HB

8354

# Alaska State Legislature

## House of Representatives

### Committee on Resources

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811


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# NOTIFICATION

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|---|---|---|---|
| HB 854 | 2/28/78 | Dept. of Natural Resources | 3/16 & 3/17/78 |
| | " | Dept. of Commerce | " " |
| | " | Dept. of Revenue | " " |
| | " | Alaska Pipeline Commission | " " |
| | " | N.W. Alaska Pipeline Co. | " " |
| | " | State/Fed. Land Use Planning Comm. | " " |
| | " | Special Committee on Royalty Oil | " " |
| | " | Div. of Minerals & Energy Mgmt. (Joe Green, Dir.) | " " |
| | " | Alaska Oil & Gas Association (Keith Arnold) | " " |
| | " | Jack Roderick, Dept. of Natl. Res. | " " |
| | " | Exxon (Bob Walker) | " " |
| | " | Steering Council for Alaska Lands | " " |
| | " | Keith Specking | " " |
| | " | Geoff Haynes | " " |
| | " | Alaska Federation of Natives | " " |
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HB 257

February 17, 1978

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

Under authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.30.060(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill extensively amending and updating AS 38.05.180, Oil and Gas Leasing.

I am pleased to present for your consideration this major piece of legislation dealing with Alaska's energy future. Not since statehood has the legislature addressed itself to determining how best to lease our petroleum land. Conditions have changed dramatically since then, both for the petroleum industry and the state, and it is time to make such a reappraisal.

The proposed changes will update the leasing law to provide increased public control over exploration, development, and production from state land, obtain a fair return from our non-renewable resources, and, at the same time, provide land from which explorers may find new energy supplies.

How Alaska leases its oil and gas lands will in large part determine our continuing relationship with the oil industry. Many of the problems we now confront in determining the state's fair share of the Prudhoe field could certainly best have been resolved at the time the initial leases were offered by the state. This legislation would make that more likely in the future.

As you are aware, Congress is presently debating a new law covering federal oil and gas leasing on the

Outer Continental Shelf. As you are also aware, much of the attractive OCS land is directly adjacent to Alaska's three-mile offshore land. For this reason, my proposed legislation attempts to be as inclusive as the federal OCS legislation, but more workable, and thus, hopefully, more acceptable to the oil and gas industry.

This legislation is designed to accomplish a number of important state objectives. First, it requires state land to be offered competitively under any of several new leasing methods, including bidding by royalty, sliding royalty net profits and work commitment or a combination of any of these methods. Under certain circumstances, land may be offered on a noncompetitive basis.

Second, it reduces the length of the term of a lease from ten years to five years, to assure that exploration begins promptly once state land is leased. Under certain severe environmental conditions a lease may be for a longer period, but not to exceed ten years.

Third, the legislation increases rentals, including those on shut-in fields, to increase incentives to explore and produce oil and gas fields.

Fourth, the bill grants to the state the right to purchase up to 16 2/3 per cent of the oil and 100 per cent of the natural gas or gas products from the lease, thereby protecting sale commitment of royalty oil and gas in the event the state's royalty is reduced on marginal fields.

Fifth, it reduces the acreage limitation on state uplands so that more companies will have an opportunity to participate in exploring in Alaska and, for the same reason, it allows the state to restrict joint bidding by major or international oil companies.

Finally, the legislation provides that the executive branch will file two reports with the legislature each year. One will outline the state's leasing program for the forthcoming five years. The other will explain the leasing methods used or to be used. I have chosen this method of informing the legislature and the public because I believe there is a need to create as much certainty in leasing policies and procedures as possible. Requiring a five-year state

leasing program to be made public will, I believe, lend stability and predictability to the petroleum exploration business in Alaska and will also raise the level of consciousness of the citizens of Alaska about the workings of the oil business. I can think of no better way to the inform the legislature and the public than to report on a regular basis what land will be made available for oil and gas leasing and by which of several leasing methods the state proposes to offer that land.

The second report will note which leasing methods were used during the preceding year and which methods are proposed to be used in the coming year. Hopefully, enough explanation as to why one method was chosen over another will help educate us all. Although this places an increased burden on those chosen to make these day-to-day decisions, I think it appropriate to use this public accounting procedure for all subsequent state oil and gas lease sales.

Through your leadership, the legislature and my Department of Natural Resources have worked together in an effort to find a solution to Alaska's future leasing policy.

The legislature's action in commissioning Dr. Mason Gaffney's study last year and the subsequent work by the department has paid dividends in developing our understanding of the options available to the state. I wish to thank you for your foresight and cooperation in this most important matter.

Sincerely,

Jay S. Hammond
Governor

THE LEGISLATURE OF THE STATE OF ALASKA
TENTH LEGISLATURE

# FISCAL NOTE

I. REQUEST
Bill/Resolution No. HOUSE BILL NO. 354
Title: Leasing and exploration of state land for oil and gas development
Requested by: Governor Date:

II. FISCAL DETAIL
Agency Affected: Department of Natural Resources
Program Category Affected:
Budget Request Unit(s) Affected:

EXPENDITURES (Thousands of Dollars)

| | FY 78 | FY 79 | FY 80 | FY 81 | FY 82 | FY 83 |
|---|---|---|---|---|---|---|
| 100 PERSONAL SERVICES | | | | | | |
| 200 TRAVEL | | | | | | |
| 300 CONTRACTUAL | | | | | | |
| 400 COMMODITIES | | | | | | |
| 500 EQUIPMENT | | | | | | |
| 600 LAND & STRUCTURES | | | | | | |
| 700 GRANTS, CLAIMS, ETC. | | | | | | |
| TOTAL | | | | | | |

FUNDING (Thousands of Dollars)

| | | | | | | |
|---|---|---|---|---|---|---|
| GENERAL FUND | 0 | 0 | 0 | 0 | 0 | 0 |
| FEDERAL FUNDS | | | | | | |
| OTHER (Specify) | | | | | | |
| | | | | | | |
| | | | | | | |

POSITIONS

| | | | | | | |
|---|---|---|---|---|---|---|
| FULL TIME | 0 | 0 | 0 | 0 | 0 | 0 |
| PART TIME | | | | | | |
| TEMPORARY | | | | | | |

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)
Existing administrative staff are capable of evaluating and carrying out lease sales under any of the proposed leasing methods within the reporting period unless the number and volume of sales in significantly larger than expected. Should net profits or a post-discovery type leasing method be used by the State, prior to production some auditing and/or assessing functions will have to be increased. However, some of these services are now being performed by Department of Revenue personnel in reserves tax assessing, and by 1983, or thereabouts and beyond, when the impact of production is felt, may be interchangeable with Natural Resources personnel.

Jack Roderick

IV. DATE February 6, 1978 PREPARED BY Jack Roderick
AGENCY Commissioner's Office, Dept. of Nat. Resources
PHONE 279-5577

Original: Legislative Finance
cc: Budget and Management
Prime Sponsor (First Legislator Named)

33-001 (Rev. 12/77)

LETTER OF INTENT

CSHB 854 (RESOURCES)

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature

Dear Mr. Speaker:

The Resources Committee substitute for House Bill 854 makes numerous changes in the legislation as proposed by the Governor. Two of these changes involve the deletion of the following language:

1. Subsection (f) on page 6.

2. In subsection (j) the following sentence (at the top of page 8 in the original bill) - "The commissioner may provide by regulation and in the lease that the lessee may earn production rights only to the depth drilled at the beginning of production from the lease."

The record should show that the committee's intent in deleting these two items was not to limit the discretion of the Commissioner of Natural Resources in these areas, but simply the result of its determination that the authority in both of these areas is implied, and does not require special authorizing language in the bill.

Alvin Osterback

Alvin Osterback, Chairman
House Resources Committee

Date: 4/14/78

## DESCRIPTION OF LEASING METHODS IN HB854

Currently, the State of Alaska's leasing system is a cash bonus bid with a minimum fixed royalty of 12.5 percent. The methods outlined below include the present system with different fixed royalties, sliding scale royalty with bonus bid, sliding scale royalty bid with fixed bonus, net profit share bid with fixed bonus, royalty bid with fixed bonus and exploration work commitment. The basic elements of these methods are summarized below.

(1) Bonus Bid With Fixed Royalty

Bonus bid with fixed royalty is the system currently used by the State of Alaska. In a lease sale, the winning bid for a tract is the one which makes the highest sealed or auctioned cash bonus bid. There is also a minimum royalty of 12.5 percent. An advantage of this system is that government receives revenue regardless if there are economical quantities of oil or gas found and/or produced. To avoid early termination of production, royalties need to be flexible during a field's declining years.

(2) Sliding Scale Royalty With Bonus Bid (or Sliding Scale Bid with Fixed Bonus)

Under this system, the government receives a cash bonus bid and a sliding scale royalty. We used 12.5 percent as a minimum figure and 62.5 percent as a ceiling wherein the rate in any period is dependent upon the production of that period.

The royalty rate is graduated in much the same manner as the federal personal income tax. Table I gives two examples of a sliding scale royalty schedule. The royalty is progressive, that is, the royalty on additional production increases. For example, in the South Central Area, the initial 500 barrels pay a royalty of 12.5 percent, the next 500 barrels pay 25 percent. The royalty rate increases by 12.5 percentage points per 500 barrels until 2000 barrels of output are achieved. All production beyond 2001 barrels pays a royalty of 62.5 percent. Thus, if production reaches 5000 barrels, the average royalty rate is 50 percent. In the limit, the average rate would converge towards 62.5 percent as daily production continues to increase.

As field productivity declines and well production falls, the producer backs down the schedule and royalties decline. In order to optimally exploit the field, the royalties should decline to zero near the end of field life. Actually, final rates of five or six percent would result in minimal early shut down.

TABLE I
TYPICAL SLIDING SCALE ROYALTY SCHEDULES

SOUTH CENTRAL AREA

| Daily Average Prod. Rate (Bbls./day) | Incremental Royalty Rate (%) | Royalty For Specific Producing Rates: Producing Rate (Bbls./day) | Royalty Production (Bbls./day) | Average Royalty Rate (%) |
|---|---|---|---|---|
| -500 | 12.5 | 500 | 62.5 | 12.50 |
| 501-1000 | 25.0 | 1000 | 187.5 | 18.75 |
| 1001-1500 | 37.5 | 1500 | 375.0 | 25.00 |
| 1501-2000 | 50.0 | 2000 | 625.0 | 31.25 |
| 2001-2500 | 62.5 | 2500 | 937.5 | 37.50 |
| | | 3500 | 1562.5 | 44.64 |
| | | 4500 | 2187.5 | 48.61 |
| | | 5000 | 2500.0 | 50.00 |

NORTH SLOPE AREA

| Daily Average Prod. Rate (Bbls./day) | Incremental Royalty Rate (%) | Royalty For Specific Producing Rates: Producing Rate (Bbls./day) | Royalty Production (Bbls./day) | Average Royalty Rate (%) |
|---|---|---|---|---|
| -1000 | 12.5 | 1000 | 125 | 12.50 |
| 1001-2000 | 25.0 | 2000 | 375 | 18.75 |
| 2001-3000 | 37.5 | 3000 | 750 | 25.00 |
| 3001-4000 | 50.0 | 4000 | 1250 | 31.25 |
| 4001 and above | 62.5 | 5000 | 1875 | 37.50 |
| | | 7000 | 3125 | 44.64 |
| | | 9000 | 4375 | 48.61 |
| | | 10000 | 5000 | 50.00 |

Note: The Sliding Scale Royalty Schedule for the North Slope area is significantly higher than for the South Central area because the higher North Slope operating costs result in a much higher economic limit.

Hopefully, this illustration clarifies the relationship between production rates and royalty rates.

Greater flexibility in setting the initial rate is the major advantage of this system while not running the risk of an uneconomically (for Industry) high royalty rate. On the other hand, to achieve an overall lower royalty payment, a company might spread out production over a longer period of time. Usually, however, because of the time value of money and increased operating costs, oil companies generally try to accelerate production.

(3) Net Profit Share Bid With Fixed Bonus

A small fixed bonus is required as earnest money. The bonus is low enough to encourage producers to bid a high net profit share while permitting profitable development.

(4) Royalty Bid With Fixed Bonus

This system utilizes the same method to calculate fixed bonus as described for Net Profit Share. The bid parameter is a function of production instead of net profits. Since the bonus is fixed, interested parties bid on the royalty rate that the government is to receive. The advantage of royalty bidding is that little front end money is needed by Industry. However, this could encourage speculation causing an overbid. Royalty bidding should encourage more competition among bidders and may allow the smaller companies a better chance of winning the tract.

(5) Work Commitment With Fixed Bonus, Royalty or Net Profit Share

The government itemizes the performance criteria such as the rate and amount of work to be performed on each tract. The total bid specified in dollar terms and a portion of the bid used for exploration and development activities. This system gives the government some control over the rate and extent of resource development.

## TWO VIEWS ON BIDDING STRATEGIES

### WEALTH MAXIMIZING STRATEGIES FROM THE STATE'S VIEWPOINT

The choice of bidding method cannot be made on the basis of any single criteria but is the result of evaluating a number of factors including but not limited to the potential economic payoff and physical characteristics of the lease area. HB854 offers essentially four leasing schemes. (1) Bonus Bid - Fixed Royalty, (2) Royalty Bid - Fixed Bonus, (3) Net Profit Bidding with Fixed Bonus, (4) Work Commitment with Bonus Bidding. These options will be briefly evaluated.

#### Bonus Bid - Fixed Royalty

If the royalty is fixed at 12-½%, there is no reason to use this option. It is of historical value only. At higher fixed royalties, it has some merit, but the higher fixed royalty means a lower bonus bid which is supposedly the advantage of the system. Private discount rates are too high for bonus bidding to be advantageous to the State. For example, a brief examination of an annuity table suggests that increases in the discount rate rapidly diminish the present value of a future income stream. This income stream can be interpreted as the discounted net revenues resulting from the potential discovery and development of an oil field. Table II illustrates the discount rate effect.

Table II
Present Value of an Annuity of $1 Million
(Values in $10^6$)

| Number of Years | Discount Rates | | | | | |
|---|---|---|---|---|---|---|
| | 6% | 10% | 14% | 16% | 18% | 20% |
| 20 | $11.470 | $ 8.514 | $6.623 | $5.929 | $5.353 | $4.879 |
| 30 | 13.765 | 9.427 | 7.003 | 6.177 | 5.517 | 4.979 |
| N | 16.67 | 10.00 | 7.14 | 6.25 | 5.56 | 5.00 |

From the State's viewpoint, a 6% discount rate may properly reflect the present value of the income generated by the potential oil discovery. The industry, on the other hand, is likely to discount the future net income stream at much higher rates, say 20%. Thus, the maximum bid under ideal circumstances would be $5 million for an income stream that would yield net revenues of on million per year in perpetuity. Perpetuity is longer than the life of Prudhoe Bay.

#### Royalty Bid - Fixed Bonus

Relatively easy to administer - reduces risk and front end filter to the private sector. With sliding scale, most early shut down problems are avoided. The fact

that the State receives a revenue stream over a $20^{+}$ year time horizon also is an attractive feature. The Beaufort Sale is an ideal candidate for a royalty bidding scheme.

Net Profit Bidding

This is very attractive from a risk sharing point of view. All risks (geologic, exploration, development, and production costs as well as product price) are shared with the industry. Would increase exploration and development in remote high risk areas. May be useful where there is low probability of bid find. Under ideal circumstances (political) is the best of all possible options but does have serious administrative problems.

Work Commitment

Cases where State wants information and is willing to specify type of information desired. Good for high risk areas in remote locations. May also be used where the State wants more information before putting structures up for competitive bidding scheme.

On balance, the royalty bidding schemes represent a substantial improvement over bonus bidding and are administratively tractable. Given the time to build the expertise, it may be advisable to shift to profit sharing or ad valorem schemes.

MULTIPURPOSE STRATEGIES

Bonus Bids

Bonus bidding should be applied in cases where the State has either:

(a) A very great amount of knowledge about the resource, or
(b) The prospect is of extremely high risk, the lessor has little knowledge of the resource and expected value revenues would be marginal.

The first case (a) where tracts might be offered for Bonus Bidding could be that of a drainage or near drainage situation where the State wished to maximize its near term discounted revenues. It would be advisable to not offer all of the tracts for bonus bidding, but to withhold a percent of acreage to be sold at a later date, (Report 2-77). Also, since royalty and other bidding methods have shown to offer higher expected value revenues for lower risk cases it could be advisable to mix royalty bidding with the bonus bidding, a practice followed by the Federal Government in the recent Cook Inlet OCS sale.

In the second case (b), that of extreme high risk, bonus bidding can be used as a filter to determine the value of marginal tracts. This is discussed under the section on (t) low potential, high risk and previously leased.

Report 2-77 indicates that for very high risk cases all bidding methods approach the same level of expected value income for the State. In cases of small and marginal potential reservoirs the bonus bid method with its ease of administration might afford optimum state revenues. Report 2-77 also indicates that in probability of success percentages of 1 percent or less bonus bids could afford higher revenues, but the State should ensure that leasing under such high risk cases only occurs when sufficient knowledge is gained to indicate that the land to be leased is of such a low potential. For example, a geologic structure as large as the Prudhoe Bay anticline may have had a high degree of risk before it was drilled but its potential to hold enormous reserves was there. Bonus bidding should not have been used in that instance.

In summary, bonus bidding can be used when:

(1) Very small potential reservoirs are expected;

(2) Extreme risk is expected and the gaining of sufficient knowledge to determine the presence of reservoirs is unwarrented because of marginal to low potential indications.

(3) A sliding royalty should be considered in all bonus bid cases;

(4) This method could be used in a mixture with other methods such as royalty bidding;

(5) Also, in general, this method should only be considered when leasing in the less desirable state areas, i.e. those below the top 10 rank.

Royalty Bidding - Fixed Bonus

Report 2-77 indicates that royalty bidding and profit sharing deliver the highest expected value revenues to the State of all bidding methods. It is particularly effective where the probability of occurrence is high (i.e. low risk) and especially when the expected reservoirs are large. A sliding scale should be added in the declining production years to eliminate the problem of premature shut down. Cases for royalty bidding would be when:

(1) The State has enough knowledge to assess the size of potential traps.

(2) Potential reservoirs are not extremely small or of extreme risk.

The Beaufort Sea sale is a good example of a case for using Royalty bidding on tracts. In general, this method should be considered when leasing in the top 10 leasing areas on the desirability scale.

Net Profit Bidding

Net profit bidding would be most advantageous when costs and oil prices are in a state of extreme fluctuations making economic predictions unreliable. In remote high risk areas, this method might attract stronger bids than the royalty

or the bonus bid method.

Of the 35 potential State leasing areas, this method might be used to advantage on those areas below the top 10 in desirability.

Work Commitment

(See section (t)).

This bidding method can be best used where the State has a large (i.e. 100,000+ acres) area of probable low potential where industry has shown a general lack of interest in exploration and leasing. By offering a large area for lease to one lease owner, the State provides an extra incentive to undertake exploration and the State ensures the exploration by making the bid variable.

This method would be used in remote low potential high risk areas. Some of the State's 3 mile limit lands such as Area IX might be applicable to this method.

Low Potential & High Risk and Previously Leased Section (t)

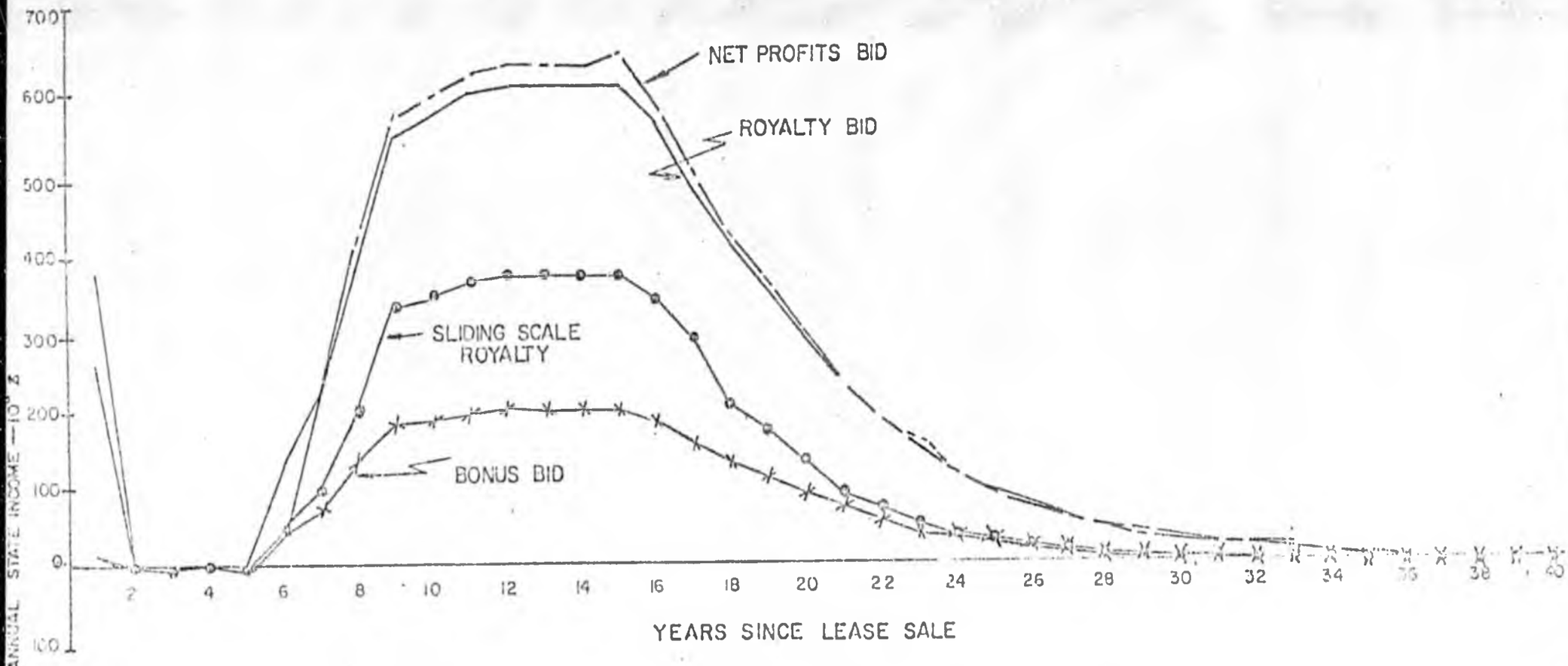
On the basis of exploration knowledge, lack of interest by industry and reasonable analysis, the department may determine that lands have very low potential for oil and gas.

As a means of encouraging the evaluation and possible development of these low potential lands, the department could:

(1) Offer the lands for competitive lease using a bonus bid with sliding royalty. A minimum bid equal to the first year's rentals could be used to filter the bids. This should give a check on the potential of the lands. The sliding royalty would act as a safeguard for very low value bonus bid tracts if a discovery is made later on the lands.

(2) On tracts that receive no acceptable bids, the commissioner could hold a non-competitive similtaneous drawing after proper notice (30 days). Tracts not receiving applications for the drawing could then be opened for over the counter applications. Tracts could be offered at fixed 50¢/year rentals, 5 year terms. A sliding scale royalty would be used in all cases to provide a revenue safeguard against future potential discoveries.

(3) In some cases, all tracts not receiving acceptable bids could be aggregated into large blocks (100,000 acres or more) and offered for work commitment bidding or development contracts.




COMPARISON OF STATE INCOME
FOR VARIOUS LEASING METHODS
AT 90% CHANCE SUCCESS

BEW 1-30-78

LEASING METHODS EXAMINED

BUT NOT INCLUDED IN HB 854

1. The so-called "dual leasing" system which would authorize the State to issue separate exploration and production leases. Senator Ted Steven's amendment to S-9 would permit the exploratory lessee to share with the government (Federal) the costs of the exploratory drilling program, which would be managed by the lessee, in exchange for a share of the revenues received by the government from a subsequently issued production lease.

   The Administration believes that the State can know before it offers its land for drilling what development and production activities it expects to take place.

2. Dr. Mason Gaffney's ad valorem charge, or a "post" royalty system versus the "ante" systems in HB 854. In other words, the state determines its take before discovery, not after. Other governments, like the Canadian national, are going to the "post" systems, i.e. "progressive incremental royalty."

3. Incentives. There are no direct incentives to lessees contemplated in HB 854, except that "work commitment" would allow cash bonuses not to go to the government but instead used by industry for exploration.

4. Government equities in leases or state-owned and operated exploration companies are not envisioned in HB 854.

5. Oil Payment Bidding - shift royalty to rental.

6. Performance System which provides government with the authority to specify the exact rate and extent of resource development.

7. Share Bidding or Phillips Plan. Bonus bids are entered for the entire structure instead of for a specific tract. Based on their equity in the field, each company receives a percent of the profits or losses with a maximum percentage participation by any one company.

8. Alberta's so-called "checkerboard" leasing system wherein a reservation holder may apply for leases over not more than 50% of the area in the reservation in a checker-board pattern. These leases convey the right to produce and sell the Crown's oil and gas, and the government retains the right to alter unilaterally the terms and conditions of the arrangement.

# SUMMARY OF FEDERAL OCS REGULATIONS

## PERTAINING TO GEOLOGICAL AND GEOPHYSICAL INFORMATION

Title 30, Section 251.12 of the Code of Federal Regulations specifies that individuals and companies granted OCS exploration permits are required to allow the Department of the Interior (DOI) to inspect and select the forms of information listed below. The permittee must notify the DOI immediately of the acquisition or analysis of any geological data (part a of the section) or the acquisition, processing, or reprocessing of any geophysical data (in part b) collected under the permit. The DOI has at least one year after such notification to choose the material. A longer time period may be specified in the individual permits. The permittee is not required to submit interpreted geological or geophysical information for inspection and selection. If the permittee transfers geophysical data or processed geophysical information to a third party or a third party who has received geophysical data or processed geophysical information directly or indirectly from a permittee transfers said data or information to another third party, the transferor must notify the DOI of the action and bind the third party to the obligations of the permittee. The first set of regulations of this type were approved and put into effect in November, 1975.

The geological data from which the DOI may select includes: (This applies to COST-type and other stratigraphic test holes.)

1. Complete record of all geological and geochemical data and information resulting from each operation;

2. Paleontological reports identifying the microfossils by depth, unless washed samples are kept for inspection by the USGS;

3. Copies of well logs or charts (electrical, radioactive, sonic, etc.);

4. Core or bottom samples analyses or a representative cut of the samples;

5. Detailed descriptions of hydrocarbon shows or hazardous conditions; and

6. Other geological data and analyzed geological information obtained under the permit, as specified by DOI.

The geophysical data, processed geophysical information and reprocessed geophysical information which may be selected includes:

1. A complete record of each geophysical survey conducted, including the final location maps of all survey locations;

2. All common depth point and high resolution seismic data;

3. Processed geophysical information derived from the seismic data;

4. Geophysical data and processed information obtained from, but not limited to:

a. Shallow and deep subbottom profiles

b. Bathymetry

c. Side-scan sonar

d. Magnetometer systems

e. Bottom profiles

f. Gravity surveys

g. Magnetic surveys

h. Special studies such as refraction and velocity surveys, and

5. Reprocessed information such as true amplitude sections, migrated sections, and bright spot analyses.

The DOI may choose any or all of the above data or information at any stage of processing. Thus far the local USGS Conservation Division Office has been selecting final processed data and information. The geophysical data must be kept confidential for ten years after the issuance of the permit. Processed, reprocessed, and interpreted geophysical information is released to the public ten years after it has been submitted to the USGS. Geological data and analyzed and interpreted geological information obtained from deep stragigraphic tests are released five years after completion of the test well or 60 calendar days after the issuance of the first Federal lease within 50 geographic miles of the test site, whichever is earlier.

# STATE'S RIGHT TO PURCHASE OIL & GAS IN HB 854

The State has the right in HB 854(v) to purchase not more than 16 2/3% of the oil and up to 100% of the gas at the regulated price or fair market value at the point of sale. The right to purchase is needed to protect the "in kind" taking of its royalty by Alaska, a sale of said royalty, and a subsequent reduction of the royalty in the later stages of production (d).

New Mexico, 1973, enacted a law which gives it the right to reserve an option to purchase at any time at the prevailing market price any or all minerals, including oil and gas, produced from State land. Thus, New Mexico may purchase 100% of the oil and gas found on State land.

Whereas the New Mexico Commissioner is authorized to waive the reservation option with respect to any specific mineral, he may not do so for oil or gas.

The Act, Chapter 26 of the Session Laws of 1973, has never been exercised by New Mexico; thus no opportunity has been given to test its constitutionality.

If Alaska were to reserve an option to purchase up to the amount of the royalty, fixed or bid, an equivalent net profit share would have to be determined.

TESTIMONY BEFORE ALASKA HOUSE RESOURCES COMMITTEE
ON HOUSE BILL 854
APRIL 8, 1978

(The following is written from notes which were referred to in the testimony before members of the committee who were holding a work session on the bill.)

My name is John Carson. I am Division Geologist in Alaska for Chevron U.S.A. Inc. I testified before your committee on March 17 on this same bill. My purpose today is threefold.

1. To re-emphasize the major points of my previous testimony;
2. To address "Suggested Revisions to HB 854" submitted by another major oil company; and
3. To answer any questions that the committee may have at this time.

In reviewing my previous testimony I would like to first restate that Chevron sees no need for HB 854. We do see a need for a stable, predictable, planned leasing program on State of Alaska lands.

In my earlier testimony I stated seven points of opposition to the bill. I would like to repeat those now.

First, we oppose the wide variety of bidding methods to be employed.
Second, we are opposed to the requirement of having to submit our proprietary data to the Commissioner.
Third, we oppose the State's right to have a call on production above their royalty share.
Fourth, we feel the five-year term is too short.
Fifth, we oppose the Commissioner having to submit his leasing program to the legislature and also to his having to defend the methods used.
Sixth, we oppose the ban on joint bidding between major oil companies.
Seventh, we feel the reduction of chargeability on upland acreage from 500,000 to

200,000 is arbitrary and unwarranted.

Chevron's reactions to the "Suggested Revisions of HB 654" can be categorized in three ways: First, we will emphasize where we disagree with the revisions, second we will support a revision and amplify by adding comment; and third, we will make no comment to those sections with which we agree. I would now like to proceed through the copy of the dually printed bill which displays the original text on the left-hand side of the page and displays "Suggested Revisions" on the right-hand side.

Page 5, (c). Chevron supports the deletion of this section. We feel that the Commissioner will lose control of the leasing procedure. We are also concerned that the requirement that no method be used more than 50% of the time without reason will encourage experimentation into untried methods.

Page 6, (c). Suggested revisions have added wording at the bottom of the page which apparently has the intent of forcing the Commissioner to use cash bonus bidding unless the Commissioner finds that another method will better serve the State's purpose. Chevron agrees with the intent, but feels that this clause has nothing in it which will satisfy that intent. The Commissioner can surely "find" that a method he chooses is better. He does not have to defend it or prove it. We feel that a far better way to treat this matter is to delete those bidding methods from the bill which are onerous. In our opinion, all are onerous except cash bonus bidding which we feel is the best method for determining the market value of oil and gas leases.

Page 9, (d). While we agree that, if royalty bidding is used, an ity to reduce the royalty will have to be employed, we think this clause points one of the problems with royalty bidding. The industry is encouraged to bid a high royalty to win a tract thereby entering into a contract which they may not be able to fulfill.

Page 10, (f) Original HB 654. We agree with this deletion. The Commissioner already

has this authority.

Page 10, (f) Suggested Revisions. Chevron feels that this drilling incentive credit system may have some merit. However, we feel it must be spelled out very clearly as to what portion of what costs will be applied. Footage drilled may be misleading. Also it seems that it must be made clear as to what areas the credit may be applied to.

Page 13, (j). Chevron feels that a ten year lease term is mandatory. Operating in Alaska's environment is particularly troublesome with a five-year term. A special problem is confronted when the original well drilled is unsuccessful but encourages the operator to explore farther. In such a case the unit which may have been formed to drill the first well will fall apart unless another well is drilled within a specified time. Time may be needed to record more seismic data. In fact, two seasons may be needed. If enough encouragement is displayed to drill another well, then further permitting, rig contracting, etc., will use up valuable time.

Chevron feels that a reasonable rental escalation for the last portion of a ten-year lease term may be acceptable. However, rental rates should be frozen and not subject to escalation once reserves are established and the operator must wait for gathering or transportation systems to be permitted and installed. These delays are often out of the operator's control and he should not be punished for them.

Page 13, (j). The suggested revisions have wisely deleted the sentence about two-thirds of the way down the page which grants authority to the Commissioner to grant limited production rights. This is an onerous, unworkable stipulation and ignores traditional oilfield practices as well as subsurface geometric principles.

Page 18,(o). The last sentence of this section should be deleted. Chevron is unclear as to what is intended but if the State is to become a working interest participant, we are opposed. In addition, we do not think the taxpayers should share in this type of risk capital expenditure.

Page 21, (u). For reasons stated previously we agree with the deletion of the section which could ban joint bidding by any companies, including majors.

Page 21, (v). Chevron does not feel that the State should have a call on any of an operator's production above the royalty share. An operator needs assurance that he will have a certain amount of production in order to enter into and fulfill his contracts. The suggested revisions are a step in the right direction but they do not go far enough.

Page 21, (w). Chevron is opposed to submitting our geophysical data to the State. We are concerned that confidentiality which will be threatened by oversights and State employees leaving to enter private industry. These data are the very heart of our program and we are not willing to see their confidentiality threatened.

Page 22, (c). Although we still do not see the need for the reduction of acreage chargeability limitation in the upland, we feel that 400,000 acres is more reasonable than 200,000.

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

JUL 1 1976

JUN 29 1976

BAN ON JOINT BIDDING

Dear Mr. Chairman:

Section 105(e) of Public Law 94-163, the Energy Policy and Conservation Act, requires me to report to the Congress with respect to the feasibility and desirability of extending to onshore Federal energy leases the prohibition which now exists on joint bidding for Outer Continental Shelf oil and gas leases. I am happy to enclose the required report.

The recommendations of the report are that a joint-bidding ban be extended to oil and gas onshore, and to coal, but that no action be taken at this time as to oil shale, since no general leasing program for oil shale is now under way. It is our feeling that although little or no joint bidding has actually occurred in the past for onshore oil and gas or for coal, on balance the advantages of a limited ban seem to outweigh the disadvantages in these energy materials. We see no need to decide the issue for oil shale until general leasing is planned, at which time further experience with oil shale development may enable us to make a better-informed decision.

As you know, a ban on Outer Continental Shelf joint bidding was originated by the Department of the Interior and was in effect before the Energy Policy and Conservation Act was passed in December 1975. That Act legislated essentially the same ban as had previously been in our regulations. We have authority under the Mineral Leasing Act to promulgate onshore joint-bidding limitations as well, either by regulation or by announcement of qualifications for bidding. It is my view that legislation on this matter is unnecessary and undesirable, since a legislated ban is far too inflexible to suit the continually changing circumstances of the market for Federal energy leases. Rapid world energy price changes, differences in exploration risk among regions and even among individual leases in the same region, changing company structures and investment policies, and many other factors make it essential that joint-bidding limitations be easily and quickly adjusted, as they can be only if they are regulatory in character.

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

Therefore, while it is my intention to limit joint bidding along the general lines suggested in this study, I do not recommend legislation on the matter. Further, I believe that more study is necessary of certain issues not yet adequately addressed. The exact size limits to be placed on eligibility for joint-bidding in coal are not well substantiated and need further work. No mention is made in this study of the criteria by which waivers to a ban should be granted when risks are unusually high because of large exploration costs, great exploration uncertainty, high technology, or any of a number of other possibilities for which allowance should be made. I am directing my staff to provide me with recommendations on these matters before I decide on the final promulgation of joint-bidding limitations.

Sincerely,

Secretary of the Interior

The Honorable Henry M. Jackson
Chairman
Senate Interior Committee
Washington, D.C. 20510

Enclosure

# JOINT BIDDING FOR FEDERAL ONSHORE OIL AND GAS LANDS,

# AND COAL AND OIL SHALE LANDS

(A study required by Section 105(e) of P.L. 94-163, the Energy Policy and Conservation Act of 1975)

Department of the Interior
Office of Policy Analysis
June 1976

In the Energy Policy and Conservation Act of 1975[1/], the Congress instructed the Secretary of the Interior to prescribe and make effective a rule which prohibits participation by more than one of the "major" oil companies in a joint bid for the oil and gas rights on any lands located on the Outer Continental Shelf (OCS), except where extremely high risk exists or where high exploration and development costs are involved. The Secretary was also instructed to study and report on the feasibility and desirability of extending this prohibition on joint bidding to the sales of oil and gas rights on Federal onshore lands, and to the sales of coal and oil shale rights on such lands.

The report that follows studies these questions In Section 2 the theory of joint bidding is outlined briefly. Here we examine the risk-sharing features of joint bidding in ventures whose outcomes are uncertain, and the consequent encouragement offered to smaller, more risk-averse firms to enter the bidding competition. But joint bidding has an opposite effect as well: a joint bid consolidates many offers into one, and converts what might have been active competition into legitimate collusion. We note some of the other features of joint bidding that bear on competition -- such as the opportunity that joint bidding negotiations may provide to exchange information about potential bids and geological data.

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1/ 42 USC 6201; Public Law 94-163, 94th Congress, S. 622, Dec. 22, 1975. (See Appendix B where the relevant Sections 103(a-e) are reproduced).

We conclude that joint bidding is likely, on balance, to encourage competition if risks are large, and to discourage competition if risks are low.

In Section 3 we review the history of OCS bidding since its start in 1954, and we summarize some of the discussions and analyses of that history leading up to the 1975 restrictions on OCS joint bidding. This history is most useful as a benchmark against which to compare the situations in the current onshore oil and gas bidding, and the soon-to-be-active bidding for Federal coal and oil shale lands.

In Section 4 the characteristics of the bidding for competitively offered Federal onshore oil and gas lands are examined. Attention is focused on the levels of aggregate activity and on the investments, the costs, and the risks involved in onshore oil and gas ventures, especially as they compare to their counterparts in OCS ventures.

In Section 5 the prospects for competition in the sales of coal are examined. The structure of the industry -- which includes many firms not ordinarily considered coal mining firms -- is described, and the expected influence on that industry's behavior of the complicated patterns of western land ownership are analyzed.

We conclude that there is little justification for joint bidding for competitively leased Federal onshore oil and gas tracts. Although the probability is high that any such venture will not discover oil or gas, the magnitude of the typical operation in terms of the investment at

stake is so small that no pooling of risk is required to encourage competition. So long, then, as joint bidding is freely permitted there exists the potential that industry may use this device to obtain Federal leases at less than their true market value.

We recommend, then, that the restriction on joint bidding, exactly as stated in Section 105(a-d) of the Energy Policy and Conservation Act of 1975 (42 USC 6213), should be extended to cover the bidding for any right to develop crude oil, natural gas, and natural gas liquids on Federal lands other than those located on the Outer Continental Shelf.

We judge that the competition that can be expected in the bidding for western Federal coal lands is too fragile to allow the further dilution that unrestricted joint bidding would bring. We do not find the risks involved in undertaking the initial development of a coal tract to be of a large enough magnitude to justify unrestricted joint bidding. We conclude that a restriction on joint bidding, similar to that contained in Section 105 of the Energy Policy and Conservation Act of 1975 (42 USC 6213) should be extended to cover the bidding for any right to develop coal on Federal lands. We recommend, further, that the firms which are to be restricted from bidding with each other in joint coal ventures shall be those firms producing more than 25 million tons of coal annually.

In Section 6 the recent beginnings of a prototype shale oil industry on Federal lands are reviewed. Here technological uncertainties dominate

the picture. Experience is too limited to predict the future or, indeed, even the existence of this new industry with any assurance. One set of lease sales has taken place; more sales await the experiences gained in the early developmental stages of the four tracts already leased. The risk involved in a shale oil venture is high and might therefore appear to justify allowing joint bidding to make entry into competition more attractive. But the risk seems to be more at the development stage of the venture -- like some of the more advanced coal conversion proposals -- than at the discovery stage -- like OCS oil. There is the possibility, then, that means other than joint bidding can be found which will enable bidders to share these risks with other firms. Since new leasing in any quantity is, in any event, to be postponed until more developmental experience is gained on the four tracts already leased, it is appropriate to defer any action on a joint bidding restriction as well.

We recommend, then, that the decision on whether to restrict joint bidding for Federal oil shale lands be postponed to that time -- possibly three or four years hence -- when sufficient evidence on development and production experience shall have accumulated to warrant the resumption of leasing. At that time it will be more nearly feasible to assess the incidence of risk on the winner of an oil shale lease.

#3

SUGGESTED REVISION OF HOUSE BILL NO. 854

~~Deleted~~

(f) The commissioner may provide for the establishment of a drilling incentive credit system whereby a lessee drilling a well deemed to be an exploritory well on state lands may earn credits based on the footage drilled and the region in which the well is sited. Such credits are assignable, shall be effective for a limited period and may be used during that period toward a bid in a state lease sale, for royalty, lease rental or severance tax payments. In the same manner and under the same conditions the commissioner may provide for credits to be earned by persons doing geophysical work on state lands, provided that such work is performed during a period of two seasons prior to an announced lease sale on lands in the sale area. Such geophysical data shall become public after the sale has occurred.

b) (1) The commissioner shall annually prepare and submit to the legislature, between the first and the fourteenth day of each regular legislative session, a proposed oil and gas leasing program specifying as precisely as practicable the location of tracts proposed to be offered for oil and gas leasing during the third and fourth calendar years following the calendar year in which the proposed program is submitted to the legislature. Within 60 days after receiving the proposed oil and gas leasing program the legislature may by concurrent resolution disapprove all or any part of the proposed leasing program.

(2) Except as provided in (3) of this subsection, no oil and gas lease issued by the commissioner shall be valid unless it was included in a proposed leasing program submitted to the legislature during the third and fourth calendar years preceeding the year in which the lease is issued and was in a part of the program not disapproved by the legislature, except that an area proposed for leasing in the fourth calendar year after the year in which the program is submitted to the legislature may be leased if the commissioner reproposes the area to the following regular legislative session, and the area is not subsequently disapproved in accordance with (1) of this subsection.

(3) The commissioner may issue oil gas leases that have not been submitted to the legislature in accordance with (1) of this subsection if:

(A) the land to be leased was previously subject to a valid state of federal oil and gas lease;

(B) the land to be leased is contiguous to land already under state, federal or private lease, is no more than 5760 acres in area, and the commissioner finds, after hearing, that leasing of the land would result in a substantial probability of exploratory drilling activity on or adjacent to the land to be leased; or

(C) the land to be leased is adjacent to land owned or controlled by another party on which a discovery of commercial quantities of oil or gas has been made, and where the commissioner finds, after hearing, that a reasonable probability that the land to be leased contains oil or gas in communication with the oil or gas discovered on the land of the other party.

* Sec. 5. Transitional Provision. By the 14th day of the first session of the Eleventh Legislature the Commissioner of Natural Resources shall submit a proposed oil and gas leasing program to the legislature in accordance with AS 38.05.180(b), except that the proposed program shall cover all areas to be leased in 1979 through 1983. No lease, except as authorized under AS 38.05.180(b)(3), shall be issued during 1979, 1980, or 1981 unless it was included in this proposed leasing program, and was not disapproved by the legislature by concurrent resolution within 60 days of the date it received the proposed program.

Oil, Gas & Mineral Properties

# LUM LOVELY, Geologist

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Phone (907) 277-1551

April 4, 1978

The Hon. C. V. Chatterton
Alaska House of Representatives
Pouch V
Juneau, Alaska 99811

Re: House Bill 854

Dear "Chat":

I believe I've already mentioned to you that, in my opinion, the best interests of the State, the major oil companies, and independents alike will continue being served best by current oil and gas leasing laws. Not only is HB 854 not needed, it would in fact be counter productive in that it would thwart, rather than encourage, new exploration for oil and gas in Alaska. It also sets the stage for a burgeoning bureaucracy which the taxpayer needs like a hole in the head, and it begs for State encroachment into sectors of the oil business which would best be left in the hands of private enterprise.

In the event that HB 854 is enacted, it should at least contain a provision to retain our present system of non-competitive oil and gas leasing, for legal and moral as well as practical reasons.

For two years, now (since April 19, 1976), the State has been legally obligated under AS 38.05.145(b) to issue non-competitive leases on at least 100,000 acres that I know of in the Becharof Lake area on the Alaska Peninsula. These leases will have to be issued even if AS 38.05.145(b) is repealed with enactment of HB 854, that is, unless the repeal is made retroactive to a date preceding the State's original leasing obligation date. To make the repeal retroactive, however, would call for an immoral, if not illegal, breach of trust on the part of the Administration (who authored the bill). I would of course also view a retroactive repeal as a reprehensible abuse of legislative power.

From a practical standpoint, non-competitive leasing as we know it today is also needed in order to encourage exploration in Alaska's little explored, remote, and/or geologically questionable oil and gas provinces. Some specific practical as well as moral and legal reasons why non-competitive leasing must be retained for Susitna Basin (and similar low-priority areas) are set forth in my letter of March 31, 1978, to Natural Resources Commissioner Robert E. LeResche.

Rep. C. V. Chatterton April 4, 1978

After you have had an opportunity to read the enclosed copy of my letter to Mr. LeResche, I hope you will see your way clear to do what you can to kill HB 854 altogether. Barring that, any pressure which you or your colleagues can bring to bear to retain our present non-competitive leasing law through appropriate amendments to HB 854 will be greatly appreciated.

Very truly yours,

LUM LOVELY

Encl.

Copy: Robert E. LeResche, Commissioner of Natural Resources
Steve Cowper, Chairman, House Finance Committee
Alvin Osterback, Chairman, House Resources Committee
Samuel R. Cotten, Chairman, House Rules Committee
Joseph L. Orsini, Alaska Senate
Kay Poland, Chairman, Senate Resources Committee
Joseph P. Green, Director, DMEM, Anchorage
Patrick Dobey, Petroleum Manager, DMEM, Anchorage
Jack Roderick, Special Projects, DMEM, Anchorage
Gregg Erickson, Director, Div. of Research, Leg. Affairs Agcy.
Wm. W. Hopkins, Alaska Oil & Gas Association, Anchorage

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March 31, 1978

Dr. Robert E. LeResche, Commissioner
Alaska Department of Natural Resources
Pouch M
Juneau, Alaska 99811

Re: Issuance of non-competitive oil and gas leases in Susitna Basin

Dear Dr. LeResche:

It has just come to my attention that you or Governor Hammond will be announcing within the next few days that a relatively small area near Flaxman Island on the North Slope will soon be opened for competitive oil and gas leasing, and that many non-competitive oil and gas (and coal?) leases will finally be issued by the State pursuant to applications filed by numerous individuals as long as 2½ years ago. It is also my understanding that you will be announcing your intention to reject all currently pending non-competitive lease applications filed by oil and gas companies in Susitna Basin (many were filed nearly 2 years ago), in order that the land now covered by those applications might be reclassified for competitive oil and gas leasing only.

Your proposed North Slope competitive lease sale will surely generate spirited bidding because of Exxon's recent nearby oil discovery. And, you are certainly to be commended for acting affirmatively at long last on those non-competitive oil and gas lease applications which so many individuals filed in good faith so many years ago. If you have been adivsed that competitive interest will be high in those areas which are now covered by oil company applications for non-competitive leases in Susitna Basin, however, then your advisors are sadly out of touch with reality.

As an independent geologist who makes his living principally from oil and gas leasing activities, and as the one person who has more leasing experience in Susitna Basin than any other individual, I can assure you on the basis of real world experience that interest in Susitna Basin is extremely low at this time despite Union Oil Company's current reconnaissance seismic activities in the southwestern corner of the basin.

Rejection of oil company applications in Susitna Basin at this time will serve only to dampen what little interest there is in Susitna Basin already. Even if competitive interest were eventually to develop in the basin, however, required cumbersome and time consuming pre-leasing and leasing procedures would necessarily result in undue delays in exploration and development activities. If it is your intention to encourage early exploration for natural gas and/or oil in Susitna Basin, therefore, you will approve, rather than reject, all oil company non-competitive oil and gas

lease applications in the Basin, forthwith, just as you contemplate doing for those non-competitive lease applications which were filed by individuals in the area.

Please bear in mind that Susitna Basin is an extremely low-priority geologic province where oil possibilities are believed to be nil and possibilities for natural gas are marginal at best. The sedimentary section is thin in Susitna Basin, and structural information there is extremely scarse.

Moreover, hundreds of thousands of acres remain unleased (or even applied for) in the basin, despite the fact that this land has been available for non-competitive oil and gas leasing for many years now. I also wish to stress that Texaco dropped its oil and gas leases on over 150,000 acres in Susitna Basin after first conducting an extensive seismic program there some eight years ago. Furthermore, to my knowledge Texaco has no plans to drill its remaining 70,000 acres of leases in the basin before they expire next December.

I also think you should know that oil companies haven't exactly been stumbling all over themselves trying to buy my leases in Susitna Basin, either. It took me 7½ years to sell my 40,000-acre Yentna River lease block (to Union Oil Company and Pacific Lighting) in the southwest part of the basin, for example, and, after nearly eight years, I still haven't found any takers for my 47,000-acre Highway Bridge lease block in the east-central part of the basin despite the fact that Union Oil Company is now conducting seismic operations only 25 miles away. As a matter of fact, I still own leases in the immediate vicinity of Union's current shooting area which I haven't yet been able to sell or farm out!

I caution you not to interpret as an indication of high general interest the over-the-counter non-competitive oil and gas lease applications which Amarex Inc. and Gas Supply Corporation of Alaska (GASCOA, a subsidiary of Anchorage Natural Gas) filed jointly on 40,000 acres in the southeastern part of the basin, and on 36,000 acres in the north-central part of the basin nearly two years ago. These companies are so cautious about Susitna Basin, in fact, that, prior to filing the aforementioned applications, they were unwilling to purchase either my Yentna River lease block (which Union Oil and Pacific Lighting now own) or my Highway Bridge lease block, even for as little as $3.00 per acre (my rental investment at that time). In their view, there were (and still are) simply too many geological unknowns in Susitna Basin to justify spending more than a state filing fee of $20.00 per application plus the required annual rental of 50¢ per acre for leases there. Inasmuch as Amarex and GASCOA filed their applications with my help, I can also attest to the fact that their applications cover prospects which are inferred, only, on the basis of best-guess extrapolations from old, incomplete, and now publicly available seismic data which Pure Oil Company filed with the U.S.G.S. over 14 years ago.

Neither should you misconstrue Union Oil Company's recent over-the-counter filings for oil and gas leases in Susitna Basin as an indication that an abundance of favorable geological data is available in that area.

As a matter of fact, in filing its recent applications for non-competitive oil and gas leases on approximately 100,000 acres west of Mt. Yenlo, Union Oil Company had even less geological information to go on than Amarex and GASCOA had when they filed their aforementioned applications elsewhere in Susitna Basin. No outcrops are present where Union filed, for example, and neither has any seismic exploration ever been conducted in the area. Moreover, it should be obvious from the simple rectangular pattern of Union's filings west of Mt. Yenlo that the company hasn't the foggiest notion of what to expect geologically in the area. It would therefore be unrealistic, indeed, to expect Union (or anyone else, for that matter) to pay any more for leases in the area than the small filing fees and rentals which are presently required for state non-competitive leases.

Amarex, GASCOA (now McAlester Fuel Company), and Union Oil Company obviously filed their respective non-competitive oil and gas lease applications in Susitna Basin with the intention of eventually exploring large areas where geologic information is currently sparse or non-esistent. In data deficient areas such as these, however, history shows that 90% or more of the land will be condemned geologically by future exploration. These companies are therefore faced with the unpleasant task of condemning most is not all of their respective areas of interest as cheaply as possible!

In these circumstances, of course, it would be totally unrealistic to expect that any of the aforementioned companies (or any others) would suddenly become spirited bidders for competitive leases in any of the geologically questionable areas mentioned above. In fact, it is safe to say that no exploration whatsoever will be initiated in the aforementioned areas by either Amerex, McAlester, or Union Oil unless inexpensive non-competitive leases are first issued to them by the State pursuant to their currently pending applications

The facts make it clear that reclassification of the aforementioned areas for competitive leasing, only, would result in postponement, if not total abandonment, of new exploration and development efforts in Susitna Basin. The question is, however, "Can the State afford to block exploration in Susitna Basin at this time in hopes that competitive interest in the area may pick up at some indefinite time in the future?" I don't believe it can. Here's why.

As you know, Mr. Pat Dobey of the Division of Minerals and Energy Management here in Anchorage has warned the Administration and the public that the Anchorage Bowl area will be faced with a critical shortage of natural gas by 1985 (just seven years from now), unless more discoveries are made in south-central Alaska soon, or, in the alternative, unless a state-built-or-subsidized gas pipeline is laid from Prudhoe Bay to Anchorage.

It would of course be unwise for the State to spend taxpayers' money on a gas pipeline from Prudhoe Bay to Anchorage, when oil companies such as those who have filed for non-competitive leases in Susitna Basin appear ready, willing, and able to spend money from the private sector to explore for and develop natural gas reserves right here in Anchorage's own back yard.

It therefore behooves the State to approve the aforementioned oil companies' non-competitive oil and gas lease applications, forthwith, in order to clear the way for new exploration in Susitna Basin as soon as possible. Remember, Anchorage is rapidly running out of gas, and new discoveries of oil and gas generally require lead times ranging from five to ten years. The State simply cannot afford to hold up development in Susitna Basin any longer. To do so would be totally irresponsible.

While new exploration in Susitna Basin could be highly beneficial to the State of Alaska in general, and to Anchorage natural gas consumers in particular, it could also result in a significantly broadened tax base for the Matanuska-Susitna Borough in which Susitna Basin is situated. Obviously, any further impediments to early leasing, exploration, and development in the aforementioned areas will definitely not be in the best interests of the Matanuska-Susitna Borough. It is therefore to be expected that your proposal to reclassify lands for competitive leasing in Susitna Basin will be denounced by the Matanuska-Susitna Borough Assembly and Planning Department when your competitive reclassification proposal comes up for notice and review pursuant to Section 38.05.305 of the Alaska Statutes. Undue delay in broadening the borough's tax base could be avoided, of course, if you would simply approve all currently pending oil-company (and individually-filed) applications for non-competitive oil and gas leases in Susitna Basin forthwith.

While I believe you can justify immediate approval of all pending non-competitive oil and gas lease applications in Susitna Basin on the basis of the foregoing reasons alone, you must of course also consider the moral and legal aspects of your forthcoming proposal to reject all lease applications filed by oil companies while approving similar applications filed by individuals.

First of all, it must be remembered that all of the now-pending applications were filed in good faith pursuant to laws and regulations which were in effect when the applications were filed (and still are in effect). Moreover, it clear that most of these applications would have been approved already, were it not for the current land freeze.

The land freeze, of course, was originally designed to protect certain aggrieved parties until such time that their grievances could be reconciled by the courts and/or the Legislature (these grievances have since been reconciled). It was not intended to be used as a means of cheating oil companies out of non-competitive oil and gas leases when it was first instituted, and it should not be used as a weapon to be turned against oil companies now.

The oil companies which are involved here (and individuals, too, for that matter) have filed their lease applications pursuant to laws and regulations which are supposed to protect their first-priority rights to the lands in which they have revealed their interest to the world in good faith (their areas of interest are described in their applications, of course, and their applications are on public file for all to see). Accordingly, use of the land freeze as a means of selectively blocking the issuance of leases to

oil companies, while allowing the issuance of such leases to individuals, not only would constitute a reprehensible breach of trust on the part of the admininstation but also would serve double duty as an arbitrary and capricious abuse of administrative power which probably could be challenged successfully in court.

While oil and gas possibilities in Susitna Basin are generally considered to be marginal (even by those oil companies now holding oil and gas leases and lease applications in the area), the element of surprise in oil and gas exploration is such tnat significant reserves of oil and gas could nevertheless be discovered there. For a low-priority area such as Susitna Basin, however, economic incentives for exploration must be unusually attractive. You can provide this needed incentive, of course, simply by making it easy for everyone (including oil companies) to assemble large blocks of inexpensive non-competitive oil and gas leases in the area.

An early increase in the rate of exploration and development in Susitna Basin will clearly bring economic benefits not only to the State but to the Matanuska-Susitna Borough as well. It will also provide new jobs for oil workers, and it will stimulate new business for the service companies. Moreover, by making it known that you are clearing the way for possible early discoveries which could prevent the occurrence of an impending natural gas crisis in the Anchorage area, you could make considerable political hay in this important election year.

The foregoing observations make it obvious that competitive leasing will not stimulate urgently needed new exploration for oil and gas in Susitna Basin, whereas non-competitive oil and gas leasing will. I therefore urge you to reconsider your present plans to reclassify lands in Susitna Basin for competitive leasing only, and, instead, to approve all presently pending applications which oil companies and individuals alike have filed for non-competitive oil and gas leases in the area to date. I also urge you to lift the current land freeze in order to clear the way for future non-competitive oil and gas leasing in Susitna Basin. The sooner you take these important steps, of course, the sooner exploration can get under way, and the better it will be for all parties concerned.

Very truly yours,

L. C. LOVELY

Copies to: Jay S. Hammond, Governor, Juneau
Joseph P. Green, Director, DMEM, Anchorage
Patrick Dobey, Petroleum Manager, DMEM, Anchorage
Jack Roderick, Special Projects, DMEM, Anchorage
Gregg K. Erickson, Director, Div. of Research, Juneau
Lance Garola, Mat-Su Borough Planning Department, Palmer
Rep. C. V. "Chat" Chatterton, Juneau

(continued)

(continued)

Copies to: Senator Joseph L. Orsini, Juneau
Dale Teel, President, Alaska Gas & Service Co., Anchorage
R. L. Rich, Manager of Land, Amarex Inc., Oklahoma City
W. B. "Buzz" Sawyer, V. P., McAlester Fuel Co., Magnolia, Ark.
Wayne Rodges, Land Manager, Union Oil Co., Anchorage
Wm W. Hopkins, Executive Director, AOGA, Anchorage
Don Hartmen, Exploration Representative, Texaco Inc., Anchorage

SUMMARY OF ACREAGE LIMITATION
CHANGE IN HB 854

The acreage any one State lessee may hold is 500,000 acres upland and 500,000 acres offshore. HB 854 reduces the uplands to 200,000 acres. This is to help increase the number of upland lessees by limiting the holdings of the larger major oil companies. Offshore holdings will be unaffected.

No other state that we are aware of has an acreage limitation. But no other state is Alaska's size nor has any state tens of millions of acres available to lease.

The Federal government has an acreage maximum for its uplands within each state. During Alaska's territorial days the Federal oil and gas acreage limitation in Alaska was 100,000 acres. In other states it was 46,080 acres.

After 1961 the Federal maximum for Alaska rose to 300,000 acres in the Northern district (approximately north of the Yukon River) and 300,000 in the Southern district. These apply today. There is no Federal acreage limitation on the Outer Continental Shelf. Presently, the acreage limitation is 246,080 uplands acres of Federal leases per state, other than Alaska.

HB 854 grants companies five years from the effective date of the act to comply with the 200,000 upland acre maximum.

A list of major leaseholdings as of February, 1978, (showing uplands and offshore holdings of those companies which now exceed 200,000 acres) follows:

# ALASKA OIL AND GAS ACREAGE HOLDINGS
(as of March 13, 1978)

| COMPANY | ACRES | | |
|---|---|---|---|
| ARCO | 408,151.21 | 356,882.86 | acres of uplands |
| | | 51,268.35 | offshore |
| | | 408,151.21 | total |
| UNION | 287,032.83 | 233,138.75 | uplands |
| | | 53,894.08 | offshore |
| | | 287,032.83 | total |
| PHILLIPS PETROLEUM | 243,227.94 | 80,332.74 | uplands |
| | | 162,895.20 | offshore |
| | | 243,227.94 | total |
| EXXON | 158,627.73 | | |
| TEXACO | 156,027.03 | | |
| SOHIO PETROLEUM | 135,588.28 | | |
| BP ALASKA | 103,218.99 | | |
| CITIES SERVICE | 140,071.58 | | |
| CHEVRON | 126,493.55 | | |
| AMOCO | 126,134.64 | | |
| MOBIL | 120,375.19 | | |
| MARATHON OIL | 71,538.36 | | |
| BEARD OIL | 71,260.49 | | |
| SHELL OIL | 40,603.10 | | |
| GETTY | 29,857.30 | | |
| SUN OIL | 27,453.87 | | |

WORK DRAFT
INCORPORATING CHANGES
MADE UP TO 4/9/78

ERICKSON
4/10/78

Introduced: 2/17/78
Referred: Resources and Finance

IN THE HOUSE

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

HOUSE BILL NO. 854

IN THE LEGISLATURE OF THE STATE OF ALASKA

TENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to the leasing and exploration of state land for oil and gas development."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

Section 1. AS 38.05.180 is repealed and re-enacted to read:

Sec. 38.05.180. OIL AND GAS LEASING. (a) The legislature finds that

(1) the people of Alaska have an interest in the development of the state's oil and gas resources to

(A) maximize the economic recovery of the resources;

~~(B) minimize the exploitation of these natural resources in protection of the public interest;~~

B (C) maximize competition among parties seeking to explore and develop the resources;

C (D) maximize use of Alaska's human resources in the development of the resources;

(2) it is in the best interests of the state to encourage an assessment of its oil and gas resources and to allow the maximum flexibility in the methods of issuing leases to

(A) recognize the many varied geographical regions of the state and the different costs of exploring for oil and gas in these regions;

~~(B) recognize the need for stimulating development in particular regions of the state;~~

B (C) minimize the adverse impact of exploration, develop-

ment, production, and transportation activity, ~~on the environment of the state;~~

(B) maximize state revenue from profitable oil and gas production, while minimizing revenue from unsuccessful exploration and from marginal economic oil and gas production.

b) (1) The commissioner shall annually prepare and submit to the legislature, between the first and the fifteenth day of each regular legislative session, a proposed oil and gas leasing program specifying as precisely as practicable the location of tracts proposed to be offered for oil and gas leasing during the third and fourth calendar years following the calendar year in which the proposed program is submitted to the legislature. Within 60 days after receiving the proposed oil and gas leasing program the legislature may by concurrent resolution disapprove all or any part of the proposed leasing program.

(2) Except as provided in (3) of this subsection, no oil and gas lease issued by the commissioner shall be valid unless it was included in a proposed leasing program submitted to the legislature during the third and fourth calendar years preceeding the year in which the lease is issued and was in a part of the program not disapproved by the legislature, except that an area proposed for leasing in the fourth calendar year after the year in which the program is submitted to the legislature may be leased if the commissioner reproposes the area to the following regular legislative session, and the area is not subsequently disapproved in accordance with (1) of this subsection.

(3) The commissioner may issue oil gas leases that have not been submitted to the legislature in accordance with (1) of this subsection if:

(A) the land to be leased was previously subject to a valid state of federal oil and gas lease;

(B) the land to be leased is contiguous to land already under state, federal or private lease, is no more than 5760 acres in area, and the commissioner finds, after hearing, that leasing of the land would result in a substantial probability of exploratory drilling activity on or adjacent to the land to be leased; or

(C) the land to be leased is adjacent to land owned or controlled by another party on which a discovery of commercial quantities of oil or gas has been made, and where the commissioner finds, after hearing, that a reasonable probability that the land to be leased contains oil or gas in communication with the oil or gas discovered on the land of the other party.

(4) Simultaneously with submission of the leasing program required under (1) of this subsection, the commissioner shall submit to the legislature a report containing the following:

(A) the schedule of all lease sales held during the preceding calendar year, the bidding method or methods utilized and an analysis of the results of the bidding;

(B) a description of all lease sales to be held during the current and next two succeeding calendar years and, if determined, the bidding methods to be used;

(C) the reasons a particular bidding method has been selected.

(c) The commissioner may issue oil and gas leases on state land to the highest responsible qualified bidder determined by competitive bidding under regulations adopted by the commissioner. Bidding may be by sealed bid or according to any other bidding procedure the commissioner determines is in the best interests of the state. Whenever, under any of the leasing methods listed in this subsection, a royalty share is reserved to the state, it is free of all lease or unit expenses, including but not limited to separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation off the lease or unit area. Following a pre-sale analysis, the commissioner may choose at least one of the following leasing methods:

(1) bonus bidding

(A) a cash bonus bid with a fixed royalty share reserved to the state of not less than 12 1/2 per cent in amount or value of the production removed or sold from the lease or unit area encompassing the lease;

(B) a cash bonus bid with a fixed royalty share reserved to the state based on a sliding scale according to volume of production but in no event less than 12 1/2 per cent in amount or value of the production removed or sold from the lease or unit area encompassing the lease;

(2) royalty bidding

(A) a fixed cash bonus with a royalty share reserved to the state as the bid variable but not less than 12 1/2 per cent in amount or value of the production removed or sold from the lease or unit area encompassing the lease;

(B) a fixed cash bonus with a royalty share reserved to the state based on a sliding scale according to the volume of production as the bid variable but not less than 12 1/2 per cent in amount or value of the production removed or sold from the lease or unit area encompassing the lease;

(3) net profit bidding

(A) a cash bonus bid with a fixed royalty share reserved to the state of not less than 12 1/2 per cent in amount or value of the production removed or sold from the lease or unit area encompassing the lease and a fixed share of the net profit derived from the lease of not less than 30 per cent reserved to the state;

(B) a fixed cash bonus with the share of the net profit derived from the lease reserved to the state as the bid variable;

(C) a fixed cash bonus with a fixed royalty share reserved to the state of not less than 12 1/2 per cent in amount or value of the production removed or sold from the lease or unit area encompassing the lease with the share of the net profit derived from the lease reserved to the state as the bid variable;

(D) the share of the net profit derived from a lease reserved to the state under this subsection is royalty sale proceeds for the purpose of the Alaska Permanent Fund under AS 37.10.065;

(4) a work commitment bid with a fixed cash bonus, or a fixed royalty or a fixed sliding scale royalty or a fixed net profits share reserved to the state, or any combination of these methods, at the discretion of the commissioner, with a work commitment stated in a dollar amount as the bid variable; however, in no event may a royalty

share reserved to the state be less than 12 1/2 per cent in amount or value of the production removed or sold from the lease or unit area encompassing the lease.

(d) To prolong the economical life of an oil and gas field, the commissioner shall adopt regulations for all bidding methods to allow reduction of royalty to compensate for increasing costs in the later stages of production decline. The commissioner may grant such a reduction of royalty so long as the reduced royalty begins no sooner than two years after initial production from the lease.

(e) The commissioner may, in his discretion, defer any part of the payment of a cash bonus, under (c) of this section, according to a schedule announced at the time of the announcement of the lease sale, but such payment shall be made in total no later than five years from the date of the lease sale.

~~(f) The commissioner may withhold acreage from leasing in a particular lease sale.~~

(g) The commissioner shall adopt regulations governing the calculation of net profits for lease sales under (c)(3) of this section. In the event of any dispute between the state and a lessee concerning the calculation of the net profits under the regulation adopted under this subsection, the burden of proof is on the lessee.

(h) The commissioner shall adopt regulations governing the exploration work commitment leasing method under (c)(4) of this section. The commissioner shall require either (i) a cash deposit for 20 per cent of the work commitment or, (ii) a performance bond, in form and substance and with a surety satisfactory to the commissioner, in the principal amount of 20 per cent of the exploration work commitment assuring the commissioner that the commitment will be faithfully discharged in accordance with this section, the regulations, and the lease.

A lessee who fails to discharge a work commitment in its entirety is liable to the state for the undischarged portion of the commitment. At his discretion, the commissioner may terminate the work commitment if he finds that the work would be unnecessary or cumulative.

h (f) At his discretion, the commissioner may enter into an agreement whereby, with the consent of the lessee, the state's royalty share of oil and gas production may be stored or retained in storage by the lessee, or the commissioner may enter into an agreement with one or more of the affected field lease holders to trade current royalty production from a field for a like amount, kind, and quality of future production, on the condition that the state receives back its stored or traded royalty share during the first half of the estimated field life or no later than 15 years after start of production, whichever is sooner.

i (f) An oil and gas lease must cover a reasonably compact area not exceeding 5,760 acres, and must be for a period of five years. The commissioner may grant a lease for a term greater than five years but not to exceed 10 years, where he finds that the longer period is necessary to encourage exploration and development in areas where environmental conditions severely restrict operations. An oil and gas lease shall be automatically renewed if 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. A lease issued under this section covering land on which there is a well capable of producing oil or gas in paying quantities does not expire because the lessee fails to produce oil or gas unless the lessee is allowed reasonable time to place the well on a producing status. Upon renewal, the commissioner may increase lease rentals so long as the increased rental rate does not exceed 150 per cent of the rate for the

preceding year. The commissioner may provide by regulation and in the lease that the lessee may earn production rights only to the depth drilled at the beginning of production from the lease. If drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, including such operations as redrilling, sidetracking, or other means necessary to reach the originally proposed bottom hole location, the lease continues in effect until 90 days after drilling has ceased and for so long thereafter as oil or gas is produced in paying quantities.

j(k) The commissioner may establish by regulation that after a well has been plugged and abandoned, the rental rate which was in effect during the year of abandonment is maintained for the remainder of the term. Rental is payable in advance and continues until income to the state from royalty, net profit, or exploration work commitment exceeds rental income to the state for that year; after the rental income schedule has been exceeded for three consecutive years, the rental terminates. Oil and gas leases shall provide for payment to the state of rental on the following basis:

(1) for the first year, $1.00 per acre;

(2) for the second year, $1.50 per acre;

(3) for the third year, $2.00 per acre;

(4) for the fourth year, $2.50 per acre;

(5) for the fifth year, $3.00 per acre.

k(l) Upon timely application as provided by regulation, the state may issue to the holder of a federal or private lease, a state shorelands lease covering land within the exterior boundaries of the federal or private lease which has been excluded on the basis of navigability or which is later administratively or judicially determined to be shoreland. The term of such a state shoreland lease shall be the same

as the term of the federal or private lease, but may not exceed five years.

(l) To conserve the natural resources of all or a part of an oil or gas pool, field, or like area, whether or not the part is then subject to a cooperative or unit plan of development or operation, lessees and their representatives may unite with each other, or jointly or separately with others, in collectively adopting or operating under a cooperative or a unit plan of development or operation of the pool, field, or like area, or a part of it, when determined and certified by the commissioner to be necessary or advisable in the public interest. The commissioner may, with the consent of the holders of leases involved, establish, change, or revoke drilling, producing, rental minimum royalty, and royalty requirements of the leases and adopt regulations with reference to the leases, with like consent on the part of the lessees, in connection with the institution and operation of a cooperative or unit plan as he determines necessary or proper to secure the proper protection of the public interest. The commissioner may require oil and gas leases issued under this section to contain a provision requiring the lessee to operate under a reasonable cooperative or unit plan, and he may prescribe a plan under which the lessee must operate. The plan must adequately protect all parties in interest, including the state.

(m) A plan authorized by (l) of this section, which includes land owned by the state, may contain a provision vesting the commissioner, or a person, committee, or state agency with authority to modify from time to time the rate of prospecting and development and the quantity and rate of production under the plan. All leases operated under a plan approved or prescribed by the commissioner are excepted in determining holdings or control under sec. 140 of this

chapter. The provisions of this section concerning cooperative or unit plans are in addition to, and do not affect AS 31.05.

(n) Producing acreage on a known geologic structure of a producing oil or gas field is excluded from chargeability as against the acreage limitation provisions of sec. 140 of this chapter.

(o) When separate tracts cannot be individually developed and operated in conformity with an established well-spacing or development program, a lease, or a portion of a lease, may be pooled with other land, whether or not owned by the state, under a communitization or drilling agreement providing for an apportionment of production or royalties among the separate tracts of land comprising the drilling or spacing unit when determined by the commissioner to be in the public interest. Operations or production under the agreement are considered as operations or production as to each lease committed to the agreement.

(p) The commissioner may, on conditions which he prescribes, approve drilling, or development contracts made by one or more lessees of oil or gas leases, with one or more persons, when, in his discretion, the conservation of natural resources or the public convenience or necessity requires it or the interests of the state are best served. All leases operated under approved drilling or development contracts, and interests under them, are excepted in determining holding or control under sec. 140 of this chapter. Drilling or development contracts may include, at the discretion of the commissioner, provisions authorizing the state to share in the costs of exploration.

(q) To avoid waste or to promote conservation of natural resources, the commissioner may authorize the subsurface storage of oil or gas whether or not produced from state land, in land leased or subject to lease under this section. This authorization may provide for the payment of a storage fee or rental on the stored oil or gas, or,

instead of the fee or rental, for a royalty other than that prescribed in the lease when the stored oil or gas is produced in conjunction with oil or gas not previously produced in paying quantities.

(i) Each oil or gas lease issued by the state must contain a provision requiring the lessee to furnish the Department of Labor a quarterly report regarding the employment of state residents on the leased property. The commissioner of labor shall adopt regulations necessary to implement thi subsection. No lease issued under this chapter is valid unless it contains provisions requiring the employment of qualified Alaska residents in accordance with AS 38.40.030, and complies in all respects with the requirements of ch. this title.

(j) Notwithstanding any other provision of this section, land which has been offered for lease within the previous five years but which received no bids at competitive sale may be, at the discretion of the commissioner, immediately offered for lease, under regulations adopted by him, upon terms appearing most advantageous to the state, including leasing noncompetitively. The commissioner shall use a sliding scale royalty based upon such formulae as he determines to be in the public interest but not less than 12 1/2 per cent at the beginning of production from the lease in amount or value of the production removed or sold from the lease or unit area encompassing the lease. A lease must provide for payment to the state of rental but need not adhere to the rental schedule in (k) of this section nor to the 5,760-acres-per-lease limitation in (j) of this section. The lease term may not exceed five years except as provided in (j) and (k).

(t) In accordance with regulations adopted in advance the commissioner, with respect to any individual oil and gas lease sale, may, for the purpose of promoting competition, restrict joint bidding among major oil and gas companies.

(u) Each oil and gas lease shall give to the state has the right to purchase not more than 16 2/3 per cent of the volume of oil and up to 49 per cent of the volume of gas produced from a lease issued in accordance with this section, at the regulated price, or, if no regulated price applies, at the fair market value at the point of sale, except that any oil or gas obtained by the state as royalty or net profits shall be credited against the amount that may be purchased under this subsection. Oil and gas purchases under this subsection shall be subject to the provisions of AS 38.06.

(v) A lessee or permittee conducting any exploration for, or development or production of, oil or gas on state land shall provide the commissioner access to all noninterpretive data obtained from that activity and shall provide copies of that data, as the commissioner may request. The confidentiality provisions of AS 38.05.035 shall apply to the information obtained under this subsection.

(w) The commissioner shall promulgate regulations as may be necessary to carry out the purposes of this chapter.

4/10/78

* Sec. 2. AS 38.05.135(b) is repealed and re-enacted to read:

(b) When minerals are to be leased, in addition to any other notice given, notice must also be given as provided in secs. 305 and 345 of this chapter.

* Sec. 3. AS 38.05.140(c) is amended to read:

(c) No person may take or hold at one time phosphate leases on state lands exceeding in the aggregate 10,240 acres. No person may take or hold sodium leases or permits during the life of sodium leases on state lands, exceeding in the aggregate acreage 5,120 acres, except that the commissioner may, where it is necessary in order to secure the economic mining of sodium compounds, permit a person to take or hold sodium leases or permits for up to 15,360 acres. No person may take or hold at any one time oil or gas leases exceeding in the aggregate 500,000 acres granted on tide and submerged lands, and 200,000 [500,000] acres on all land [LANDS] other than tide and submerged land [LANDS], including leases held both as lessee and under option or operating agreement from others. A person has five years from the effective date of this Act to conform to the 200,000-acre upland limitation. Where more than a single person holds an interest in an oil or gas lease, each person shall be charged only with that percentage of the total acreage which corresponds to its percentage share of the total beneficial interest in the lease.

* Sec. 4. AS 38.05.145(b) is repealed.

* Sec. 5. Transitional Provision. By the fifteenth day of the first session of the Eleventh Legislature the Commissioner of Natural Resources shall submit a proposed oil and gas leasing program to the legislature in accordance with AS 38.05.180(b), except that the proposed program shall cover all areas to be leased in 1979 through 1983. No lease, except as authorized under AS 38.05.180(b)(3), shall be issued during 1979, 1980, or 1981 unless it was included in this proposed leasing program, and was not disapproved by the legislature by concurrent resolution within 60 days of the date it received the proposed program.

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Anchorage, Alaska 99510
Telephone 907 277 5637

April 6, 1978

The Honorable Alvin Osterback
Chairman, Resource Committee
Alaska House of Representatives
Pouch V
Juneau, Alaska 99811

Dear Chairman Osterback:

Recently, Mr. Mark Singletary provided the Resources Committee with verbal testimony reflecting Atlantic Richfield Company's reaction to proposals contained in HB 854.

Attached is written commentary on HB 854 which I would respectfully request that the Committee consider and include in the official record of these proceedings.

Sincerely,

Dave Harbour

Dave Harbour
Director
Alaska State and Local
Government Relations

ATLANTIC RICHFIELD COMPANY COMMENTS ON
HOUSE BILL 854

"An Act relating to the leasing and exploration of state land for oil and gas development."

April 6, 1978

Comments on Section 1:

Sec. 38.05.180(a)(1)(B)

In the description of the legislative purposes of this bill, there is a negative connotation given the word "exploitation" in Sec. 38.05.180(a)(1)(B). This section in general suggests sinister motives to the oil and gas industry which need to be "minimized." A possible modification should read, "regulate the development of these natural resources in protection of the public interest."

Sec. 38.05.180(a)(2)

Underlying this section is the notion that it is in the State's best interest to maximize the leasing methods available to the State. However, it is our view that the new leasing methods proposed are largely untested and may result in reduced revenues to the State. Further, it is not at all clear how a unit agreement could ever be formulated for a group of lessees who had obtained their leases under a combination of the proposed bidding methods.

Sec. 38.05.180(b)

This section deals with the Commissioner's obligations to prepare a leasing program for the following 5 year period and his obligation to keep the legislature informed. We are in favor of such a long-range leasing program and support the State's acknowledged

goal of "stability and predictability" in a petroleum leasing program. However, the long-range benefits intended and the State's goal are frustrated by the ability, and, indeed requirement, that the Commissioner review and possibly revise the leasing program at least annually. Perhaps the possibility of revision could be limited to the last two years of the ongoing five year programs so that industry could expend exploration dollars with some certainty that a sale will be held. Alternatively, Sec. 38.05.180(b)(3) should be deleted.

The annual submission to the legislature of the leasing program, although for "its information," would seem to presuppose further modification of the leasing program. Again, opportunity for yearly modification of the leasing program abrogates the State's goal of a stable and predictable petroleum leasing system. As an alternative to reporting to the legislature, the Commissioner could be required to make an annual public report of the leasing program.

Additionally, in Sec. 38.05.180(b)(5)(E), the Commissioner is required to justify in his report to the legislature why more than 50 percent of an area is leased under any one method of leasing. This requirement of justification seems to be an incentive, if not explicit direction, to utilize the full array of leasing alternatives for any one sale and to, in effect, "experiment".

The language in Sec. 38.05.180(b)(2) is extremely confusing and should be clarified. Further, it is not clear whether or not this section is directed to or will have any effect, intended or otherwise, on the Beaufort Sea sale.

Sec. 38.05.180(c)

This section authorizes four generic categories or methods of leasing: (1) "Bonus bidding," (2) "Royalty bidding," (3) "Net profit bidding," and (4) a "Work commitment bid." Several combinations or variations of methods are authorized under each of the generic headings.

The first method of conventional bonus bidding has the best overall record from the lessor's standpoint. A study of federal OCS sales through 1975 showed that industry had invested $35 billion in bonuses, exploration and development on OCS leases while receiving $22 billion in revenue.

Net profit bidding opens up a multitude of problems as to the definition of "net profit." This method would allow many companies to get into a land position for speculative purposes. It is a

fierce deterrent to early drilling as it is far easier and cheaper to wait out the competition. It is extremely cumbersome to administer and audit, and is even more costly to operate than royalty bidding methods.

The last method of bidding, a work commitment for a lease which cannot, by definition, exceed 5,760 acres, seems completely unworkable as such an area is much too small. This method is usually used in European and mid-east concessions or Canadian permits or reservations which share a common characteristic of being very large geographic areas.

In each of the four leasing methods, the language describing the State's royalty is troublesome. Each description of the State's royalty provides, "... royalty share reserved to the state of not less than 12 1/2 cent in amount or value of the production removed or sold from the lease or unit area encompassing the lease ...." (emphasis added) This language would preclude anything but 100 percent state units. Unitization of lands involving federal or native lands and state lands would be impossible because of the inability of the participants to give the state at least 12-1/2 percent of the production from the "unit area encompassing the [state] lease."

Further, it should be noted that all of the methods and components of the alternate leasing methods will necessitate substantial increases in the budgets and personnel of the agencies involved.

Finally, if some minimum flexibility in leasing methods is desired, the same could be accomplished with minor changes in the existing law.

Sec. 38.05.180(d)

This section allows the Commissioner to reduce royalty when production becomes uneconomical, but only after two years of production. The most recent federal leases require only one year of production, which would be more in line with the stated goal of the bill to minimize revenue from marginal production. Given the explicit description of the royalty in Sec. 38.05.180(c) as "not less than 12 1/2 percent ...," it is not clear whether the Commissioner could ever reduce royalty to any figure below 12 1/2 percent.

Sec. 38.05.180(e)

This section purportedly authorizes the Commissioner to defer payment of any part of a cash bonus bid, provided the bonus is paid within five years. This authority is in direct conflict with AS 38.05.335(c), neither referenced nor repealed by the bill, which requires a deposit of 20 percent, in cash, of the bid.

Sec. 38.05.180(f)

This section authorizes the Commissioner to withhold acreage from leasing in a particular sale. It is assumed that the motive of

this provision is a desire to increase the state's income from leasing by leasing, for example, only part of a structure, and then, once proven productive, leasing the remainder for higher amounts. However, this authority to withhold acreage can just as easily decrease the state's income, in the event the first acreage leased is found non-productive -- which is usually the case. In essence, this section is authorization for the Commissioner to "gamble" on the productivity of state lands.

This section also seems unfair to the first lessees, who, if the first tracts leased prove productive, are faced with the prospect of having to buy themselves back into the fruits of their own risk at a higher rate.

Sec.'s 38.05.180(g) and (h)

These sections relate net profits and work commitment leasing which, as previously discussed, are ill-advised.

Sec. 38.05.180(i)

There are no objections to this section so long as the trading or storage of royalty oil remains and is clearly the subject of mutual agreement.

Sec. 38.05.180(j)

This section concerns several of the provisions to be included in state oil and gas leases:

First, this section reduces the primary term of state leases from 10 to 5 years. It should be understood that in most areas of Alaska the ability to carry out exploration work is limited to a four month period per year, consequently a five year lease allows only 1-2/3 years of exploratory work. This is clearly insufficient in such a high cost, high risk area.

Second, this section provides that a state lease will be "renewed", if and for so long thereafter as oil and gas is produced in paying quantities or if the lease is committed to a unit. The term "renewed" should be replaced with the term "extended" as this is the long-understood and recognized effect of production or commitment to a unit.

Third, the section's provision concerning shut-in wells should be clarified, since, in its present form, it appears as though the shut-in well must be located on the land prior to the issuance of a lease

Fourth, this section authorizes the Commissioner to increase rentals up to 150 percent of the preceding year's rate and to provide that a lessee earns production rights only to the depth drilled at the beginning of production. Both of these provisions should be deleted as unnecessary and unworkable.

As to rental increases, as noted, Alaska is already a high cost, high risk area. The prospect of substantial rental increases

during the primary term of a lease will serve only to curb exploration not encourage it.

The provision concerning production rights only as to the depth drilled is unnecessary and unfair. Aside from an obvious example of the lessee drilling into the top of a reservoir and being mechanically unable to go deeper and thereby losing the main body of the reservoir, it also could result in split owne·ship of a lease with one party having to drill through another's rights to reach his own with possible damage to the upper reservoir resulting.

Finally, the means of extending a lease by drilling are set forth in this section. Given the seasonal nature of drilling in Alaska, the 90 day grace period after drilling has ceased should be expanded if further drilling is prevented by environmental considerations or other circumstances imposed by the State.

Sec. 38.05.180(k)

The increased rentals proposed in this section will discourage exploration and will not increase income to the State because the extra expense will be compensated by lower bid totals. The present $1.00 per acre per year rental should be retained.

Further, this section alters substantially the nature of the ordinary rental provisions in oil and gas leases. The rental to be paid under these provisions is no longer a delay rental. This

section provides, "Rental is payable in advance and continues until income to the state from royalty, net profit, or exploration work commitment exceeds rental income to the state ... for three consecutive years ...." There is no provision for credit or set-off of rental paid during those three years against the state's income from production. Consequently, for the first three years of production, the state would receive both rental income and production income.

Sec. 38.05.180(l)

This section should be modified to provide that the state shall issue a State shorelands lease, as AS 38.05.180 presently reads. Also, the Commissioner should be given the discretion to grant a shorelands lease in excess of five years.

Sec.'s 38.05.180(m) and (n)

These two sections concern the unitization of state leases and are re-enactments of present law. However, given the alternate leasing methods of the bill, and the previously discussed, implicit direction to the Commissioner to "experiment" with these methods, unitization of state leases will be extremely difficult, if not impossible.

It is entirely reasonable to assume that under this bill, a proposed unit will be composed of leases involving highly disparate royalty percentages and one net profits or other kind

of lease. The extreme difficulty of applying these completely different lease burdens to the production allocated to each lease under a proposed unit are obvious. These difficulties constitute a disincentive to unitization and therefore nullify the conservation benefits of unitization.

Sec. 38.05.180(o)

This section concerns the acreage chargeability of KGS leases and is unobjectionable.

Sec. 38.05.180(p)

This section is a re-enactment of the present authorization for the pooling of state leases. Like the provisions concerning unitization, the problems inherent in alternate leasing methods will make pooling more difficult, to the detriment of the conservation objectives of pooling.

Sec. 38.05.180(q)

This section authorizes the State to share in the costs of exploration under a drilling or development contract. Oil and gas exploration is extremely risky and historically the province of private enterprise. Financial participation by the state in an exploration venture raises fundamental questions as to the appropriate role of state government. Given the fact that most wells drilled are unsuccessful, and the substantial sums involved in drilling in Alaska, additional challenges may be anticipated as to the authority or wisdom of the State to participate in a particular drilling project.

Sec. 38.05.180(r)

This section is a re-enactment of present law concerning the subsurface storage of oil or gas on state leases. However, the present law's provision concerning the extension of the lease used for storage for the period of storage and so long thereafter as oil and gas are produced was deleted. This extension provision should be retained.

Sec. 38.05.180(s)

This section concerns the employment of state residents on state leases is substantially the same as the existing law.

Sec. 38.05.180(t)

This section is an attempt by the state to encourage exploration on lands on which no bids have been tendered. This philosophy is laudable. However, the Commissioner should not be restricted by the leasing details of this section.

Sec. 38.05.180(u)

This section would restrict joint bidding and should be deleted. Joint bidding can very well be to the advantage of the state as it tends to increase the size of the bids submitted and facilitates the exploration process. See, for example, the paper in the November 1976 issue of "Journal of Petroleum Technology" in which the authors conclude that "joint bidders tend to bid on more sought-after (and apparently more valuable) leases and that they tend to bid higher, on the average, than solo-bidding

competitors". Industry testimony before the U.S. Senate has indicated that since the first OCS sale in 1954, 172 companies have purchased OCS leases. 42% of these leases were not purchased by the major companies, and in recent years the smaller companies have increased their share of OCS production at the expense of the major oil companies.)

Depending on the content of the regulations adopted, this section may violate Article 8, §17 of the Alaska Constitution. This Constitutional provision requires that laws and regulations governing the use or disposal of natural resources must apply equally to all persons "similarly situated".

Sec. 38.05.180(v)

This section grants the state an unfettered option to purchase 16-2/3 percent of oil and up to 100 percent of gas produced from a state lease. This section will in effect eliminate the lessee's ability to use the gas sales contract as a method of financing. Consequently, gas exploration in Alaska will be discouraged if not precluded. Similarly, if the state should wait several years before deciding to take up to 100 percent of the gas, the discoveror of a gas field would be deprived of all income from his legally obtained gas, because he could not enter into a contract with any other user. This section would also eliminate or impair the ability of lessees to utilize the production payment as a method of financing, likewise discouraging exploration.

Sec. 38.05.180(w) This section requires state access to all of a permittee or lessee's exploration data and should be eliminated from the bill. This section is, in essence, a confiscation of valuable proprietary data, for the sole purpose of deciding whether the explorer has found anything or not. If the state decides he has, the area could then be thrown open to all other competitors, thereby removing any incentive for an aggressive company to be a leader or employ innovative ideas to discover new resources. This section completely removes that incentive, and thereby will cause significant state natural resources to remain unsought.

In addition, grave problems as to the preservation of the confidential nature of the data are inherent in this section. It is common knowledge that such information is extremely confidential and closely guarded by the individual members of the industry.

The existing law upon which the oil and gas industry has relied for the confidentiality of information is contained in AS 38.05.035(a)(9)(C). This existing provision requires the director to keep geological, geophysical and engineering data confidential "upon request of the persons supplying the information." As the Bill's provision requires disclosure of information to the Commissioner, not the director, and since it requires also access, as distinct from supplying copies, are the confidentiality provisions incumbent upon the director not

applicable to the information required to be disclosed to the Commissioner?

If this section is to be applicable to existing exploration data, then the Commissioner's access and utilization of such existing data is almost certainly an unconstitutional taking of this valuable and expensive property. If the Commissioner is to be allowed access at all to such data, such access should be limited to future data only. Further, there should be a requirement of the adoption of regulations prescribing the confidentiality of this data and the addition of statutory criminal penalties for intentional disclosure of such data.

Section 2

There are no objections to this section concerning notice of mineral leasing.

Section 3

This section would amend AS 38.05.140(c) to reduce the upland acreage limitation from 500,000 acres to 200,000 acres. In Alaska, where there are large areas of state lands which are potentially eligible for bid, a 500,000 acre limitation, which the present statute contemplates, is not unreasonable. The effect of a 200,000 acre limitation would clearly be to limit the participation of those individuals who are most active in exploration business in Alaska, i.e., those individuals who have

historically submitted the highest bids to the state. It is not at all clear why the state would seek to discourage, rather than to encourage, the continued involvement of those individuals in Alaska. Further, this section's applicability to the holding of existing lessee's -- requiring them to reduce their holdings within 5 years -- is an unconstitutional taking of leasehold estates.

# STATE OF ALASKA
# THE LEGISLATURE

POUCH Y - STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

## LEGISLATIVE AFFAIRS AGENCY

File

March 15, 1978

MEMORANDUM

SUBJECT: Leasing of State Land for Oil and Gas Development - HB 854 (W.O. #11/R)

TO: The Honorable Alvin Osterback

FROM: Gregg K. Erickson
Director of Research

You requested that we provide an analysis of this bill. We have done this below in a cursory manner, and have attached additional material provided by the Department of Natural Resources (DNR). We have also noted some areas where we see potential problems. You will undoubtedly be taking a great deal of testimony on this bill from DNR, the legislature's consultants (Milton Lipton and Mason Gaffney), and the industry. After you have heard the testimony we would be pleased to address any points that you may at that time wish to have analyzed in depth.

Under current law the state is restricted to leasing oil and gas lands under the bonus bid system, or by the non-competitive system, which is essentially a lottery. However, the use of the non-competitive system has been of little importance during the past fifteen years, since all lands of medium or high potential have been classified so as to make them only eligible for bonus bidding.

In recent years other jurisdictions, most notably the federal government, have been moving towards expanding the number of bidding systems that could be used in leasing oil and gas lands. The U.S. Senate and House of Representatives have passed different versions of a bill that would accomplish this, and are about to enter conference on this legislation.

The legislation before your committee, HB 854, resembles this federal legislation in a number of important ways. The major thrusts of both the Alaska bill and the federal legislation are directed at expanding a number of leasing systems that may be used by the government in disposing of its land, increasing the opportunities for smaller firms to participate in development of oil and gas resources, and at insuring that the government achieves an appropriate return for the leasing of its oil and gas lands. In addition, the federal legislation establishes

procedures for coordination and review of federal leasing plans by adjacent states, and establishes institutional arrargements for protection of the environment.

The attached material headed "Description of Leasing Methods in HB 854" sets out in summary form the systems that would be allowable under the Alaska legislation as it now stands. Also attached is a memorandum from Mr. Jack Roderick to Commissioner LeResche which describes the rationale which went into choosing these systems. This particular memorandum has been released by the Department with the request that its circulation be restricted to legislators and legislative staff. All the other attached material may be released to the public, if you so choose.

Some points which you may particularly wish to look into in your consideration of HB 854 are noted below:

1. Legislative Review. The legislation calls for submission by the commissioner to the legislature of an annual "leasing program". The administration apparently intends that no lease would be issued unless "it is for an area included in" the program (page 2, line 19). If this is indeed the intent, it perhaps could be clarified by amending language at this point. In any case, the you should note that the bill has been carefully drafted to avoid any active involvement in leasing policy by the legislature. This, of course, is no change from the current policy, but under HB 854 the latitude of the commissioner, in choosing leasing systems and in other matters, has been substantially increased, and the legislature may wish to be more involved.

2. Expenses Charged Against Royalty Oil. The bill contains language (subsection (c), on page 4) which would insure that future leases are not subject to the same sort of dispute over the cleaning and dehydration costs as the state is now litigating with the Prudhoe Bay producers.

3. Choice of Leasing Systems by the Commissioner. Nowhere in the bill does the legislature give the Commissioner of Natural Resources any guidance as to when he should or should not use a particular leasing system. The commissioner is required, in his annual "leasing program" submission, to explain to the legislature why he believes a particular system should be used in a particular area. However, the choice and the adequacy of the justification remain beyond legislative review. In the attached material DNR has provided some explanation as to the conditions that would call for the use of one system or another. The legislature may wish to consider these explanations, and - if it agrees with them - may wish to include language within the law to give the commissioner (and future commissioners) guidance along these lines.

4. Work Commitment Bidding. Paragraph (4) (on page 5) would establish work commitment bidding as a leasing alternative. Under this system the bid variable would be the amount of effort the lessee agrees to expend in exploring the land. Use of this alternative will, on the average, result in less revenue to the state, with the revenue that is foregone by the state being expended in developing resources that would otherwise be uneconomic. This is a clear instance of economic subsidy. The legislature may wish to consider whether this subsidy is desirable, and if so, whether this is the most efficient way to provide it.

5. Commissioner's Discretionary Authority to Reduce Royalty. The commissioner now has authority to reduce the royalty rate on tracts having marginal production. So far as we know this authority has never been utilized. Subsection (d) of the proposed law (page 6) retains this authority to lower royalties. It becomes much more significant in the context of this bill, however, because of its use of royalty bid and sliding scale royalty leasing systems. Particularly in the case of the royalty bid arrangement, a lessee may, with a very high royalty bid, acquire a tract on the assumption that the commissioner will reduce that royalty if and when production is developed. The legislature may wish to consider the possibly of limiting this authority to only to royalties paid ~~the~~ WHEN production level is within the lowest block of the royalty schedule, i.e., at the bottom of the "sliding scale".

6. Non-competitive Bidding. HB 854 would allow the commissioner, at his discretion, to offer acreage on a lottery system if the acreage had not received a bid in an earlier competitive sale. The legislature should be aware that this system, in combination with initial offerings at unrealistically high minimum bids, could be used to give away the state's oil and gas resources to private individuals or firms.

We will be pleased to examine these or other questions in more detail. We are confident that Mr. Lipton, Professor Gaffney, and the industry will raise additional questions that the legislature may also wish to examine.

GKE:dh
Attachments

My name is Morris Lowman and I represent Marathon Oil Company in Anchorage, Alaska, as its Senior Petroleum Landman. I have had 32 years experience in the oil industry of which 27 has been land related work. This experience has been in the states of California, Oregon, Washington and Alaska. My first exposure to Alaska work came in the late 1940's when I reduced surface geological work done by our geologist on triangular air photos to a plain map. In the 1950's, I was involved in the preparation of offers to lease for Federal lands when interest developed on the Kenai Peninsula. I was one of many petroleum landmen on the scene when it was announced that oil had been discovered at Swanson River. I had continued working acquaintances with Alaska land problems off and on until my permanent assignment to Anchorage in 1966.

We wish to thank you for the opportunity to express our views regarding HB 854, the proposed legislation entitled "An Act relating to the leasing and exploration of State land for oil and gas development".

I am submitting in writing a detailed statement of comments regarding this proposed piece of legislation and in my brief oral testimony I will dwell on the more onerous provisions and highlight or summarize our objections.

There are probably some provisions of the existing leasing act that need to be looked at, however, the existing law has been workable and the State has profited from its operation. We feel the whole-sale modifications as proposed in HB 854 are unnecessary and will create a considerable burden on the management of a leasing program with little or no net increase compensation to the State. It will be a burden to adjudicate and because of the many alternative discretionary decisions permitted, the commissioner may find himself open to challenges.

We have long encouraged the State to establish a leasing program as proposed in 38.05.180(b). We feel such a program

schedule, manpower needs and their financial needs. We do fear the provision contained therein that the commissioner must review and revise every year. This requirement takes away all stability a five year program is trying to provide.

Under Section 38.05.180(c), several alternative leasing methods are proposed. Other than the Cash Bonus bidding, we believe the systems proposed would not be to the best interest of the State of Alaska. When you use the royalty bidding or net profits bidding, you are assuming some of the risk and a governmental body should not be in the risk business. The costs and manpower required to manage and audit a net profits operation could become a bureaucratic nightmare and the net results to the State could be increased operational costs and less net returns for the benefit of its citizens. It is our belief that a work commitment type bidding would not be feasible or workable when a lease size is limited to 5,760 acres. This type of lease contract can best be utilized when large concessions can be granted. The agreements made by the Native Corporations are a good example.

Royalty bidding may be attractive to some operators, however, it is not the type of contract that encourages early evaluation of a tract. Also, there could be a danger of a party over bidding and rather than lose money on operations he would withhold development or would be requesting a modification of the terms of contract pursuant to Section 180(d) of this proposed legislation. How would a fair and equitable adjustment be made when you have the unsuccessful competitive bidders looking over your shoulder?

The report to the legislature on the various leasing methods, if used, as required Section 180(b)(5) would not be pertinent as it would probably be 10 to 15 years before a true evaluation is known. With competitive cash bonus bidding, you can generally determine its then present value when you have a willing seller and a willing buyer or buyers. Under

competitive royalty bidding,

may be open to question or challenge. For this reason, it would be smart to eliminate the royalty bidding method.

Section 180(g) provides for the commissioner to adopt regulations governing calculation of net profits. There are many interpretations of how to determine net profits and any rules established must be mutually acceptable and understood or it could be challenged. As stated above, such an auditing operation would be required and would cost the State more to audit such a method than by a straight royalty lease.

Section 180(h) gives the commissioner the discretion to terminate a portion of a work commitment if he finds that the work would be unnecessary or cumulative. This discretionary authority is dangerous as it would require the use of interpretative data. When dealing with geological information, it is highly interpretative and two identically educated persons can have legitimate differences of opinion which could be cause for challenge of any action taken.

Section 180(j) gives the commissioner the authority to provide a regulation and lease term that a lessee may earn production rights only to the depth drilled at the beginning of production from a lease. This in industry parlance is called horizontal segregation. This is a dangerous procedure and a poor business practice. When a party decides to test a structure, he usually drills to the best or the known productive horizon and if a discovery is made he will complete said well and continue development operations. It may be several years following initial drilling when enough data is available or the risk of drilling deeper is further minimized to merit such deeper drilling. By creating horizontal segregation, you increase the demand or call on surface usage and increase potential damage to the surface. Also, there would be danger of damage to shallow producing horizons from third party operations. We strongly oppose this provision and feel it is a detriment to the State.

Under Section 180(k), a rental in an oil and gas lease

for the rental period which is usually a year. When an operator drills a well and commences production operations, he then starts paying royalties or in some cases minimum royalties. Section 180(k) states that a lessee will continue paying rental until royalties have exceeded the rental rate for three (3) consecutive years. This sounds like the State wants its cake and to eat it also. This is an inflationary and a highly unethical proposal and we object to it. Also, we recommend the State establish a fixed rental rate and maintain it for the primary term of the lease or until the lease is placed on a production classification.

Section 180(v) says that the State has rights to purchase up to 100 percent of the volume of gas produced from a lease. If this type provision is included, it will do considerable harm to a viable petroleum industry. It would be difficult for a wildcatter to get financing and those companies that have already developed gas processing facilities would be in jeopardy of not having supplies for its plant. This section will in effect eliminate or impair the ability of lessees to use gas sales contracts or production payments as a method of financing, likewise discouraging exploration. No one should have this type of monoply on gas - not even a governmental body.

Section 180(w) provides for state access to all of a lessee's or permittee's exploration data and is objectionable to Marathon. A company's private proprietary data is its stock in trade and guarded closely. Any taking without due compensation is a grave injustice. This provision should be deleted.

There are several areas that need to be looked at closely for meaning or definition, however, those points herein above spoken to are the most objectionable and need to be eliminated.

Thank you for your attention and patience and if there are any questions, I will attempt to answer them.

Bristol Bay Native Corporation
445 E. 5TH AVENUE / P.O. BOX 220 / ANCHORAGE, ALASKA 99510 / PH (907) 278-3602

March 10, 1978

The Honorable Alvin Osterback
Chairman
House Resource Committee
Pouch V
Juneau, Alaska 99811

RE: H.B. 854

Dear Mr Chairman:

It is my understanding your committee will be holding hearings on H.B. 854 on March 16th and 17th, 1978. Unfortunately, we will have no representative at the hearings to testify and therefore, we respectfully request this letter be included in the official record of the hearings.

First of all, we object to most sections of this Bill as it is very complex, creates a multiple choice system that is unworkable, discourages exploration on State lands, and above all would have a serious impact on the development of our lands. We strongly urge that no action be taken on H.B. 854 this year.

Previous State selections and proposed selections in our region total several million acres with oil and gas potential in the Nushagak Basin (Bristol Bay Basin). BBNC lands in the onshore portion of this sedimentary basin would total about 1,750,000 acres surrounding 17 villages, several of which the Native lands are not contiguous. In other words, most of our lands with the new proposed State selections would be adjacent to or surrounded by State lands. In many instances, a drilling unit would involve both State and Native lands and in some instances, Federal lands. Therefore, any changes in leasing of State lands will have a direct effect on BBNC lands. Most of the provisions of H.B 854 would change the economics of State and Native lands in a producing unit. The net result will be that the portion of the unit under State leases would become uneconomical and abandoned first and the Native portion of the unit would then become less economical followed by early abandonment and thusly leaving large amounts of oil or gas in the ground. This could hardly be called conservation.

BBNC has had a joint agreement with a major oil company whereby, with commercial production, we will become a producing oil company. We do not lease our lands! Knowing some of our selected lands might not be adequate to cover undefined seismic structures, we anticipated leasing State or Federal lands in order to form drilling units for early development of our lands. About three years ago, we filed the necessary qualifying documents to hold both State and Federal oil and gas leases and have filed offers to lease on several thousand acres of Federal lands.

We have no problem with the present leasing system as it has been tried, tested, proven and above all, is understandable. Such a mixed bag of radical, czarist possibilities as proposed in H.B. 854 is uncomprehensible, unjustified and will no doubt have the opposite effect of the original intent, unless the intent was to retard development of State lands indefinately and in effect retard development of much of our lands.

Again, we strongly urge the postponement of any action on this Bill.

Sincerely,

W. C. Bishop

W. C. Bishop
Manager, Subsurface Resources

Bristol Bay Native Corporation
445 E. 5TH AVENUE / P.O. BOX 220 / ANCHORAGE, ALASKA 99510 / PH (907) 278-3602

March 10, 1978

The Honorable Alvin Osterback
Alaska House of Representatives
Pouch V
Juneau, Alaska 99811

Dear Al:

Due to previously scheduled meetings, we will be unable to have anyone at the hearings on H.B. 854, rescheduled for March 16th and 17th, 1978. Enclosed are sufficient copies of our testimony for each of the committee members.

Al, this Bill, if passed, would be disasterous for BBNC or any other region that has large areas of State selected lands with oil and gas potential. We would be especially hard hit as the State proposes to select several million more acres in our region which we had earlier supported.

This Bill would be a disservice to the entire State and a disaster to the Natives. It is so complex that few, even with an oil industry leasing background, would or could understand it. Certainly it would take months of research in order to salvage much that would be logical. Since there is a somewhat limited time this session, I would strongly urge you, as Chairman, to hold this Bill in committee without any further action.

With best regards.

Sincerely,

Bill

W. C. Bishop
Manager, Subsurface Resources

Encl: a/s

cc: Rep Nels Anderson, Jr.

# SUMMARY OF FEDERAL OCS REGULATIONS

## PERTAINING TO GEOLOGICAL AND GEOPHYSICAL INFORMATION

Title 30, Section 251.12 of the Code of Federal Regulations specifies that individuals and companies granted OCS exploration permits are required to allow the Department of the Interior (DOI) to inspect and select the forms of information listed below. The permittee must notify the DOI immediately of the acquisition or analysis of any geological data (part a of the section) or the acquisition, processing, or reprocessing of any geophysical data (in part b) collected under the permit. The DOI has at least one year after such notification to choose the material. A longer time period may be specified in the individual permits. The permittee is not required to submit interpreted geological or geophysical information for inspection and selection. If the permittee transfers geophysical data or processed geophysical information to a third party or a third party who has received geophysical data or processed geophysical information directly or indirectly from a permittee transfers said data or information to another third party, the transferor must notify the DOI of the action and bind the third party to the obligations of the permittee. The first set of regulations of this type were approved and put into effect in November, 1975.

The geological data from which the DOI may select includes: (This applies to COST-type and other stratigraphic test holes.)

1. Complete record of all geological and geochemical data and information resulting from each operation;

2. Paleontological reports identifying the microfossils by depth, unless washed samples are kept for inspection by the USGS;

3. Copies of well logs or charts (electrical, radioactive, sonic, etc.);

4. Core or bottom samples analyses or a representative cut of the samples;

5. Detailed descriptions of hydrocarbon shows or hazardous conditions; and

6. Other geological data and analyzed geological information obtained under the permit, as specified by DOI.

The geophysical data, processed geophysical information and reprocessed geophysical information which may be selected includes:

1. A complete record of each geophysical survey conducted, including the final location maps of all survey locations;

2. All common depth point and high resolution seismic data;

3. Processed geophysical information derived from the seismic data;

4. Geophysical data and processed information obtained from, but not limited to:

a. Shallow and deep subbottom profiles

b. Bathymetry

c. Side-scan sonar

d. Magnetometer systems

e. Bottom profiles

f. Gravity surveys

g. Magnetic surveys

h. Special studies such as refraction and velocity surveys, and

5. Reprocessed information such as true amplitude sections, migrated sections, and bright spot analyses.

The DOI may choose any or all of the above data or information at any stage of processing. Thus far the local USGS Conservation Division Office has been selecting final processed data and information. The geophysical data must be kept confidential for ten years after the issuance of the permit. Processed, reprocessed, and interpreted geophysical information is released to the public ten years after it has been submitted to the USGS. Geological data and analyzed and interpreted geological information obtained from deep stragigraphic tests are released five years after completion of the test well or 60 calendar days after the issuance of the first Federal lease within 50 geographic miles of the test site, whichever is earlier.

## STATE'S RIGHT TO PURCHASE OIL & GAS IN HB 854

The State has the right in HB 854(v) to purchase not more than 16 2/3% of the oil and up to 100% of the gas at the regulated price or fair market value at the point of sale. The right to purchase is needed to protect the "in kind" taking of its royalty by Alaska, a sale of said royalty, and a subsequent reduction of the royalty in the later stages of production (d).

New Mexico, 1973, enacted a law which gives it the right to reserve an option to purchase at any time at the prevailing market price any or all minerals, including oil and gas, produced from State land. Thus, New Mexico may purchase 100% of the oil and gas found on State land.

Whereas the New Mexico Commissioner is authorized to waive the reservation option with respect to any specific mineral, he may not do so for oil or gas.

The Act, Chapter 26 of the Session Laws of 1973, has never been exercised by New Mexico; thus no opportunity has been given to test its constitutionality.

If Alaska were to reserve an option to purchase up to the amount of the royalty, fixed or bid, an equivalent net profit share would have to be determined.

TESTIMONY ON

ALASKA LEASING POLICY BILL

(H.B. 854)

By
Rod L. Boane
Alaska District Manager
Exxon Company, U.S.A.

Before The
State of Alaska
House Resources Committee

Juneau, Alaska

March 17, 1978

Mr. Chairman and Members of the Committee --

I am Rod L. Boane, District Manager for the Alaska Exploration District of Exxon Company, U.S.A. I appreciate the opportunity to be here today and present the views of my Company concerning the proposed Leasing Policy Bill.

First, let me say that Exxon believes the existing provisions of Section 38.05.180 of the Alaska Statutes are quite satisfactory in administering adequate control over exploratory and development activities on State leases. Therefore, we do not believe these new amendments to the Statutes are needed to protect the public interest. On the contrary, we think the proposed amendments would create unnecessarily involved and cumbersome procedures that will neither foster needed exploration nor benefit the State of Alaska. Although we take exception to almost all features of the proposed amendments, in the interest of time, I intend to discuss only the more troublesome provisions, with particular emphasis on the proposed bidding methods.

Exxon believes that the best method for awarding leases is on a cash bonus basis. This system has several advantages which I would like to review.

- First, the successful bidder sees very strong incentives to explore and develop rapidly and to recover the maximum economic volume of hydrocarbons at the lowest possible cost. This is necessary in order for him to maximize the return on the cash bonus invested.

- o Second, under the cash bonus system, the State bears none of the risk that commercial reserves will not be found. This risk is placed directly on industry where it belongs. This is a particularly critical concept in Alaska which is still essentially a frontier province where very little exploratory drilling has occurred and thus very little is known about the oil and gas potential of most of the State. When one further takes into account the fact that Alaska is a very high cost area due to its remoteness and harsh operating environment, it should be easy to see that the exploration risks and costs are indeed great. The Gulf of Alaska history should prove this point as, thus far, no commercial discovery has been made.

- o Third, under the cash bonus system there is no possible way that the awards will be made in an arbitrary manner since the highest bid is obvious.

- o Finally, the system is simple and inexpensive to administer, and its integrity is unaffected by future events. The State would not have to expand its staff to implement this system.

Now I would like to compare the alternate bidding methods proposed in this legislation to conventional cash bonus bidding with fixed royalty. Basically, the proposed alternative bidding methods fall into one of three categories. The first category involves some form of royalty bidding. The second category uses

some form of net-profit bidding. The third category uses some form of work commitment. All three categories require a cash bonus, either as a bid variable or a fixed amount. Let's first examine the royalty bidding systems.

(1) It is not uncommon for operators to discover reserves of lesser magnitude than anticipated. With high fixed royalty, some of these discoveries could not be developed profitably unless the State agreed to accept a lower royalty than originally bid. Downward adjustment in royalty rate prior to any development would be difficult to administer and could undermine the integrity of this bidding system.

(2) With royalty bidding, the successful bidder does not have a strong incentive for rapid exploration and development since front-end cash investment is small. Speculators could therefore see incentives to acquire leasehold interest, and then wait in hopes that they will be able to cash in on the discoveries made by others. This situation would obviously result in delayed exploration and development activities.

(3) With exclusive royalty bidding, the public bears the major portion of the exploration risk because if the tract doesn't contain commercial hydrocarbon reserves, as the majority will not, the public receives no compensation whatever. As an example, the State received $900 million in bonus for acreage on the North Slope in the September 1969 sale. Under a royalty bidding system the State would have received little income to date. We strongly believe that risk-taking and its associated rewards or losses are more properly the province of private enterprise.

The second royalty bidding system involves a sliding scale royalty system which would be difficult to monitor and, practically speaking, would make it impossible to compare bids unless you know the total reserves, the price at which production would be sold, and the rate of production. Sliding royalty could result in widely differing positions on prudent development. Also, unitization of tracts would be a very complex and difficult job.

With these comments in mind, let's review recent experience with royalty bidding in the Federal sector. A program of experimentation began with the recent sale in the Lower Cook Inlet. Thirty-four percent of the tracts were put up for royalty bidding. Selection of these tracts was in such a manner that they were scattered over the entire sale area. When this type of tract distribution is coupled with a forced unitization lease stipulation, it is not difficult to conclude that the owners of the royalty tracts have no incentive for rapid evaluation. They can just sit back and wait for the owners of cash bonus tracts to do the initial drilling. They can then join the units covering any reservoirs that extend under their tract.

After the Cook Inlet sale, this problem apparently became obvious to the Department of Interior. For the North Atlantic Sale (Sale #42), they attempted to "fix" this problem by grouping the royalty tracts together and having them removed from the cash bonus tracts. They further expanded the experiment by having a group of cash bonus tracts that had a fixed royalty of 40 percent.

Industry comments relating to royalty bidding have apparently begun to create some concerns about this system. In the upcoming South Atlantic Sale (Sale #43), we see another attempt to "fix" difficulties in the previous system. Tracts are being offered by cash bonus bidding with a sliding scale royalty. They have attempted to "fix" the unitization problem by again grouping the sliding scale royalty tracts together. However, they did not address how a group of sliding scale royalty tracts or sliding scale royalty and cash bonus tracts would be unitized.

Now that this experimentation process has begun, we see the continuing creation of new difficulties and complexities as attempts are made to correct previous difficulties and problems. It appears that this process is going to have a "snow-balling" effect and may eventually reduce competition. In this situation, only the companies that can afford to dedicate a large professional staff to the long unitization negotiations and wait long periods for initial production will servive. This certainly does not promote increased competition.

Now let's look at the second bidding category a profit-sharing system, which has most of the same adverse characteristics as royalty bidding, but with four added complications and disadvantages.

(1) Using net profits will be much like selecting a contractor to perform a job. The operating efficiency of the bidder could become an important consideration in determining which of

several bidders had submitted the high bid inasmuch as the gross proceeds to be received by the public would be a direct function of the efficiency of the operator. Thus, the successful bidder would no longer be obvious. Since the relative operating efficiency of companies cannot be determined quantitatively, the Commissioner would be vulnerable to charges that bid awards were being made in an arbitrary or discriminatory manner.

(2) A profit-sharing system would be difficult and costly to administer. A large administrative organization would likely be established to audit and monitor the continuing activities of lessees. Discretionary judgments would be required by the State with regard to what costs were to be included or rejected in the profit base. This system could lead to State control of expenditures.

(3) A profit-sharing system would significantly reduce the incentive for a successful bidder to operate at maximum efficiency. Any prudent operator utilizes a priority system when restraints of either manpower or materials create limitations. When these restraints exist, net-profit tracts will have low priority. The result - reduction of efficiency. It would also reduce the timing and incentive for development of advanced technology currently in progress by industry.

(4) Most important, sharing in net profits would signal the State's entry into the production phase of the oil business. It might be politically and economically difficult for the State not

to be deeply involved in decisions about day-to-day operations and thereby become an operating partner. This step would not be consistent with the maintenance of a strong private enterprise system either within the oil industry or within the State itself.

The third category of biddi system is work commitment which can be combined with any of the other methods. A work commitment bid becomes a form of cash bonus bidding. If an operator has a high interest in a tract, he will bid a work commitment which is equivalent to what he would bid in a cash bonus system. In many instances, this committment would be much larger than required for evaluation. If early exploration results are negative, the operator remains committed to drill more wells than would normally be prudent or necessary.

The provision that the Commissioner can terminate a work commitment further complicates the issue. Termination of a work commitment for one operator would undoubtedly result in inequities because he has received an unfair competitive advantage. Continuation of this practice could result in extremely high work commitments in anticipation of cancellation after performing only a portion of the work.

A work commitment bid will be nothing more than a form of cash bonus. The same result can be ac omplished more easily and efficiently with a cash bonus bid.

Now I would like to discuss a few other provisions which give us concern.

(1) AS38.05.180(v) Right to Purchase - The provision gives the State the right to purchase not more than 16 2/3 percent of the oil and 100 percent of the gas. The most onerous portion of this provision is the right of the State to purchase 100 percent of the gas.

The present and potential supplies of gas within Alaska far exceed reasonably anticipated demands by the State residents. Therefore, to find a market, this gas will have to move into interstate commerce. This requirement, that the State could remove the gas from the market, could severely hamper a producer's ability to market the reserves. Without a reasonable expectation that the developed gas can be marketed, there is greatly reduced incentive to explore.

It would also retard development of natural gas for State residents. The risk that the gas could be diverted would have significant impact on ventures to install gas transportation systems.

In addition to these concerns, it raises other questions such as:

1. Determination of fair market value
2. Use of gas for lease fuel
3. Timing and rate of production - could the State control these to satisfy their own requirements or desires?

(2) AS380.05.180(w) - Exxon is strongly opposed to this proposed section which requires any lessee or permittee conducting exploration for, or development or production of, oil or gas on State land, to provide the Commissioner access to all data obtained from such activity and to provide copies of such specified data, as the Commissioner may request. Access to all data could potentially permit endless intrusions into private business. Much of this data is very costly. In a competitive industry such as ours, a considerable amount of data is proprietary. Disclosure of this type of data could result in the loss of a competitive edge. In none of the other producing states are operators required to provide access to all data. In addition, we feel that any such requirement would, in effect, constitute a "taking" for which compensation by the State would be required. We believe this proposed amendment is unnecessary and should be deleted because the existing regulations provide the State with adequate control over exploration and development activities.

(3) AS38.05.100(1) - We are strongly opposed to the concept of earning production rights only to the depth drilled at the beginning of production from a lease. We are not aware of this language in lease forms for any other producing state.

This language is somewhat similar to that commonly used by a lessee in "farming out" acreage for the purpose of evaluating specific geologic objectives by a third party. In a frontier

province like Alaska it doesn't make any sense to place such restrictions in the lease form. The idea should be to give the lessee maximum flexibility in evaluating his acreage - not to curtail or to require unreasonable and costly actions on his part. We, therefore, strongly suggest that this language be deleted.

We also recommend that reworking be added to the list of actions which will hold a lease in force. In fact, a grace period of 60 days should be allowed between cessation of production and initiation of drilling or reworking operations. This useful and desirable feature is in the present law.

(4) AS38.05.180(j) Lease Term - A five-year primary lease term is very restrictive in Alaska. The remote location of most prospects, rugged terrain, short construction season, and reduced drilling season, either necessary or imposed, make completion of the exploration cycle a difficult and time-consuming process. Once a discovery is made, additional drilling is required before an estimate of the field size can be made. All of the previously mentioned factors affect this drilling too. Once the lengthy process of discovering a field and establishing its commerciality is complete, the long development phase must begin. We strongly recommend that the 10-year lease term be retained.

(5) AS38.05.180(c) Uplands Acreage Limitation - The proposed 200,000-acre limitation on all lands other than tide and submerged lands is very restrictive compared with the current 500,000-acre limitation in a State like Alaska which has so many frontier

interior basins to explore. In a hostile high cost environment such as Alaska, a large block of acreage may be necessary in order to justify exploration. We believe the proposed 200,000-acre limitation would be a strong disincentive of an operator to explore these frontier interior basins and strongly recommend maintenance of the current 500,000-acre limitation.

(6) AS38.05.180(u) Joint Bidding - The provision allowing the Commissioner to restrict joint bidding, if he so desires, could prohibit the involvement of some companies most capable of operating in the Alaskan environment.

A study was performed by the University of Southern California and the USGS to determine the effects of restricting majors from bidding jointly in the OCS. They concluded that on the average, this restriction resulted in more bids per lease by the major oil companies.

(7) Legislative Review - We object to the requirement for submission of the leasing program for annual review by the Legislature because we believe it will result in unnecessary delays in implementing leasing programs.

(8) AS38.05.180(q) Drilling and Development Contracts - The proposed amendment which would allow the State to share in exploration costs is inconsistent with the provisions of the lease agreement, as the State's royalty interest is free of all exploration

and development costs. If this is intended to allow the State to share in working interest, we a - opposed since it would signal entrance of State Government into the oil and gas business.

In closing, I would like to reiterate that Exxon believes the current leasing statutes and the implementing and regulations have served the State and industry well and do not need to be changed.

Passage of this bill will require the State to embark into an experimental program. Because these systems are unknown, many mistakes will be made. New "wrinkles" will be tried in order to correct these mistakes. In fact, the State of Alaska will find itself taking a course which is identical to the course presently being followed by the Federal Government. The end result will be an extremely complex system which may allow only a few companies to survive.

This concludes my prepared testimony, and I will be happy to answer any questions which yo" may have.

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# STATE'S RIGHT TO PURCHASE OIL & GAS IN HB 854

The State has the right in HB 854(v) to purchase not more than 16 2/3% of the oil and up to 100% of the gas at the regulated price or fair market value at the point of sale. The right to purchase is needed to protect the "in kind" taking of its royalty by Alaska, a sale of said royalty, and a subsequent reduction of the royalty in the later stages of production (d).

New Mexico, 1973, enacted a law which gives it the right to reserve an option to purchase at any time at the prevailing market price any or all minerals, including oil and gas, produced from State land. Thus, New Mexico may purchase 100% of the oil and gas found on State land.

Whereas the New Mexico Commissioner is authorized to waive the reservation option with respect to any specific mineral, he may not do so for oil or gas.

The Act, Chapter 26 of the Session Laws of 1973, has never been exercised by New Mexico; thus no opportunity has been given to test its constitutionality.

If Alaska were to reserve an option to purchase up to the amount of the royalty, fixed or bid, an equivalent net profit share would have to be determined.

TESTIMONY ON H.B. 854

Mr. Chairman, members of the committee, my name is John Carson, and I appreciate the opportunity to comment on House Bill 854.

I've been a petroleum geologist for 22 years, and I'm presently Division Geologist in Alaska for Chevron U.S.A., the principal domestic oil and gas subsidiary of the Standard Oil Company of California. I've lived and worked in this state, and since 1965, I've been actively involved in all state lease sales and the two OCS sales in the Gulf of Alaska and the Lower Cook Inlet.

Chevron is aware of the amount of preliminary work done by the state administration and the Department of Natural Resources in researching and drafting this legislation.

We commend efforts in drafting legislation that proposes a five-year leasing program for Alaska. We believe the state should be encouraged in its effort to establish and maintain such a long-term program, with appropriate industry participation.

Members of the committee, the petroleum industry--as indicated by its response to your solicitations--clearly desires a realistic plan that can serve as the basis for an effective working relationship between the industry and the state.

Frankly, we believe the proposed legislation will inhibit or prevent orderly development of oil and gas resources in Alaska--to the detriment of the state government, its taxpayers and my own industry.

I will say candidly that this legislation is untenable from our point of view. If enacted into law, H.B. 854 would have a serious and far-reaching impact on my own company, and would give us serious cause to reconsider our exploration activities in the high-cost, high-risk frontier state lands of Alaska.

The situation we face today reminds me of a quote I heard the other day attributed to an executive of Walt Disney Productions, which recently announced that it was abondoning its latest recreation complex because of excessive and oppressive regulation.

The Walt Disney executive blamed the end of the project on, and I quote: "An irresponsible proliferation of delays, the never-ending requests for more irrelevant information and studies, and bureaucratic sidetracking and meanderings into unreasonable alternatives."

I realize this is the first of many hearings on this legislation, but H.B. 854, as now written, would be counter-productive. It actually would be a step backward at the very time our nation desperately needs an effective oil and gas exploration program.

Generally stated, we object to provisions covering: 1) the wide variety of bidding methods to be employed; 2) the Commissioner's access to all the lessee's data, including proprietary data; 3) the state's call on production; 4) short and restrictive lease term and conditions; 5) the need for the Commissioner to submit and defend his lease plan before the legislature; 6) the Commissioner's right to ban joint bidding by major companies; and 7) reduced acreage chargeability on state uplands.

Time does not permit me to discuss in detail each of the provisions, but I will attempt to outline our most significant objections:

First, the wide variety of bidding methods:

In advocating numerous bidding schemes--actually a shift from only cash bonus bidding, a system that has worked well--the administration hopes to maximize its financial return from state lands.

But Chevron believes a move away from the cash bonus method means the perilous abandonment of a proven concept that has brought stability to the state's leasing program. The bonus system would be replaced by an array of untested leasing methods, particularly in the frontier areas.

We believe this provision, if enacted, will transform Alaska into a trial-and-error laboratory in oil and gas leasing. It means replacing orderly development with uncertainty and the unknown. It's not a gamble Chevron feels is worth taking.

Before discussing each bidding system, all concerned parties should be aware that a move away from cash bonus bidding will result in three key developments:

First, it will shift a substantial part of the burden of risk from industry to the taxpayer.

Second, it will serve as a substantial deterrent to exploration and development, and

Third, it will cause the rapid and constant growth of state agencies to administer, evaluate and audit the leases and subsequent production. This places increasing demands on taxpayers to support this bureaucracy.

Chevron believes these are unacceptable consequences which would be intolerable to the taxpayers and leaders of this state.

As you know, cash bonus bidding provides that leases be awarded to the highest cash bonus bidder. This bonus is paid before the lessee can proceed with exploratory drilling on the lease.

The other bid methods provide for bid variables such as royalty, net profit, or work commitment. In these cases, the state receives nothing other than perhaps a small fixed bonus at the time of leasing. Other revenue is not forthcoming under the royalty and net profit schemes unless there is production. Simply stated: No production, no revenue.

In our opinion, cash bonus bidding is the only method that will strongly encourage the petroleum industry to lease and explore the state land.

We further believe that this method will result in the production of the most oil and gas and consequently will provide the most revenue, both to the state and the petroleum industry.

The other methods, employing biddable royalties and net profits, reduce the incentive to explore and produce. These alternatives, particularly in the case of biddable royalties, serve to shorten the economic life of the fields--resulting in less production and, therefore, less revenue.

Cash bonus bidding is particularly advantageous to the lessor in frontier areas of high risk. Most of Alaska's lands are in this category.

Now let's compare other proposed bidding methods with traditional cash bonus bidding. Because of time limitations, I can only touch briefly on these, but I am prepared to go into more detail if questions arise.

The royalty bidding method, although it allows oil and gas companies to acquire land with little cash, is a strong deterrent to early drilling. Very simply, it is easier and cheaper to wait on others to bear the risk and expense of exploratory drilling.

Having spent little capital to acquire the lease, an operator is tempted not to spend a dime to evaluate the lease, hoping an adjacent leaseholder may do it for him. Carried to the extreme, the effect of this would be that no wells would be drilled to evaluate the leases. This same problem is inherent in the net profits system, which I'll talk about shortly. On the other hand, when cash bonus is involved, the winning bidder has a strong incentive for early drilling because his bonus investment is earning him nothing.

In cash bonus bidding the state assumes none of the risk but still receives revenue from leases, whether or not they are productive.

The advantages of this system were clearly demonstrated a few years ago in the sale of federal leases off the coasts to Mississippi, Florida and Louisiana. Successful bidders paid $743 million for several tracts on one structure, the Destin Anticline, and spent over 10 million dollars drilling seven dry holes on the structure--all at no cost to the taxpayer. Under royalty or net profit bidding, the government would have received nothing.

What would government have received if it had sold the Gulf of Alaska on a royalty bid basis? As in the Gulf of Mexico case I previously cited, nothing. Should the taxpayer and the government be forced to suffer the loss of more than one-half billion dollars--when to date, no royalty appears forthcoming?

The NPRA comes to mind as another example of an area adjudged to possess high potential, but which so far is a disappointment. Again, if sold on a royalty bidding method, the lessors would have received nothing to date.

Let me emphasize that in all these cases, the areas were considered extremely attractive to both the industry and government. These are precisely the types of areas in which the state might be enticed to use a royalty or net profit bidding method. Yet none of these has led to any discovery or government revenue.

Proponents of royalty bidding believe it encourages competition among bidders and allows the small company and the independent improved entry into oil and gas lease bidding. Cash bonus bidding usually is blamed for tending to discourage small companies from bidding.

This is not supported by the facts. Small companies gain entry into the sale by joining with a larger company or with several other smaller companies. In the recent Lower Cook Inlet sale, independents and smaller companies bid on royalty and cash bonus tracts with about the same frequency as the majors. Of the 34 companies which bid in the sale, 18 were smaller companies. These 18 made successful cash bonus bids on 26 tracts, of which 13 were sold for more than one million dollars. Moreover, the small companies are represented in half of the top tracts of the sale.

The second proposed bidding method we are concerned about is net profit bidding. This system has most of the disadvantages of royalty bidding plus two more: It requires a huge staff to administer and audit.

For example, each property would require a battery of accountants to audit the companies' production and costs. Just as in the case of royalty bidding, the risks are passed on to the government. Furthermore, net profit bidding discourages cost-effective, efficient development practices.

Work commitment bidding is the least onerous alternative to cash bonus bidding methods and would be beneficial, provided that it is enforceable. We view this method with some caution because of the uncertainty of the conditions under which it might be imposed.

At this point, I would like to summarize why we believe a majority of the industry prefers cash bonus as the best method for both the state and the energy explorers.

First, we believe it is the foundation for all free enterprise contract arrangements;

Second, it is the simplest and easiest to determine and administer by all parties;

Third, it is fair and equitable; by this I mean that all parties travel at their own risk, and finally,

The right to explore is paid for in advance.

In 1977 the Department of Natural Resources completed a report entitled, "A Study of Petroleum Leasing Methods and Possible Alternatives." H.B. 854 apparently is based on this study and its conclusions.

In this study, a great deal of attention is given to the "percentage of acreage option." We assume this is the reason for granting the Commissioner authority to withhold acreage from any sale areas under Section 180 (c) (4) (f). Under this scheme, certain amounts of acreage would be withheld from a sale so that following a discovery the state could collect a windfall on drainage acreage sales. This is a workable approach only if you know which acreage to withhold and on which structures. This is rarely the case, as we saw in the MAFLA, Gulf of Alaska and NPRA. Furthermore, industry cannot bid or drill on only portions of prospects in high risk or high cost areas which predominate in Alaska.

I would like to make a few more comments about the Department of Natural Resources' report. The one overriding conclusion of that study was that a variety of bidding methods, widely employed, would increase the state's return from its commitment of oil and gas properties.

Chevron believes this conclusion is biased against cash bonus bidding, and we feel that the odds are against anyone knowing all they need to know to use the right method at the right time. The state, even if armed with a skilled staff and large amounts of data, can hope to do no better than an individual company in evaluating potential and risks, and these companies are more often wrong than right in their appraisals.

We believe the state's report, and particularly its main bias against cash bonus bidding, is based on a few but major faulty economic assumptions.

First, the authors of the report assume that the industry will make an 18 percent rate of return. Although this is very desirable, and would not be out of line considering the high risk involved, past experience shows that the industry has averaged no more than seven to eight percent from OCS ventures which approximates Alaska lands, according to several exhaustive studies. For example, in May 1977 Prof. Walter J. Mead of U.C. Santa Barbara testified before a U.S. House of Representatives Committee that weighted average rate of return from 184 leases issued in the Gulf of Mexico in 1954-55 amounted to only 7½ percent before taxes. This sale period was selected because these leases have a 20-year production history which provides a comprehensive data base.

Second, no reduction of state income was assumed in royalty cases, but it almost certainly will occur. The economic limit of a field is going to be greatly influenced by the amount of royalty. The higher the royalty, the earlier the economic limit is reached. When an operator can no longer produce oil or gas profitably the result will be oil and gas left in the ground and neither industry, nor the state, will make any money on it.

* * *

Next, I would like to turn to the provision of the bill that would require the lessee or permittee to make available to the Commissioner all data obtained from exploration and production activities on the lease or permit. We believe this provision raises fundamental questions about the appropriateness of the state's entry into the exploration business, and secondly, points to grave problems--from our point of view--about the preservation of confidentiality.

should but
The language in the proposed legislation does not distinguish between, "raw", "processed" and "interpretative" data. We are unalterably opposed to providing the state with the results of the efforts of our interpretative staff. Industry cannot operate under this law. We urge the committee to delete this section.

We are also opposed to giving the state our basic geophysical data. We are not convinced that the state can hold this data confidential because of its large staff and turnover rate. Any leak of this sensitive information to our competitors definitely will have an immediate and adverse impact on our exploration program in this state.

The third provision we object to (Sec. 38.05.180(v)) gives the state the right to purchase up to 16 and two-thirds percent of the lessee's share of the oil and up to 100 percent of the lessee's gas.

We are not opposed to the state's right to take its royalty share of oil or gas in kind, but we oppose any provisions which empowers the state to take any portion of the lessee's share.

In order to justify the risk and expense of exploration and development, and be able to satisfy its contractual commitments, the lessee must retain the right to dispose of all of its share of production. Without this right, the state of Alaska lands become less desirable to explore and develop. We believe this is another step toward the state's entry into the oil and gas business, which should stay with private industry.

It seems inconceivable to Chevron that the state would take a portion of the lessee's share when that is the very incentive for industry to explore in the state initially.

Another provision we oppose is Paragraph Q. Paragraph Q refers to drilling and development contracts and to the authority of the state to share in the cost of exploration.

We're not clear on the meaning and intent of this paragraph. If it means the state intends to become a working interest participant in leases, then we strongly object.

Our next objection concerns the terms and conditions of the lease itself. Because of the remoteness of most of Alaska's land and the seasonal restriction on operations, Chevron prefers a ten-year primary lease term. We feel this length of time is necessary to adequately evaluate a lease under Alaskan conditions.

There is one provision which would allow the Commissioner to grant rights on leases only to the depth drilled at the time p duction begins. Chevron is at a total loss to see how this provision can benefit the state in any way. It will certainly cause waste in time and money for the industry because wells will be drilled far beyond primary objectives--just to ensure earning the rights of a normal lease. In effect, this will delay production and thereby delay revenue to the state.

Considering the geological, legal and practical ramifications of this provision, one must conclude that it is totally unacceptable to the industry and can do the state no good. It should be stricken from the bill.

Our next objection is to any effort to restrict joint bidding between majors or multinational companies. In Alaska, particularly, with its accompanying expensive costs of exploration and production, it is essential for large and small companies to be able to join together to share the risk.

A ban on joint bidding by majors does not necessarily increase state income. In fact, a recent study by the Department of Interior showed that joint bidders tend to bid higher, on the average, than solo bidding competitors. (November 1976 issue of the Journal of Petroleum Technology.)

The next provision we wish to discuss deals with the need for the Commissioner to submit and defend his leasing program to the legislature. We prefer that the various reporting methods set out in this section not be prescribed in law. We believe this review is an administrative function and that public hearings are an adequate and effective vehicle for gathering comments and reactions to the proposed action. Neither the timber leases nor any other types of state lease are submitted to the legislature, and to require this approach in law for the petroleum industry will lead to further delays in development of the state's natural resources. Particularly objectionable to us is the requirement that the Commissioner must defend his previous year's program and explain why he used certain methods. This is certain to toss the entire leasing program into an interminable bureaucratic morass.

And finally we oppose the provision which deals with acreage chargeability. We believe the reduction to 200,000 acre limitation on uplands is arbitrary and unjustified. The 500,000 acre limitation in this state, where there are large areas of state lands potentially available for bid, is not unreasonable. A large acreage position is necessary as an incentive for an operator to explore frontier areas.

In closing, Mr. Chairman, Chevron believes H.B. 854 is an unreasonable, unwise and unworkable piece of legislation that simply is not in the best interest of the citizens of Alaska.

As I said at the outset of my remarks, my own company would be faced with the prospect of seriously reassessing its current and future exploration activities on Alaska state lands if this bill is enacted.

It is our opinion that this legislation will only serve to inhibit or prevent the orderly exploration and development of Alaska's oil and gas properties.

We oppose a shift away from the successful cash bonus bidding system because we believe that the cash bonus ensures a fair and equitable return to the state, as well as ensuring the fair share of any revenue resulting from production.

It is conceivable that Prudhoe Bay may not have been found if royalty or net profits bidding or percentage acreage option had been employed.

Mr. Chairman, members of the committee, we have serious concern that if this legislation becomes law, the ultimate losers will be the citizens of this state, as well as the consumers of oil and gas.

Thank you for giving Chevron this opportunity to comment on this proposed legislation.

* * *

## DESCRIPTION OF LEASING METHODS IN HB854

Currently, the State of Alaska's leasing system is a cash bonus bid with a minimum fixed royalty of 12.5 percent. The methods outlined below include the present system with different fixed royalties, sliding scale royalty with bonus bid, sliding scale royalty bid with fixed bonus, net profit share bid with fixed bonus, royalty bid with fixed bonus and exploration work commitment. The basic elements of these methods are summarized below.

(1) Bonus Bid With Fixed Royalty

Bonus bid with fixed royalty is the system currently used by the State of Alaska. In a lease sale, the winning bid for a tract is the one which makes the highest sealed or auctioned cash bonus bid. There is also a minimum royalty of 12.5 percent. An advantage of this system is that government receives revenue regardless if there are economical quantities of oil or gas found and/or produced. To avoid early termination of production, royalties need to be flexible during a field's declining years.

(2) Sliding Scale Royalty With Bonus Bid (or Sliding Scale Bid with Fixed Bonus)

Under this system, the government receives a cash bonus bid and a sliding scale royalty. We used 12.5 percent as a minimum figure and 62.5 percent as a ceiling wherein the rate in any period is dependent upon the production of that period.

The royalty rate is graduated in much the same manner as the federal personal income tax. Table I gives two examples of a sliding scale royalty schedule. The royalty is progressive, that is, the royalty on additional production increases. For example, in the South Central Area, the initial 500 barrels pay a royalty of 12.5 percent, the next 500 barrels pay 25 percent. The royalty rate increases by 12.5 percentage points per 500 barrels until 2000 barrels of output are achieved. All production beyond 2001 barrels pays a royalty of 62.5 percent. Thus, if production reaches 5000 barrels, the average royalty rate is 50 percent. In the limit, the average rate would converge towards 62.5 percent as daily production continues to increase.

As field productivity declines and well production falls, the producer backs down the schedule and royalties decline. In order to optimally exploit the field, the royalties should decline to zero near the end of field life. Actually, final rates of five or six percent would result in minimal early shut down.

TABLE I
TYPICAL SLIDING SCALE ROYALTY SCHEDULES

SOUTH CENTRAL AREA

| Daily Average Prod. Rate (Bbls./day) | Incremental Royalty Rate (%) | Royalty For Specific Producing Rates: Producing Rate (Bbls./day) | Royalty Production (Bbls./day) | Average Royalty Rate (%) |
|---|---|---|---|---|
| -500 | 12.5 | 500 | 62.5 | 12.50 |
| 501-1000 | 25.0 | 1000 | 187.5 | 18.75 |
| 1001-1500 | 37.5 | 1500 | 375.0 | 25.00 |
| 1501-2000 | 50.0 | 2000 | 625.0 | 31.25 |
| 2001-2500 | 62.5 | 2500 | 937.5 | 37.50 |
| | | 3500 | 1562.5 | 44.64 |
| | | 4500 | 2187.5 | 48.61 |
| | | 5000 | 2500.0 | 50.00 |

NORTH SLOPE AREA

| Daily Average Prod. Rate (Bbls./day) | Incremental Royalty Rate (%) | Royalty For Specific Producing Rates: Producing Rate (Bbls./day) | Royalty Production (Bbls./day) | Average Royalty Rate (%) |
|---|---|---|---|---|
| -1000 | 12.5 | 1000 | 125 | 12.50 |
| 1001-2000 | 25.0 | 2000 | 375 | 18.75 |
| 2001-3000 | 37.5 | 3000 | 750 | 25.00 |
| 3001-4000 | 50.0 | 4000 | 1250 | 31.25 |
| 4001 and above | 62.5 | 5000 | 1875 | 37.50 |
| | | 7000 | 3125 | 44.64 |
| | | 9000 | 4375 | 48.61 |
| | | 10000 | 5000 | 50.00 |

Note: The Sliding Scale Royalty Schedule for the North Slope area is signifi cantly higher than for the South Central area because the higher North Slope operating costs result in a much higher economic limit.

Hopefully, this illustration clarifies the relationship between production rates and royalty rates.

Greater flexibility in setting the initial rate is the major advantage of this system while not running the risk of an uneconomically (for Industry) high royalty rate. On the other hand, to achieve an overall lower royalty payment, a company might spread out production over a longer period of time. Usually, however, because of the time value of money and increased operating costs, oil companies generally try to accelerate production.

(3) Net Profit Share Bid With Fixed Bonus

A small fixed bonus is required as earnest money. The bonus is low enough to encourage producers to bid a high net profit share while permitting profitable development.

(4) Royalty Bid With Fixed Bonus

This system utilizes the same method to calculate fixed bonus as described for Net Profit Share. The bid parameter is a function of production instead of net profits. Since the bonus is fixed, interested parties bid on the royalty rate that the government is to receive. The advantage of royalty bidding is that little front end money is needed by Industry. However, this could encourage speculation causing an overbid. Royalty bidding should encourage more competition among bidders and may allow the smaller companies a better chance of winning the tract.

(5) Work Commitment With Fixed Bonus, Royalty or Net Profit Share

The government itemizes the performance criteria such as the rate and amount of work to be performed on each tract. The total bid specified in dollar terms and a portion of the bid used for exploration and development activities. This system gives the government some control over the rate and extent of resource development.

SUMMARY OF ACREAGE LIMITATION
CHANGE IN HB 854

The acreage any one State lessee may hold is 500,000 acres upland and 500,000 acres offshore. HB 854 reduces the uplands to 200,000 acres. This is to help increase the number of upland lessees by limiting the holdings of the larger major oil companies. Offshore holdings will be unaffected.

No other state that we are aware of has an acreage limitation. But no other state is Alaska's size nor has any state tens of millions of acres available to lease.

The Federal government has an acreage maximum for its uplands within each state. During Alaska's territorial days the Federal oil and gas acreage limitation in Alaska was 100,000 acres. In other states it was 46,080 acres.

After 1961 the Federal maximum for Alaska rose to 300,000 acres in the Northern district (approximately north of the Yukon River) and 300,000 in the Southern district. These apply today. There is no Federal acreage limitation on the Outer Continental Shelf. Presently, the acreage limitation is 246,080 uplands acres of Federal leases per state, other than Alaska.

HB 854 grants companies five years from the effective date of the act to comply with the 200,000 upland acre maximum.

A list of major leaseholdings as of February, 1978, (showing uplands and offshore holdings of those companies which now exceed 200,000 acres) follows:

# ALASKA OIL AND GAS ACREAGE HOLDINGS
(as of March 13, 1978)

| COMPANY | ACRES | | |
|---|---|---|---|
| ARCO | 408,151.21 | 356,882.86 | acres of uplands |
| | | 51,268.35 | offshore |
| | | 408,151.21 | total |
| UNION | 287,032.83 | 233,138.75 | uplands |
| | | 53,894.08 | offshore |
| | | 287,032.83 | total |
| PHILLIPS PETROLEUM | 243,227.94 | 80,332.74 | uplands |
| | | 162,895.20 | offshore |
| | | 243,227.94 | total |
| EXXON | 158,627.73 | | |
| TEXACO | 156,027.03 | | |
| SOHIO PETROLEUM | 135,588.28 | | |
| BP ALASKA | 103,218.99 | | |
| CITIES SERVICE | 140,071.58 | | |
| CHEVRON | 126,493.55 | | |
| AMOCO | 126,134.64 | | |
| MOBIL | 120,375.19 | | |
| MARATHON OIL | 71,538.36 | | |
| BEARD OIL | 71,260.49 | | |
| SHELL OIL | 40,603.10 | | |
| GETTY | 29,857.30 | | |
| SUN OIL | 27,453.87 | | |

31-Q1LH

# STATE OF ALASKA


**THE LEGISLATURE**

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

FINANCE DIVISION
POUCH WF—STATE CAPITOL

JUNEAU 99801


April 3, 1978

M E M O R A N D U M

TO: Members of the Legislature

FROM: Gerald L. Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit

SUBJECT: Release of Audits

In accordance with AS 24.20.311, the following audit report was approved for release to the Legislature and the public on April 3, 1978:

A Review of Alaska Coastal Management Program, Grant No. 04-6-158-50029, Office of the Governor, Division of Policy Development and Planning

A Special Review of The Division of Marine Transportation, Department of Transportation and Public Facilities

Enclosed is a short digest covering the audit for your convenience. Should you desire a copy of the completed report, it is available at the following libraries or through our office (465-3830):

Alaska State Library
Alaska Historical Library
University of Alaska Library, College
University of Alaska Library, Anchorage
Z. J. Loussac Public Library, Anchorage
Fairbanks-North Star Borough Library, Fairbanks
Ketchikan Public Library
Kotzebue Public Library
Bethel Public Library
A. Holmes Johnson Public Library, Kodiak

Enclosure

31-Q1LH

# STATE OF ALASKA

**THE LEGISLATURE**

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

FINANCE DIVISION
POUCH WF—STATE CAPITOL

JUNEAU 99801

March 3, 1978

SUMMARY OF: A Special Review of the Division of Marine Transportation, Department of Transportation and Public Facilities

## PURPOSE OF THE REVIEW

In accordance with your request and Title 24 of the Alaska Statutes, this special report has been prepared on all passenger service aspects of the Division of Marine Transportation, Southeast System. The Steward's Department is responsible for passenger services. The report encompasses:

1. Purchasing and warehousing of supplies used by the Steward's Department.

2. Operating procedures of the Steward's Department on board vessels.

3. Accounting and management control of all passenger services activities.

## FINDINGS AND RECOMMENDATIONS

Most of the problem areas noted in our review have been addressed in prior audits, not only by the Division of Legislative Audit (November, 1973 and April, 1976) but also by the Governor's Management and Efficiency Review (May, 1976), the Department of Transportation and Public Facilities' Internal Review (November, 1977), and the Department of Administration's Division of Internal Audit (April, 1966). Each of the previously mentioned reviews emphasized the inadequacy of the Division's accounting and management information system. Yet, management still lacks any effective means of evaluating the Passenger Services Operation.

In addition, all reports noted deficiencies in procedures for purchasing and/or controlling inventory. Our current review again addresses the supply function. Unresolved problems exist in purchasing, receiving, record-keeping,

controlling merchandise transfers, and reconciling physical inventories with accounting records.

The dates of the above audits show that a sufficient period of time for effective action has elapsed since problem areas were initially addressed.

1. DOT-PF should review the total system of providing passenger services for the Marine Transportation Division--including supply, operating, and accounting functions--in order to coordinate efforts and clearly define responsibilities. When the analysis has been completed, procedures should be documented in an operating manual, distributed to appropriate personnel, and regularly updated.

2. The current system of reporting operating results to management is totally inadequate. Management must develop and utilize informational tools to effectively monitor current operations and to make sound long range policy decisions.

3. Material usage should be determined for all retailing operations of the Steward's Department. The usage should be regularly compared to developed usage standards and to sales.

4. Purchases should be planned in advance and based upon realistic usage expectations.

5. The Department should regularly dispose of inventory which exceeds reasonable need. The variety of inventory items should be reduced.

6. The Department's supply section should periodically conduct a complete inventory at all warehousing locations. The accounting section should develop and maintain inventory control accounts for all warehouse locations. These accounts should be reconciled by accounting to its project ledger data as well as to the results of supply's physical counts.

7. The Department's supply section should strengthen warehouse controls in two areas: 1) Receiving goods and 2) accuracy of warehouse records.

8. Accounting for merchandise transfers would be improved by controlling documents.

9. Control over goods and the accuracy of information generated by vessel personnel would be improved by instituting written procedures (see Recommendation

No. 1), training personnel, and improving communications between shore and vessels.

10. Petty cash accounts on vessels should be reduced to minimum amounts necessary for making change and small expenditures.

11. Coin-operated vending machines on vessels should be either owned by the State or covered by a valid contract.

12. Payments to foreign vendors should be made directly to the vendor. When a voucher is prepared the exchange rate should be determined from a local bank and the adjustment in U.S. funds should be recorded on the vendor's invoice.

31-Q1LH

# STATE OF ALASKA

**THE LEGISLATURE**

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

FINANCE DIVISION
POUCH WF—STATE CAPITOL

JUNEAU 99801

February 3, 1978

SUMMARY OF: A Review of the Alaska Coastal Management Program

## PURPOSE OF THE REVIEW

To perform a review of the Alaska Coastal Management Program second year grant (Grant No. 04-6-158-50029). The review included audit determinations in the areas of:

1. Financial Compliance
2. Economy and Efficiency
3. Program Results

## FINANCIAL ACTIVITIES

$1,788,169.52 was expended by the Alaska Coastal Management Program during the second grant year. As a result of this audit, we have questioned $548,480.34 of the expenditures.

## FINDINGS AND RECOMMENDATIONS

1. Property records maintained by the five departments purchasing equipment with Coastal Zone Management (CZM) funds should identify the source of funds used to acquire the property.

   Twenty-five equipment items purchased with CZM funds were examined. Seven of 25 items were not on the property list. Twelve of the remaining 18 items did not indicate funding source.

2. The Alaska Coastal Management Program should not conduct primary research for purposes of completing an Alaska Coastal Management Plan in accordance with the Coastal Zone Management Act of 1972. (PL 92-583, PL 94-37)

   The Department of Environmental Conservation (DEC) purchased equipment in the amount of $6,376 for use in gathering primary data. These expenditures were not authorized by ACMP.

3. Approved time reports should be submitted for all employees charging time to the grant.

Four departments, Office of the Governor, DEC, Natural Resources and Community and Regional Affairs do not require approved time sheets from their CZM employees. Consequently we were unable to determine if payroll charges were properly charged to CZM.

4. The methods of accounting for CZM Federal and match funds by the grantee and subgrantees need to be improved.

We found several exceptions in auditing the CZM funds which individually are insignificant, but when looked at together indicate weaknesses in the accounting for CZM funds.

5. The Alaska Coastal Management Program should establish policies and procedures for the accounting and reporting of in-kind match contributions.

Two departments, Fish and Game and Natural Resources have commingled CZM State match funds with regular operating funds. Consequently, we were unable to separately identify CZM expenditures.

EFFICIENCY AND ECONOMY OF OPERATIONS AND PROGRAM RESULTS

6. The Office of Coastal Zone Management should establish a work schedule that identifies and assigns priority to work program elements which must be completed and included as part of the federally approved Alaska Coastal Management Plan.

The Policy Base Document, which is the heart of the Coastal Management Program, is several months behind schedule.

7. The Office of Coastal Zone Management should review all work program elements to be sure all sections of the Alaska Coastal Management Act and the Federal Coastal Management Act are complied with.

We noted several program compliance contingencies which may prevent Federal and State approval of the Alaska Coastal Management Plan.

8. The Office of Coastal Zone Management should establish policies and procedures to assure effective use is made of available management and financial aids.

A. ACMP did not timely file required quarterly financial and progress reports.

B. ACMP did not timely process reimbursement requests. This cost the State approximately $100,000 in lost interest income.

9. State departments participating in the Alaska Coastal Management Program should obtain a federally approved indirect cost rate and apply it to eligible Federal reimbursable expenditures.

State departments did not claim indirect costs for reimbursements. This amounted to approximately $50,000.

HB 857

February 17, 1978

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

Under authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.30.060(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a bill extensively amending and updating AS 38.05.180, Oil and Gas Leasing.

I am pleased to present for your consideration this major piece of legislation dealing with Alaska's energy future. Not since statehood has the legislature addressed itself to determining how best to lease our petroleum land. Conditions have changed dramatically since then, both for the petroleum industry and the state, and it is time to make such a reappraisal.

The proposed changes will update the leasing law to provid increased public control over exploration, development, and production from state land, obtain a fair return from our non-renewable resources, and, at the same time, provide land from which explorers may find new energy supplies.

How Alaska leases its oil and gas lands will in large part determine our continuing relationship with the oil industry. Many of the problems we now confront in determining the state's fair share of the Prudhoe field could certainly best have been resolved at the time the initial leases were offered by the state. This legislation would make that more likely in the future.

As you are aware, Congress is presently debating a new law covering federal oil and gas leasing on the

Outer Continental Shelf. As you are also aware, much of the attractive OCS land is directly adjacent to Alaska's three-mile offshore land. For this reason, my proposed legislation attempts to be as inclusive as the federal OCS legislation, but more workable, and thus, hopefully, more acceptable to the oil and gas industry.

This legislation is designed to accomplish a number of important state objectives. First, it requires state land to be offered competitively under any of several new leasing methods, including bidding by royalty, sliding royalty net profits and work commitment or a combination of any of these methods. Under certain circumstances, land may be offered on a noncompetitive basis.

Second, it reduces the length of the term of a lease from ten years to five years, to assure that exploration begins promptly once state land is leased. Under certain severe environmental conditions a lease may be for a longer period, but not to exceed ten years.

Third, the legislation increases rentals, including those on shut-in fields, to increase incentives to explore and produce oil and gas fields.

Fourth, the bill grants to the state the right to purchase up to 16 2/3 per cent of the oil and 100 per cent of the natural gas or gas products from the lease, thereby protecting sale commitment of royalty oil and gas in the event the state's royalty is reduced on marginal fields.

Fifth, it reduces the acreage limitation on state uplands so that more companies will have an opportunity to participate in exploring in Alaska and, for the same reason, it allows the state to restrict joint bidding by major or international oil companies.

Finally, the legislation provides that the executive branch will file two reports with the legislature each year. One will outline the state's leasing program for the forthcoming five years. The other will explain the leasing methods used or to be used. I have chosen this method of informing the legislature and the public because I believe there is a need to create as much certainty in leasing policies and procedures as possible. Requiring a five-year state

leasing program to be made public will, I believe, lend stability and predictability to the petroleum exploration business in Alaska and will also raise the level of consciousness of the citizens of Alaska about the workings of the oil business. I can think of no better way to the inform the legislature and the public than to report on a regular basis what land will be made available for oil and gas leasing and by which of several leasing methods the state proposes to offer that land.

The second report will note which leasing methods were used during the preceding year and which methods are proposed to be used in the coming year. Hopefully, enough explanation as to why one method was chosen over another will help educate us all. Although this places an increased burden on those chosen to make these day-to-day decisions, I think it appropriate to use this public accounting procedure for all subsequent state oil and gas lease sales.

Through your leadership, the legislature and my Department of Natural Resources have worked together in an effort to find a solution to Alaska's future leasing policy.

The legislature's action in commissioning Dr. Mason Gaffney's study last year and the subsequent work by the department has paid dividends in developing our understanding of the options available to the state. I wish to thank you for your foresight and cooperation in this most important matter.

Sincerely,

Jay S. Hammond
Governor

DEPARTMENT OF NATURAL RESOURCES

INTRA-DEPARTMENT ROUTE SLIP

TO:
DIV/SEC: _____ LOCATION: _____

ATTN: Hugh Malone

| | |
|---|---|
| ☐ Approval | ☐ Note & Return |
| ☒ Signature | ☐ Initial & Return |
| ☐ Comment | ☐ Return As Requested |
| ☐ Contact Me | ☐ Return For Approval |
| ☐ Prepare Reply | ☐ Necessary Action |
| ☐ For Your File | ☒ Your Information |

REMARKS:

APR 26 1978

TB54

FROM:
BY: Jack Roderick DATE: 4/24/78

DIV/SEC: Special Projects DNGM. LOCATION: Anch

STATE
of ALASKA

# MEMORANDUM

HB 854

DEPARTMENT OF NATURAL RESOURCES
DIVISION OF MINERALS AND ENERGY MANAGEMENT

TO: Robert LeResche
Commissioner, DNR

DATE: April 24, 1978

FROM: Jack Roderick JR
Special Projects, DMEM

HB 854 - Alberta's Oil and Gas Incentive Credit regulations.

Having reviewed Alberta's drilling and geophysical incentive credit programs, I think we should familiarize ourselves before Michael Day, or some Alberta official, briefs us as to how the programs are actually administered. (see my 4/18 memo to Boness)

From reading the attached incentive regulations, it appears that the Board of Energy Resources Conservation (5 appointed persons regulating all energy matters in Alberta) decides which wells qualify for incentive credits. The Minister of Energy and Natural Resources (formerly mines and minerals) decides which seismic surveys qualify. In both cases, a certificate is issued to the qualifier when the permit is issued, prior to the actual drilling or shooting.

Credits may be taken against bonuses, rentals, royalties, and taxes for a fixed period of time (until December 31, 1978 under existing law). Please note that neither drilling nor geophysical credits are transferable. However, in the case of geophysical credits, if a licensee can show that he is not a holder of a "mineral right" under Alberta law the Minister may pay him an amount of money equivalent to the amount of credit he has earned. Gas credits are treated differently from oil credits.

For drilling credit purposes, Alberta is divided into 3 drilling and 4 geophysical regions. The intent, obviously, is to make certain areas of the Province more attractive for exploration by increasing (or decreasing) incentive credits in those areas.

The noninterpretive geophysical data collected by the licensee is made available by the licensee to the public for a period of not less than five years after acquisition at a designated percentage cost of the credit allowance. The government, therefore, enforces the law and regulations but the actual transfer of information takes place within the petroleum industry, not the government.

I have attached copies of Alberta's basic incentive credit regulations. I caution that they have been amended several times since their adoption, but in no structural way that I am aware of.

Michael Day, or whomever, can give us the details when and if he comes to Juneau. Milton Lipton, being a consultant to Alberta, will be able to contribute some comments, also.

cc: Green
Dobey
Speaker Hugh Malone
Gregg Erickson

GOVERNMENT OF THE PROVINCE OF ALBERTA

## ALBERTA REGULATION 18/74

*(Filed January 31, 1974)*

THE MINES AND MINERALS ACT

(O.C. 210/74)

Approved and Ordered,

GRANT MacEWAN,

Lieutenant Governor. Edmonton, January 30, 1974.

Upon the recommendation of the Honourable the Minister of Mines and Minerals, the Lieutenant Governor in Council, pursuant to section 14, clause (h) and sections 31 and 142 of The Mines and Minerals Act, makes the regulations in the Appendix attached hereto, being the "Exploratory Drilling Incentive Regulations, 1974".

PETER LOUGHEED (Chairman)

### EXPLORATORY DRILLING INCENTIVE REGULATIONS, 1974

1. In these regulations,

(a) "Board" means the Energy Resources Conservation Board;

(b) "class A footage" and "class B footage" mean the respective intervals of depth that are deemed by the Board to qualify for credit of an incentive exploratory well in accordance with section 6 of these regulations;

(c) "crude oil" means crude oil as defined under The Oil and Gas Conservation Act;

(d) "Department" means the Department of Mines and Minerals;

(e) "gas" means gas as defined under The Oil and Gas Conservation Act;

(f) "incentive exploratory well" means a well certified by the Board on or after January 1, 1974 as an incentive exploratory well;

(g) "licensee" means the person to whom a licence is granted under The Oil and Gas Conservation Act for a well certified as an incentive exploratory well;

(h) "Minister" means the Minister of Mines and Minerals;

(i) "plains area", "northern area" and "foothills area" mean the respective areas of Alberta defined in SCHEDULE C to these regulations.

2. (1) Where a licence is granted on or after January 1, 1974 for the drilling of a well for oil or gas, the Board, on the advice of its Geology Department, shall determine whether or not the well qualifies as an incentive exploratory well.

(2) Where a well qualifies as an incentive exploratory well under subsection (1), the Board shall so certify and attach a copy of the certification to each copy of the well licence.

(3) Within 30 days after the granting of a licence for a well that did not qualify as an incentive exploratory well, the applicant for the licence may request the Board to review the eligibility of the well for certification.

(4) Upon conclusion of the review under subsection (3) the Board shall notify the applicant of its decision and if the well qualifies as an incentive exploratory well the Board shall send two copies of the certification to the licensee.

3. (1) A certification lapses 30 days after the date thereof unless the drilling of the well has been commenced.

(2) Where the drilling of an incentive exploratory well is not being conducted to the satisfaction of the Board until completion or abandonment of the well, the Board shall so notify the licensee and thereupon the certification lapses.

(3) When a certification lapses the Board shall inform the Department.

4. (1) When a certification for an incentive exploratory well lapses the holder of the well licence may, within 30 days after the date on which certification lapsed, apply to the Board for a new certification and if the well qualifies as an incentive exploratory well the Board shall so certify subject to subsections (2) and (3).

(2) If any other well has been licensed and certified in the area influenced by the well for which an application for new certification is made under subsection (1), the Board will determine the amount of qualifying footage for the well as though the existing incentive exploratory well had not been certified, and in the event of more than one well having been licensed and certified, priority for credit will be determined by the date of certification.

(3) For the purpose of determining priority for credit between a well under subsection (1) and a well under subsection (2), the application for new certification under subsection (1) shall be treated by the Board as though it were an initial application for well licence and certification.

(4) Where the well referred to in subsection (1) or (2) is certified as an incentive exploratory well, the Board shall send two copies of the certification to the licensee.

5. The Board shall send a copy of each certification to the Department.

6. (1) After the drilling of an incentive exploratory well is completed and upon receipt by the Board of all relevant information relating to the well the Board shall determine what intervals of depth, if any, of the well qualify as class A footage and class B footage.

(2) Upon conclusion of the determination under subsection (1) the Board shall notify the licensee of its decision.

(3) The licensee may forthwith advise the Board that he accepts the determination indicated under subsection (2).

(4) Within 30 days of the notification made under subsection (2) the licensee may apply to the Board to review the determination and the application shall be accompanied by particulars to substantiate any alternative determination of class A footage or class B footage made by the licensee.

(5) Upon conclusion of the review under subsection (4) the Board shall notify the licensee of its decision.

7. When an incentive exploratory well is completed or abandoned to the satisfaction of the Board, it shall inform the Department

(a) the date that the well was completed or abandoned,

(b) the depth of the well in feet, and

(c) the intervals of depth that qualify as class A footage or class B footage.

8. (1) When an incentive exploratory well has been completed or abandoned to the satisfaction of the Board, a credit shall be determined by the Department in accordance with SCHEDULE A or SCHEDULE B and the licensee shall be notified of the credit as determined.

(2) The licensee, within 30 days after the notification made under subsection (1) shall inform the Department in writing as to the manner of allocation of the credit among the participants including those referred to in subsection (5), and the credit shall be allocated and established accordingly.

(3) If the licensee fails to inform the Department within 30 days of the manner of allocation of credit, the credit as determined in subsection (1) shall be established in the records of the Department in the name of the licensee

(4) If an amendment to a well licence is obtained to deepen an incentive exploratory well beyond the formation originally authorized by the well licence, the credit with respect to the deepened portion of the well shall be established according to subsection (2) or (3) unless within 30 days after being notified under subsection (1) the licensee informs the Department in writing as to the manner of allocation of the credit relating to the deepened portion of the well, and thereupon the credit shall be allocated and established accordingly.

(5) The licensee in allocating credit under subsection (2) or (4) shall not allocate more than 20 per cent of the credit to those participants who do not contribute to the actual cost of drilling the well.

(6) Credit established for an incentive exploratory well may, after its allocation, be revised at the discretion of the Minister if the revision is warranted based on information not previously regarded or correctly processed by the Board or the Department.

(7) Credit established under this section is not transferable

9. A credit shall not be established for any incentive exploratory well the drilling of which is commenced after December 31, 1977.

10. Credit established pursuant to section 8, upon the written request of the holder thereof, and subject to procedures established by the Department, may be applied in satisfaction of

(a) moneys payable by him with respect to any applications and dispositions made under Part 5 of The Mines and Minerals Act,

(b) moneys payable by him pursuant to section 40 of The Mines and Minerals Act, or

(c) taxes levied under The Freehold Mineral Taxation Act,

and becoming due and payable between January 1, 1974 and December 31, 1979.

11. Crude oil production

(a) obtained from the class A or class B footage interval of an incentive exploratory well that was certified after January 1, 1974 and that commenced drilling before December 31, 1977,

(b) obtained from a pool in which no other well within three miles has been exempted from payment of royalty to the Crown either under these regulations or under Alberta Regulation 378/72, and

(c) attributable to the drilling spacing unit of the incentive exploratory well referred to under (a),

shall be exempt from payment of royalty to the Crown for a period terminating five years after the date on which production of the well commences.

12. (1) Gas production

(a) obtained from the class A or class B footage interval of an incentive exploratory well that was certified after January 1, 1974 and that commenced drilling before December 31, 1977,

(b) obtained from a pool in which no other well within three miles has been exempted from payment of royalty to the Crown under these regulations, and

(c) attributable to the drilling spacing unit of the incentive exploratory well referred to under (a),

shall be exempt from payment of royalty to the Crown for a period terminating two years after the date on which production of the well commences.

(2) The exemption in subsection (1) is void at the end of seven years from the original finished drilling date of the incentive exploratory well but may be extended at the discretion of the Minister.

13. Where a drilling spacing unit contains a well that is completed for crude oil production in accordance with clauses (a) and (b) of section 11, it shall be exempt from the payment of tax under The Freehold Mineral Taxation Act with respect to petroleum for a period of five calendar years immediately following the year in which the well was completed.

14. Where a drilling spacing unit contains a well that is completed for gas production in accordance with clauses (a) and (b) of section 12, it shall be exempt from the payment of tax under The Freehold Mineral Taxation Act with respect to natural gas for a period of two calendar years immediately following the year in which the well was completed.

15. A decision of the Board under these regulations is final.

## SCHEDULE A

### Applicable to Class A Footage

Class A footage shall be determined as being the depth interval of a well that has not been duplicated either by

(i) a drilled and abandoned well within approximately one and one-half miles, or

(ii) a completed well or a well that in the opinion of the Board warrants completion, within approximately three miles

| *Depth, Feet* | *Basis for Credit, Plains Area* | | *Basis for Credit, Northern Area* | | *Basis for Credit, Foothills Area* | |
|---|---|---|---|---|---|---|
| | *Cumulative Dollars* | *Incremental $/foot* | *Cumulative Dollars* | *Incremental $/foot* | *Cumulative Dollars* | *Incremental $/foot* |
| 0 | 0 | | 0 | | 0 | |
| | | 4.00 | | 6.00 | | 8.00 |
| 1,000 | 4,000 | | 6,000 | | 8,000 | |
| | | 4.00 | | 6.00 | | 9.00 |
| 2,000 | 8,000 | | 12,000 | | 17,000 | |
| | | 5.00 | | 7.00 | | 10.00 |
| 3,000 | 13,000 | | 19,000 | | 27,000 | |
| | | 6.00 | | 8.00 | | 11.00 |
| 4,000 | 19,000 | | 27,000 | | 38,000 | |
| | | 7.00 | | 9.00 | | 12.00 |
| 5,000 | 26,000 | | 36,000 | | 50,000 | |
| | | 8.00 | | 11.00 | | 14.00 |
| 6,000 | 34,000 | | 47,000 | | 64,000 | |
| | | 10.00 | | 13.00 | | 17.00 |
| 7,000 | 44,000 | | 60,000 | | 81,000 | |
| | | 15.00 | | 19.00 | | 23.00 |
| 8,000 | 59,000 | | 79,000 | | 104,000 | |
| | | 20.00 | | 23.00 | | 28.00 |
| 9,000 | 79,000 | | 102,000 | | 132,000 | |
| | | 26.00 | | 30.00 | | 36.00 |
| 10,000 | 105,000 | | 132,000 | | 168,000 | |
| | | 35.00 | | 40.00 | | 48.00 |
| 11,000 | 140,000 | | 172,000 | | 216,000 | |
| | | 47.00 | | 50.00 | | 56.00 |
| 12,000 | 187,000 | | 222,000 | | 272,000 | |
| | | 62.00 | | 66.00 | | 72.00 |
| 13,000 | 249,000 | | 288,000 | | 344,000 | |
| | | 83.00 | | 85.00 | | 96.00 |
| 14,000 | 332,000 | | 373,000 | | 440,000 | |
| | | 110.00 | | 107.00 | | 120.00 |
| 15,000 | 442,000 | | 480,000 | | 560,000 | |
| | | 147.00 | | 148.00 | | 160.00 |
| 16,000 | 589,000 | | 628,000 | | 720,000 | |
| | | 196.00 | | 184.00 | | 200.00 |
| 17,000 | 785,000 | | 812,000 | | 920,000 | |
| | | 255.00 | | 228.00 | | 240.00 |
| 18,000 | 1,040,000 | | 1,040,000 | | 1,160,000 | |
| | | 340.00 | | 316.00 | | 320.00 |

## SCHEDULE B

### Applicable to Class B Footage

Class B footage shall be determined as being the depth interval of a well that has been duplicated by the deepest drilled and abandoned well within approximately one and one-half miles, providing that such depth interval has not been duplicated within approximately three miles by a completed well or a well that in the opinion of the Board warrants completion.

| *Depth, Feet* | *Basis for Credit, Plains Area* | | *Basis for Credit, Northern Area* | | *Basis for Credit, Foothills Area* | |
|---|---|---|---|---|---|---|
| | *Cumulative Dollars* | *Incremental $/foot* | *Cumulative Dollars* | *Incremental $/foot* | *Cumulative Dollars* | *Incremental $/foot* |
| 0 | 0 | | 0 | | 0 | |
| | | 3.00 | | 4.00 | | 6.00 |
| 1,000 | 3,000 | | 4,000 | | 6,000 | |
| | | 3.00 | | 5.00 | | 7.00 |
| 2,000 | 6,000 | | 9,000 | | 13,000 | |
| | | 4.00 | | 5.00 | | 8.00 |
| 3,000 | 10,000 | | 14,000 | | 21,000 | |
| | | 4.00 | | 6.00 | | 8.00 |
| 4,000 | 14,000 | | 20,000 | | 29,000 | |
| | | 5.00 | | 7.00 | | 9.00 |
| 5,000 | 19,000 | | 27,000 | | 38,000 | |
| | | 6.00 | | 8.00 | | 11.00 |
| 6,000 | 25,000 | | 35,000 | | 49,000 | |
| | | 8.00 | | 10.00 | | 13.00 |
| 7,000 | 33,000 | | 45,000 | | 62,000 | |
| | | 11.00 | | 14.00 | | 16.00 |
| 8,000 | 44,000 | | 59,000 | | 78,000 | |
| | | 15.00 | | 18.00 | | 21.00 |
| 9,000 | 59,000 | | 77,000 | | 99,000 | |
| | | 20.00 | | 22.00 | | 27.00 |
| 10,000 | 79,000 | | 99,000 | | 126,000 | |
| | | 26.00 | | 30.00 | | 36.00 |
| 11,000 | 105,000 | | 129,000 | | 162,000 | |
| | | 35.00 | | 38.00 | | 42.00 |
| 12,000 | 140,000 | | 167,000 | | 204,000 | |
| | | 47.00 | | 49.00 | | 54.00 |
| 13,000 | 187,000 | | 216,000 | | 258,000 | |
| | | 62.00 | | 64.00 | | 72.00 |
| 14,000 | 249,000 | | 280,000 | | 330,000 | |
| | | 83.00 | | 80.00 | | 90.00 |
| 15,000 | 332,000 | | 360,000 | | 420,000 | |
| | | 110.00 | | 111.00 | | 120.00 |
| 16,000 | 442,000 | | 471,000 | | 540,000 | |
| | | 147.00 | | 138.00 | | 150.00 |
| 17,000 | 589,000 | | 609,000 | | 690,000 | |
| | | 191.00 | | 171.00 | | 180.00 |
| 18,000 | 780,000 | | 780,000 | | 870,000 | |
| | | 255.00 | | 237.00 | | 240.00 |

## SCHEDULE C

### FOOTHILLS AREA

The Foothills Area consists of the lands in Alberta listed below and those lands within Alberta located south and west of the listed lands:

Township 1, Range 24; Township 2, Range 25; Township 3, Range 26; Township 4, Range 27; Township 5, Range 28; and Townships 6 to 11 inclusive, Range 29, all west of the 4th Meridian;

and

Townships 12 and 13, Range 1; Townships 14 to 20 inclusive, Range 2; Townships 21 and 22, Range 3; Townships 23 to 28 inclusive, Range 4; Townships 29 and 30, Range 5; Townships 31 to 34 inclusive, Range 6; Townships 35 and 36, Range 7; Township 37, Range 8; Township 38, Range 9; Townships 39 and 40, Range 10; Township 41, Ranges 11, 12 and 13 inclusive; Township 42, Range 14; Township 43, Ranges 15 and 16; Township 44, Range 17; Townships 45 and 46, Range 18; Townships 47 and 48, Range 19; Township 48, Range 20; Township 49, Ranges 21 and 22; Township 50, Range 23; Townships 51 and 52, Range 24; Townships 53 and 54, Range 25; Township 54, Range 26; Townships 55 and 56, Range 27, all west of the 5th Meridian;

and

Township 56, Range 1; Townships 57 and 58, Range 2; Township 58, Range 3; Townships 59 and 60, Range 4; Township 60, Ranges 5 and 6; Township 61, Ranges 7 and 8; Township 62, Ranges 9, 10 and 11; Townships 63 and 64, Range 12; and Township 65, Ranges 13 and 14, all west of the 6th Meridian.

### PLAINS AREA

The Plains Area consists of the lands in Alberta contained within the outer perimeter of the lands listed below:

On the east by Townships 1 to 52 inclusive, Range 1; on the north by Township 52, Ranges 1 to 12 inclusive; on the east by Townships 53 to 58 inclusive, Range 13; and on the north by Township 58, Ranges 13 to 26 inclusive; all west of the 4th Meridian;

and

On the north by Township 58, Ranges 1 to 4 inclusive; on the west by Townships 35 to 58 inclusive, Range 4; all west of the 5th Meridian;

and

On the west from Townships 1 to 34 inclusive, the lands immediately adjacent to the FOOTHILLS AREA.

and

On the south by Township 1, Ranges 1 to 23 inclusive, all west of the 4th Meridian.

### NORTHERN AREA

The Northern Area consists of the remaining lands in Alberta not included in the FOOTHILLS AREA or the PLAINS AREA.

(Extract from *The Alberta Gazette*, February 15, 1974)

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GOVERNMENT OF THE PROVINCE OF ALBERTA

## ALBERTA REGULATION 35/75

*(Filed February 11, 1975)*

THE MINES AND MINERALS ACT

(O.C. 219/75)

Approved and Ordered,

RALPH G. STEINHAUER,

Lieutenant Governor. Edmonton, February 10, 1975.

Upon the recommendation of the Honourable the Minister of Mines and Minerals, the Lieutenant Governor in Council, pursuant to section 14, clause (h) of The Mines and Minerals Act, makes regulations in accordance with the Appendix attached hereto, being the Geophysical Incentives Program Regulations.

PETER LOUGHEED (Chairman)

## GEOPHYSICAL INCENTIVE PROGRAM REGULATIONS

1. In these regulations,

(a) "Department" means the Department of Mines and Minerals;

(b) "foothills area", "green area", "yellow area" and "plains area" mean the respective areas of Alberta described in Schedule C to these regulations;

(c) "geophysical incentive program" means a seismic survey conducted for the purpose of exploring for petroleum or natural gas or both and certified by the Minister as a geophysical incentive program;

(d) "geophysical information and data" means all field data, field reports and the standard processed sections that are stacked after filtering and correction for statics and normal moveout;

(e) "licence" means a licence issued pursuant to Part 9 of The Mines and Minerals Act;

(f) "licensee" means the holder of a licence;

(g) "minimum subsurface coverage" means the coverage obtained when seismic pulses generated from not less than four different source positions are reflected from a subsurface point;

(h) "Minister" means the Minister of Mines and Minerals;

(i) "seismic survey" means a survey conducted by the use of the geophysical prospecting technique known as the seismic reflection method.

2. These regulations do not apply to a seismic survey the recording of which commenced before January 1, 1975.

3 (1) A licensee may, in accordance with these regulations, apply to the Minister to have a seismic survey certified as a geophysical incentive program.

(2) An application under subsection (1) shall be made

(a) prior to commencing the recording of the seismic survey, or

(b) in a case where the recording of the seismic survey commenced on or after January 1, 1975 and before the coming into force of these regulations, not later than February 28, 1975.

(3) The application shall be in Form 1 of Schedule A to these regulations.

(4) Where a seismic survey initially qualifies as a geophysical incentive program, the Minister shall issue an Interim Certificate in Form 2 of Schedule A to these regulations which shall be attached to the copy of the licence in the records of the Department.

(5) A copy of the Interim Certificate shall be sent to the licensee.

4. (1) An Interim Certificate lapses one year after the date thereof unless the seismic survey to be conducted under the Interim Certificate has been commenced.

(2) An Interim Certificate may be granted for one or more seismic surveys to be conducted thereunder.

5. Where a seismic survey is being conducted under an Interim Certificate, the Minister or any person authorized by him may at any time for the purposes of investigation and inspection have access to all the field data and field reports obtained by the licensee during the course of conducting the seismic survey, and the licensee or his representative shall render to the Minister or the person authorized by him such assistance as may be necessary.

6. (1) Within 90 days of completing a seismic survey or surveys under an Interim Certificate, the licensee shall submit to the Minister a final report in Form 3 of Schedule A to these regulations for each seismic survey so completed.

(2) The final report in subsection (1) shall be executed on behalf of the licensee by a registered member of The Association of Professional Engineers, Geologists and Geophysicists of Alberta under seal.

(3) Upon submitting the final report or reports, the licensee may in writing request the Minister to approve a reduction in the size or extent of a seismic survey, and where the Minister approves the reduction the Interim Certificate shall be amended accordingly and a copy shall be sent to the licensee.

(4) Upon receipt of the final report or reports, the licensee shall, at the request of the Minister, make available to the Department for purposes of investigation and inspection all geophysical information and data obtained from each seismic survey completed under the Interim Certificate.

7. (1) When the seismic survey or surveys under an Interim Certificate are completed to the satisfaction of the Minister, the Minister shall certify the seismic survey or surveys as a geophysical incentive program and a credit shall be determined by the Minister in accordance with Schedule B to these regulations, and the licensee shall be notified of the credit as determined.

(2) The Minister shall not give a certification under subsection (1) where he is satisfied that

(a) the seismic survey fails to meet the minimum subsurface coverage, or

(b) the seismic survey is not conducted in accordance with the standards of good geophysical practices.

(3) The licensee, prior to the recording of a seismic survey that is the subject of an application under section 3, shall inform the Minister

in writing as to the manner of allocation of the credit among the participants who have contributed to the actual cost of conducting the seismic survey.

(4) If the licensee fails to inform the Minister of the manner of allocation of the credit, the credit as determined in subsection (1) shall be established in the records of the Department in the name of the licensee.

(5) A credit established pursuant to this section is not transferable.

8. (1) Subject to subsection (2), a credit established pursuant to section 7 may, upon the written request of the licensee, be applied in satisfaction of

(a) moneys payable by him pursuant to dispositions under Part 5 of The Mines and Minerals Act; or

(b) taxes levied under The Freehold Mineral Taxation Act.

(2) Where a licensee provides the Minister with satisfactory evidence indicating that the licensee is not the registered owner of a mineral right within the meaning of The Freehold Mineral Taxation Act or the holder of an agreement under Part 5 of The Mines and Minerals Act, the Minister may pay to the licensee an amount in money equivalent to the amount of credit established in his name in the records of the Department.

9. (1) Any geophysical information and data obtained pursuant to a certified geophysical incentive program shall be made available by the licensee to any person for a period of not less than five years,

(a) three years after the date upon which the geophysical incentive program was certified under section 7, and

(b) at a cost to that person of not more than 60 per cent of the credit established under section 7 for each mile of minimum subsurface coverage.

(2) If a licensee, within the three-year period referred to in subsection (1),

(a) withdraws from Alberta and ceases carrying on business in Alberta, or

(b) being a corporation, is dissolved or is struck off the register pursuant to The Companies Act

he shall place in trust with a person approved by the Minister all the geophysical information and data obtained pursuant to a certified geophysical incentive program until the three-year period has expired and for an additional period of five years, and any credit held in the name of the licensee in the records of the Department shall be cancelled.

10. (1) Where a seismic survey or surveys conducted under an Interim Certificate are not completed to the satisfaction of the Minister and certification as a geophysical incentive program is not granted, all geophysical information and data obtained from the seismic survey or surveys shall be made available in accordance with section 9.

(2) Where a licensee fails to make available geophysical information and data in accordance with section 9, his licence and any credit established under section 7 shall be cancelled.

11. Any of the powers of the Minister under these regulations may be exercised by any employee of the Department authorized in writing by the Minister for that purpose.

SCHEDULE A

Form 1

(Section 3)

APPLICATION FOR CERTIFICATION OF A GEOPHYSICAL INCENTIVE PROGRAM

DATE: .....

NAME OF LICENSEE: .....

ADDRESS: .....

LICENCE NO. .....

PROGRAM NO. ..... NUMBER OF SURVEYS IN PROGRAM:

PROGRAM COMMENCEMENT DATE:

ANTICIPATED PROGRAM COMPLETION DATE:

LICENSEE REPRESENTATIVE: TELEPHONE NO.

.....

*(Note: Complete one survey schedule for each survey indicated in above application.)*

SURVEY SCHEDULE

SURVEY NO.

NAME OF PERMITTEE:

ADDRESS:

PERMIT NO. PARTY NO.

SURVEY RECORDING TO COMMENCE:

ANTICIPATED RECORDING COMPLETION DATE:

ENERGY SOURCE:

SOURCE SPACING (FEET):

RECEIVER SPACING (FEET):

NUMBER OF TRACES:

*yellow-plains* *green* *foothills*

MILES PLANNED (APPROX.):

INCENTIVE ANTICIPATED (APPROX.):

TOTAL INCENTIVE ANTICIPATED:

*Licensee*

*(Note: Application must be accompanied by a map or maps on a scale of not less than 1" = 1 mile.)*

Form 2
(Section 3)
INTERIM CERTIFICATE NO.

DATE:

NAME OF LICENSEE:

ADDRESS:

LICENSE NO.

PROGRAM NO. NUMBER OF SURVEYS IN PROGRAM:

*Minister of Mines and Minerals*

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Form 3
(Section 6)
FINAL REPORT

LICENSEE:
LICENSE NO.:
ADDRESS:
INTERIM CERTIFICATE NO.: INTERIM CERTIFICATE DATE
RECORDING COMMENCEMENT DATE
RECORDING COMPLETION DATE
PERMITTEE:
PERMIT NO.:
ADDRESS: PARTY NO.
RECORDING COMMENCEMENT DATE
RECORDING COMPLETION DATE
AMPLIFIER MAKE MODEL NO. OF TRACES
24 48 Other

SOURCE INTERVAL RECEIVER INTERVAL SOURCE TYPE

| | *yellow-plains* | *green* | *foothills* |
|---|---|---|---|
| No. of miles of minimum subsurface coverage. (Accurate to two significant decimals) | | | |
| | 500 x 1 | 500 x 2 | 500 x 3 |
| Credit (in dollars) applied for | = $ | = $ | = $ |
| | | | Total $ |

I, the undersigned, certify that I am qualified to report on this program and have personal knowledge of and attest to the accuracy of the above report.

*Name and Seal* *APPEGGA Class*

*(Note: Must be accompanied by a map or maps on a scale of not less than 1" = 1 mile showing location of data recorded.*
*A final report must be completed for each seismic survey in a program.)*

## SCHEDULE B

## DETERMINATION OF CREDIT

The credit in dollars for a certified geophysical incentive program shall be calculated in accordance with the following equation:

Credit (in dollars) = 500 KM

where K is the incentive factor for the area of Alberta described in Schedule C in which the geophysical incentive program was conducted,

and

M is the number of miles of minimum subsurface coverage in that area.

*Incentive Factors*

For the purposes of section 7 and this Schedule, the incentive factors established for the areas of Alberta described in Schedule C are:

(a) 1 for the yellow area and the plains area;

(b) 2 for the green area; and

(c) 3 for the foothills area.

## SCHEDULE C

*Foothills Area*

The foothills area consists of the lands in Alberta listed below and those lands within Alberta located south and west of the listed lands:

Township 1, Range 24; Township 2, Range 25; Township 3, Range 26; Township 4, Range 27; Township 5, Range 28; and Townships 6 to 11 inclusive, Range 29, all west of the 4th Meridian;

and

Townships 12 and 13, Range 1; Townships 14 to 20 inclusive, Range 2; Townships 21 and 22, Range 3; Townships 23 to 28 inclusive, Range 4; Townships 29 and 30, Range 5; Townships 31 to 34 inclusive, Range 6; Townships 35 and 36, Range 7; Township 37, Range 8; Township 38, Range 9; Townships 39 and 40, Range 10; Township 41, Ranges 11, 12 and 13 inclusive; Township 42, Range 14; Township 42, Ranges 15 and 16; Township 41, Range 17; Townships 45 and 46, Range 18; Townships 47 and 48, Range 19; Township 48, Range 20; Township 49, Ranges 21 and 22; Township 50, Range 23; Townships 51 and 52, Range 24; Townships 53 and 54, Range 25; Township 54, Range 26; Townships 55 and 56, Range 27, all west of the 5th Meridian;

and

Township 56, Range 1; Townships 57 and 58, Range 2; Township 58, Range 3; Townships 59 and 60, Range 4; Township 60, Ranges 5 and 6; Township 61, Ranges 7 and 8; Township 62, Ranges 9, 10 and 11; Townships 63 and 64, Range 12; and Township 65, Ranges 13 and 14, all west of the 6th Meridian.

*Green Area*

The green area consists of that part of Alberta in which public lands are classified a forest land not available for agricultural develop-

ment other than grazing by an order of the Minister of Lands and Forests pursuant to section 12 of The Public Lands Act, but does not include those lands described in this Schedule as the foothills area.

*Yellow Area*

The yellow area consists of that part of Alberta in which public lands are classified as being adaptable to any kind of disposition by an order of the Minister of Lands and Forests pursuant to section 12 of The Public Lands Act.

*Plains Area*

The plains area consists of the remaining lands in Alberta not described in the foothills area, the green area or the yellow area.

(Extract from *The Alberta Gazette*, February 28, 1975)

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