said she looks at this as a revenue enhancement bill. She offered her understanding that horizontal drilling technology is becoming more capable and it could occur without the state knowing.

MS. PAINE replied the state currently does not contemplate that drilling from adjacent leases is actively occurring, but the bill sets the stage for the state to not have to go through AOGCC to maximize revenue for those lands.

SENATOR VON IMHOF recapped that the bill prepares for what could happen and it ensures the state maximizes the revenue. She read, "To allow the legislature to appropriate revenue from these leases to the Renewable Energy Grant Fund." in Section 4 and asked if some of the money will go to a designated fund.

MS. PAINE answered yes, the legislature may choose to appropriate revenues from the leases to the Renewable Energy Grant Fund.

[4:18:50 PM](#)

SENATOR VON IMHOF asked her to confirm that legislative appropriation to the Renewable Energy Grant Fund is currently not happening, but this would change that.

MS. PAINE answered yes.

SENATOR MICCICHE asked her to confirm that only funds from projects that are associated with the specified type of lease would be deposited into the Renewable Energy Grant Fund.

MS. PAINE answered yes, the bill would only authorize leases from the specified area to have monies allocated to the Renewable Energy Grant Fund.

SENATOR MICCICHE pointed out the bill only affects Township 5 South, Range 15 West—an area of interest because of the [Cosmopolitan Unit] and other developments. He asked her if the state has seismic [data] in that particular area that looks interesting.

MS. PAINE replied the noted areas are currently under development with their pools and being delineated. The state

does not have a specific reason at this time to say that the development is going to occur. However, the bill simply allows for departmental preparation to move forward with land leasing should development occur within the Kenai Peninsula and Anchor Point area.

SENATOR MICCICHE asked if separate legislation—including a "Section 3" that identifies the specific township and range—would occur if an additional area in Alaska at some point has some potential or interest by someone.

MS. PAINE offered her understanding that with the general provision in place the department would need to find out if there is a specific closure area that is already enshrined for that particular location, and then that particular statute would require modification.

[4:21:25 PM](#)

SENATOR STEVENS asked her to confirm that appropriations are currently deposited into the Alaska Permanent Fund and the bill would allow for appropriations to the Renewable Energy Grant Fund. He asked what the funds from the Renewable Energy Grant Fund are used for.

MS. PAINE replied that from a broad perspective the Renewable Energy Grant Fund has been used to fund projects in different communities throughout Alaska that are in the research and development stage. She offered to follow up with a more detailed explanation.

SENATOR KIEHL said his question goes back to the general applicability of directional drilling under lands that are otherwise not open for oil and gas leasing, specifically parks and some state marine parks that include both surface and subsurface waters. He asked if her sense is that should the bill pass, the state will not have to worry about some of the incompatible use restrictions currently in the state management plans for parks or other special areas. For example, things like noise and lights associated with industrial development for oil and gas extraction.

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MS. PAINE explained that imbedded in the current formal lease contract is all the regulatory authority and protection for mitigation measures and other authorization that dictates how a development may occur in a particular area. The bill does not

set aside any plans or agreements that have been set out in any way.

MS. PAINE said the department will continue to do successful and safe resource development in areas throughout the state where there are other management plans using the best interest findings process as well as the mitigation measures for a specific lease. The department addresses those and ensures those aspects are only authorized in a manner that is compatible with a plan of operations.

[4:24:45 PM](#)

CHAIR REVAK opened public testimony on SB 623; finding none, he closed public testimony.

[4:25:10 PM](#)

CHAIR REVAK held SB 62 in committee.

[4:25:46 PM](#)

There being no further business to come before the committee, Chair Revak adjourned the Senate Resources Standing Committee meeting at 4:25 p.m.