

HB

128

# HOUSE COMMITTEE REPORT

(9)

Date Referred: January 30, 1989

FURTHER REFERRALS: FINANCE

Date of Committee Action: 3-28-89

The RESOURCES Committee recommends that:

HOUSE BILL NO. 128 [OIL & GAS LEASES & ROYALTY REDUCTION]  
"An Act relating to state oil and gas and geothermal leasing practices and adjustments of state royalties to encourage commercial production."

be replaced with CS HB 128 (RES)  the same title  
 a new title

have attached amendment(s)

- do pass
- do not pass
- no recommendation
- individual recommendations
- additional referral to the \_\_\_\_\_ Committee

DOPTS: \_\_\_\_\_ letter of intent

ATTACHES NEW FISCAL NOTE(S):

- fiscal impact
- zero fiscal note
- zero with analysis

APPROVES PREVIOUS:

- fiscal note(s) published: \_\_\_\_\_
- zero fiscal notes(s) published: \_\_\_\_\_

SIGNING DO PASS:

Cliff Davidson  
George Farkas  
Mike Deuss  
Mike Savane

SIGNING OTHER THAN DO PASS:

(Do Not Pass, No Recommendation, Amend)

Bob A. Mann No-Rec  
Bill Hulse No-Rec  
W. J. ... Do Not Pass

Cliff Davidson  
 Chairman's signature

3/28/89  
HB 128

AMENDMENT

by BROWN

page 3, line 12:

Delete "find"  
Insert "make a written finding"

Adopted

3-28-89

STEVE COWPER, GOVERNOR

March 15, 1989

**DEPARTMENT OF NATURAL RESOURCES**

400 WILLOUGHBY AVE.  
JUNEAU, ALASKA 99801-1796  
PHONE: (907) 465-2400

OFFICE OF THE COMMISSIONER

The Honorable Cliff Davidson  
Alaska State Representative  
The Honorable Curt Menard  
Alaska State Representative  
Co-Chairmen  
House Resources Committee  
Alaska State Legislature  
P.O. Box V  
Juneau, AK 99811

Dear Representative Davidson and Representative Menard:

Subject: House Bill 128, relating to state oil, gas and geothermal leasing practices, and adjustments of royalties to encourage commercial production.

Position: The Department of Natural Resources supports this bill. It would allow us to be more responsive to industry requests for oil and gas lease sales, would clarify existing public noticing requirements, and would enable us to grant a royalty reduction for shut-in oil and gas that makes resumption of production economically feasible.

Background: Sections one and three of this bill reflect administrative changes in the state's oil and gas leasing program that would lead to increased efficiency for the department, and would generate additional revenues for the state.

An "exempt" oil and gas lease sale consists of acreage that has already been leased at least once by the state, or acreage that is adjacent to already leased lands. A "reoffering" sale consists of acreage that was offered for lease at least once by the state but, for various reasons, was never purchased.

Existing statutes allow the department to hold an exempt oil and gas lease sale without preparing a new written finding, if a written finding has been prepared for the general area during the previous 3 years. This bill would increase the elapsed time before a new finding needs to be prepared to five years. The existing three year period is not enough time for us to offer eligible acreage, as requested by industry, for lease.

This bill would also make the five year exemption from a written finding available to us for reoffering sales, and would increase the lease term for a reoffering sale from five years to ten. Ten

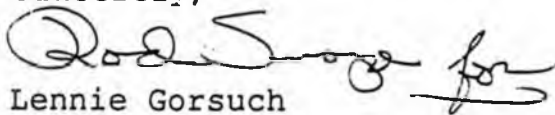
years is the lease term used for other oil and gas lease sales.

Section two of the bill would assist owners of shut-in fields to reestablish commercial production by allowing the Commissioner, based on certain conditions, to reduce the required lease royalty. Royalty reductions granted under this bill would be conditioned to protect the state's interest.

Section four of this bill is an housekeeping measure that would clarify the public noticing requirements for state oil and gas lease sales.

Please let me know if you would like additional information related to this bill.

Sincerely,

A handwritten signature in cursive script, appearing to read "Lennie Gorsuch for".

Lennie Gorsuch  
Commissioner

cc: Committee members  
Sponsor  
Bob Evans  
Denby Lloyd  
Dennis Kelso  
Don Collinsworth  
Jim Eason

6-0529E ✓  
Chenoweth  
3/29/89

Original sponsors: Brown, M.Davis,  
Gruenberg, and Ellis

1 IN THE HOUSE

BY THE RESOURCES COMMITTEE

2 CS FOR HOUSE BILL NO. 128 (Resources)

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 SIXTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to state oil and gas and geothermal  
7 leasing practices and adjustments of state royalties  
8 to encourage commercial production."

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

10 \* Section 1. AS 38.05.035(e) is amended to read:

11 (e) Upon a written finding that the interests of the state will  
12 be best served, the director may, with the consent of the commis-  
13 sioner, approve contracts for the sale, lease, or other disposal of  
14 available land, resources, property or interests in them, and, in  
15 addition to the conditions and limitations imposed by law, may impose  
16 additional conditions or limitations in the contracts as the director  
17 determines, with the consent of the commissioner, will best serve the  
18 interests of the state. A contract for the sale, lease, or other  
19 disposal of available land or an interest in land is not legally  
20 binding on the state until the commissioner approves the contract but  
21 if the appraised value is not greater than \$50,000 in the case of the  
22 sale of land or an interest in land, or \$5,000 in the case of the  
23 annual rental of land or interest in land, the director may execute  
24 the contract without the approval of the commissioner. Before a  
25 public hearing, if held, or in any case no less than 21 days before  
26 the sale, lease, or other disposal of available land, property, re-  
27 sources, or interests in them, the director shall make available to  
28 the public a written finding that sets out the facts and applicable  
29 law upon which the determination that the sale, lease, or other

1 disposal will best serve the interests of the state was based. A  
2 written finding is not required before the approval of

3 (1) a contract for a negotiated sale authorized under  
4 AS 38.05.115;

5 (2) a lease of land for a shore fishery site under AS 38.-  
6 05.082;

7 (3) a permit or other authorization revocable by the com-  
8 missioner;

9 (4) a mineral claim located under AS 38.05.195;

10 (5) a mineral lease issued under AS 38.05.205; [OR]

11 (6) a production license issued under AS 38.05.207; [OR]

12 (7) an exempt oil and gas sale under AS 38.05.180(d) of  
13 acreage offered in a sale that was held within the previous five years  
14 if the sale was subject to [FOR WHICH] a written best interest find-  
15 ing, [HAS BEEN ISSUED FOR THE AREA OF THE SALE WITHIN THE 36 MONTHS  
16 BEFORE THE DATE OF THE SALE] unless the commissioner determines that  
17 new information has become available that justifies a revision of the  
18 best interest finding; or

19 (8) a lease sale under AS 38.05.180(w) of acreage offered  
20 in a sale that was held within the previous five years if the sale was  
21 subject to a best interest finding, unless the commissioner determines  
22 that new information has become available that justifies a revision of  
23 the best interest finding.

24 \* Sec. 2. AS 38.05.180(j) is amended to read:

25 (j) To prolong the economic life of an oil and gas field or to  
26 reestablish commercial production of shut-in oil or gas that would not  
27 otherwise be economically feasible, the commissioner shall adopt  
28 regulations [FOR ALL BIDDING METHODS] to allow reduction of royalty on  
29 leases [WITHIN THE FIELD TO COMPENSATE FOR INCREASING COSTS IN THE

1 LATER STAGES OF PRODUCTION DECLINE]. The commissioner may not grant a  
2 reduction of royalty unless the [UNTIL TWO YEARS' INITIAL PRODUCTION  
3 FROM THE FIELD HAS OCCURRED AND EACH] lessee requesting the reduction  
4 makes [HAS MADE] a clear showing that the revenue from the lessee's  
5 share of all hydrocarbons produced from the field is or is likely to  
6 continue to be insufficient to produce a reasonable rate of return  
7 with respect to the [THAT] lessee's total investment in the field.  
8 The commissioner may condition a royalty reduction granted under this  
9 subsection in any way necessary to protect the state's interest,  
10 including restoration of the state's royalty share in the event of an  
11 increase in the price of oil or gas. Before approving a royalty  
12 reduction, the commissioner shall make a written finding that the  
13 state has obtained the maximum possible economic return that is com-  
14 patible with allowing a reasonable rate of economic return for the  
15 lessee.

16 \* Sec. 3. AS 38.05.180(w) is amended to read:

17 (w) Notwithstanding any other provisions of this section, land  
18 which has been offered for lease within the previous five years and  
19 which received no bids at competitive sale or for which no bid was  
20 accepted may be, at the discretion of the commissioner, immediately  
21 offered for lease, under regulations adopted by the commissioner, upon  
22 terms appearing most advantageous to the state; however, noncompeti-  
23 tive leasing is prohibited. The commissioner shall establish a royal-  
24 ty determined to be in the public interest but not less than 12 1/2  
25 percent. A lease must provide for payment to the state or rental but  
26 need not adhere to the rental schedule in (n) of this section nor to  
27 the 5,760-acres-per-lease limitation in (m) of this section. The  
28 lease term may not exceed 10 [FIVE] years, except as provided in (m)  
29 and (o) of this section.

1 \* Sec. 4. AS 38.05.945(c) is amended to read:

2 (c) Notice [EXCEPT FOR OIL AND GAS LEASING UNDER AS 38.05.180  
3 AND GEOTHERMAL LEASING UNDER AS 38.05.181, NOTICE] at least 30 days  
4 before action under (a) of this section shall also be given to the  
5 following:

6 (1) to a municipality if the land is within the boundaries  
7 of the municipality, to a coordinating body established by community  
8 councils in a municipality if the coordinating body or a community  
9 council within the area served by a coordinating body requests notice  
10 in writing; if there is no coordinating body within the municipality,  
11 notice shall be provided to each community council established by the  
12 charter or ordinance of the municipality if the land is located within  
13 the boundaries of the municipality and if the community council re-  
14 quests notice in writing;

15 (2) to a regional corporation if the boundaries of the  
16 corporation as established by sec. 7(a) of the Alaska Native Claims  
17 Settlement Act encompass the land and the land is outside a municipal-  
18 ity;

19 (3) to a village corporation organized under sec. 8(a) of  
20 the Alaska Native Claims Settlement Act if the land is within 25 miles  
21 of the village for which the corporation was established and the land  
22 is located outside a municipality;

23 (4) to the postmaster of a permanent settlement of more  
24 than 25 persons located within 25 miles of the land if the land is  
25 located outside a municipality, with a request that the notice be  
26 posted in a conspicuous location;

27 (5) to a nonprofit community organization or a governing  
28 body that has requested notification in writing and provided a map of  
29 its boundaries, if the land is within the boundaries.

# Kay Brown

## Alaska State Legislature House of Representatives

TO: Representative Cliff Davidson, Co-Chair  
Representative Curt Menard, Co-Chair  
House Resources Committee

FROM: Representative Kay Brown

DATE: March 16, 1989 *Kay*

SUBJ: HB 128/Oil and Gas Leasing Practices and State Royalties

Thank you for scheduling a hearing on HB 128. I appreciate the opportunity to discuss this legislation with the Resources Committee.

As indicated in the attached sectional analysis, the proposed legislation has several different provisions that collectively will improve the efficiency of the state's oil and gas leasing program; encourage production from marginal oil and gas fields; and strengthen the public notice requirements for proposed leasing actions undertaken by the state.

attachment

Rep. Kay Brown  
03/15/89

## SECTIONAL ANALYSIS

### HB 128 - Oil and Gas Leasing Practices and State Royalties

#### Section 1

Amends existing law regarding the requirement to prepare a new "best interest finding" in the case of "exempt" oil and gas lease sales under AS 38.05.180(d) and AS 38.05.180(w). The proposed change would allow the Department of Natural Resources to lease lands under these statutes without preparing a new "best interest finding" if a finding had been prepared within the previous five years, unless the Commissioner determines that new information has become available that justifies revision of the prior finding.

#### Section 2

Would give the Commissioner of the Department of Natural Resources authority to reduce royalties in order to reestablish shut-in oil and gas production that would otherwise not be economically feasible. Before granting a royalty reduction, the lessee must make a clear showing that the shut-in resources would not be economical to produce without a reduction. Further, the Commissioner would have to find that the state was obtaining the maximum possible economic return compatible with a reasonable rate of return for the lessee.

#### Section 3

Amends AS 38.05.180(w) regarding the term of a lease that has been re-offered. Existing law stipulates that the term of a re-offered lease shall be limited to five years. The proposed change would increase the maximum term of a re-offered lease to ten years.

#### Section 4

Amends the Department of Natural Resources public notice requirements as they pertain to the leasing of hydrocarbon and geothermal resources. The proposed change would reestablish the requirement that the department provide broad public notice of leasing actions to potentially affected parties.

# MEMORANDUM

# State of Alaska

DEPARTMENT OF FISH AND GAME

TO: Pamela Rogers  
Leasing Manager  
Division of Oil and Gas  
Department of Natural Resources

DATE: September 9, 1988

FILE NO.:  
TELEPHONE NO.: 267 2343

SUBJECT: Proposed Changes  
to Title 38  
(Oil and Gas  
Leasing)

FROM: Lance L. Trasky -  
Regional Supervisor  
Region II  
Habitat Division  
Department of Fish and Game

The Alaska Department of Fish and Game has reviewed your August 4 memorandum to Commissioner Brady regarding suggested changes to Title 38. We have no objections to the proposed revisions, provided that significant public opposition does not arise regarding the suggested change to Section AS 38.05.035(a)(7). It is very important to maintain a credible oil and gas planning process, even if this requires extra effort on the part of the state agencies. Should this revision be strongly opposed, and thereby compromise the credibility of the planning process for exempt and reoffering sales, we would encourage maintaining the 30 month timeframe rather than adopting the suggested 5-year time period.

Thank you for the opportunity to comment on the suggested changes to Title 38. If you would like to discuss this matter further, please do not hesitate to contact either me or Claudia Slater (267-2346).

cc: Frank Rue  
Al Ott

\*\*\*\*\* MEMO \*\*\*\*\*

FAX TRANSMITTAL

TO: Jay Nelson

DEPT: House Res. Com FAX #: 465-2718

FROM: Pam Rogers PHONE: 762-2584

CO: DNR/DOEG FAX # \_\_\_\_\_

Post-It brand fax transmittal memo 7871

|              |
|--------------|
| NO. OF PAGES |
| 1            |

Tom Painter  
Division Manager

Conoco Inc.  
3201 C Street  
Suite 200  
Anchorage, AK 98503

March 16, 1989

The Honorable Kay Brown  
Alaska House of Representatives  
P. O. Box V  
Juneau, Alaska 99811

Dear Representative Brown:

RE: HB 128

We have reviewed with much interest the provisions of HB 128. Conoco believes enactment of this legislation would send a strong signal that the State of Alaska recognizes the current economic dilemma we all are in and is willing to make provisions to ensure the continued economic development and production of it's oil resources in times of volatile crude prices. Conoco foresees crude price volatility remaining the dominant factor effecting oil and gas investment decisions for some time to come. The following statement is offered in support of HB 128:

Section 1. Amendment to AS 38.05.035(e).

The proposed amendments to this statute will enable tracts offered for lease during the previous five years to be reoffered for lease through an expedited process. Removing both the two year scheduling requirement and a repeat best interest finding will remove some of the cumbersome detail currently necessary for leasing reoffered tracts. Continued effort to further streamline the present leasing system is needed and encouraged.

Section 2. Amendment to AS 38.05.180(j).

Conoco has been involved both legislatively and administratively with the interpretation of AS 38.05.180(j) for the past several years. We believe the changes proposed in HB 128 will clarify much of the confusion with the existing statute.

When Title 38 was rewritten in 1978, the legislature authorized royalty and net profits share to be included as bid variables. As we interpret the intent, subsection (j) was added to limit the circumstances under which a lessee could reduce its royalty below their bid value submitted to obtain a lease at a competitive lease sale. We believe it was not the legislature's intent at that time to prevent the Commissioner from utilizing authorities granted under subsection (p) which apply during the operation of a unit. The record shows specifically that the legislature rejected an amendment in 1978 that would have limited the Commissioner's authority under (p) by the provisions in (j).

The Honorable Kay Brown  
March 16, 1989  
Page 2

As applied however, the limitations of subsection (j) have apparently restricted the Commissioner's actions under subsection (p). The changes to 180 (j), as proposed in HB 128, will remove the interpretation conflicts between language originally intended for bidding provisions and the subsequent operation of a unit either producing or mechanically capable of production.

The late 1970's and early 1980's were "boom" times for both the oil industry and the State of Alaska. With oil prices in excess of \$30/bbl and forecasted to increase further, the perception and financial condition of both the State and industry were vastly different than under the economic realities of today. The realities of resource development today dictate changes by both the State and industry if continued economic development of the State's resources is to continue. Industry must reduce and optimize development and operational costs, and the State must institute royalty and taxing systems that preferentially attract and encourage continued private sector investment in Alaska.

Conoco views it's relationship with the State as a partnership, with each partner adhering to the implied and contractual obligations of the other. The partnership will be successful when both partners are able to work together, trust and respect each other, and perceive that they are receiving an equitable return from the partnership. By amending 180 (j) we believe the State would be contributing significantly towards a successful partnership.

Specifically the proposed amendments to HB 128 will:

- Remove the ambiguities between bidding methods and lease operations;
- Remove the arbitrary and poorly defined "two years initial production;"
- Give the Commissioner broader authority to protect the State's interests with crude price increases.

For these reasons, Conoco enthusiastically supports all of the proposed revisions.

Although we have made the decision to resume production from the Milne Point Unit, it should be noted that our anticipated income stream, while generating a small positive cash flow, remains insufficient to provide a positive rate of return on our total investment. Under existing statutes we are eligible to apply for a reduced royalty at Milne Point after approximately ten additional months of production. Although the proposed amendments to 180 (j) may not directly effect Milne Point at this time, we envision they may, given the volatility of crude prices, be of direct future benefit to Milne Point or any other smaller field in the State.

The Honorable Kay Brown  
March 16, 1989  
Page 3

Section 3. Amendment to AS 38.05.180(w).

Changing the proposed lease term from five years to ten years is very important for leases in frontier areas such as Alaska. With the long lead times for permitting and the potentially limited exploratory drilling seasons, five years is insufficient to adequately evaluate a lease. Increasing the term to ten years will make the leases more attractive to industry, which should also be reflected in lease bonuses to the state.

This concludes my statement supporting HB 128. If you have any questions or need additional clarification, please call me at 564-7601.

Very truly yours,

  
FOL  
Tom Painter  
Division Manager

AEH(jah)



**Oil and Gas Lease Sale Options .**  
**Comparison of existing statutes with changes proposed in HB 128**  
**to AS 38.05.035(e) and AS 38.05.180(w)**  
**Prepared by Division of Oil & Gas**

Regular Sales

Exempt Sales

Reoffering Sales

| <u>Regular Sales</u>  |                        | <u>Exempt Sales</u>  |  | <u>Reoffering Sales</u>  |  |
|---|------------------------|--|--|--|--|
| Existing Statutes   | HB 128 Proposed Change | Existing Statutes  | HB 128 Proposed Change   | Existing Statutes  | HB 128 Proposed Change   |
| Must be on five-year leasing schedule. [AS 38.05.180(b)]                    | *No changes            | Not required to be on five-year schedule. [AS 38.05.180(d)]  |  | Not required to be on five-year schedule. [AS 38.05.180(w)]                  |  |
| Sales proposed by Div. of Oil & Gas; industry comments solicited each year. |                        | Sales based on unsolicited industry nominations; several received each year.                             |  | Sales based on unsolicited industry nominations; several received each year. |  |
| Acreage consists of new "frontier" areas and old areas offered in the past. |                        | Acreage previously leased and now relinquished or expired; or, acreage adjacent to existing leases.      |  | Acreage previously offered but not leased.                                   |  |
| New best interest finding required for each sale; public notices issued.    |                        | Can use up to 3-year-old best interest finding if no new significant information; public notices issued. | *Allows use of up to 5-year-old best interest finding if no new significant information. All public notices will still be issued. [AS 38.05.035(e)(7)] | New best interest finding required for each sale; public notices issued.     | *Allows use of up to 5-year-old best interest finding if no new significant information. All public notices will still be issued. [AS 38.05.035(e)(8)] |
| Lease term up to ten years.   |                        | Lease term up to ten years.  |  | Lease term no more than five years.  | *Allows lease term of up to ten years. [AS 38.05.180(w)]   |

3/16/89