509 HRES HB 854

HB

8354

Alaska State Legislature

House of Representatives

Committee on Resources

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811

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NOTIFICATION

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

HB 257

February 17, 1978

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

Dear Mr. Speaker:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sincerely,

Jay S. Hammond
Governor

THE LEGISLATURE OF THE STATE OF ALASKA
TENTH LEGISLATURE

FISCAL NOTE

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

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

EXPENDITURES (Thousands of Dollars)

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

FUNDING (Thousands of Dollars)

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

POSITIONS

FULL TIME	0	0	0	0	0	0
PART TIME						
TEMPORARY						

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

Jack Roderick

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

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

33-001 (Rev. 12/77)

LETTER OF INTENT

CSHB 854 (RESOURCES)

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature

Dear Mr. Speaker:

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

1. Subsection (f) on page 6.

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

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

Alvin Osterback

Alvin Osterback, Chairman
House Resources Committee

Date: 4/14/78

DESCRIPTION OF LEASING METHODS IN HB854

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

(1) Bonus Bid With Fixed Royalty

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

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

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

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

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

TABLE I
TYPICAL SLIDING SCALE ROYALTY SCHEDULES

SOUTH CENTRAL AREA

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

NORTH SLOPE AREA

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

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

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

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

(3) Net Profit Share Bid With Fixed Bonus

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

(4) Royalty Bid With Fixed Bonus

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

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

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

TWO VIEWS ON BIDDING STRATEGIES

WEALTH MAXIMIZING STRATEGIES FROM THE STATE'S VIEWPOINT

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

Bonus Bid - Fixed Royalty

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

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

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

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

Royalty Bid - Fixed Bonus

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

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

Net Profit Bidding

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

Work Commitment

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

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

MULTIPURPOSE STRATEGIES

Bonus Bids

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

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

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

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

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

In summary, bonus bidding can be used when:

(1) Very small potential reservoirs are expected;

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

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

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

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

Royalty Bidding - Fixed Bonus

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

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

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

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

Net Profit Bidding

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

or the bonus bid method.

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

Work Commitment

(See section (t)).

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

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

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

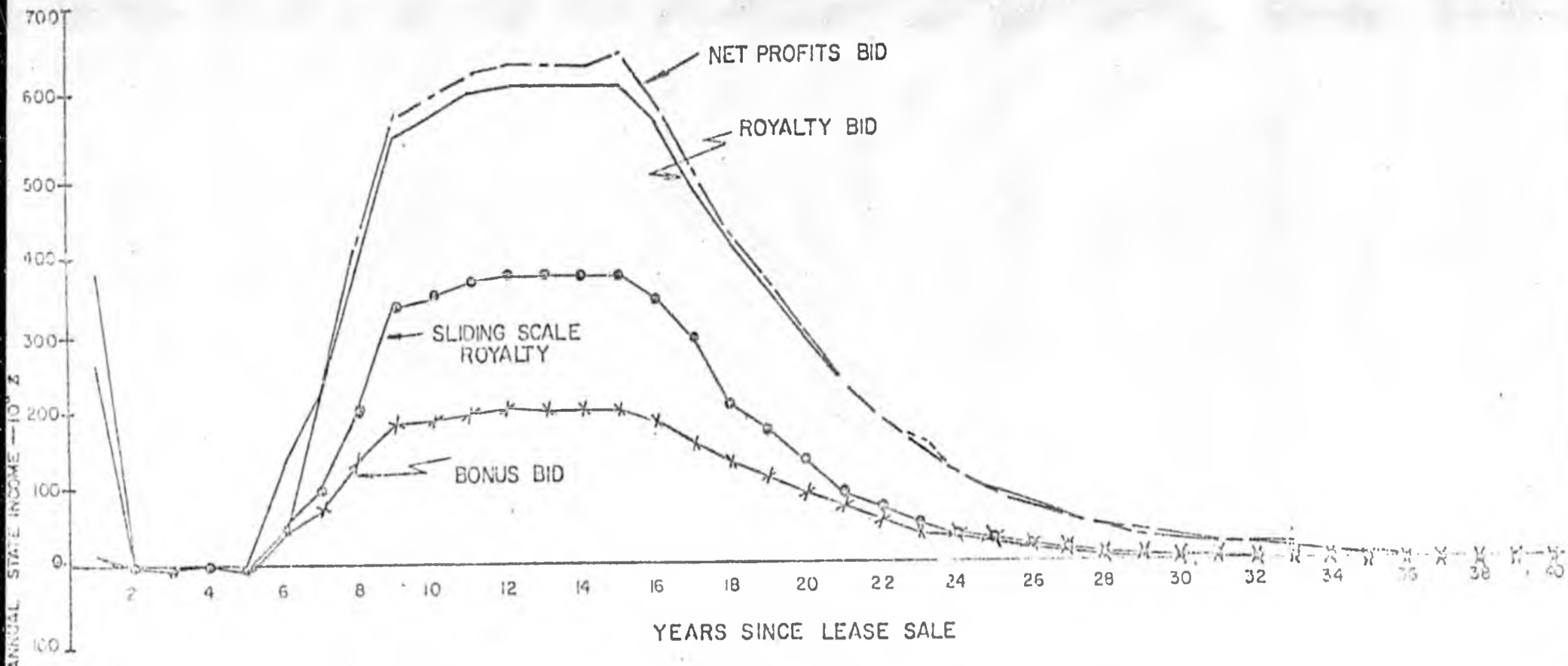
On the basis of exploration knowledge, lack of interest by industry and reasonable analysis, the department may determine that lands have very low potential for oil and gas.

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

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

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

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



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

BEW 1-30-78

LEASING METHODS EXAMINED

BUT NOT INCLUDED IN HB 854

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

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

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

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

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

5. Oil Payment Bidding - shift royalty to rental.

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

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

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

SUMMARY OF FEDERAL OCS REGULATIONS

PERTAINING TO GEOLOGICAL AND GEOPHYSICAL INFORMATION

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

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

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

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

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

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

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

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

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

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

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

3. Processed geophysical information derived from the seismic data;

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

a. Shallow and deep subbottom profiles

b. Bathymetry

c. Side-scan sonar

d. Magnetometer systems

e. Bottom profiles

f. Gravity surveys

g. Magnetic surveys

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

200,000 is arbitrary and unwarranted.

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

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

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

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

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

has this authority.

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

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

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

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

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

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

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

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

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

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

JUL 1 1976

JUN 29 1976

BAN ON JOINT BIDDING

Dear Mr. Chairman:

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

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

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

AMERICAN REVOLUTION BICENTENNIAL 1776-1976

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

Sincerely,

Secretary of the Interior

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

Enclosure

JOINT BIDDING FOR FEDERAL ONSHORE OIL AND GAS LANDS,

AND COAL AND OIL SHALE LANDS

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

Department of the Interior
Office of Policy Analysis
June 1976

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#3

SUGGESTED REVISION OF HOUSE BILL NO. 854

~~Deleted~~

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

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

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

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

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

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

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

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

Oil, Gas & Mineral Properties

LUM LOVELY, Geologist

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Anchorage, Alaska 99510

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Anchorage, Alaska 99501
Phone (907) 277-1551

April 4, 1978

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

Re: House Bill 854

Dear "Chat":

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

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

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

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

Rep. C. V. Chatterton April 4, 1978

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

Very truly yours,

LUM LOVELY

Encl.

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

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March 31, 1978

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

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

Dear Dr. LeResche:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Very truly yours,

L. C. LOVELY

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

(continued)

(continued)

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

SUMMARY OF ACREAGE LIMITATION
CHANGE IN HB 854

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

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

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

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

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

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

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

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

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

ERICKSON
4/10/78

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

IN THE HOUSE

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

HOUSE BILL NO. 854

IN THE LEGISLATURE OF THE STATE OF ALASKA

TENTH LEGISLATURE - SECOND SESSION

A BILL

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

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

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

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

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

(A) maximize the economic recovery of the resources;

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(1) bonus bidding

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

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

(2) royalty bidding

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

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

(3) net profit bidding

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

4/10/78

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

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

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

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

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

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

AtlanticRichfieldCompany Post Office Box 360
Anchorage, Alaska 99510
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April 6, 1978

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

Dear Chairman Osterback:

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

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

Sincerely,

Dave Harbour

Dave Harbour
Director
Alaska State and Local
Government Relations

ATLANTIC RICHFIELD COMPANY COMMENTS ON
HOUSE BILL 854

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

April 6, 1978

Comments on Section 1:

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

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

Sec. 38.05.180(a)(2)

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

Sec. 38.05.180(b)

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

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

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

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

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

Sec. 38.05.180(c)

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

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

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

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

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

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

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

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

Sec. 38.05.180(d)

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

Sec. 38.05.180(e)

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

Sec. 38.05.180(f)

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

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

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

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

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

Sec. 38.05.180(i)

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

Sec. 38.05.180(j)

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

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

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

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

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

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

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

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

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

Sec. 38.05.180(k)

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

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

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

Sec. 38.05.180(l)

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

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

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

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

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

Sec. 38.05.180(o)

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

Sec. 38.05.180(p)

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

Sec. 38.05.180(q)

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

Sec. 38.05.180(r)

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

Sec. 38.05.180(s)

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

Sec. 38.05.180(t)

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

Sec. 38.05.180(u)

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

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

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

Sec. 38.05.180(v)

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

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

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

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

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

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

Section 2

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

Section 3

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

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

STATE OF ALASKA
THE LEGISLATURE

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

LEGISLATIVE AFFAIRS AGENCY

File

March 15, 1978

MEMORANDUM

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

TO: The Honorable Alvin Osterback

FROM: Gregg K. Erickson
Director of Research

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

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

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

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

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

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

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

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

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

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

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

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

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

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

GKE:dh
Attachments

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

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

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

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

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

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

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

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

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

competitive royalty bidding,

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

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

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

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

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

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

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

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

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

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