HB
71

RESOURCE DEVELOPMENT COUNCIL

Growing Alaska Through Responsible Resource Development

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April 30, 2005

Senator Thomas Wagoner, Chair
Senate Resources Committee
Alaska State Legislature
State Capitol, Room 427
Juneau, Alaska 99801-1182

Re: House Bill 71 — Oil and Gas Exploration Credit and Lease Terms

Dear Senator Wagoner:

On behalf of the Resource Development Council for Alaska, Inc. (RDC), I am writing to express our serious concern with House Bill 71 as amended on the House Floor Thursday, April 28.

RDC is a private, non-profit business association representing individuals and leading companies from each of Alaska's basic industries — oil and gas, mining, timber, tourism and fisheries. Also included in the organization's membership are Alaska Native regional and village corporations, local communities, organized labor and industry support firms. RDC's mission is to grow Alaska's economy through the responsible development of the state's natural resources.

RDC objects to House Bill 71 as it is currently drafted on a number of points. First, House Bill 71 underwent a radical transformation on the House Floor without the benefit of a single committee hearing. New language regarding standards for interpreting state oil and gas leases and unit agreements was added and the bill's title was changed without opportunity for the public to comment.

Furthermore, open debate on the House Floor regarding this substantial alteration was limited to less than 10 minutes. This aborted process did not allow for adequate public participation, nor did it give legislators a proper chance to study the new language's policy implications. An issue of this magnitude warrants a thorough, transparent analysis by both legislative bodies.

Second, RDC believes the bill's new language may change the terms of existing state oil and gas leases and unit agreements. It is not clear to RDC that the state is well served by the Legislature reinterpreting long-standing contractual arrangements. This situation is not conducive to the state successfully negotiating a contract to commercialize Alaska's North Slope natural gas. In fact, the bill may have a detrimental effect on the state's ongoing discussions with each of the parties that have filed applications under the Stranded Gas Development Act.

121 West Fireweed, Suite 250, Anchorage, Alaska 99503-2035
Phone: 907/276-0700 Fax: 907/276-3887 Email: Resources@akrdc.org Website: www.akrdc.org

Third, the bill seems to make the state final arbiter on the question of whether a particular lease or unit can be developed profitably. Is this the appropriate role for the state to play in a market system? Is it realistic for the state to accurately determine rates of return, profit margins and estimated costs for a project with the size, scope and complexity of a natural gas pipeline? Rather than establishing regulatory predictability and stability, House Bill 71 creates a climate of uncertainty. In the likely event a lessee disagrees with the state's interpretation, one would expect a drawn-out, costly legal dispute to follow. Such a scenario does not bring Alaska closer to commercializing its natural gas resources.

Finally, beyond the bill's possible legal and commercial ramifications, RDC believes the new language sends a troubling message to current and future investors in Alaska — particularly those companies looking to do business in Alaska's oil patch. RDC understands the Legislature's mandate with regard to Alaska's natural resources as spelled out in Article VIII of the State Constitution. However, we fear House Bill 71 may serve the opposite purpose. Rather than encouraging maximum use and maximum benefit, this bill sends a clear anti-free market message to Alaska's resource industries. It is likely to act as a disincentive to future investment.

RDC shares the Legislature's eagerness to see Alaska's gas delivered to market. Efforts to commercialize our North Slope natural gas resources must be given the utmost attention and deliberation. Unfortunately, House Bill 71 has not undergone the scrutiny it deserves. The policy, legal and commercial consequences of the bill do not appear to align with the state's goal of identifying and encouraging the best possible gas-commercialization project.

Thank you for considering our position on this important issue.

Sincerely,

RESOURCE DEVELOPMENT COUNCIL
for Alaska, Inc.

Tadd Owens
Executive Director

cc: Senator Ralph Seekins, Vice Chair
Senator Ben Stevens
Senator Bert Stedman
Senator Fred Dyson
Senator Kim Elton
Senator Gretchen Guess

"Reasonably Profitable" Legislation
HB 71, Sections 1 and 2
Statement
May 2, 2005

As stated in the title to HB 71, Sections 1 and 2 of the proposed legislation provide standards for the interpretation of certain terms in state oil and gas lease and unit agreements and set a maximum time limit on the development, production, processing, and marketing of gas after that gas has been determined to meet the standards.

However, this legislation is in many ways very modest in its ambitions. It uses average prices and average returns. It does not create a new obligation if one does not already exist. It does not create new remedies for breach of existing obligations. It simply defines undefined terms in both old and new oil and gas leases and unit agreements, rather than leaving those definitions to other branches of government. It gives the Administration guidance on a tool it already has and can choose to use, or not, in getting North Slope gas to market. And, if and when the Administration chooses to use that tool, it sets a seven-year clock on getting gas to market. The seven-year clock, when and if used, is intended to assure not just the promise of a pipeline or an option on changes to tax and royalties terms in the event a pipeline is built, but the pipeline itself, at the earliest reasonable date, bringing jobs to Alaskans, affordable energy to Alaskans and Americans, and billions of dollars to the State and its municipalities before declining oil revenues diminish our northern way of life.

Senate Resources **May 2, 2005**

HB 71 – Sec 1 & 2 Info Materials

- When "Reasonably Profitable"? sheet: 1 page – source
- Overall company return on capital employed: 1 page
- Actual and projected natural gas prices : 1 page
- Capital costs/tolls: 1 page
- Legal Memorandum: April 29, 2005: Application to Gas Only

Is There a Legal Obligation to Develop and Market Gas <u>When "Reasonably Profitable"</u>?

- Spencer Hosie testified that there is an obligation <u>implied</u> in oil and gas leases: to develop and market oil and gas when "reasonably profitable."

- The State's oil and gas lease agreements and Prudhoe Bay and Pt. Thomson unit agreements also contain <u>explicit</u> language to the same or similar effect. Examples follow:

- **<u>The Leases state</u>:**

  - The lessee is granted the exclusive right to state lands "for the sole and only purposes of exploration, development, production, processing and marketing oil, gas, and associated substances produced therewith, and of installing pipe lines and structures ... to find, produce, save, store, treat, process, transport, take care of and market all such substances" (DL-1, para. 1)

  - "This lease contemplates the reasonable development of said land for oil and gas as the facts may justify." (DL-1, para. 19)

  - "DILIGENCE .... Lessee shall exercise reasonable diligence in ... producing ....." (DL-1, para. 20)

- **<u>The Prudhoe Bay Unit Agreement states</u>:**

  - "To the end that Unitized Substances economically recoverable may be increased ...., Working Interest Owners shall with due diligence develop the Unit Area in accordance with good ... production practices. Such ... production practices shall include a plan of development and operation ... designed to efficiently and economically produce Unitized Substances." (Sec. 4.2)

  - "Rate of Prospecting, Development and Production. The Director [of the State of Alaska's Division of Lands, i.e. DNR] is hereby vested with authority to alter or modify from time to time the quantity and rate of production ... limited to alteration or modification in the public interest ...." (Sec. 4.3)

- **<u>The Pt. Thomson Unit Agreement states</u>:**

  - "PLAN OF FURTHER DEVELOPMENT AND OPERATION. ... Any plan ... shall be as complete and adequate as the Director may determine to be necessary for timely development ... of the oil and gas resources of the unitized area ...." (Para. 10)

  - "Rate of Prospecting, Development and Production. The Director is hereby vested with authority to alter or modify from time to time the quantity and rate of production ... limited to alteration or modification in the public interest ...." (Para. 21)

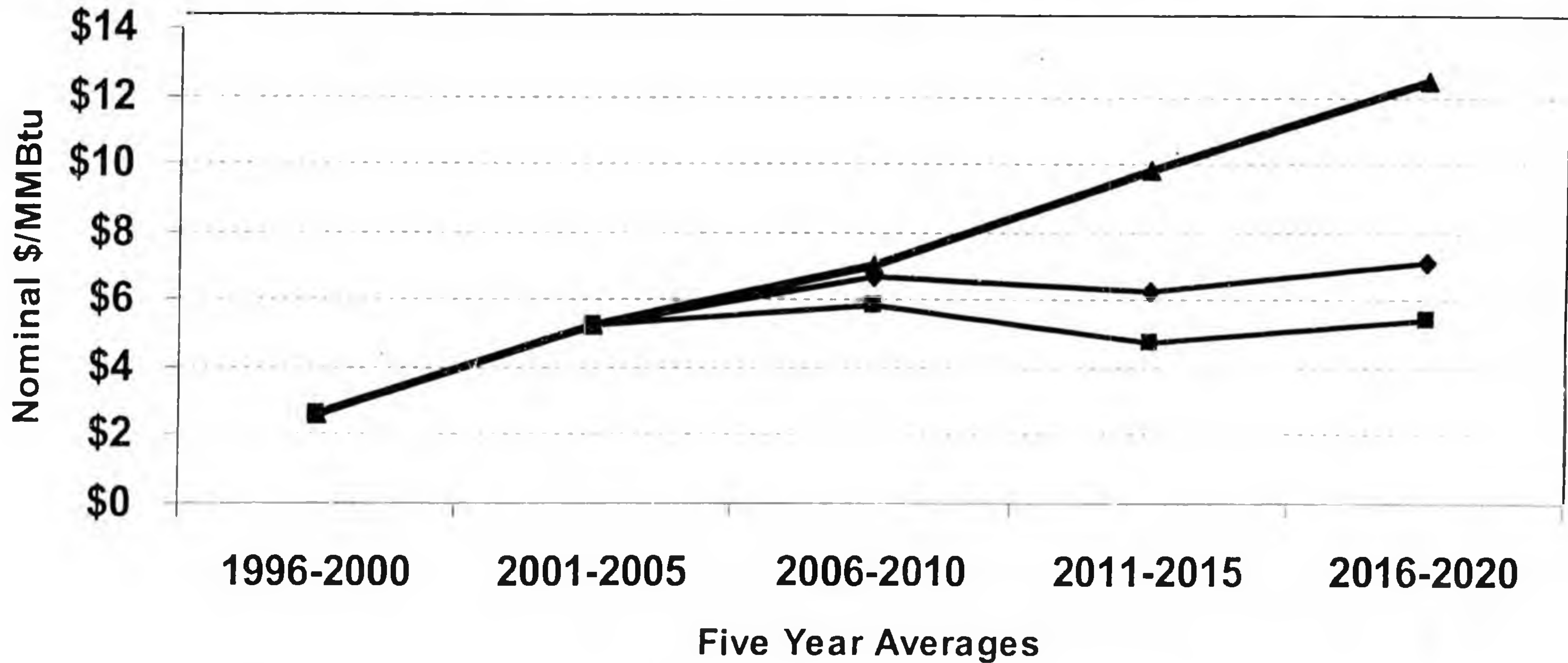
- **<u>But this legislation does not attempt to resolve any dispute over whether the obligation exists</u>.** This legislation simply interprets "reasonably profitable" and related terms where the obligation is found to exist.

Overall Company Return on Capital Employed:

Top 4 International Petroleum Companies and Conoco Phillips

Company	Actual										
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Past 10 Years
	(Percent)										
ExxonMobil	13.7%	14.5%	16.6%	13.7%	12.1%	22.0%	19.2%	13.9%	18.1%	23.8%	16.8%
Royal Dutch Shell	12.3%	12.2%	12.8%	9.2%	12.5%	21.8%	20.2%	14.4%	14.4%	18.4%	14.8%
BP	14.9%	17.2%	18.7%	9.3%	12.7%	16.3%	17.4%	11.3%	13.5%	1[illegible]5%	14.8%
ChevronTexaco	11.2%	14.3%	15.2%	6.9%	9.6%	21.3%	8.5%	3.5%	16.2%	25.0%	13.2%
ConocoPhillips	11.2%	14.0%	12.8%	5.7%	7.1%	16.2%	8.3%	3.7%	9.8%	14.3%	10.3%
Average	**12.7%**	**14.4%**	**15.2%**	**9.0%**	**10.8%**	**19.5%**	**14.7%**	**9.4%**	**14.4%**	**19.6%**	**14.0%**

Actual and Projected Natural Gas Prices (Henry Hub)



Capital Costs / Tolls

	Southern Route	Northern Route
Capital Cost ('01, $billion)		
Gas Treatment Plant	2.6	2.6
Alaska to Alberta	11.6	10.8
Alberta to Market	4.6	4.6
NGL Extraction Facilities	0.6	0.6
Alaska Project Share	***19.4***	***18.6***
Mackenzie Delta Share	-	*1.4*
Uncertainty	***+/- 20%***	***+/- 20%***
Sales Gas Rate (bcfd)		
Alaska	4.3	4.3
Mackenzie Delta	-	1.0
Total	4.3	5.3
Project Toll ($/mcf)		
Gas Treatment Plant	0.41	0.41
Alaska to Alberta	1.36	1.28
Alberta to Market	0.62	0.62
Toll to Market	***2.39***	***2.31***
Range	***1.90 - 2.85***	***1,85 - 2.75***

LEGAL SERVICES

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LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

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FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
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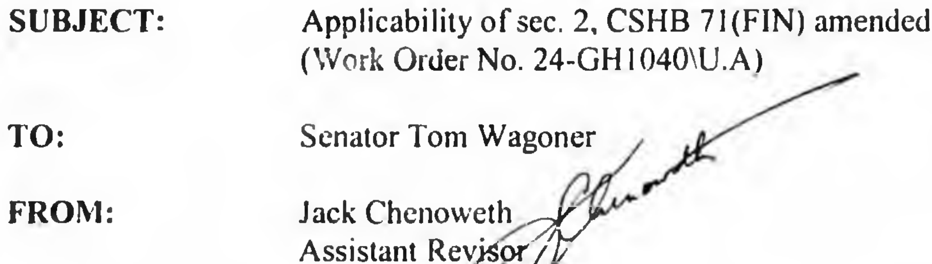
MEMORANDUM April 29, 2005

SUBJECT: Applicability of sec. 2, CSHB 71(FIN) amended
(Work Order No. 24-GH1040\U.A)

TO: Senator Tom Wagoner

FROM: Jack Chenoweth
Assistant Revisor



Your committee assistant, Mary Jackson, is correct when she represents that proposed AS 38.05.180(hh), added by sec. 2, CSHB 71(FIN) amended, has application only to gas.

Section 2 adds a new subsection to AS 38.05.180, the leasing provision of the Alaska Land Act (AS 38.05) covering oil and gas. The normative use or reference throughout AS 38.05.180 is to "oil and gas lease" (subsections (b), (c), (d)(2)(A) (two references), (f)(1), and (m) (multiple references)), "oil and gas leases" (subsections (a)(2)(B), (f), (ff)), or "leases for oil and gas" (subsections (d)(1) and (n)(1)), using the conjunctive "and".[1] The specific language of terms establishing required obligations of oil and gas lessees and unit operators, and that is being interpreted in bill section 2, appears in documents that are styled "oil and gas leases," and the parties to those agreements may produce both.

Standard lease terminology should not distract from the fact that, in substance, the provisions of proposed (hh)(1) and (hh)(2) apply, by their terms, to "development, production, processing, and marketing of ***gas*** from the lease or unit area."

JBC:med
05-320.med

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[1] Use of "oil ***or*** gas" as a modifier of "lease" in AS 38.05.180 is an exception. *See* AS 38.05.180(t) with its reference to "one or more lessees of oil or gas leases."

In addition, last session, you may recall, in conjunction with legislative attention to elimination of general references to shallow natural gas/coalbed methane and substitution of references to "nonconventional gas" in that Act, the words "gas only leases" was added following most references to "oil and gas lease."

Senate Resources **May 2, 2005**

HB 71 – Sectional, Bill & Fiscal Notes

- Talking Points – **WITHOUT** amendment on House Floor
- Bill Description **WITHOUT** amendment on House Floor
- CS HB 71(FIN) am: 9 pages
- FN #1: DNR: 12-8-04: 1 page
- FN #2: DOR: 1-11-05: 2 pages
- FN #3: DNR: 4-06-05: 1 page
- Letters of Opposition:
  Alliance: May 2, 2005: 2 pages
  AOGA: April 29, 2005: 3 pages
  Resource Development Council: April 30, 2005: 2 pages

Talking Points HB 71

This bill builds on the work we did in 2003 to make exploration in Alaska more internationally competitive.

That bill, SB 185 was focused on frontier exploration – trying to expand the boundaries and reach of North Slope development. It created a four year window for explorers to have up to 40% of the cost for finding oil or gas reimbursed by the State of Alaska.

This bill does several things

(1) It clarifies the rules for North Slope exploration for 2006 and 2007, the last two years of the window.
(2) It opens the window in the rest of the state even wider – encouraging exploration for the next five years. Among the areas that we hope will become active producing provinces because of this bill are the Alaska Peninsula (the original target of HB 71), the Copper River Basin, the Healy Basin, Red Dog area and the Nenana Basin.
(3) **This bill incorporates several incentives appropriate for a mature, well explored basin like the Cook Inlet. Instead of 25 miles from an existing unit, well work need only be 10 miles distant to qualify. If an explorer wants to spend money looking for distinct exploration targets, even if they are closer than three miles to another well, under this bill those targets can qualify for a tax credit. And to make sure we haven't gone too far in changing those rules, the total amount of credits under these distinct rules in the Cook Inlet Basin is limited to 20 million dollars over the next five years.**
(4) Finally, this bill looks at another area where we don't believe any incentives are needed – the Artic National Wildlife Re[illegible] – and prohibits the state from spending any more money to "encourage" drilling there.

The administration supports this bill because it is a targeted use of tax incentives. In the short term we might get more money if had no credits. But the money we give up in the short term is in exchange for people plunking down exploration, drilling and seismic work dollars here in Alaska. And in the long term, if Alaska is as prospective as we think, the additional royalties, income taxes, property taxes and perhaps even production taxes more than make up for the credits.

DED
4/20/05

Bill Description HB 71 (FIN)

The House Finance CS for HB 71 extends the AS 43.55.025 (production tax) exploration credit program enacted in 2003 everywhere in Alaska south of the Brooks Range to July 1, 2010. It also provides a new set of rules for the exploration tax credit in the Cook Inlet Basin.

Section 1 rewrites the statutory language to clear up confusion that has arisen over the original language. It makes clear that there are only four possible situations:

(1) Well work more than three miles from an existing well, but not more than 25 miles from a unit that qualifies for a 20% credit,
(2) Well work more than 25 miles from an existing unit but not more than 3 miles from an existing well that qualifies for a 20% credit,
(3) Well work that is both 25 miles from an existing unit and 3 miles from an existing well that qualifies for a 40% credit, and
(4) Seismic work that qualifies for a 40 % credit.

There is no way to combine these to get an 80% credit for any given dollar outlay.

Section 2 does two things. It extends the sunset of the existing credit from 2007 to 2010 for all work performed south of the Brooks Range. In the Cook Inlet, while also extending the sunset to 2010, section 2 also sets new rules, effective July 1 2005, more appropriate for a mature basin like the Cook Inlet.

Section 3 makes some changes to make the section one rewrites more precise, and for the Cook Inlet introduces the notion that if the commissioner of DNR certifies that the target is separate exploration target, the well work qualifies for the credits as though it were three miles from another well – even though it may be closer.

Section 5 also makes some changes to make the section one rewrites more precise, and for the Cook Inlet reduces the qualifying distance from an existing unit from 25 miles to 10 miles.

Section 5 changes a single phrase to make the section one rewrites more precise.

Section 6 clarifies the process whereby a Cook Inlet explorer can get the required certification from the commissioner of DNR to qualify for the credit with a separate exploration target. It also further limits the total of special Cook Inlet credit to 20 million dollars.

Section 7 sets forth several definitions pertinent to Cook Inlet.

Section 8 exempts work in the Arctic National Wildlife Refuge from qualifying for the credit.

DED
4/20/05

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: HB 71
(H) Publish Date: 1/12/05

Revision Date/Time (Note if correction):
Title: Extending Exploration Credit against Production Tax
Sponsor: Rules
Requester: Governor

Dept. Affected: Natural Resources
RDU: Resource Development
Component: Oil & Gas Development
Component No. 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	***					

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2005) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal: [ ]

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill extends the sunset date on the oil and gas exploration credit against production tax (SB185, CH59, SLA03) only for the proposed Alaska Peninsula sale area. The proposed Alaska Peninsula sale is tentatively scheduled for fall of 2005. It is anticipated that leases would not be issued until spring 2006. It is likely that exploration expenditures on these leases would occur after the current July 1, 2007 deadline, in which case they would not be credited against future production taxes unless the current statute is amended.

*** An extension of the sunset deadline to the proposed sale area may encourage additional or higher competitive bids, although these additional revenues are impossible to predict or quantify.

Prepared by: Janet Baxter
Division: Commissioner's Office
Phone: 465-4730
Date/Time: 12/8/2004

Approved by: Tom Irwin
Agency: Natural Resources
Date: 12/8/2004

(Revised 9/23/2004 OMB)

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number:	2
Bill Version:	HB 71
(H) Publish Date:	1/12/05

Revision Date/Time (Note if correction):		Dept. Affected:	Revenue
Title	Credit for Certain Exploration Expenses Against Oil & Gas Properties Production Taxes	RDU	Revenue Operations
		Component	Tax Division
Sponsor	Rules Committee		
Requester	Governor	Component No.	2476

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	**See Analysis**					

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2005) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal: [ ]

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

Currently the State plans to hold a Bristol Bay lease sale in October of 2005 assuming a favorable preliminary best interests finding. If bids are received and accepted at this lease sale, leases would be issued in spring 2006, with exploration of this region beginning that summer, FY 2007-FY2008. It is possible that 1 to 2 wells per year will be drilled on average over the period 2007 to 2009. Wells will be drilled from onshore facilities, but given the remoteness of the area and lack of infrastructure, we estimate that the wells could cost roughly $15 million per well. We assume that on average these wells would qualify for a production tax credit equal to 30% of qualified costs, half qualifying for the 40% credit and half for the 20% credit. (continued on Pg 2)

Prepared by:	Tom Boutin	Phone	
Division	Department of Revenue	Date/Time	1/11/05 2:59 PM
Approved by:	Tom Boutin	Date	1/11/2005
Agency	Department of Revenue		

STATE OF ALASKA **BILL NO. HB 71**
2005 LEGISLATIVE SESSION **Fiscal Note #2**

ANALYSIS CONTINUATION

As a result the credit would be worth around $7 million per year to the exploration firms from fiscal year 2008 through fiscal year 2010 (assuming a year lag between exploration expense and claiming of the credit). The adoption of this severance tax credit could yield revenue in two ways. First, the existence of an exploration credit over the period of likely exploration could prompt companies to participate in a lease sale when they otherwise would not. Currently, the State does not include any revenue from the lease sale in its revenue forecast. Such a lease sale could yield around $10 million if bids were based on the possibility of finding a field containing a minimum economic field size of between 100 and 200 million barrels of oil. Such a field, if discovered and developed, would yield about $50 million dollars a year in revenue (royalty, severance tax, and corporate income tax) over the first 10 years of production.

FISCAL NOTE

STATE OF ALASKA
2005 LEGISLATIVE SESSION

Fiscal Note Number: 3
Bill Version: CSHB 71(FIN)
(H) Publish Date: 4/18/05

Revision Date/Time (Note if correction):
Dept Affected: Natural Resources
Title: Credit for certain exploration expenses against oil and gas properties production taxes on oil and gas ...
RDU: Resource Development
Component: Oil & Gas Development
Sponsor: Rules by Request of Governor
Requester: House Resources
Component No: 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )	***					

FUND SOURCE (Thousands of Dollars)

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2005) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal: [ ]

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill extends the sunset date on the oil and gas exploration credit against production tax (SB 185, CH 59, SLA 03) for the Nenana basin exploration license (issued October 2002) and the proposed Alaska Peninsula sale area. The proposed Alaska Peninsula sale is tentatively scheduled for fall of 2005. It is anticipated that leases would not be issued until spring 2006. It is likely that exploration expenditures on these leases would occur after the current July 1, 2007 deadline, in which case they would not be credited against future production taxes unless the current statute is amended.

*** An extension of the sunset deadline to the proposed Alaska Peninsula sale area may encourage additional or higher competitive bids, although these additional revenues are impossible to predict or quantify.

Prepared by: Sean Parnell, Deputy Director — Phone: 269-8800
Division: Oil & Gas — Date/Time: 4/5/2005
Approved by: Tom Irwin, Commissioner — Date: 4/6/2005
Agency: Natural Resources

(Revised 9/23/2004 OMB)

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Larry J. Houle

THE ALLIANCE

... for responsible development of Alaska's Oil, Gas & Mineral Resources

May 2, 2005

The Honorable Thomas Wagoner
Alaska State Senate
Chair, Senate Resources Committee
State Capitol, Room 427
Juneau, AK 99801-1182

Re: Request to testify in opposition to Amendment #1 to HB 71, Oil & Gas Exploration Credit and Lease Terms.

Dear Senator Wagoner:

On behalf of the Board of Directors of the Alaska Support Industry Alliance, I would like express our opposition to Amendment #1 to HB 71 as adopted on the House floor Thursday morning, April 28, 2005. While we believe the amendment represents significant legal challenges at both the State and Federal levels, what was most disconcerting was the way the amendment was introduced on the House floor without opportunity for public debate. Therefore, we respectfully appreciate you and your committee for providing such an opportunity to testify.

Our main concern with the amendment is that it raises serious constitutional issues in that it attempts to allow the State to unilaterally change the terms and conditions of both the existing oil and gas leases and unit agreements. The amendment raises the fundamental question as to the ability of any party to rely upon the representations of the State when entering into commercial transactions. This can effectively set Alaska on a future path of litigation for impairment of contracts on all oil and gas leases thereby destroying investor confidence in Alaska.

We look forward to the opportunity to testify in greater detail during today's public hearing.

Sincerely,

Larry Houle
General Manager
907.563.2226

Alaska Oil and Gas Association

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Anchorage, Alaska 99503-2035
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Judith Brady, Executive Director

April 29, 2005

The Honorable Thomas Wagoner
Alaska State Senate
Chair, Senate Resources Committee
State Capitol, Room 427
Juneau, AK 99801-1182

<u>Request for Opportunity to Testify on Amendment #1 to HB 71, Oil & Gas Exploration Credit & Lease Terms</u>

Dear Senator Wagoner:

This is to inform you of the Alaska Oil & Gas Association's unqualified opposition to amendment #1 to HB 71 adopted on the House floor Thursday, April 28. This amendment would profoundly affect all oil and gas leases in Alaska as well as the State's relationship with the oil and gas industry.

We respectfully request notice and opportunity to participate in any hearings in the Senate Resources Committee on this measure, so that we may explain the reasons that lead us to so strongly oppose it.

We are extremely disappointed in the tactics employed by the House to pass this measure. The amendment was introduced and adopted on the House floor under a process designed to limit the public's opportunity to express its views. The amendment was characterized as merely "a change in definition". This statement is not accurate. The absence of hearings meant there was not opportunity to correct this misstatement or to consider the public policy and legal issues involved.

We are still reviewing the issues raised by this amendment. However, just at first reading, the following questions deserve thoughtful and careful review:

Can the State retroactively change or substantially affect an existing contract (lease) already in place?

What constitutional issues are involved?

The amendment refers to oil and gas leases but the requirement is for gas development. What does the State envision happening to the rights to the oil from a lease that is producing oil and but not gas?

Is it legal or reasonable to give the Commissioner of Natural Resources the power to determine when oil and gas leaseholders must develop, produce, process or market gas– based on the State's *forecast* of the *estimated return* on a gas pipeline project and the State's *forecast* of gas prices far into the future minus the currently *estimated cost* of the project? Whose estimated cost will the Commissioner rely on?

What happens if the State's forecasts are inaccurate? When the State is inaccurate in its oil price forecasts the result is overspending the next year's budget. The State takes the risk of its own forecast. Under this amendment, the private company takes the risk of the State's forecast. What happens when the State is inaccurate in its gas price forecasts and relied on that forecast to try and force a company to risk billions of dollars? If the State decides it has such a right, must the State guarantee the investment it is requiring in the event its forecasts and estimates prove to be inaccurate? If it doesn't provide a guarantee, has it made an unconstitutional taking?

The amendment requires the Commissioner to estimate the rate of return that the Federal Energy Regulatory Commission (FERC) *will approve in the future*. Does the State have the capability of FERC on rate matters sufficient to pre-guess what their approved rate of return will be? How does such pre-guessing affect the legal role of FERC?

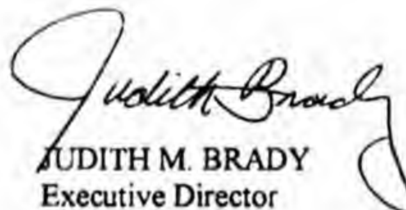
The amendment requires the Commissioner to estimate the rate of return that the Regulatory Commission of Alaska *will approve in the future*. Does the Department of Natural Resources have the capability of the RCA on rate matters sufficient to pre-guess the RCA? How does such pre-guessing affect the legal role of the RCA?

The amendment process for determining rate of return for non regulated portions of the proposed pipeline involve reviewing returns on capital from a "sample group of oil and gas companies ...subject to publicly reported information". Is this a reasonable process? What about the risk factor? Won't the market require a higher rate of return on a high risk and high cost project than the return resulting from a rolling average of overall past investment?

As we complete our review, more questions and issues are certain to arise. An overriding concern is our belief that the amendment casts serious doubt on the sanctity of any contract with the State, including the gas pipeline contract currently under negotiation.

We urge the Senate to recognize the seriousness of the subject matter and provide the hearings and time necessary for its review.

Sincerely,



JUDITH M. BRADY
Executive Director

cc: Governor Frank Murkowski
Members of the Alaska State Legislature
Commissioner Tom Irwin, Alaska Department of Natural Resources
Commissioner William Corbus, Alaska Department of Revenue
Attorney General David Marquez, Department of Law
Chief of Staff Jim Clark
Alaska Support Industry Alliance
Resource Development Council for Alaska

FORM NO. OL-1
REVISED OCT., 1963

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES
Division of Lands

LEASE NO. ADL 28381

Competitive Oil and Gas Lease

THIS LEASE is made by and between the State of Alaska, acting by and through the Director of the Division of Lands, Department of Natural Resources or his authorized agent, hereinafter called "Lessor", and RICHFIELD OIL CORPORATION, a Delaware corporation ~~555 SOUTH FLOWER STREET~~ LOS ANGELES, CALIFORNIA 90054 ADL-QF #4 HUMBLE OIL & REFINING COMPANY, a Delaware corporation, 612 SOUTH FLOWER STREET LOS ANGELES, CALIFORNIA 90017 ADL-QF #63

hereinafter called "Lessee", whether one or more.

1. GRANT. For and in consideration of a cash bonus and the first year's rental, the receipt of which is hereby acknowledged, and of the rentals, royalties, covenants, and conditions herein contained on the part of the Lessee to be paid, kept and performed, and subject to the conditions and reservations herein contained, Lessor does hereby grant and lease unto Lessee, exclusively, without warranty, for the sole and only purposes of exploration, development, production, processing and marketing of oil, gas, and associated substances produced therewith, and of installing pipe lines and structures thereon to find, produce, save, store, treat, process, transport, take care of and market all such substances, and for drilling water wells and taking underground and surface water for use in its operations thereon, and for housing and boarding employees in its operation thereon, the following described tract of land in Alaska:

TRACT C14-277

T. 9 N., R. 23 E., U. M.

Section 15: All
Section 16: All
Section 21: All
Section 22: All

containing 2560.00 acres, more or less, hereinafter called "said land".

For the purposes of this lease, said land contains the legal subdivisions, as shown on the plat of said land attached hereto, marked Exhibit A and by this reference made a part of this lease.

If said land is described above by protracted legal subdivision and Lessor hereafter causes said land to be surveyed under the public land rectangular system, the boundaries of said land shall be those established by such survey, when approved, subject, however, to the provisions of the regulations relating to such surveys.

2. "OIL AND GAS". "Oil" means crude petroleum oil and other hydrocarbons regardless of gravity which are produced and saved in liquid form at the well by ordinary production methods. "Gas" means all natural gas and all hydrocarbons produced at the well not defined herein as oil. "Associated substances" mean all substances produced in association with oil or gas and not defined herein as oil or gas.

3. TERM. This lease is issued for an initial primary term of ~~six~~ ten years from date hereof, subject to extension as provided in Paragraph 4 hereof, and shall continue so long thereafter as oil and gas or either or any of them are produced in paying quantities from said land; provided, that this lease may be extended beyond its primary term as provided in Paragraph 5 hereof and shall not expire under the conditions set forth in Paragraphs 6, 7, and 8 hereof.

4. EXTENSION BY SUSPENSION OF OPERATIONS. If, prior to the expiration of the primary term, Lessor, in the interest of conservation, directs or assents to the suspension of all operations and production, if any, hereunder, the primary term will be extended by adding the period of suspension thereto.

5. EXTENSION BY UNIT PRODUCTION. (a) This lease shall without application be extended beyond its primary term if upon or prior to the expiration date of such term the lease is committed to a unit agreement approved or prescribed by Lessor as provided in the regulations, production of oil or gas is had in paying quantities under the agreement, and a portion of such production is allocated to said land under the agreement. In such event this lease shall continue in effect so long as it remains subject to such agreement and actual production under said agreement is allocated to said land; (b) The Commissioner may, in his discretion provide for the extension of the term of this lease, if such lease is on the expiration date thereof included in an approved unit plan or if it is included in a program of secondary recovery operation designed to bring about or restore production, provided, however, that if any lease or portion thereof is eliminated from such unit plan or recovery program, or if such unit plan or recovery program is terminated, then any such lease or portion thereof shall continue in full force and effect for ninety (90) days from the date of such elimination or termination and so long thereafter as drilling or redrilling operations are being conducted thereon and so long thereafter as oil or gas is produced in paying quantities.

6. EXTENSION BY DRILLING. (a) If production shall have been obtained in paying quantities during the primary term, and if, at the end of the primary term, or at any time prior to the end of the primary term, such production shall have ceased from any cause, or in the event production shall at any time or times after the expiration of the primary term cease from any cause, then this lease shall not terminate if the Lessee commences drilling or reworking operations (either in a well from which such production has ceased or in a new well) within sixty days after the cessation of production, and the lease shall remain in full force and effect so long as such operations are prosecuted with reasonable diligence or are suspended under Paragraph 27 hereof; and, if such drilling or reworking operations result in the production of oil or gas, the lease shall remain in full force and effect so long as oil or gas is produced therefrom in paying quantities; (b) If actual drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, such operations to include redrilling, sidetracking or other means necessary to reach the originally proposed bottom hole location, the lease shall continue in full force and effect until ninety (90) days after such drilling had ceased and for so long thereafter as oil or gas is produced in paying quantities; (c) If all or part of the lands covered by the lease are lands that have been selected by Alaska under the laws of the United States granting lands to Alaska and the conditional lease was issued thereon, the term of the lease shall be extended for a period equal to the period during which the lease was conditional.

eav 7-19-65 Dc

7. EXTENSION BY SHUT-IN PRODUCTION. If, upon the expiration of the primary term or at any time or times thereafter, there is on said land a well capable of producing oil or gas in paying quantities, this lease shall not expire because Lessee fails to produce the same unless Lessor gives notice to Lessee allowing a reasonable time, which shall not be less than sixty days, after such notice to place the well on a producing status, and Lessee fails to do so; provided, that after such status is established such production shall continue on the said land unless and until suspension of production is allowed by Lessor.

8. EXTENSION BY SUSPENSION OF PRODUCTION. This lease shall not expire because of any suspension of operations in or upon or production from said land if such suspension is made under any order or with the consent of Lessor.

9. RENTAL. This lease shall terminate on any anniversary date hereof prior to the completion on said land of a well capable of producing oil or gas in paying quantities, unless on or before said anniversary date Lessee shall pay or tender to Lessor as annual rental a sum equal to $1.00 per acre, or fraction thereof, then included in this lease, or unless such annual rental has been waived or suspended as provided in Paragraph 13 of this lease. If Lessor's office is not open for business on the anniversary date, the time for payment is extended to include the next day on which said office is open for business.

10. MINIMUM ROYALTY. Commencing with the lease year beginning on or after completion on said land of a well capable of producing oil or gas in paying quantities, Lessee shall pay Lessor, at the expiration of each lease year, in lieu of rental a minimum royalty equal to $1.00 per acre, or fraction thereof, then included in this lease, or the difference between the actual royalty paid on production during the year if less than $1.00 per acre and the prescribed minimum royalty.

11. ROYALTY ON PRODUCTION. Except for oil and gas used on said land for development and production or unavoidably lost, Lessee shall pay Lessor as royalty the following:

(a) On oil ...12½... per cent in amount or value of the oil produced and saved and removed or sold from said land.

(b) On gas ...12½..... per cent in amount or value of the gas produced and saved and sold or used off said land or used for the extraction of natural gasoline or other products therefrom.

(c) On associated substances ...12½..... per cent in amount or value of such substances produced and saved and removed or sold from said lands.

12. REDUCTION OF ROYALTY RATES FOR DISCOVERY. If Lessee shall drill on said land and make the first discovery of oil or gas in commercial quantities in any geological structure, the royalty rate under this lease shall, instead of the rates prescribed in Paragraph 11, be five per cent for a period of ten years following the date of such discovery, and thereafter the royalty rates shall be those prescribed in Paragraph11. If this lease is committed to a unit agreement approved or prescribed by Lessor as provided in the regulations, the five per cent royalty rate shall not apply to all, but only, the production allocated to this lease under such agreement.

13. REDUCTION OF RENTAL AND ROYALTY. Rental or minimum royalty may be waived, suspended, or reduced, or royalty may be reduced on all of said land or any tract or portion thereof segregated for royalty purposes if Lessor finds that such relief is necessary for the purpose of encouraging the greatest ultimate recovery of oil or gas and is in the interest of conservation of natural resources and either that such relief is necessary in order to promote development or that the lease cannot be successfully operated under the terms provided herein.

14. ROYALTY IN KIND. Whenever, at the option of Lessor, which may be exercised from time to time upon not less than six months notice to Lessee, Lessor elects to take its royalty in kind, Lessee shall deliver free of charge (on said land or at such place as Lessor and Lessee mutually agree upon) to Lessor or to such individual, firm, or corporation as Lessor may designate all royalty oil and/or gas produced and saved from said land. Such oil and/or gas shall be in good and merchantable condition. Lessee shall, if necessary, furnish storage for royalty oil free of charge for thirty days after the end of the calendar month in which the oil is produced from said land; provided, that Lessee shall not be held liable for loss or destruction of royalty oil and/or gas from causes beyond Lessee's reasonable control. Should Lessee dehydrate or clean the oil or gas produced from said land, Lessee shall be entitled to an allowance of the actual cost of dehydrating or cleaning said royalty oil or gas.

15. ROYALTY IN VALUE. At the option of Lessor, which may be exercised from time to time upon not less than six months notice to Lessee, and in lieu of royal', in kind, Lessee shall pay to Lessor the field market price or value at the well of all royalty oil and/or gas. All royalty that may become payable in money to Lessor shall be paid on or before the last day of the calendar month following the month in which the oil or gas is produced. The payments shall be accompanied by copies of run tickets or other satisfactory evidence of sales, shipments, and amounts of gross production.

16. PRICE. The field market price or value of royalty oil or gas shall not be less than the highest of: (1) The price actually paid or agreed to be paid to Lessee at the well by the purchaser thereof, if any; or (2) The posted price of Lessee in the field for such oil or gas at the well, if any; or, (3) The prevailing price received by other producers in the field at the well for oil of like grade and gravity or gas of like kind and quality at the time such oil or gas is removed from said land or run into storage, or such gas is delivered to an extraction plant.

17. PAYMENTS. All payments to Lessor under this lease shall be made payable to the Department of Revenue of the State of Alaska and shall be tendered to Lessor at the place designated under Paragraph 43 for giving notices to Lessor.

18. OFFSET WELLS. Lessee shall drill such wells as a reasonably prudent operator would drill to protect Lessor adequately from loss by reason of drainage resulting from production on other land. Without limiting the generality of the foregoing sentence, if oil or gas should be produced in a well on other land not owned by Lessor or on which Lessor receives a lower rate of royalty than the royalty under this lease, which well is within 500 feet in the case of an oil well or 1,500 feet in the case of a gas well of lands then subject to this lease, and such well shall produce oil or gas in paying quantities for a period of thirty consecutive days, and if, after notice to Lessee and an opportunity to be heard, Lessor finds that production from such well is draining lands then subject to this lease, Lessee shall within 120 days after written demand by Lessor begin in good faith and prosecute diligently drilling operations for an offset well on said land. In lieu of drilling any well required by this paragraph, Lessee may with Lessor's consent compensate Lessor in full each month for the estimated loss of royalty through drainage in the amount determined by Lessor.

19. OTHER WELLS. This lease contemplates the reasonable development of said land for oil and gas as the facts may justify. Upon discovery of oil or gas in paying quantities on said land, Lessee shall drill such wells as a reasonably prudent operator would drill having due regard for the interests of Lessor as well as the interests of Lessee.

20. DILIGENCE: PREVENTION OF WASTE. Lessee shall exercise reasonable diligence in drilling, producing, and operating wells on said land unless consent to suspend operations temporarily is granted by Lessor; shall carry on all operations hereunder in a good and workmanlike manner in accordance with approved methods and practices, having due regard for the prevention of waste of oil and gas and the entrance of water to the oil and gas bearing sands or strata to the destruction or injury of such deposits and the preservation and conservation of the property for the future productive operations; shall use reasonable care and all proper safeguards to prevent the pollution of water; shall plug securely in an approved manner any well before abandoning it; shall allow Lessor to inspect all operations at any time; shall carry out at Lessee's expense all reasonable orders and requirements of Lessor relative to the prevention of waste and the preservation of said land, and on failure of Lessee so to do, Lessor shall have the right together with any other recourse available to it to enter on said land to repair damage or prevent waste at Lessee's expense; and shall, abide by and conform to valid applicable rules and regulations of the Alaska Oil and Gas Conservation Commission and the regulations of Lessor relating to the matters covered by this paragraph in effect on the effective date hereof or hereafter in effect if not inconsistent with any specific provisions of this lease.

21. WELL LOCATIONS. Lessee shall within five days after spudding in a well advise Lessor in writing of the location and date of spudding of said well.

22. APPROVAL OF PLANS. Lessee shall not place into actual operation any plan or method for the purpose of stimulating or increasing production on said land other than plans and methods in common use without first having obtained the written approval of Lessor.

23. LOGS AND RECORDS. An electric log or radioactive log, if taken, and a descriptive geologic sample log, if taken, and a record of all tests run for each well drilled on said land, together with a plat showing the exact location of each such well, shall be filed with Lessor within thirty (30) days after such well has been completed, suspended, or abandoned. Any and all information filed by Lessee with Lessor in connection with this lease shall be available at all times for the confidential use of Lessor for the purpose of enforcing compliance with the terms, covenants, and conditions of this lease and the regulations of the Lessor but shall not be open for inspection by any person other than officers, or employees of Lessor and persons performing any function or work assigned to them by Lessor for a period of twenty-four (24) months after the thirty (30) day filing period, except upon written consent of Lessee. Notwithstanding any other provision hereof, said information may be disclosed to any person where such disclosure is reasonably necessary for the administration of the functions, responsibilities, and duties vested by law in the Commissioner of the Department of Natural Resources or in the D[illegible]on of Lands or the Director thereof, including but not limited to functions, responsibilities, and duties arising in connection with any litigation or administrative [illegible]dication relating to this lease or to the rights, d[illegible]', and obligations arising hereunder.

24. RECORDS. Lessee shall keep and [illegible] in its possession books and records showing the [illegible]uction and disposition of all oil and gas produced from said land and shall permit Lessor or its agents at all reasonable hours to examine the [illegible]. Such records and reports of production shall be based upon such methods and techniques as shall insure the most accurate figures reasonably available without requiring the Lessee to provide separ-

by Lessor or its Lessee until provision has been made to pay the owner of the land upon which the reserved rights are sought to be exercised full payment for all damages sustained by said owner by reason of entering on said land; provided, that if said owner for any cause whatever refuses or neglects to settle said damages, Lessor or Lessee shall have the right to institute such legal proceeding in a court of competent jurisdiction wherein the land is situated as may be necessary to determine the damage which the owner of such land may suffer. Lessee hereby agrees to pay any damage that may become payable under said statutory provisions and to indemnify Lessor and hold it harmless from and against any claims, demands, liabilities, and expenses arising from or in connection with such damage. The furnishing of a bond in compliance with this Lease will be regarded by Lessor as a sufficient provision for the payment of all damage that may become payable under said statutory provisions.

26. BONDS.

(a) If required by Lessor, Lessee shall furnish a bond prior to the issuance of this lease in an amount equal to at least $2.00 per acre or fraction thereof contained in said land but not less than $1,000.00 and shall maintain said bond as long as required by Lessor.

(b) Before beginning drilling operations on said land Lessee must have furnished and shall maintain a bond in an amount of at least $5,000.00.

(c) Lessee may, in lieu of the foregoing, furnish and maintain a statewide bond in the amount of $100,000.00

(d) Lessor may, after notice to Lessee and an opportunity to be heard, require a bond in a reasonable amount greater than the amount specified above in this paragraph where such greater amount is justified by the nature of the surface and its uses and improvements in the vicinity of said land and the degree of the risks involved in the types of operations being or to be carried out under this lease. A statewide bond will not satisfy any requirement of a bond imposed under this subparagraph but will be considered by Lessor in determining the need for and the amount of any additional bond under this subparagraph.

(e) If said land is committed in whole or in part to a cooperative or unit agreement approved or prescribed by Lessor pursuant to law and the regulations and a unit bond is furnished in accordance with the regulations, Lessee need not thereafter maintain any bond with respect to the portion of said land so committed to such agreement.

27. ACTS OF GOD. Should Lessee be prevented from complying with any expressed or implied covenant of this lease, from conducting drilling operations thereon, or from producing or marketing oil or gas from said land after efforts made in good faith, by reason of war, riots, acts of God, severe weather in the area of said land, acts of governmental authorities, failure or lack of adequate transportation facilities, or any other cause beyond Lessee's reasonable control whether similar to those enumerated or not, then while so prevented and for a reasonable time thereafter within which to resume operations, Lessee's obligation to comply with such covenant shall be suspended and Lessee shall not be liable for damages for failure to comply therewith. If drilling or reworking operations are suspended by virtue of this paragraph and the prosecution of such operations would have had the effect of preventing the expiration or termination of this lease, then this lease shall not terminate during the period which the obligation to perform such operations is suspended under this paragraph; provided, however, that nothing in this paragraph shall be construed to suspend the payment of rentals or of minimum royalties.

28. SUSPENSION. Lessor may from time to time direct or assent to the suspension of production or other operations or both under this lease if such action is necessary or justified in the interest of conservation.

29. RESERVATIONS. Lessor reserves the right to dispose of the surface of said land to others subject to this lease, and the right to authorize others by grant, lease, or permit subject to this lease and under such conditions as will prevent unnecessary or unreasonable interference with the rights of Lessee and operations under this lease, to enter upon and use said land:

(a) To explore for oil or gas by geological or geophysical means including the drilling of shallow core holes or stratigraphic tests to a depth of not more than 1,000 feet.

(b) To explore for, develop and remove natural resources other than oil, gas, and associated substances on or from said land.

(c) For nonexclusive easements and rights of way for any lawful purpose including shafts and tunnels necessary or appropriate for the working of said land or other lands for natural resources other than oil, gas or associated substances.

(d) For well sites and well bores of wells drilled from or through said land to explore for or produce oil, gas, and associated substances in and from other lands.

(e) For any other purpose now or hereafter authorized by law and not inconsistent with the rights of Lessee under this lease.

30. UNDERGROUND STORAGE. This lease does not authorize the subsurface storage of oil or gas except as a necessary incident to recycling pressure maintenance, repressuring, or other similar operation designed to increase the ultimate recovery of oil or gas or prevent the waste of oil or gas produced from said land or from any unit area of which the said land is a part. Lessor reserves the right to authorize the subsurface storage of oil or gas in said land by Lessee or by others in order to avoid waste or to promote conservation of natural resources and upon such conditions as will prevent unnecessary or unreasonable interference with the rights and operations of Lessee under this lease, including conditions prohibiting the storage of oil or gas without the consent of Lessee in any reservoir covered by this lease capable of producing oil or gas in paying quantities.

31. ASSIGNMENTS. This lease or any undivided interest herein may with the approval of Lessor be assigned or subleased as to said land or any one or more legal subdivisions included therein, or any separate and distinct zone or geological horizon underlying said land or such one or more legal subdivisions, to any person or persons qualified to hold a lease. No transfer of any interest in this lease including assignments of working or royalty interests and operating agreements and subleases shall be binding upon Lessor unless approved by Lessor. Lessee shall remain liable for all obligations under this lease accruing prior to the approval of such transfer. Approval of transfer of this lease or an interest therein will not be denied except (1) for failure to comply with the regulations, (2) in the discretion of Lessor, where the transfer covers any distinct zone or geological horizon, or (3) where Lessor determines that the best interests of Lessor justify such action. Applications for approval of a transfer under this paragraph must comply with the regulations and must be filed within ninety days after the date of final execution of the instrument of transfer. Where a transfer is made of all or a part of Lessee's interest in and to a portion of the acreage in said land the assigned acreage shall, at the option of Lessor, or may upon request of the transferee and with the approval of Lessor be segregated into a separate and distinct lease having the same effective date as this lease.

32. UNITIZATION. Whenever determined and certified by Lessor to be necessary or advisable in the public interest for the purpose of properly conserving the natural resources of any oil or gas pool, field or like area or any part thereof, which includes or underlies said land or any part thereof, Lessee may unite with other Lessees of Lessor or with others owning or operating lands not belonging to Lessor including lands belonging to the United States and with others, jointly or separately, in collectively adopting and operating under a cooperative or unit agreement for the development or operation of the pool or field or like area or part thereof. Lessee shall within thirty days after demand by Lessor subscribe to such a cooperative or unit agreement, which agreement shall be reasonable and shall adequately protect all parties in interest including Lessor. Lessor may with the consent of Lessee establish, alter, change, or revoke drilling, producing, rental, minimum royalty, and royalty requirements of this lease if committed to any such cooperative or unit agreement and may make such regulations with reference to this lease with the like consent of Lessee in connection with the institution and operation of any such cooperative or unit agreement as Lessor may determine to be necessary or proper to secure the proper protection of the public interest. If a portion of said land is committed to an approved or prescribed unit agreement, the committed acreage shall at the option of Lessor and may upon the request of Lessee and with the approval of Lessor be segregated into a separate and distinct lease having the same effective date as this lease.

33. SURRENDER. Lessee may at any time make and file with Lessor a written surrender of all rights under this lease or any portion thereof comprising one or more legal subdivisions or, with the consent of Lessor, of any separate and distinct zone or geological horizon underlying said lands or such one or more legal subdivisions thereof. Such a surrender shall be effective as of the date of filing subject to the continued obligations of Lessee and his surety to make payment of all royalties theretofore accrued and to place all wells on the surrendered land or in the surrendered zones or horizons in condition satisfactory to Lessor for suspension or abandonment; thereupon, Lessee shall be released from all other obligations accrued or to accrue under this lease with respect to the surrendered lands, zones, or horizons.

34. DEFAULT; TERMINATION. Whenever Lessee fails to comply with any of the provisions of this lease other than the payment of rental and and Lessee fails within sixty days after written notice of such default to commence to remedy and thereafter prosecute diligently operations to remedy such default, Lessor may cancel this lease if at that time there is no well on said land capable of producing oil or gas in paying quantities. If at such time there is on said land a well capable of producing oil or gas in paying quantities, this lease may be cancelled only by judicial proceedings. In the event of any cancellation under this paragraph, Lessee shall have the right to retain under this lease any and all drilling or producing wells as to which no default exists together with a parcel of land surrounding each such well or wells and such rights of way through said land as may be reasonably necessary to enable Lessee to drill and operate such retained well or wells.

35. EXCESS AREA. If for any reason said land includes more acreage than the maximum permitted under applicable laws and/or regulations, this lease shall not be void but the acreage included in said land shall be reduced to the permitted maximum. Whenever Lessor determines that this lease so exceeds the permitted acreage and notifies Lessee stating the amount of acreage that must be eliminated, Lessee may within sixty days after such notice surrender one or more legal subdivisions included in said lands comprising at least the amount of acreage that must be eliminated. If such a surrender is not filed within such sixty days Lessor may terminate this lease as to the acreage that must be eliminated by mailing notice of such termination to Lessee describing the parcel or parcels eliminated. Such a notice shall have the effect of terminating this lease as to the parcel or parcels described in such notice.

36. RIGHTS ON TERMINATION. Upon the expiration or earlier termination of this lease as to all or any portion of said lands, Lessee shall have the privilege at any time within a period of six months thereafter, or such extension thereof as may be granted Lessor, of removing from said land or portion thereof all machinery, equipment, tools, and materials other than improvements needed for producing wells. Any materials, tools, appliances, machinery, structures, and equipment subject to removal as above provided which are allowed to remain on said land or portion thereof shall become the property of Lessor upon expiration of such period; provided, that Lessee shall remove any and all of such properties when so directed by Lessor. Subject to the foregoing, Lessee shall deliver up said lands or such portion or portions thereof in good order and condition.

37. INTEREST IN LAND. It is the intention of the parties that the rights vested in Lessee by this lease shall constitute an interest in real property in said land.

38. LESSER INTEREST. If Lessor owns a lesser interest in the oil and gas deposits in said land than the entire and undivided fee simple estate, then the royalties and rentals herein provided shall be paid Lessor only in the proportion which its interest bears to the whole and undivided fee.

39. CONDITIONAL LEASE. If all or a part of said land is land that has been selected by the Lessor under laws of the United States granting lands to Lessor, but such land has not been patented to Lessor by the United States, then this lease is a conditional lease as provided by law until such patent becomes effective. If for any reason such a selection is not finally approved or such a patent does not become effective, any rental, royalty or minimum royalty payments made to Lessor under this lease will not be refunded.

40. DRILLING OPERATIONS. As used in this lease "drilling operations" mean any work or actual operations undertaken or commenced in good faith for the purpose of carrying out any of the rights, privileges or duties of Lessee under this lease, followed diligently and in due course by the construction of a road or derrick and/or other necessary structures for the drilling of an oil or gas well, and by the actual operation of drilling in the ground. Any such work or operations preliminary to drilling in the ground may be undertaken either on said land or in the vicinity of said land in any order Lessee shall see fit.

41. ACTUAL DRILLING. As used in this lease, "actual drilling" means any and all operations necessary or convenient to the drilling of a well in the ground after the first drilling or spudding with equipment of sufficient size and capacity to drill to the total depth proposed for the well.

42. RULES AND REGULATIONS. As used in this lease "regulations" mean the applicable and valid oil and gas leasing regulations of the Commissioner of the Department of Natural Resources in effect on the effective date of this lease unless otherwise specified.

43. INTERPRETATION. As used in this lease words which are defined in the regulations have the meaning assigned by such definition except where the context clearly requires a different meaning. The paragraph headings are not a part of this lease and are inserted only for convenience.

44. NOTICES. Any notice required or permitted under this lease shall be in writing and shall be given by registered or certified mail, return receipt requested, addressed as follows:

To Lessor:

Director, Division of Lands
State of Alaska
344 Sixth Avenue
Anchorage, Alaska

To Lessee:

RICHFIELD OIL CORPORATION
555 SOUTH FLOWER STREET
LOS ANGELES, CALIFORNIA 90054

Any such notice shall be deemed given when delivered to the foregoing address. Either party may change the address to which such notices are to be sent, by a notice given in accordance with this paragraph.

45. HEIRS AND ASSIGNS. Subject to the other provisions of this lease, the covenants, conditions, and agreements contained in this lease shall extend to and be binding upon the heirs, executors, administrators, successors, or assigns of Lessor and Lessee.

46. WILDLIFE STIPULATIONS. This lease is subject to such stipulations as are attached.

IN WITNESS WHEREOF the parties have executed this lease effective as of the first day of October 19 65.

RICHFIELD OIL CORPORATION
By [signature] Its Attorney in Fact

HUMBLE OIL & REFINING COMPANY
By [signature] Its Attorney in Fact

LESSEE

STATE OF ALASKA

By Erle Mathis

Title Minerals Officer LESSOR

THE UNITED STATES OF AMERICA)
STATE OF ALASKA } ss

This certifies that on the 14th day of Sept., 19 65 before me, a notary public in and for the State of Alaska, duly commissioned and sworn, personally appeared Erle Mathis, to me known and known to me to be the person described in and who executed the foregoing lease on behalf of the State of Alaska as Director of the Division of Lands, Department of Natural Resources, or his authorized agent. The said Erle Mathis executed said lease in my presence and, after being duly sworn according to law, stated to me under oath that he is the Director of the Division of Lands, Department of Natural Resources, or his authorized agent, and has authority pursuant to law to execute the foregoing lease as such Director, or authorized agent, on behalf of the State of Alaska, acting through the Division of Lands, Department of Natural Resources and that he executed the same freely and voluntarily as the free and voluntary act and deed of the said State of Alaska and for the Division of Lands, Department of Natural Resources.

WITNESS my hand and official seal of the day and year in this certificate above written.

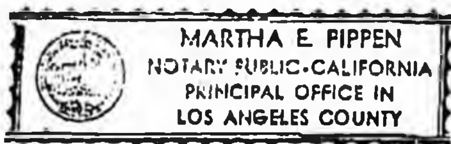
[signature] Notary Public in and for Alaska. My Commission expires 5/13/68

NOTARY

STATE OF CALIFORNIA }
COUNTY OF LOS ANGELES } ss.

ON THIS 2nd day of July 1965, before me, the undersigned, a Notary Public in and for said County and State personally appeared J. R. JACKSON, JR., known to me to be the person whose name is subscribed to the within instrument, as the Attorney in Fact of HUMBLE OIL & REFINING COMPANY, a corporation, and acknowledged to me that he subscribed the name of HUMBLE OIL & REFINING COMPANY thereto as principal and his own name as Attorney in Fact.

WITNESS my hand and official seal.



Martha E. Pippen
MARTHA E. PIPPEN
My Commission Expires October 5, 1965
(Print, stamp or type name)
Notary Public in and for Said County and State.

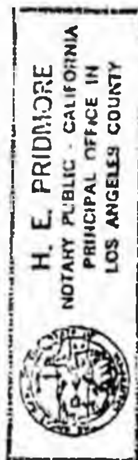
STATE OF CALIFORNIA }
COUNTY OF LOS ANGELES } ss.

On this 6th *day of* JULY, *in the year 19* 65, *before me,* H. E. PRIDMORE, *a Notary Public in and for the said County and State, personally appeared* G. R. SHEPPHIRD, *known to me to be the person whose name is subscribed to the within instrument, as the attorney-in-fact of* RICHFIELD OIL CORPORATION *and acknowledged to me that* he *subscribed the name of* RICHFIELD OIL CORPORATION *thereto as principal*, *and* his *own name as attorney-in-fact.*

IN WITNESS WHEREOF, *I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.*

My commission expires MAY 13, 1966

H. E. Pridmore
Notary Public in and for said County and State.



ALASKA - ATTORNEY-IN-FACT
ROC 2029-8 10-64
PRTD. IN U.S.A.

UNIT AGREEMENT

PRUDHOE BAY UNIT

STATE OF ALASKA

3.8 *Operating Rights.* Working Interest Owners, and Unit Operators in their behalf, shall have the same rights as are granted in the several oil and gas leases of ingress, egress, use of the surface and subsurface, use of water, use of other substances, use for the laying of pipelines and any other rights in said leases, which shall extend to and may be exercised for the benefit of the Unit Operations, the same as if the entire Unit Area were covered by a single oil and gas lease containing such provisions. Such rights shall extend to all lands hereafter added to the Unit Area and shall continue in full force and effect as to any lands hereafter excluded from the Unit Area (whether by virtue of Section 9.3 of this agreement or otherwise) which, when excluded, are either being utilized for the benefit of Unit Operations or to be utilized pursuant to an approved plan of development and operation.

ARTICLE 4

Unit Operators and Plan of Development and Operation

4.1 *Unit Operators.* Working Interest Owners are concurrently herewith entering into the Unit Operating Agreement designating Unit Operators. BP ALASKA INC., with offices at 3111 "C" Street (P.O. Box 4-1379, 99509), Anchorage, Alaska, is designated as Unit Operator for the following identified leases or portions thereof included within the Unit Area:

State of Alaska Lease No.	Tract No.
47445	1
28235	2
28254	3
47469	9
47448	10
28256	11
28255	12
28237	13
47447	14
47446	15
25637	16
47449	17
28239	18
28238	19
28259	20
28258	21

State of Alaska Lease No.	Tract No.
28257	22 & 22-A
28279	23
28278	24
28277	25
28299	26
28304	43
28280	44
28281	45
28282	46
28260	47
28261	48
47450	49
28240	50
28241	51 & 51-A
28244	52
28245	53
28262	54 & 54-A
28263	55 & 55-A
47451	56
28283	57
28284	58
28285	59
28305	60
28310	75
28286	76
28287	77
28288	78
28264	79
47452	80
47453	81
28246	82
47454	83
28265	84
28289	85 & 85-A
47471	86
47472	87
28313	88
47475	103
47476	104
28290	105

ATLANTIC RICHFIELD COMPANY, with offices at 711 West 8th Avenue (P.O. Box 360, 99510), Anchorage, Alaska, is designated as Unit Operator for the following identified leases or portions thereof included within the Unit Area:

State of Alaska Lease No.	Tract No.
34625	4
34626	5
34627	6
34624	7
28297	8
28300	27
28301	28
34628	29
34629	30
34630	31
34635	32
34634	33
34633	34
34636	35
28337	36
28338	37
28320	38
34631	39
34632	40
28302	41
28303	42
28306	61
28307	62
28321	63
28322	64
28323	65
28339	66
28340	67
28341	68
28343	69
28324	70
28325	71
28326	72
28308	73
28309	74
28312	89
28311	90
28329	91
28328	92
28327	93
28345	94
28344	95
28347	96
28346	97
28332	98
28331	99
28330	100

State of Alaska Lease No.	Tract No.
28315	101
28314	102
47482	106
28316	107 & 107-A
28335	108
28334	109 & 109-A
28333	110
28349	111

Further reference in this agreement and the Unit Operating Agreement to Unit Operators shall mean BP ALASKA INC., with respect to that portion of the Unit Area for which it is designated as Unit Operator, and ATLANTIC RICHFIELD COMPANY, with respect to that portion of the Unit Area for which it is designated as Unit Operator. Unit Operators shall have the right to conduct Unit Operations, which shall conform to the provisions of this agreement and the Unit Operating Agreement. By signature hereto, BP ALASKA INC. and ATLANTIC RICHFIELD COMPANY, hereby agree to accept the duties and obligations of Unit Operators for discovery, development and production of Unitized Substances as herein provided. A change of either Unit Operator may be made in accordance with the Unit Operating Agreement, and the Director shall be notified promptly of any such change. In the event of any such change, the Unit Operator herein designated, change of which is desired, shall continue in its capacity as a Unit Operator until a qualified successor shall have been selected and approval thereof is given by the Director and the successor shall have assumed its duties as a Unit Operator. No change of a Unit Operator shall become effective until approved by the Director. Upon a change of Unit Operator, the outgoing Unit Operator shall deliver possession of all equipment, materials and appurtenances used in conducting Unit Operations and owned by the Working Interest Owners to the new, duly qualified and approved successor Unit Operator.

4.1.1 Each Unit Operator shall file with the appropriate State of Alaska office all applications for permits and make all reports and file all notices which pertain to wells, facilities or Unit Operations conducted or to be conducted within that portion of the Unit Area for which it is designated as a Unit Operator.

4.1.2 Both Unit Operators must accept joint responsibility for the following reports and filings, as may be lawfully required, by jointly submitting same:

4.1.2.1 Establishment and revision of any Participating Area.

4.1.2.2 Plans of development and operation.

4.1.2.3 Reports concerning monthly production including allocation of the royalty portion of such production to the Working Interest Owners for settlement with the State of Alaska.

4.1.2.4 Plans for gathering lines, injection systems and other facilities related geographically to both operating areas.

Whenever the State of Alaska should require both Unit Operators to take any action or to report any matter, such matter shall be submitted jointly. The Unit Operators shall act hereunder only as authorized in accordance with provisions of this agreement and the Unit Operating Agreement, and the State shall be entitled to rely upon any action by the Unit Operators hereunder as authorized in accordance with said Unit Operating Agreement.

4.2 *Method of Development and Operation.* To the end that Unitized Substances economically recoverable may be increased and waste prevented, Working Interest Owners shall with due diligence develop the Unit Area in accordance with good engineering and production practices. Such engineering and production practices shall include a plan of development and operation on a Reservoir basis (or portion thereof), designed to efficiently and economically produce Unitized Substances. The plan for development and operation of the Oil Rim Participating Area and the Gas Cap Participating Area, as those Participating Areas are respectively defined in Sections 5.1(o) and 5.1(c) of this agreement, is attached hereto as Exhibit E, and is approved by the Director's approval of this agreement. Modifications of Exhibit E shall be submitted to the Director for approval.

A plan for the development and operation of lands not included in the initial Participating Areas is attached hereto as Exhibit E-1

and is approved by the Director's approval of this agreement. Within five (5) years after the Effective Date, Unit Operators shall submit for the Director's approval a further plan of development and operation for lands not then included in a Participating Area. If Unit Operators fail to submit an acceptable further plan of development and operation or fail in a substantial respect to conduct the operations included in an approved plan, the Director may upon notice to Unit Operators and the affected Working Interest Owners exclude from Unit Area any lands not then included in a Participating Area; provided, however, that such lands shall not be excluded while bona fide drilling operations are being conducted on any such lands and continued diligently, with at least one well being commenced each calendar year and followed by a good faith attempt to complete such well during the winter drilling season; provided further that if Unit Operators have timely submitted a plan of development and operation on a Reservoir basis (or portion thereof), covering a portion of such lands, and such plan has been approved by the Director, then lands covered by such plan of development and operation shall not be excluded from the Unit Area so long as operations are being diligently conducted pursuant thereto. The Director may modify the drilling requirements of this section by granting reasonable extensions of time when in his opinion such action is warranted.

Development and operation of the Unit Area, as it may be enlarged or contracted, pursuant to a plan or plans submitted and approved by the Director in accordance with this Section 4.2, shall be deemed full performance of all obligations for development and operation with respect to each and every Tract included in such plan or plans, regardless of whether there is any development of any particular Tract or Tracts of the Unit Area, notwithstanding anything to the contrary in the lease.

A plan of development and operation for each subsequently established Participating Area shall be submitted to the Director for approval as information upon which to base such plan is developed.

4.3. *Rate of Prospecting, Development and Production.* The Director is hereby vested with authority to alter or modify from

time to time the quantity and rate of production under this agreement when such quantity and rate is not fixed pursuant to State law or does not conform to any state-wide voluntary conservation or allocation program which is established, recognized and generally adhered to by the majority of operators in such State, such authority being hereby limited to alteration or modification in the public interest, the purpose thereof and the public interest to be served thereby to be stated in the order of alterations or modification. Without regard to the foregoing, the Director is also hereby vested with authority to alter or modify from time to time the rate of prospecting and development and the quantity and rate of production under this agreement when such alteration or modification is in the interest of attaining the conservation objectives stated in this agreement and is not in violation of any applicable State law.

Powers in this section vested in the Director shall only be exercised after notice to Unit Operator and opportunity for hearing to be held not less than thirty (30) days from notice, and shall not be exercised in a manner that would (i) require any increase in the rate of prospecting, development or production in excess of that required under good and diligent oil and gas engineering and production practices; or (ii) alter or modify the rates of production from the rates provided in the approved plan of development and operations then in effect or, in any case, curtail rates of production to an unreasonable extent, considering unit productive capacity, transportation facilities available, and conservation objectives; or (iii) prevent this agreement from serving its purpose of adequately protecting all parties in interest hereunder, subject to applicable conservation laws and regulations.

4.4. *Drilling by Working Interest Owners.* Any Working Interest Owner shall be entitled to drill wells under circumstances and limitations prescribed in the Unit Operating Agreement. On approval by the Director, a plan of testing, evaluation and pilot production may be carried out by such Working Interest Owner to determine if such wells are capable of sustained commercial production of Unitized Substances in sufficient quantities to justify Working Interest Owners in developing and producing the Reservoir, or portions thereof, into which such well is completed; provided, how-

ever, that any such wells which are determined to be capable of such production must thereafter be produced by the Unit Operator.

ARTICLE 5

PARTICIPATING AREAS AND TRACT PARTICIPATIONS

5.1 *Definitions Pertaining to Participating Areas Within Prudhoe Bay (Permo-Triassic) Reservoir.*

5.1(a) *Prudhoe Bay (Permo-Triassic) Reservoir* means the accumulation of Unitized Substances correlating with the Unitized Substances found in the A.R.Co.-Humble (now A.R.Co.-Exxon) Prudhoe Bay State No. 1 well between the depths of 8,117 feet and 8,785 feet below Kelly Bushing as measured by the Schlumberger Dual Induction Laterlog, Run 4, dated February 8, 1968, and Run 5, dated March 9, 1968 (including also the Put River Sandstone, which is that sandstone interval that correlates with the interval 9,638 to 9,719 measured feet on the Borehole Compensated Sonic Log, Run 2, dated September 28, 1975, in the Atlantic Richfield-Exxon NGI No. 1 well, and any other formation that contains an accumulation of Unitized Substances in substantial hydrocarbon communication with the above-described portion of the Prudhoe Bay (Permo-Triassic) Reservoir), and which has Reservoir Limits shown on Exhibit F as such exhibit may be revised from time to time by the Working Interest Owners in accordance with the Unit Operating Agreement and Section 2.6 hereof. For the purposes of this agreement, the Prudhoe Bay (Permo-Triassic) Reservoir shall be considered as a separate, continuous accumulation of producible Unitized Substances, even if faults or other discontinuities may divide the Permo-Triassic formation within the designated area in Exhibit F into separate Reservoir segments.

5.1(b) *Prudhoe Bay (Permo-Triassic) Gas Cap* is that portion of the Prudhoe Bay (Permo-Triassic) Reservoir which originally contained Gas Cap Gas and which is distinguished from the Prudhoe Bay (Permo-Triassic) Oil Rim as being that portion of the Permo-Triassic Reservoir which originally existed above the gas-oil contact or contacts as determined by the Working Interest Owners.

DL 2
Updated June, 1975

UNIT AGREEMENT

FOR THE DEVELOPMENT AND OPERATION OF THE
POINT THOMSON UNIT
STATE OF ALASKA
FOURTH JUDICIAL DISTRICT

THIS AGREEMENT, entered into as of the 1st day of March, 1977, by and between the parties subscribing, ratifying, or consenting hereto, and herein referred to as the "parties hereto",

WITNESSETH:

WHEREAS, the parties hereto are the owners of working, royalty or other oil and gas interests in the unit area subject to this agreement; and,

WHEREAS, the Commissioner of the Department of Natural Resources, State of Alaska, is authorized by Alaska Statute 38.05 and appropriate state regulations to consent to or approve this agreement on behalf of the State of Alaska, insofar as it covers and includes lands and mineral interests of the State of Alaska; and,

WHEREAS, the parties hereto hold sufficient interests in the Point Thomson Unit Area covering the land hereinafter described to give reasonably effective control of operations therein; and,

WHEREAS, it is the purpose of the parties hereto to conserve natural resources, prevent waste, and secure other benefits obtainable through development and operation of the area subject to this agreement under the terms, conditions and limitations herein set forth; and,

WHEREAS, State lands, as that term is used in this agreement, means those lands title to which is vested or that become vested in the State of Alaska and lands which have been tentatively approved after state selection and are not covered by an existing Federal oil and gas lease at such time as any right or authority is exercised;

NOW, THEREFORE, in consideration of the premises and the promises herein contained, the parties hereto commit to this agreement their respective interests in the below-defined unit area, and agree severally among themselves as follows:

1. ENABLING ACT AND REGULATIONS. The Alaska Land Act (AS 38.05.005-370) and all valid and pertinent oil and gas statutes and reg-

Nothing in this section shall be deemed to limit the right of the Unit Operator to resign as provided in Section 5 hereof, or as requiring Unit Operator to commence or continue any drilling during the period pending such resignation becoming effective in order to comply with the requirements of this section. The Commissioner may modify the drilling requirements of this section by granting reasonable extensions of time when, in his opinion, such action is warranted.

Upon failure to commence any well provided for in this section within the time allowed, including any extension of time granted by the Commissioner, this agreement will automatically terminate; upon failure to continue drilling diligently any well commenced hereunder, the Commissioner may, after 15 days notice to the Unit Operator, declare this unit agreement terminated.

10. PLAN OF FURTHER DEVELOPMENT AND OPERATION. Within six months after completion of a well capable of producing unitized substances in paying quantities, the Unit Operator shall submit for the approval of the Director an acceptable plan of development and operation for the unitized land which, when approved by the Director, shall constitute the further drilling and operating obligations of the Unit Operator under this agreement for the period specified therein. Thereafter, from time to time before the expiration of any existing plan, the Unit Operator shall submit for the approval of the Director a plan for an additional specified period for the development and operation of the unitized land. The Unit Operator expressly covenants to develop the unit area as a reasonably prudent operator in a reasonably prudent manner.

Any plan submitted pursuant to this section shall provide for the exploration of the unitized area and for the diligent drilling necessary for determination of the area or areas thereof capable of producing unitized substances in paying quantities in each and every productive formation and shall be as complete and adequate as the Director may determine to be necessary for timely development and proper conservation of the oil and gas resources of the unitized area, and shall:

(a) specify the number and location of any wells to be drilled and the proposed order and time for such drilling; and,

AGO 10166101

(b) to the extent practicable, specify the operating practices regarded as necessary and advisable for the proper conservation of natural resources .

Separate plans may be submitted for separate productive zones, subject to the approval of the Director.

Said plan or plans shall be modified or supplemented when necessary to meet changed conditions, or to protect the interests of all parties to this agreement. Reasonable diligence shall be exercised in complying with the obligations of the approved plan of development. The Director is authorized to grant a reasonable extension of the six-month period herein prescribed for submission of an initial plan of development where such action is justified because of unusual conditions or circumstances. After completion hereunder of a well capable of producing unitized substances in paying quantities, no further wells, except such as may be necessary to afford protection against operations not under this agreement or such as may be specifically approved by the Director shall be drilled except in accordance with a plan of development approved as herein provided.

11. PARTICIPATION AFTER DISCOVERY. At least ninety (90) days prior to commencement of production of unitized substances into a pipeline or other means of transportation to market, the Unit Operator shall submit for approval by the Director a schedule based on subdivisions of the public land survey or aliquot parts thereof of all unitized land then regarded as reasonably proved to be productive of unitized substances in paying quantities; all lands in said schedule on approval of the Director are to constitute a participating area, effective as of the date such production commences or the effective date of the unit agreement, whichever is later. The acreages of both state and non-state lands shall be based upon approved protraction diagrams or appropriate computations from the courses and distances shown on the last approved protraction diagram or public land survey as of the effective date of the initial participating an or computed with reference to the last approved protraction survey or grids. Said schedule, which will be attached as Exhibit C to this agreement, shall also:

AGO 10166102

(a) such date of expiration is extended by the Commissioner, or

(b) it is reasonably determined prior to the expiration of the fixed term or any extension thereof that the unitized land is incapable of production of unitized substances in paying quantities in the formations tested hereunder and after notice of intention to terminate the agreement on such ground is given by the Unit Operator to all parties in interest at their last known addresses, the agreement is terminated with the approval of the Commissioner, or

(c) a valuable discovery of unitized substances has been made or accepted on unitized land during said initial term or any extension thereof, in which event the agreement shall remain in effect for such term and so long as unitized substances can be produced in quantities sufficient to pay for the cost of producing same from wells on unitized land and, should production cease, so long thereafter as diligent operations are in progress for the restoration of production or discovery of new production and so long thereafter as the unitized substances so discovered can be produced as aforesaid, or

(d) it is terminated as heretofore provided in this agreement.

This agreement may be terminated at any time by not less than 75 per centum, on an acreage basis, of the owners of working interests signatory hereto, with the approval of the Commissioner; notice of any such approval to be given by the Unit Operator to all parties hereto.

21. RATE OF PROSPECTING, DEVELOPMENT AND PRODUCTION. The Director is hereby vested with authority to alter or modify from time to time in his discretion the quantity and rate of production under this agreement when such quantity and rate is not fixed pursuant to state law or does not conform to any statewide voluntary conservation or allocation program which is established, recognized and generally adhered to by the majority of operators in such state, such authority being hereby limited to alternation or modification in the public interest, the purpose thereof and the public interest to be served thereby to be stated in the order of alteration or modification. Without regard to the foregoing, the Director is also hereby vested with authority to alter or modify from time to time at his discretion the rate of prospecting and development and the quantity and rate of production under this agreement when such alteration or modification is in the

AGO 10166111

interest of attaining the conservation objectives stated in this agreement and is not in violation of any applicable state law.

Powers in this section vested in the Director shall only be exercised after notice to Unit Operator and opportunity for hearing to be held not less than thirty (30) days from notice, and shall not be exercised in a manner that would (i) require any increase in the rate of prospecting, development or production in excess of that required under good and diligent oil and gas engineering and production practices; or (ii) alter or modify the rates of production from the rates provided in the approved plan of development and operations then in effect or, in any case, curtail rates of production to an unreasonable extent, considering unit productive capacity, transportation facilities available, and conservation objectives; or (iii) prevent this agreement from serving its purpose of adequately protecting all parties in interest hereunder, subject to applicable conservation laws and regulations.

22. APPEARANCES. Unit Operator shall, after notice to other parties affected, have the right to appear for and on behalf of any and all interests affected hereby before the Commissioner of the Department of Natural Resources of the State of Alaska and to appeal from orders issued under the regulations of said department, or to apply for relief from any said regulations or in any proceedings relative to operations before the Commissioner or any other legally constituted authority; provided, however, that any other interested party shall also have the right at his own expense to be heard in any such proceeding.

23. NOTICES. All notices, demands or statements required hereunder to be given or rendered to the parties hereto shall be deemed fully given if given in writing and personally delivered to the party or sent by postpaid registered mail or certified mail, addressed to such party or parties at their respective addresses set forth in connection with the signatures hereto or the ratification or consent hereof or to such other address as any such party may have furnished in writing to the party sending the notice, demand or statement.

24. NO WAIVER OF CERTAIN RIGHTS. Nothing in this agreement contained shall be construed as a waiver by any party hereto of the right to assert any legal or constitutional right or

Senate Resources
May 5, 2005

"Reasonably Profitable" Legislation
HB 71, Sections 1 and 2
Testimony of Bonnie Robson, Consultant to Legislative Budget & Audit,
Before the Senate Resources Committee
May 2, 2005

On April 20, counsel for the Administration testified before the Legislative Budget & Audit Committee about a bargain struck when the State leased its lands at Prudhoe Bay and Point Thomson. The bargain, he said, was that the State relinquished 7/8ths of production, retaining only 1/8th to itself as royalty; in exchange, the lessees promised to develop and market the State's oil and gas when "reasonably profitable" to do so. However, HB 71 does <u>not</u> resolve any dispute the lessees may raise over whether the obligation to develop and market exists, but simply defines "reasonably profitable" and related terms. The definition only gets used if the obligation does, in fact, exist. Also, if the obligation does, in fact, exist, the proposed legislation sets a time clock for getting Alaska gas to market—seven years from the date of administrative decision—because time is money—substantially more than $1 billion per year to the State at current gas prices.

This legislation is otherwise modest in its ambitions. It uses average prices and average returns. It does not create a new obligation if one does not already exist. It does not create new remedies for breach of existing obligations. It simply defines an undefined term in both old and new oil and gas leases and unit agreements, rather than leaving that definition to other branches of government. It

gives the Administration guidance on a tool it already has and can choose to use, or not, in getting North Slope gas to market. And, if and when the Administration chooses to use that tool, it sets a seven-year clock on getting gas to market. The seven-year clock, when and if used, is intended to assure not just the promise of a pipeline or an option on changes to tax and royalties terms in the event a pipeline is built, but the pipeline itself, at the earliest reasonable date, bringing jobs to Alaskans, affordable energy to Alaskans and Americans, and billions of dollars to the State and its municipalities before declining oil revenues diminish our northern way of life.

For those who wish to explore further some of the legal underpinnings of the lessees' duty to develop and market gas, the next page of these prepared remarks sets forth a sample of the explicit language contained in the State's oil and gas leases, the Prudhoe Bay unit agreement, and the Pt. Thomson unit agreement:

Is There a Legal Obligation to Develop and Market Gas
When "Reasonably Profitable"?

- Spencer Hosie testified that there is an obligation implied in oil and gas leases: to develop and market oil and gas when "reasonably profitable."

- The State's oil and gas lease agreements and Prudhoe Bay and Pt. Thomson unit agreements also contain explicit language to the same or similar effect. Examples follow:

- **The Leases state:**

  - The lessee is granted the exclusive right to state lands "for the sole and only purposes of exploration, development, production, processing and marketing oil, gas, and associated substances produced therewith, and of installing pipe lines and structures ... to find, produce, save, store, treat, process, transport, take care of and market all such substances" (DL-1, para. 1)

  - "This lease contemplates the reasonable development of said land for oil and gas as the facts may justify." (DL-1, para. 19)

  - "DILIGENCE .... Lessee shall exercise reasonable diligence in ... producing ....." (DL-1, para. 20)

- **The Prudhoe Bay Unit Agreement states:**

  - "To the end that Unitized Substances economically recoverable may be increased ...., Working Interest Owners shall with due diligence develop the Unit Area in accordance with good ... production practices. Such ... production practices shall include a plan of development and operation ... designed to efficiently and economically produce Unitized Substances." (Sec. 4.2)

  - "Rate of Prospecting, Development and Production. The Director [of the State of Alaska's Division of Lands, i.e. DNR] is hereby vested with authority to alter or modify from time to time the quantity and rate of production ... limited to alteration or modification in the public interest ...." (Sec. 4.3)

- **The Pt. Thomson Unit Agreement states:**

  - "PLAN OF FURTHER DEVELOPMENT AND OPERATION.... Any plan ... shall be as complete and adequate as the Director may determine to be necessary for timely development ... of the oil and gas resources of the unitized area ...." (Para. 10)

  - "Rate of Prospecting, Development and Production. The Director is hereby vested with authority to alter or modify from time to time the quantity and rate of production ... limited to alteration or modification in the public interest ...." (Para. 21)

- **But this legislation does not attempt to resolve any dispute over whether the obligation exists.** This legislation simply interprets "reasonably profitable" and related terms where the obligation is found to exist.

Again, this legislation does not attempt to resolve any dispute over whether the obligation to develop and market gas exists when it is "reasonably profitable" to do so. This legislation simply interprets "reasonably profitable" and related terms where the obligation is found to exist. It allows the legislature to voice its opinion on a level of profit above which the legislature expects the oil and gas lessees who have signed a contract giving them the exclusive right to develop and market gas from state lands are expected to do just that—develop and market the gas, even if they would prefer to defer their investment in Alaska until a later day.

How does the legislation interpret "reasonably profitable"? The short answer is: a minimum of a 14% return on capital for production and processing operations, and the FERC-regulated rate for pipeline operations. But let us also discuss the long answer. The legislation does not use the figure "14%." Instead, it allows the Administration to select a sample group of oil and gas companies and use a simple average of the sample group's most recent ten year average return on capital employed. The Administration has discretion in selecting an appropriate sample group for the project under consideration, but for purposes of discussion today, we assume that the Administration chooses to use a group consisting of the four largest international petroleum companies and the three largest Alaskan oil and gas companies. For this sample group, the most recent ten-year simple average of returns on capital employed is 14%, as the following exhibit shows:

Overall Company Return on Capital Employed:

Top 4 International Petroleum Companies and Conoco Phillips

	Actual										
Company	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Past 10 Years
ExxonMobil	13.7%	14.5%	16.6%	13.7%	12.1%	22.0%	19.2%	13.9%	18.1%	23.8%	16.8%
Royal Dutch Shell	12.3%	12.2%	12.8%	9.2%	12.5%	21.8%	20.2%	14.4%	14.4%	18.4%	14.8%
BP	14.9%	17.2%	18.7%	9.3%	12.7%	16.3%	17.4%	11.3%	13.5%	16.5%	14.8%
ChevronTexaco	11.2%	14.3%	15.2%	6.9%	9.6%	21.3%	8.5%	3.5%	16.2%	25.0%	13.2%
ConocoPhillips	11.2%	14.0%	12.8%	5.7%	7.1%	16.2%	8.3%	3.7%	9.8%	14.3%	10.3%
Average	**12.7%**	**14.4%**	**15.2%**	**9.0%**	**10.8%**	**19.5%**	**14.7%**	**9.4%**	**14.4%**	**19.6%**	**14.0%**

But what does a 14% return on capital mean? It does not mean 14% return on shareholders' equity, unless the North Slope producers choose to finance their operations with 100% equity—the most expensive form of capital. It means some rate higher than 14%, and possibly as high as 46%, in light of the federal loan guarantee available on up to 80% of the debt used to finance not only a gas pipeline, but also North Slope production operations and a new gas treatment plant to be built at Prudhoe Bay. We turn to another graphic to demonstrate what a 14% return on capital may mean for an Alaska natural gas pipeline project:

How Are Investments Made?

	X%	Debt (cheap)
+	Y%	Equity (expensive)
=	100%	Capital

If Capital Earns 14%, How Much Does Equity Earn?

Debt Is Repaid At Cost

	0%	Debt
+	100%	Equity
=	**14%**	Return on Equity
	50%	Debt at 6%
+	50%	Equity
=	**22%**	Return on Equity
	80%	Debt at 6%
+	20%	Equity
=	**46%**	Return on Equity

We are accustomed to hearing that an Alaska natural gas pipeline project is a high-risk project, entitled to a high rate of return, but some may argue that the rate of return allowed under this legislation is too rich. Why? First, the federal government has significantly reduced the risks and costs of the project. The federal government will provide loan guarantees for the project, allow accelerated depreciation of the pipeline over seven years rather than fifteen years, and extend tax credits for the new gas treatment plant to be built at Prudhoe Bay.

Second, the majority of gas filling this pipeline will come from the proven reserves at Prudhoe Bay. Prudhoe gas has been explored for (and found), developed, and is being produced at the rate of 8 billion cubic feet per day (though that gas is now being reinjected into the ground). Production at Prudhoe Bay should not be considered high-risk, when compared to many of the risks voluntarily undertaken by large oil and gas companies. Yet the reward—the return—included in this legislation is based on average returns earned by companies that, among other things, invest in exploration or wildcat operations—and sometimes lose it all, not just the return on capital, but the capital itself.

In fairness, it must be said that the rate of return allowed under this legislation may encompass not only the high exploration risk faced by vertically-integrated oil and gas companies, but the relatively low returns those same companies earn on certain downstream operations. Still, we think it strikes the

right balance, and, in fact, will be viewed as too generous by some when they recognize that the Administration may be limited in its ability to enforce the lessees' duty to develop and market gas where the return on equity is less than 46%. For those who see the returns discussed today as not generous enough, remember that the Administration will have discretion in selecting the sample group of oil and gas companies whose returns are included in the simple average of returns, and it may choose to use only upstream companies, or only production companies, or any other grouping of companies—as long as the companies are oil and gas companies—in getting to a fair and equitable result under the particular facts then at hand.

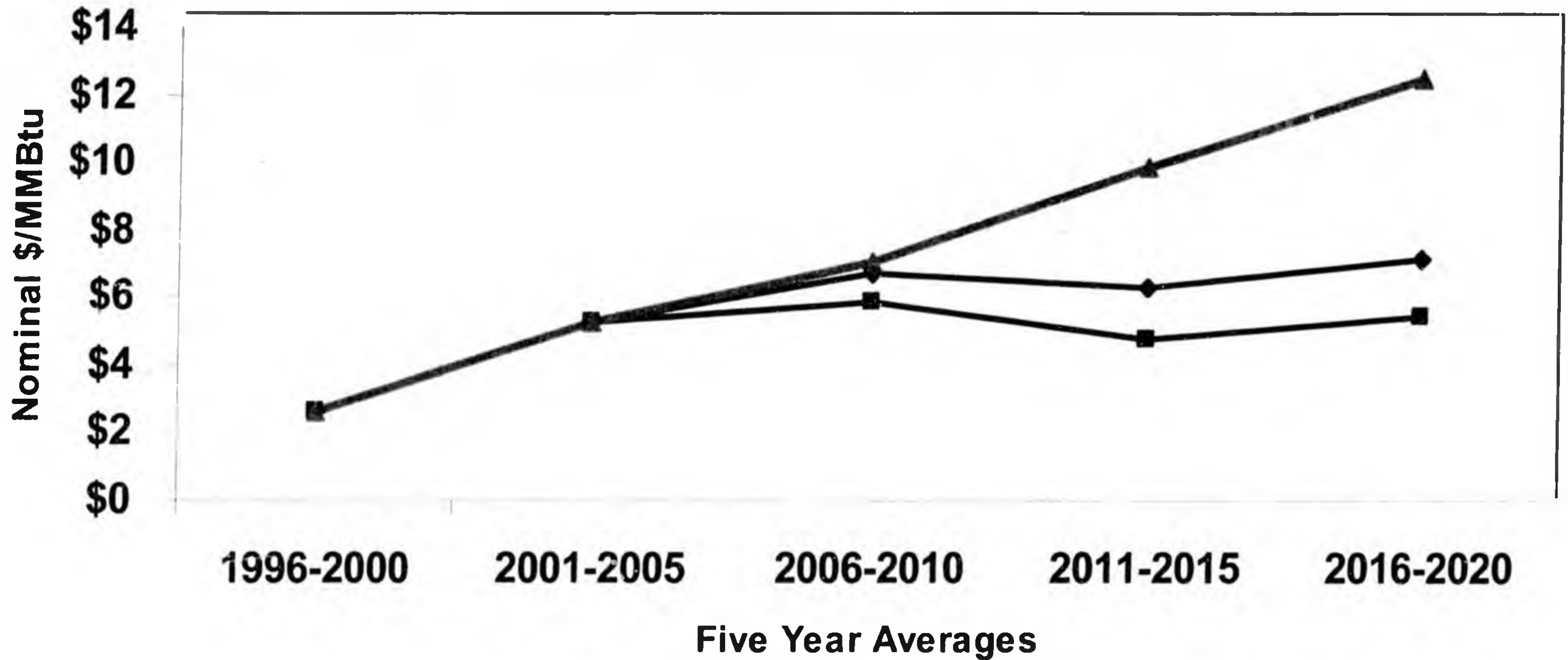
Some will also argue that the uncertainty as to future gas prices imposes a level of risk not adequately compensated for by the returns built into this legislation. Their argument may have been well founded in prior times. In prior times, abundant supply and slack demand made for modest commodity prices. In prior times—in fact, in 1998 when the Stranded Gas Development Act first became law—the only project then envisioned was a LNG project, without a possible Jones Act exemption, and without possible benefits of tax exempt status. In prior times, there was no federal loan guarantee for the project, accelerated depreciation for the pipeline, or tax credits for a new gas treatment plant at Prudhoe Bay.

But let us look at the current risk that future commodity prices will not cover the estimated costs for an Alaska natural gas pipeline project, including a regulated rate of return on regulated assets, and an adequate return at the wellhead for the lessees' gas. We could examine this risk using the Administration's economic model developed under the Stranded Gas Act. That model has been built at significant expense with the assistance of outside expertise. It is tailor-made for an Alaska natural gas pipeline project and accounts for the volumes of gas at issue, the market impacts of introducing Alaskan gas, the estimated costs of the project, the effect of future supply and demand on commodity prices, and the time value of money, among other things. Unfortunately, the Administration's model is confidential at this time and neither its inputs nor outputs can be disclosed in this hearing. However, publicly available data can provide a rough sense of whether the range of uncertainty surrounding future gas prices makes the minimum rate of return included in this legislation inadequate.

First, let's look at publicly available forecasts of future gas prices. We mention here two sets of forecasts, one by government, one by industry. The government forecasts come from the federal Energy Information Administration, or EIA. The industry forecasts come from the American Gas Foundation. There are limitations on comparing these forecasts to the costs we will discuss in a moment—imperfect matches on the time value of money and the location of gas

sales, among others—but the comparison will allow you to get a rough sense of the difference between projected revenues and projected costs, on average, over time. A single page from the American Gas Foundation forecast is included here, and additional materials from both the EIA and American Gas Foundation are included at the end of these prepared remarks:

Actual and Projected Natural Gas Prices (Henry Hub)



American Gas Foundation

As you can see, gas prices are expected to exceed $4.50/mmbtu under any scenario.

Next, we turn to data the three largest North Slope lessees released on "costs," which include—if memory serves correctly, a 12% return on equity invested in the pipeline itself. After these North Slope lessees spent $125 million studying a gas pipeline project, their best estimate was that the average toll—covering a new gas treatment plant at Prudhoe Bay, new pipe not only to Alberta, but all the way to Chicago, and extraction facilities for the removal of valuable gas liquids—would total $2.39/mcf. With the +/- 20% uncertainty modeled by these lessees, $2.39/mcf became a range of $1.90 - $2.85/mcf, as shown in the attached exhibit:

Capital Costs / Tolls

	Southern Route	Northern Route
Capital Cost ('01, $billion)		
Gas Treatment Plant	2.6	2.6
Alaska to Alberta	11.6	10.8
Alberta to Market	4.6	4.6
NGL Extraction Facilities	0.6	0.6
Alaska Project Share	*19.4*	*18.6*
Mackenzie Delta Share	-	*1.4*
Uncertainty	*+/- 20%*	*+/- 20%*
Sales Gas Rate (bcfd)		
Alaska	4.3	4.3
Mackenzie Delta	-	1.0
Total	4.3	5.3
Project Toll ($/mcf)		
Gas Treatment Plant	0.41	0.41
Alaska to Alberta	1.36	1.28
Alberta to Market	0.62	0.62
Toll to Market	*2.39*	*2.31*
Range	*1.90 - 2.85*	*1.85 - 2.75*

In looking at this exhibit, bear in mind that $1.90 - $2.85/mcf is not the same as $1.90 - $2.85/mmbtu, and mmbtu's are how gas is sold. Prudhoe Bay and Pt. Thomson gas is rich in liquids, and contains more than 1,000 btus per cubic foot. We do not know exactly how much more—that information is not public—but at 1,070 btus/cf, the range for tolls drops to $1.78 - $2.66/mmbtu. At 1,120 btus/cf, the range for tolls drops to $1.70 - $2.54/mmbtu. And, to repeat, that range covers a +/- 20% uncertainty and already includes profit on the lion's share of project costs.

Is $1.70 - $2.54/mmbtu or $1.78 - $2.66/mmbtu or $1.90 - $2.85/mcf the right range for project costs? We cannot tell you in total, in public. But we can tell you that those calculations were made by the lessees before tax credits for the gas treatment plant, federal loan guarantees, and accelerated depreciation on the pipeline became available, and the range should drop on that account. The calculations also assume new pipe would be built all the way to Chicago, yet, more probably, Alaska gas will travel from Alberta to the Lower 48 in existing pipelines and expansions of existing pipelines, a cheaper alternative. In fairness, we mention that these cost-savings undoubtedly are offset to some degree by increased steel prices. But remember the cost range given for tolls already includes a return—or profit—for the pipeline, facilities for the extraction of NGLs, and the new gas treatment plant at Prudhoe Bay. You may want to ask one of the lessees here

today, but my recollection is that their figures included repayment of debt at cost and a return on equity for regulated assets at 12% per year.

So what is the bottom line? Prices are expected to average in excess of $4.50/mmbtu on costs of less than $3.00/mmbtu. And the difference between prices and costs is indicative of wellhead value. Again, we caution you this is very rough math. The real math we must keep confidential, but we are not here to mislead you today.

One criticism that has been levied at the proposed legislation is that it is based on forecasts and estimates, and that is true; we cannot know the future in advance of the future. The legislation is similar, in this regard, to the analysis contemplated under the Stranded Gas Development Act, AS 43.82, and the analysis performed by the Department of Natural Resources when examining applications for royalty reduction under AS 38.05.180(j). Oil and gas companies also base their business decisions on commodity price forecasts and cost estimates for future projects. Forecasts and estimates are the way business is done by both industry and government.

A second and related criticism is that the State rather than the lessees forecasts prices and estimates costs under the proposed legislation. However, the lessees have repeatedly indicated in other contexts that they will not share their price forecasts with the State or with each other, and they will not share their

gasline economic models either. They have shared cost information from their $125 million study, and that information is reflected in the Administration's gasline economic model. This legislation allows the Administration, if it so chooses, to recognize lessees' reticence to share certain information, not force that issue, but still enforce the lessees' obligation to develop and market gas when reasonably profitable. Additionally, the Administration is already the arbiter of when the Prudhoe Bay and Pt. Thomson lessees must produce gas; both the Prudhoe Bay and Pt. Thomson unit agreements state that the Director of the Division of Lands—that is the Department of Natural Resources—"is vested with authority to alter or modify from time to time the quantity and rate of production . . . limited to alteration or modification in the public interest . . . ." Otherwise stated, DNR is the decision-maker now and remains the decision-maker under this legislation (subject, of course, to reversal by the court system for abuse of discretion). The lessees may not appreciate that DNR, rather than the lessees or the court system, is vested with primary responsibility for decision-making on this issue, but they granted DNR that authority decades ago when they signed the unit agreements. This legislation does nothing to alter the original bargain over the party vested with control.

Speaking of the court system, some argue that the proposed legislation promotes litigation. It does not. Understanding exactly how this legislation works

should ease concerns. First, it lets the Administration determine whether it thinks there is, in fact, a preexisting duty under the State's oil and gas leases and unit agreements for the lessees to develop and market gas when reasonably profitable. If the Administration concludes such a duty exists, it can choose to enforce that duty or not, now or later. If, say, negotiations under the Stranded Gas Development Act reach an impasse, the Administration may choose to enforce the duty, subject, of course, to finding that production and marketing of the lessees' gas would return at least a reasonable profit to the lessees. The Administration, because of the Stranded Gas Act negotiations, is already sitting on a large body of information from which it could draw conclusions about whether a gas pipeline project would be "reasonably profitable." However, before drawing conclusions, it is apt to wait until the next annual deadline for the lessees' submission of their proposed plan of development for the Prudhoe Bay unit. Same thing for the Pt. Thomson unit. However, I'll continue with the Prudhoe Bay unit as my example. So, to repeat, before drawing conclusions, DNR is apt to wait until the next annual deadline for the lessees' submission of their proposed plan of development for the Prudhoe Bay unit. Or maybe DNR would immediately send a letter to the Prudhoe Bay lessees, advising them that when their next proposed plan of development is up for review, DNR intends to make a determination on whether development and marketing of Prudhoe Bay gas would be reasonably profitable. In either case,

when the lessees submit their next annual proposed plan of development, that proposed plan, together with supporting documentation and other information within the possession of DNR or requested from the lessees by DNR, would be reviewed, analyzed, and evaluated. Assuming the lessees' proposed plan of development did not commit to produce and market gas within seven years, DNR's decision on the proposed plan would most likely condition approval of the proposed plan on a firm commitment to develop and market the gas in specified minimum quantities by a certain date. The lessees could accept DNR's conditions, and proceed to develop and market their gas, or they could reject the conditions. If the lessees rejected DNR's conditions, their current plan of development would expire, putting the unit in default for operating without an approved plan. At this stage, litigation is likely, but no more likely because "reasonably profitable" has been defined as a minimum of a 14% return on capital than because some other standard was used by DNR in determining what constitutes a "reasonable profit."

If there is litigation, the lessees have suggested that they may claim that the legislation is unconstitutional when applied to Prudhoe Bay and Pt. Thomson because it changes preexisting contract terms. Again, we think the legislation does not change preexisting contract terms and will be constitutional as applied. As previously mentioned, the legislation simply defines in a reasonable way terms that are currently undefined. It provides guidance to DNR on what "reasonably

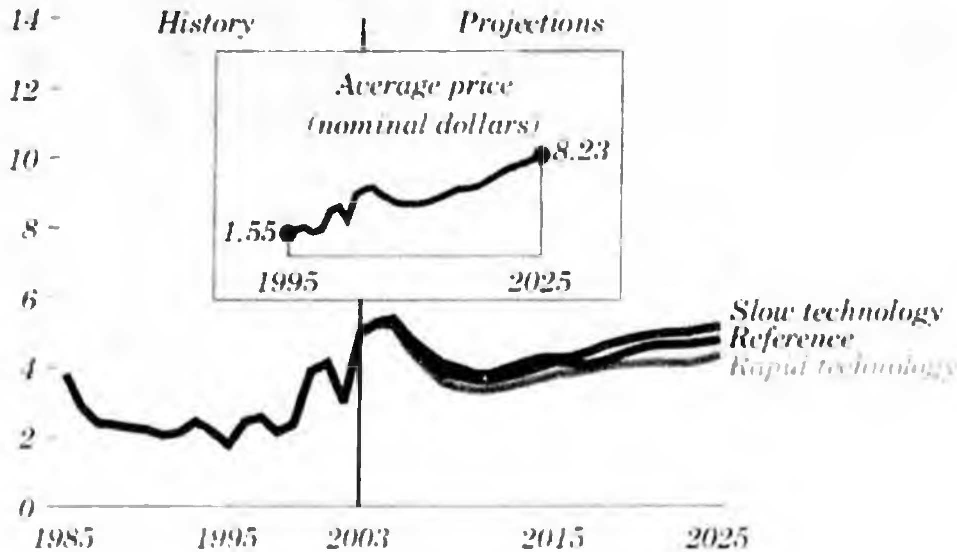
State and its municipalities hundreds of millions of dollars per dollar of wellhead value. At current gas prices, the cost of each year's delay will exceed $1 billion and could exceed $2 billion.

What happens, then, if the lessees use their best efforts to develop and market the gas in seven years, but for some reason all of us can sympathize with, it takes them eight or nine years? First, the State and municipalities are out the hundreds of millions or billions of dollars, regardless of good intent and unforeseeable circumstances. Second, the State can choose not to pursue remedies that might be available. Third, the lessees are sure to argue force majeure or "Acts of God," a term that is already defined under existing agreements and in the unit regulations.

In summary, this legislation does not create a new obligation if one does not already exist. It does not create new remedies for breach of existing obligations. It simply defines undefined terms in both old and new oil and gas leases and unit agreements, rather than leaving those definitions to other branches of government. It gives the Administration guidance on a tool it already has and can choose to use, or not, in getting North Slope gas to market. And, if and when the Administration chooses to use that tool, it sets a seven-year clock on getting gas to market. We believe the legislation is reasonable and appropriate for the current circumstances.

Annual Energy Outlook 2005 with Projections to 2025

Figure 87. Lower 48 natural gas wellhead prices in three cases, 1985-2025 (2003 dollars per thousand cubic feet)



History: Energy Information Administration, Annual Energy Review 2003, DOE/EIA-0384(2003) (Washington, DC, September 2004). Projections: AEO2005 National Energy Modeling System, runs AEO2005.D102004A, OGLTEC05.D102704A, and OGHTEC05.D102704A.

Released: February 2005

profitable" means. But I will not, as I sit here today, guarantee you that the Alaska Supreme Court will find this legislation constitutional. Still, we believe that the legislation can be applied in a constitutional manner, and, in any case, it is a vehicle for sharing with the Administration the Legislature's thoughts on what constitutes "reasonably profitable" and the time frame within which a gas pipeline should be built.

On a related note, the legislation's definition of "reasonably profitable" is intended to rise and fall independently of the seven-year clock contained in the legislation. Thus, on the chance a court strikes down the definition of "reasonably profitable" provided in this legislation, and instead uses some other definition that is nonetheless met by the facts of the case, the seven year clock still runs from the date of DNR's initial determination. Hence, lessees are encouraged to spend their time after issuance of DNR's determination working on a gas pipeline project rather than litigating, particularly if those lessees estimate project profits that would meet any court-imposed standard of "reasonably profitable."

Before closing, the seven year clock should be discussed in a little more detail. Seven years is the period two of the three gasline project proponents tell us they need to bring North Slope gas to market. A longer time period could be included in this legislation to encompass the preferences of the third project proponent, however, time is money—a lot of money. Every year's delay costs the

CONOCOPHILLIPS ALASKA, INC.
TESTIMONY REGARDING HB 71
5-2-05

Mr. Chairman and members of the Committee: My name is Joe Farrell. I am Managing Attorney for ConocoPhillips Alaska, Inc. I thank you for the opportunity to testify regarding HB 71, specifically the recently added sections 1 and 2 .

ConocoPhillips urges the Senate to reject these last-minute changes. These changes are ill-conceived and will not advance their intended purpose. Moreover, they are not needed. ConocoPhillips is committed to the existing Stranded Gas Development Act process, which is working as intended.

My testimony will address the following points:

1. The interpretation of lease obligations is a judicial function.
2. The substantive provisions of the amendment are not supported by the terms of the lease or general oil and gas law.
3. The substantive standards created in the legislation are inappropriate for judging the commercial viability of a pipeline project.
4. Finally, the bill is not needed. The SGDA is working as intended and ConocoPhillips is working hard in negotiations with the State team to make the Alaska gas pipeline a reality.

The first point is that the changes to HB 71 are not a proper subject for legislative action. The interpretation of lease obligations is a judicial function. As the Alaska Supreme Court reaffirmed just this year, oil and gas leases are contracts, which become fixed when originally signed. Moreover, the Contracts Clause of both the Federal and State Constitutions prohibit the State from passing laws impairing the obligations of contracts. As a result, the State legislature is simply without power to modify existing oil and gas leases to the detriment of the lessees, by imposing any new duties upon them or decreasing any of their rights under those leases.

It has been suggested that these changes are authorized because they really only restate existing contract terms under existing law.

This leads to my second point: that the substantive content of these changes are not supported by the terms of the lease or general oil and gas law. The fundamental proposition proposed by these changes is that lessees must build a pipeline project if the State's estimate of the rate of return for the pipeline project, based on the State's modeling of future costs, production and prices, exceeds the historical Return on Capital Employed (known as "ROCE") achieved by the lessees on their worldwide activities.

The fact is that there is not a single lease term or case that has been identified by those testifying before the legislature, and we have been able to find none, that supports this astounding proposition.

Indeed, the attorney for the Port Authority confirmed in his testimony that no court has ever found an implied duty under an oil and gas lease to build anything more than a short connector pipeline.

Nor has any proponent of this legislation shown a single case where this kind of test was applied to determine whether a lessee could be forced into risking its money in an investment for the benefit of the lessor, let alone any support for the proposition that this mechanical – but highly manipulable – approach, is legitimate or appropriate as a general test for when investment duties are created.

There is good reason for the fact that the tests that appear in the revised bill are not to be found in the lease itself or in case law. The reason is that the tests put forward are not fair and do not make economic sense. There is no mathematical formula or model under the lease or general oil and gas law that determines when a duty arises: it is always fact-specific and depends on all pertinent factors, including risk.

This makes sense, since a prudent lessee assesses each project on the basis of its particular circumstances and risks. In that regard, it is critical that the Legislature understand that decisions to develop or construct projects cannot be determined by reference to a single financial parameter, in this case the historic Return on Capital Employed (or "ROCE") for a group of oil companies over the last ten years.

First, let's address what a company's ROCE represents. Each company's ROCE is the output or result of a wide variety of very separate corporate decisions. The ROCE for any given year reflects the results of past decisions over the course of many years, and comprehend not just decisions to proceed with individual projects based on their intended return on investment (which in any event, were based upon each project's unique factors, in particular the risk associated with each project), but also decisions on exploration drilling (which has a high likelihood of failure), capital projects implemented to comply with new environmental laws or for other reasons that are recognized as non-payout, maintenance, and accounting treatment on corporate mergers. All these end up blending into a ROCE output that varies for any given year, and is highly dependent on actual market prices.

Second, let's address what factors a prudent company must take into account in making investment decisions. Any decision to invest in a major potential development project must address a wide variety of risks and uncertainties, including the potential for low prices, capital cost overruns, regulatory and permitting problems, and schedule delay. No prudent operator looks at a single financial parameter, such as ROCE, to decide to invest. And as the cost and scale of the project increase, the risk associated increases and the rigor to address uncertainties takes a higher priority.

By example, the Alaska gas pipeline project is currently estimated to cost $20 billion. The size alone, not to mention the governmental, regulatory, technical and commercial complexity, requires us to address a massive number of issues outside of a single point ROCE calculation. We have had to address the US regulatory process though congressional acts to pass the Enabling Legislation. To help mitigate some fiscal issues we worked for passage of the loan guarantee provisions, credits for the gas treatment plant similar to those for other CO_2 removal facilities, and depreciation provisions similar to those allowed for gas pipeline gathering systems. To address the uncertainty related to making such a long-term and unprecedented investment in Alaska, we have been working with the Administration on a fiscal contract as contemplated by the Stranded Gas Act. These actions have all been undertaken consistent with

analysis to address major risk elements far outside of any single economic data point.

To summarize:

- This proposed amendment attempts to quantify which projects should be developed based on what would appear to be sufficient, in the state's eyes, to provide an "adequate rate of return."
- The project's projected return is to be calculated based on estimates made by the lessor, who does not have to make the required investment.
- The amendment defines an "adequate return" by reference to a single data point, an average historic ROCE.
- Reliance on this single financial parameter is a gross oversimplification of the actual process that a prudent operator would use to determine to progress a project.
- Given the size of major projects in Alaska, including the Alaska gas pipeline, such oversimplification could do nothing but add confusion about what is really necessary to progress the project.

I believe that what was intended through this amendment was an indication of the desire to progress the development of Alaska's resources. ConocoPhillips shares these goals and believes that they can be accomplished through prudent exploration and development of oil resources and through the development of the Alaska gas pipeline. ConocoPhillips is working hard and will continue to work hard to make the Alaska gas pipeline a reality. However, this proposed amendment will only create uncertainty and impede progress toward attainment of that goal.

We respectfully urge that the Senate eliminate sections 1 and 2 from HB 71. Thank You.

Alaska Oil and Gas Association

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Testimony of the Alaska Oil and Gas Association
Regarding CSHB 71(FIN) am

Senate Resources Committee
May 2, 2005

Mr. Chairman, Members of the Committee. For the record my name is Judy Brady, and I am the Executive Director of the Alaska Oil and Gas Association. AOGA is an industry trade association whose 18 members represent the great majority of the petroleum industry in Alaska. I am here today to testify about House Bill 71 on behalf of AOGA's membership, who have approved this testimony.

Until it was amended on the floor of the House last Thursday, HB 71 was a fairly straightforward bill to extend the availability of exploration tax-credits under AS 43.55.025 so they could be earned by exploration activities in the Cook Inlet area and the Bristol Bay area, as well as the North Slope outside of ANWR. AOGA supported HB 71 because it would encourage oil and gas exploration in the state, and exploration is one of four principal strategies available for sustaining oil production at current levels despite the ongoing natural decline of the fields as they are depleted. The three other strategies, as you well know, are (1) ongoing development of existing fields to slow their natural rate of decline, (2) development of satellite fields to use available capacity in existing production infrastructure, and (3) development of the huge resource of viscous oil — well over 20 billion barrels in place — that is already known to exist.

Last Thursday's House floor amendment inserted Bill Sections 1 and 2 into the version of the Bill that is now before you, and changed the title of HB 71 to reflect these two new Bill Sections. Bill Section 2 is the portion of the amendment having true significance and substance, and Section 1 is just a laundry list of factors attempting to justify what Section 2 would do.

Bill Section 2 would amend the state oil and gas leasing statute, AS 38.05.180, by adding a new subsection (hh) to it. This new subsection would purport to mandate how existing state oil and gas leases are to be interpreted and applied, by forging a novel test from a smorgasboard of disparate phrases and concepts from leases, unit agreements and Lower 48 cases. The result is something that is unprecedented, unfair and contrary to commercial realities. This is nothing less than an effort to unilaterally rewrite the lease obligations between lessee and lessor in a material way.

It is difficult to express adequately how deeply troubled AOGA is by the House floor amendment to HB 71 and how strongly we oppose it. Our opposition comes at several levels of analysis.

First, we are troubled by the way in which the entire committee-referral process was circumvented through a floor amendment. The amendment radically altered the Bill by adding important and controversial substance to it that no House committee had had any opportunity to hear and consider, whether in the context of HB 71 or any other Bill this Session. Moreover, Section 7 in Article I of the Alaska Constitution guarantees that "[t]he right of all persons to fair and just treatment in the course of legislative and executive investigations shall not be infringed." Even if the Legislature had the authority to to rewrite the terms of our oil and gas leases, it would not constitute the "fair and just treatment" to do it without notice and opportunity to be heard.

Second, by enacting subsection (hh) to prescribe what the oil and gas leases mean and how they are to be interpreted and applied, the amendment attempts unconstitutionally to usurp the function and authority of the Judicial Branch. Under the "Separation of Powers Doctrine" the Legislative Branch writes the laws, the Executive Branch carries them out, and the Judicial Branch interprets what they mean. The Judiciary's exclusive role of determining the meaning of disputed terminology applies also to the contracts that the State may enter into. It is for the Judicial Branch, not the Legislative Branch, to determine what the leases mean and how they should be applied in a given set of circumstances.

Third, the interpretation prescribed under subsection (hh) for existing oil and gas leases would materially alter the terms and conditions of those leases. Each oil and gas lease is a contract between the State and the lessee or lessees under that lease. The contractual terms and conditions in those leases — and the duties and obligations that the parties owe to one another under the leases, whatever they might be — cannot be altered by either party unilaterally. It requires mutual agreement for any change. When the State attempts to exercise its sovereign powers to alter materially the terms and conditions of a contract — and particularly a contract that it itself has entered into — it is impairing the obligations of that contract in violation of the "Contract Impairments Clause" in Section 15 in Article I of the Alaska Constitution and Section 10 in Article I of the United States Constitution.

Fourth, even if subsection (hh) could constitutionally do what it purports to do, consider the precedent that would be created. If the terms of existing oil and gas lease contracts can be rewritten by prescribing how the key provisions in those leases are to be "clarif[ied] and interpret[ed]," But if this can be done with state oil and gas lease contracts, it can be done for any other kind of state contract as well.

Right now the Murkowski Administration is striving to negotiate a contact under the Alaska Stranded Gas Development Act in order to eliminate a major source of potential risk for a Gas Pipeline Project. This is the risk the State might otherwise change its fiscal "rules of the game" once the Gas Pipeline is built. The industry recalls well that, once pipe was ordered in 1969 to build the trans-Alaska oil pipeline, Alaska changed its tax laws for that pipeline and the Prudhoe Bay field at least a dozen times in the 1970 – 1978 period. Thus, eliminating this risk through a Stranded Gas contract is one of the most important things, if not the most important one, that the State can do to help the Gas Pipeline Project move forward. But now, if the Legis-

lature passes HB 71 with this subsection (hh) in it, you would be telling anyone who might otherwise be willing to develop the Project that the fiscal certainty under a Stranded Gas contract might not be all that "certain" after all — you would be telling them that future legislatures might alter the terms and obligations under that contract through the expedient of enacting legislation like subsection (hh) purporting to interpret and clarify what the Stranded Gas contract means.

Is it really the intent and desire of this Legislature to eviscerate the Stranded Gas Development Act and set the Gas Pipeline back like this? We think not, and we doubt the members of the House intended to do so either. But to avoid that very thing, Bill Sections 1 and 2 of the version of HB 71 before this Committee need to come out.

AOGA supported, and would support now, CSHB 71(FIN) as it read before the House floor amendment. But that amendment is unsupportable, and its enactment would create a legal precedent of the gravest danger not only to the oil and gas industry's contractual relationships with the State, but also for any other parties with significant contractual relationships with the State as well.

Thank you, Mr. Chairman, for this opportunity to testify to you.

BP Testimony
Senate Resources Committee
HB 71

Mr. Chairman, members of the Committee, my name is Ken Konrad. I am Senior Vice President for BP Alaska and responsible for BP's ongoing ANS gas commercialization efforts.

Thank-you for the opportunity to testify today regarding HB 71.

We are deeply disappointed with both the process and the content associated with the amendment to HB 71 that was passed on the House floor April 28th.

We would ask that this committee remove that amendment to preserve an otherwise supportable bill or failing that, kill the bill in its entirety.

The amendment was introduced on the House floor and passed without any prior discussion or committee work.

It seems that advisors creating the amendment were able to slip a very bad idea into legislation under cover of darkness.

Lest there be doubt, this amendment is bad for a gas pipeline project and bad for the Alaska oil and gas business. And it sets an ugly precedent for business in Alaska generally.

Government manipulation of prior contracts

The amendment effectively seeks to alter existing contracts entered between the State and leaseholders.

It would make government the all powerful decision-maker regarding project development, determining what level of profitability is "acceptable" regardless of the risks involved.

This misguided, "government knows best" approach is inconsistent with America's market based society, and, we hope, inconsistent with this committee's view of the role of government.

It suggests that government, and government alone, should be able to force investors into a multi-billion dollar project that is by all accounts a project with significant risk. Of course, the amendment does not suggest compensating investors when the government's assumptions in its all knowing economic model are wrong.

The amendment hands the critical roles of investment evaluation and field regulation directly to the Commissioner of the Department of Natural Resources, in an entirely one-sided process. Here's how it would work:

The commissioner would use a State developed economic model to determine whether a private company MUST invest in a project, and WHEN that investment must occur. With the aid of a state-determined price forecast and a state-determined cost assessment, the Commissioner determines project scope and timing.

Using an average historical rate of return figure as a benchmark for specific projects is a fundamentally flawed approach_that fails to recognize unique risk / return characteristics inherent in every individual project.

But it is the Commissioner who determines the appropriate Rate of Return hurdle rate for the investors, and tells them when to move forward with a project. Regardless of the investor's own views on risk and reward and regardless of investment criteria actually used by industry!

Are we still in America?

It is not surprising that no other state has anything remotely similar to what is contained in this amendment.

It is unprecedented – in large part because it is in direct conflict with basic State and Federal constitutional principles.

State and Fede al Constitutional Issues

The HB 71 amendment violates basic State and Federal constitutional prohibitions against legislative "Impairment of Contracts". This fundamental principle intended to ensure the sanctity of contracts is a cornerstone of the U.S. economic system.

It prevents governments from using their power to roll rough-shod over agreements that have been made with private entities. It ensures that free market principles are upheld, and that no government can choose to ignore its own contractual rights and obligations.

The amendment seeks to strip away the lessees' ability to evaluate and act on investment decisions. Changing the rights and obligations of the lessee's years after the contract was entered fails this most basic constitutional premise.

This legislative effort to alter contracts after the fact sends a chilling signal to industry at the very time we are looking for clarity and durability through a fiscal contract for gas development.

The amendment also violates fundamental government separation of powers principles by infringing the role of courts in adjudicating contracts.

We would suggest the Chairman request a balanced and thoughtful legal evaluation of this bill from the Department of Law.

An amendment made by lawyers for lawyers

Given the clear constitutional issues raised, it is safe to assume that any effort to actually invoke the amendment to challenge existing lease contract would spark a marathon of litigation. As a matter of fact, some have suggested this bill should be renamed, "the Lifetime Employment for Lawyers Act".

While a contract dispute on its own could be expected to result in significant litigation – the HB 71 amendment adds yet a couple more layers of litigation.

The first step would be constitutional challenges through State courts. Then, more litigation as similar issues are addressed through a variety of federal courts.

And while the lawyers are doing just fine – the gas project itself languishes.

Contrast to SGDA process

It is particularly surprising to see the language contained in the amendment because it is so inconsistent with the sound and thoughtful approach that was previously developed by the legislature and supported by industry.

The Legislature re-authorized the Stranded Gas Development Act in 2003.

We began informal discussions with the state shortly thereafter and in January, 2004 BP, ConocoPhillips and ExxonMobil submitted the first SGDA application received by the state.

Just two months after the U.S. congress passed the gas pipeline legislation, BP, ConocoPhillips and ExxonMobil submitted a detailed and comprehensive proposal to the State that would allow a gas project to advance to the next phase of activity.

The proposal embraced the governor's desire for direct state participation in the project.

The opportunity for gas commercialization is at our doorstep. Detailed discussions with the state are ongoing.

It should be clear that we are doing exactly what that legislation intended: negotiating toward a clear and durable fiscal contract that enhances the prospects for a commercially viable Alaska gas pipeline project.

Let's Pretend......

Please indulge me in a game of pretend to help illuminate the absurd nature of this amendment.

Let's pretend this committee votes to support this amendment and other Senate committees do likewise and the amendment is ultimately passed into law.

Let's pretend the Commissioner of Natural resources at some point in the future decides to take steps to implement this new change to prior contracts.

Let's pretend that when the constitutionality of this amendment is challenged through the State court system and all appeals are finally exhausted, that the State Supreme court does not rule this amendment as unconstitutional.

Let's pretend that when the constitutionality of this amendment is subsequently challenged through the Federal court system and all appeals are exhausted, that Federal courts allow the amendment to stand.

Now let's pretend that having survived these constitutional challenges that the State is able to prevail in the inevitable litigation over the lease contract itself.

After many years of hard work and many court victories, let's pretend all the lawyers retire very comfortably at some far away paradise.

And we may as well pretend that though this period of endless litigation centered on the very essence of the sanctity of contracts, investors continue to confidently invest billions of dollars on other oil and gas investments uninterrupted – after all we are just pretending.

Now, let's pretend industry actually begins to invest in the project as mandated by the then state government.

Let's pretend the costs the state had assumed in its economic model are exceeded by $5 billion. Would the state reimburse investors for the States poor assumption on cost?

Or let's pretend the gas prices assumed in the state economic model proved overly optimistic. Would the State pay investors the difference?

Or the project was delayed due to regulatory problems in Canada – would the State pay the costs of delay?

What fiscal regime would the State assume in its economic model? What if it changed after the state had forced the investment on industry?

Perhaps the prevailing attitude is, "Who cares about those questions. Someone else can figure them out once there's a pipeline in the ground."

We can't imagine that this body would hold such an attitude, because it would indicate a cavalier, short-sighted, anti-market mind-set, wrapped in a cheap costume that has been spray-painted, "Best for Alaska".

Well, some things can be camouflaged with spray paint. But we don't think anyone can disguise fundamental challenges to the American system of free enterprise and the rule of law. Such challenges are just too ugly.

Bad process -

In the short period of time since this amendment crawled out of the shadows on April 28, we have had an opportunity to discuss with many legislators what this amendment actually means.

It has become very clear that few Members in the House appreciated the full meaning or wide ranging consequences of the amendment when the vote was held.

This is not entirely surprising given that there was no prior debate, no prior discussion and no prior committee work in advance of the very sudden House floor vote.

Just before the floor vote, advisors whispered in hushed tones that this amendment would ensure a gas pipeline would be built.

Whispers of - "Trust me, this will help get us a gas pipeline"

Trusting and well intentioned representatives, with no time to find out otherwise, did as they were advised.

I have attached a transcript of the House floor discussion prior to the vote in its entirety to my testimony for reference. It illuminates the totality of discussion on this amendment prior to the vote.

Ugly process, ugly amendment.

Mr. Chairman, members of the committee, the amendment to HB 71 is a ridiculous, unworkable, unhelpful, unconstitutional approach that will at best set the stage for years and years of litigation.

It creates an immensely dangerous precedent that has implications for all leases and all contracts, including the gas pipeline contract currently under negotiation.

For all of Alaska industry, the bill casts serious doubt on the sanctity of ANY contract at ANY time.

I urge this committee to strip this amendment from an otherwise sound bill.

I would urge this committee to not simply bury this bill to let it die but to stand up and take a definitive and overwhelming vote to overturn this amendment........

I would urge this committee to let the private sector know that Alaska is not closed for business

Let investors know that contracts actually mean something in Alaska.

Thank-you. I would be pleased to answer any questions.

Transcript of House Floor Session 4/28/05

HB 71 Reconsideration to consider Amendment #1

Representative Samuels: Thank you Mr. Speaker. At this time I wish to bring up my vote on reconsideration on HB 71.

Speaker: Reconsideration has been asked for on House Bill 71. Madam clerk, would you please read the title for the third and final time.

Clerk: Committee Substitute for House Bill 71 Finance An Act extending and amending the requirements applicable to the credit that may be claimed for certain oil and gas exploration expenses incurred in Cook Inlet against oil and gas properties production (severance) taxes, and amending the credit against those taxes for certain exploration expenditures from leases or properties in the state; and providing for an effective date.

Speaker: Representative Samuels.

Rep. Samuels: Thank you Mr. Speaker. I move and ask unanimous consent that we move back to second reading for the purpose of a specific amendment, that being Amendment #1.

Speaker: Without objection we will go back to second reading for the purpose of a specific amendment. Representative Samuels.

Rep. Samuels: Thank you Mr. Speaker. I move Amendment #1.

Speaker: Is there objection? Hearing no objection.

Member: Object.

Speaker: Oh, there is objection. Representative Samuels.

Representative Samuels: Thank you Mr. Speaker. Amendment #1 which you have in front of you the first couple of pages are kind of why we got there. The crux of it is on page 3, section 2, it starts at line 7. And what this does is, in our leases as we heard from one of the Administration attorneys last year, there are terms in there which are not defined and what this Amendment does is simply define those terms such as "reasonably profitable". And my belief is that this provides clarity for all parties concerned. And the last thing that anybody wants to do, and I believe in my very heart that this will not happen, is that we will not end up in litigation but if we do end up in litigation, then which branch of government do you want defining those terms? Do you want the people of Alaska through their elected representatives in the legislative branch defining those terms or do you want a judge defining those terms? And, what we've done here is we've defined those terms and the crux of the Amendment is to do that. And I can go into more detail but generally speaking we are having definition of terms. We are not changing any conditions of a lease; we are not changing any remedies available; we're simply defining the terms of the lease right now. Thank you.

Speaker: Is there any.. is the objection still maintained?

Rep. Meyer: Thank you Mr. Speaker. Mr. Speaker just a question for the sponsor of the Amendment, does this pertain to all future leases or does this pertain to leases that have already been issued? And I guess if it is retroactive, is there some legal concerns there that if somebody made a bid for a certain lease and the terms were such and now we're changing them, that could cause a problem. I think this is good and would be fine for future leases but I'm concerned with it if it is retroactive.

Rep. Samuels: Thank you. Certainly for future leases and the way that I view this it is defining the terms of a current lease. Now, if we end up in litigation it will be one of the hundred points that a judge would then determine that. And if it's determined that we cannot determine that, at least a judge would know what we thought. I don't think we can lose by doing this at all. We're defining the terms that are not defined at the current time in statute.

Speaker: Any other debate?

Rep. Rokeberg: Mr. Speaker, I'm appreciative of the co-chair of Resources in bringing this forward for our attention. It is a significant issue. We recently received some information from outside council regarding these issues. But I, like the co-chair of Finance, am concerned about its impact on current versus future leases. I do agree with the co-chair of Resources that it clearly would have an impact on future leases and I'm very concerned about the legal impacts with the amount of litigation that might be generated by doing this now, because the body of law, the common law, is defining the terms under the current leases. So if the courts are going to accept these newer definitions, I find that somewhat troublesome. I'd have to defer to some members of the bar from this body to assist on seeking some clarity on this issue. But what's more concerning to me Mr. Speaker is the issue contained on page 3 lines 30 through 31 where we're developing a benchmark for profitability trying to be precise with an arithmetic formula based on 10-year averaging of a basket of companies in terms of what's "reasonable profit". I'm not sure this is doable. As a businessman and an investor I'm used to looking at some of these types of standards and I'm concerned that we can actually compute reasonable profitability from this type of arithmetic formula. Each company and each concern, each sector of the economy has different hurdle rates and different percentages that they consider adequate and reasonable returns. Clearly the bill calls for and makes the distinctions for regulated provisions of the petroleum industry ... uh, seeks to establish another benchmark here, I'm not sure this is the right one. So whereas I applaud the spirit of this to give some clarity here, I'm not sure we're doing more harm than good. So I'd like to get some response.

Speaker: Is there further debate on Amendment #1?

Rep. Hawker: Thank you Mr. Speaker. I guess I rise in puzzlement over this Amendment. I'm a little concerned with the lengthy section of findings. These would be conclusions, statements of fact that we're going to place into the permanent record and I'm not a lawyer but I understand that these do become very important if an issue ever is brought. These are statements of legislative conclusion. I see a lot of findings here are very consistent with a presentation we did here earlier, last week in the Labor and Commerce committee or, I mean, in the LB&A committee, but I believe we only heard one side of the story and I believe some of these facts may be subject to a legitimate dispute or alternate opinion because we all know what happens when we put two lawyers in a room. So I really don't know how or what to do with this

Amendment but I was just wondering if the maker of the Amendment can assure me that these are in fact facts and not matters of legal conclusion that do have an alternative interpretation. Thank you Mr. Speaker.

Speaker: Further debate on Amendment #1? Are you ready for the Question?

Rep. Samuels: Thank you. Very briefly in wrap up, I believe that this just clarifies what we think that the law is currently. And when it comes to the intent language, we just wanted to have some language in there that explains why we were trying to do what we were doing. That was the intent of having the intent language so we would have some context for the definition of that.

Rep. Meyer: Mr. Speaker, this bothers me a bit in the sense that, you know, when you go into a lease thinking the terms are such and such and you spend millions of dollars on that lease and then all of a sudden we decide well, we don't agree with those terms and conditions so we're going to change them retroactively, I'm not sure that's a good business practice. I certainly don't have a problem with making this for any future leases. We have a lot more leases to sell and so I'd like to have just a minute to talk to the sponsor of this Amendment to see if we could make it effective today and not make it retroactive.

Speaker: Brief at ease. House come back to order. All you oil guys come back to order. Is there any other debate on Amendment #1 to House Bill 71? (Come to order; sit down Norman).

Rep. Meyer: Thank you Mr. Speaker. Mr. Speaker, I appreciate the opportunity to take to the sponsor about this. I think that potentially this has some far-reaching legal and commerce implications that we don't know what those are and we can't really have a committee hearing on this on the House floor. And I am a little disappointed that this issue wasn't brought before a committee where we could have had adequate discussion so that we could, you know, talk to the economists and talk to the attorneys that the sponsor's talked to that the rest of us haven't. So, since this is being sprung on us like this, I'm just not comfortable with it so I'll be voting "no".

Speaker: Further debate? Are you ready for the question? The question is, shall Amendment #1 pass the House? Members please vote. Madam Clerk, please lock the role. Does any member

wish to change his or her vote? Rep. Gatto? Rep. Gatto from yea to nay. Any other member wish to change his or her vote? Madam Clerk.

Clerk: 28 yeas, 11 nays.

Speaker: So, with a vote of 28 yeas and 11 nays, Amendment #1 has passed the House. So we're back in third reading. Is there any further debate on the bill under reconsideration?

Rep. Kerttula: Thank you Mr. Speaker. Amendment notwithstanding, the bill still has major, major problems. The underlying bill now gives incentives throughout the entire state south of the foothills and when you're trying to incentivise, you really need to understand what you need to do so that you make it an incentive. And this is just a willy-nilly approach. It's too broad and it's not a good bill at this point. Thank you.

Speaker: Further debate on the bill?

Rep. Chenault: Thank you Mr. Speaker. I might disagree with the previous speaker about being willy-nilly. I think that what we've done here is try to open up Alaska and try to get exploration going in other areas. The Cook Inlet area has been well explored. There are areas that haven't been and the incentives are intended to provide exploration corporations the ability in the market place today to go out and actually hopefully find more gas for local consumers and value added business. While I agree with the previous speaker that there may be some issues there that maybe we need to continue to work on, and I've talked with her about them and we will continue to do that, I think that, for the most part, this does affect a lot of the areas in the state and a lot of the basins and basins that we don't know for sure what's there. But the only way we're ever going to know what's there is to get people out there drilling. And if it takes an incentive to get them out there producing our reserves then I'm willing to go there so I'd ask the body to support. Thank you Mr. Speaker.

Speaker: Further debate on the bill?

Rep. Meyer: Thank you Mr. Speaker. I almost forgot because you always tell me to sit down and be quiet, but I do potentially have a conflict of interest on this because the company that I work for when I'm not here could take advantage of it.

Speaker: Further debate?

Rep. Hawker: Thank you Mr. Speaker. I thank the previous speaker for reminding me of my duties. I also need to declare a conflict of interest because members of my family are employed in the oil and gas industry.

Speaker: There is objection. You'll be required to vote. All members having any connection to the oil industry will get a blanket having to vote. [brief at ease] Okay, are you ready for the question? The question is shall Committee Substitute for House Bill 71 Finance amended pass the House under reconsideration. Members may proceed to vote. Madam Clerk, please lock the roll. Does any member wish to change his or her vote? Madam Clerk.

Clerk: 32 yeas, 4 nays.

Speaker: So, by a vote of 32 yeas, 4 nays CS for HB 71 Finance Amended has passed the House under reconsideration.

[Without objection the roll call vote on the bill became the vote on the effective date clause]

Alaska State Legislature

Senate Majority Web: www.akrepublicans.org

Sponsor: RESOURCES
Current Version: SCR 6
Contact: Mary Jackson, 465-2828

DRAFT

Fact Sheet for: Senate Concurrent Resolution 6

Short Title: COOK INLET OIL & GAS PLATFORM ABANDONMENT

Summary:

- Urges the Governor of Alaska to have the state Division of Oil and Gas, Department of Natural Resources to review and possibly recommend new abandonment regulations for Cook Inlet oil and gas platforms.

Benefits:

- Creates possibility of abandoned platforms being used for new oil and gas production applications.

Background:

- In 1970, Cook Inlet oil production peaked at 226,000 barrels a day. In 2004, production averaged a paltry 24,000 barrels a day. Right now four of the 16 Cook Inlet wells are "lighthoused," meaning the only thing operating on them are warning lights. SCR 6 urges the Governor of Alaska to have his administration review abandonment regulations and possibly recommend new ones that encourage the industry to restart abandoned platforms. One independent oiol and gas company is using two old platforms to produce new oil finds. This resolution asks that the recommendations drafted by the Alaska Oil and Gas Conservation Commission in 1996 be used as a starting point.

Alaska State Legislature

Senate Majority Web: www.akrepublicans.org

Sponsor: RESOURCES
Current Version: SCR 7
Contact: Mary Jackson, 465-2828

DRAFT

Fact Sheet for: Senate Concurrent Resolution 7

Short Title: OIL AND GAS REG REVISIONS

Summary:

- Endorses the Murkowski administration's effort to review and revise state regulations on exploratory oil and gas operations.

Benefits:

- Encourages the oil and gas industry to invest in existing fields and to develop new marginal fields.
- In 2002, the Murkowski administration launched an aggressive effort to review and update natural resource development regulations in Alaska. SCR 6 voices the state Senate's support for the ongoing review of exploratory oil and gas operations.