State of Alaska
FY2003 Governor's Operating Budget

Department of Natural Resources
Oil & Gas Development
Component Budget Summary

Component: Oil & Gas Development

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Component Mission

The mission of the Division of Oil and Gas is to administer oil and gas lands in a manner that assures both responsible oil and gas exploration and development and maximum revenues to the state. (Differs from SLA 2001Ch.90, Section 111)

Component Services Provided

Make prospective lands available for oil and gas exploration, development, and production on a predictable basis.

Administer conventional oil and gas leases, shallow natural gas leases, and exploration licenses, as well as exploration incentive programs.

Maximize the economic and physical recovery of hydrocarbon resources through unitized or cooperative operations.

Ensure that full value is received from the extraction and sale of state resources.

Develop marketing strategies and negotiate agreements for the sale of royalty oil and gas to provide in-state benefits.

Ensure that bonus, rental, license fees, net profit, and royalty payments are correct and received when due.

Ensure that shared federal bonus, rent, and royalties are properly received and allocated.

Ensure that leasehold and unit-related operations are conducted in an environmentally sound manner.

Provide technical and policy support for the Alaska congressional delegation, the Governor's office, the Legislature, and the Commissioner of DNR.

Provide oil and gas-related information to the public and the press through our website or personal contact.

Advocate responsible petroleum development throughout the state.

Component Goals and Strategies

Convey rights to explore for, develop, and produce oil and gas by conducting competitive oil and gas lease sales and issuing oil and gas exploration licenses and shallow natural gas leases.

Initiate and administer programs that encourage responsible exploration and development.

Manage the state’s interest in oil and gas lands by monitoring lease and unit operations and accounting for oil and gas rental and royalty payments.

Collect and verify oil and gas revenues through timely and accurate accounting and auditing.

Market royalty oil and gas to maximize state revenues and stimulate economic development.

Negotiate and amend royalty settlement agreements when economically advantageous to the state.

These goals support the Governor's commitment to maintain and enhance competition, diversity, and balance in the exploration, development, and production of Alaskan resources, sustain or increase oil and gas production, and the revenues derived from that production, and ensure that the State's natural resources are developed in an environmentally and socially responsible manner.

Key Component Issues for FY2002 – 2003

The Division of Oil & Gas manages the state's oil and gas resources with a staff of 51, consisting of highly specialized technical experts schooled as geologists, geophysicists, engineers, attorneys, economists, accountants, and natural resource managers, who work as a team but are assigned to six sections: resource evaluation, leasing, lease and unit administration, commercial, royalty accounting, and administration. Together, they brought in more than $1 billion in FY01. During that same period, and in the four months since, they leased or licensed exploration on millions of acres, implemented the new shallow natural gas leasing program, negotiated agreements for the formation or expansion of seven units and three areas of production within units, oversaw the startup of the Alpine and Northstar fields, augmented royalty and net profit share revenues by auditing lessees and negotiating or amending settlement agreements, initiated proceedings for redetermination of the methodologies used by BP and Exxon in valuing North Slope royalty oil, offered royalty oil for sale and initiated an offering of royalty gas, processed thousands of applications for the assignment of interests in oil and gas leases and verified the financial responsibility of each assignee, and worked with the producers, the governor's policy council, and the legislature on gasline issues.

As the preceding paragraph suggests, every section of the division experienced an explosion in activity in and since FY01. Major activities occurring in or planned for FY01-FY03 are discussed below by section.

Leasing

North Slope, Beaufort Sea, Foothills, and Cook Inlet areawide lease sales are increasing the number of leases sold annually, as is the new shallow natural gas leasing program (see figure 1).

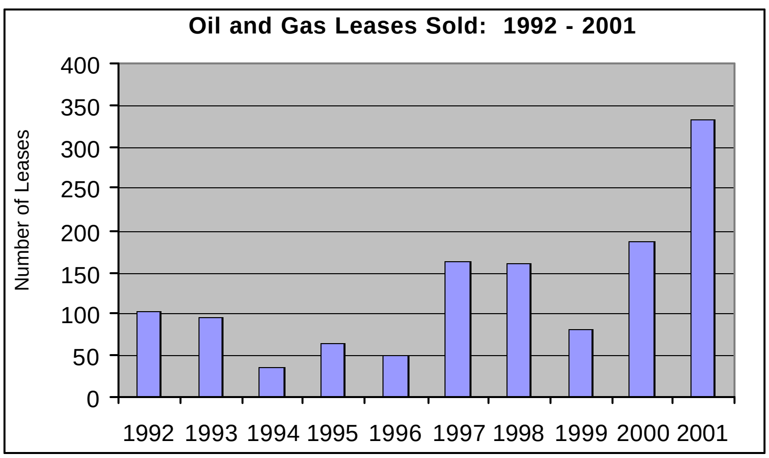

Figure 1

In four areawide lease sales during 2001, the division leased 334 tracts covering 1.6 million acres. The first-ever Foothills lease sale drew bids on 978,560 acres—the most ever in a single lease sale. New companies are participating in the leasing program, and companies that have not participated for a number of years are returning.

As more leases are sold, more leases are issued (see figure 2) and the number of leases being administered increases (see figure 3).

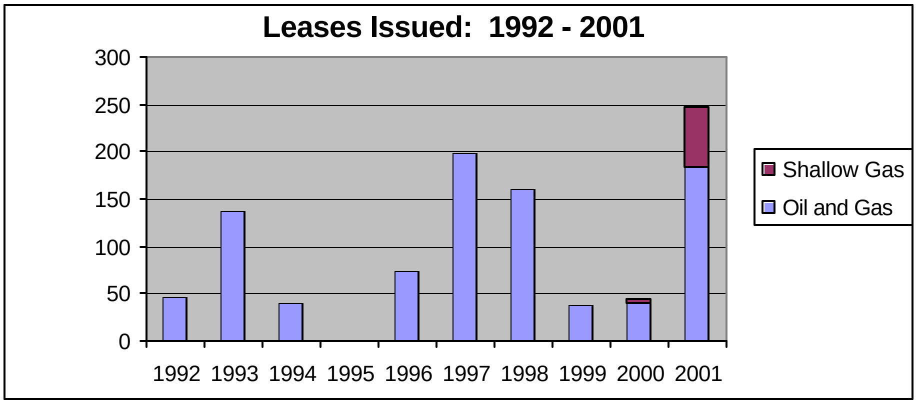

Figure 2

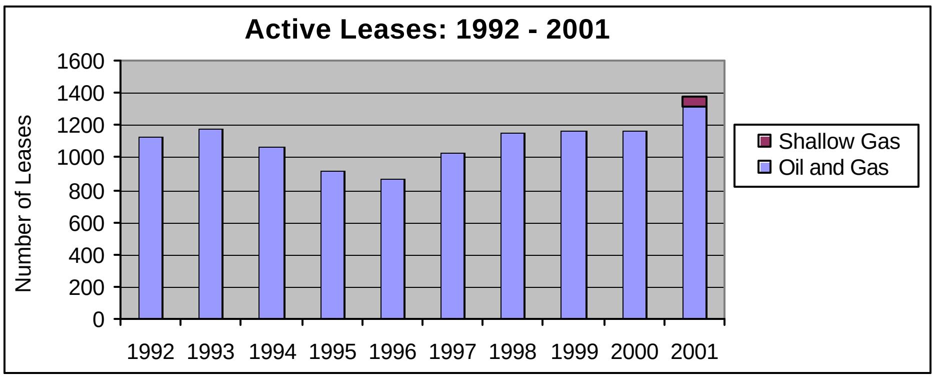

Figure 3

Interest in exploration licensing also continues to increase. The division issued the first exploration license in October 2000 and has proposals for two licenses in the Susitna Valley, west of Willow and Talkeetna, and one for the Nenana basin, located north and west of Nenana. The Susitna licenses will be ready for issuance during the fourth quarter of FY02, and the Nenana license will be issued in FY03. All of these exploration licenses require best interest findings. This program must be supported by geological fieldwork and resource assessments by the division. As a new program with apparent early success, exploration licensing presents the division with previously unscheduled work requirements, most notably title work. The Susitna licenses require title work for nearly 900,000 acres and the Nenana license involves nearly 500,000 acres. Likewise, the shallow gas-leasing program has resulted in over 300 applications, and has required title work on over a million acres. Figures 4 and 5 show the amount of acreage requiring title review work, and the increase in title work due to areawide leasing, exploration licensing and shallow gas leasing.

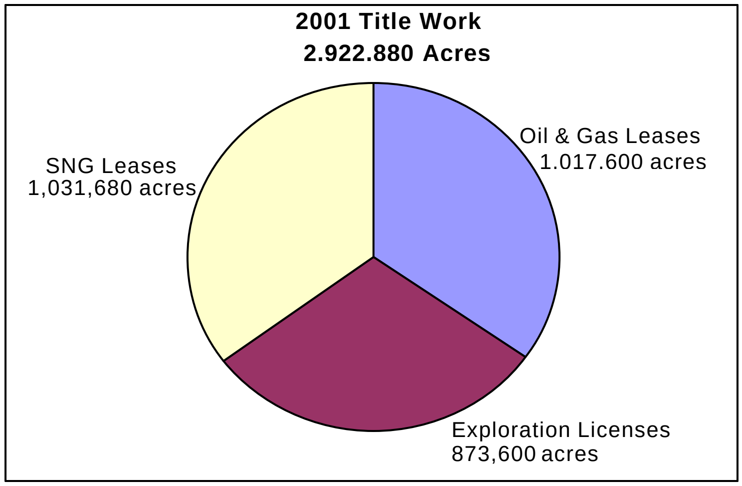

Figure 4

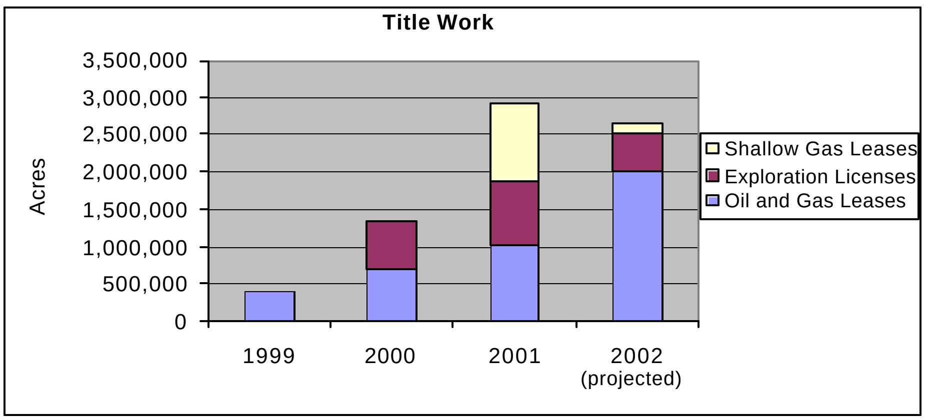

Figure 5

The success of the exploration licensing and shallow gas leasing programs combined with an additional yearly areawide sale (North Slope Foothills) has resulted in a significant increase in title work. During FY 01, the division had more than twice the amount of acreage requiring title work than it did in FY 00, and in FY 00 the division had 3.5 times as much acreage requiring title work than it had in FY 99. This increased workload has meant delays of up to eight months in issuing oil and gas leases bid on in areawide lease sales (see figure 7). This delay carries with it a significant fiscal cost. The state collects twenty percent of bonus bids during a sale; the remaining amount, along with the first year's rental, is paid when the lease is issued. The state is delaying millions of dollars in revenue because of the backlog in title work. For example, leases for North Slope areawide lease sale held in November 2000 were issued one year later, in November 2001. As shown in figure 6, over $10 million in bonus and rental payments to the state were held back because of this long delay. Additional staff is needed to complete the title work in a timely fashion.

Part of this division's request is an increment for the Oil Safety and Development Initiative. This increment will provide funding for new positions that will assist in the lease issuance process alleviating the backlog and reducing the delay in collecting revenue.

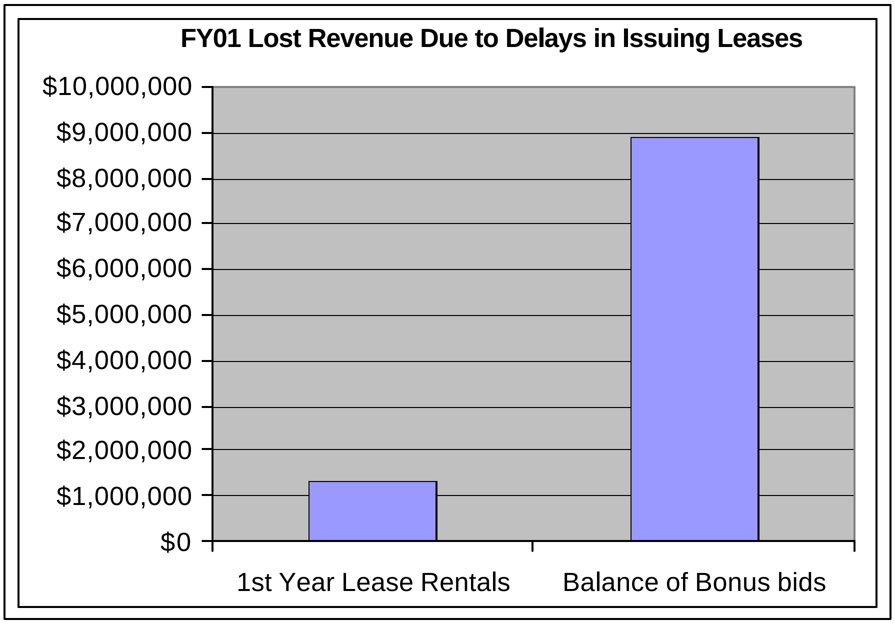

Figure 6

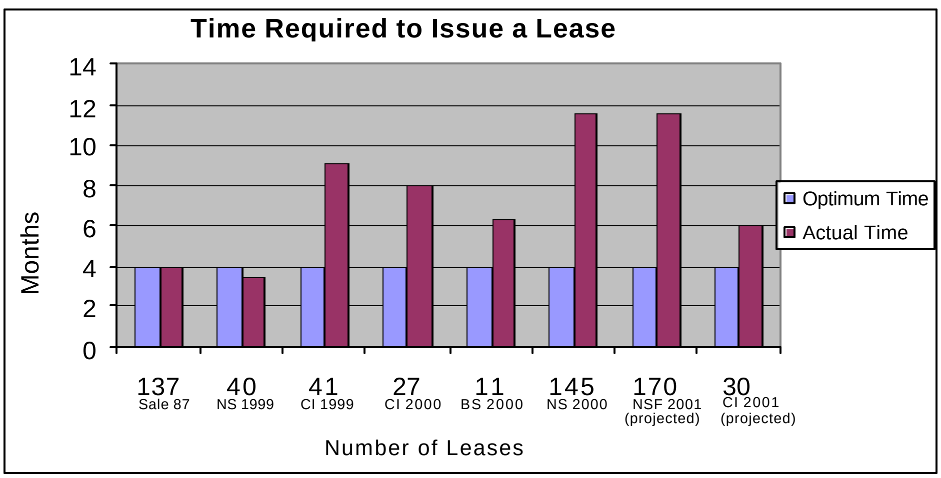

Figure 7

As part of the leasing process, the division continues to review all mitigation measures for competitive lease sales, exploration licensing, and shallow gas leasing, modifying these measures as new concerns arise and the oil and gas industry evolves.

The division must continue to defend its leasing decisions against lawsuits by environmental groups. Although DNR was successful in defending appeals of the best interest findings for Sale 85A, Cook Inlet and Beaufort Sea Areawide, the division anticipates that environmental groups will continue to challenge DNR actions involving oil and gas activities. The division has recently seen increased scrutiny by environmental litigants on its permitting actions.

Concerns over the beluga whale will continue to be an issue in Cook Inlet. The department is under court order to withhold leasing of 126 tracts until the court is satisfied that safeguards are in place to protect the belugas. The department has stated that it would not offer these tracts until subsistence hunters and the National Marine Fisheries

Service (NMFS) have agreed on a co-management plan; such a plan is now in effect. The division is working with the Department of Law to determine whether to petition the court to allow these tracts to be included in the May 2002 lease sale. The division will need to supplement the beluga whale discussion in its 1999 Cook Inlet Areawide best interest finding before these tracts can be offered in a lease sale.

Finally, the division signed a contract with IndigoPool.com to place lease sale and exploration license information on its website in order to reach a broader international market. Through IndigoPool's contacts and proactive marketing, information about the state's leasing and licensing programs is reaching a much wider audience. If funded, the division will be able to continue using IndigoPool, and will also be able to take advantage of the low advertising rates IndigoPool is given by major industry publications, which will increase worldwide exposure. The division's outreach programs including IndigoPool and it's promotional booth at two large oil and gas trade conventions (AAPG and SEG) are at least partially responsible for the increase in number of bidders at recent state sales. These companies include large independents such as, Alberta Energy and Burlington Resources, as well as smaller well-financed companies.

Lease Administration and Units

In and since FY01, the division negotiated agreements for the formation of the South East Delta, Slugger, Sakonowyak River, and Ninilchik Units, for the expansion of the Prudhoe Bay, Pt. Thomson, and Colville Units, and for the formation of the Aurora, Polaris, and Northstar Participating Areas. The division also oversaw the startup of production at Alpine and Northstar. And the division is currently evaluating applications for the formation of the Cosmopolitan, Deep Creek, and South Ninilchik Units and the Borealis Participating Area.

The division also processed more than a thousand applications for assignment of leasehold interests, many of them occasioned by the realignment of the interests of BP, Phillips, Exxon, and Forest Oil at Prudhoe Bay. In addition, the division is just starting to process assignments for the alignment of interests at Point Thomson. A third wave may be forthcoming as a result of the Chevron-Texaco merger or in the event of global alignment at Prudhoe Bay. Additionally, relatively high oil and gas prices, the potential for a North Slope gas line, and last year's abbreviated North Slope winter exploration program are leading to much greater activity in the division and in the field. Phillips and BP are both projecting production growth of at least 15 percent. BP has publicly stated that they have lowered operating costs at the PBU from $3.00/bbl to $1.50/bbl, which should make many more projects economic within that unit. Moreover, the equalization of the majority interests in the Prudhoe Bay leases has spurred an increase in the activity for satellite developments and gas-related projects in the unit. As a result of a number of successful "satellite" wells, the number of unit actions has increased. Although they involve fewer barrels than the major reservoir at Prudhoe Bay, these actions are extremely complex. Much of the new activity occurs at the edges of existing units (which is why they are called satellites) or at the conjunction of two (or more) units and involves commingling of different production streams through common facilities and facility sharing agreements.

Additionally, exploration and development activity will also require more time from the division's permitting group. More projects will have to be reviewed, permitted, and monitored for stipulation compliance. Moreover, the emergent gas-to-liquids technology and ongoing push towards North Slope gas commercialization will increase the permitting and inspection workload due to new developments, pads, pipelines and infrastructure both in Cook Inlet and on the North Slope.

High oil prices, gas prices and declining gas reserves are causing an increase in exploration activity in Cook Inlet. Smaller companies and new companies are showing an interest in drilling exploration wells and operating existing facilities. Smaller and new companies tend to have less experience or resources compared to larger companies. This can slow the permitting process and increase the risk of environmental damage and default under the terms of the oil and gas leases. Staff are spending larger amounts of time educating and guiding these companies through the permitting process and formulating performance bonds to lower risk to the state.

In addition, the shallow gas lease and the exploration license programs are providing an incentive to explore for oil and gas in areas where a significant percent of the surface is owned by private parties. Consequently, more staff time is required to educate the public. Moreover, the relationship between surface and subsurface owners involves complex legal issues that have not yet been fully resolved in Alaska. The uncertainty is resulting in appeals and hearings over the issue of damages and compensation to the surface owner. Staff is spending larger amounts of time on these issues.

Issuance of shallow gas leases may result in new short term drilling activity because the primary term of the lease is three years. To keep the lease beyond that period requires ongoing drilling, drilling a well capable of production or unitization. The state should expect drilling programs and applications to unitize to be proposed very soon after the leases are issued. Existing Cook Inlet markets and infrastructure improve the economics for shallow gas exploration and production.

The first coal bed methane unit (the Pioneer Unit) has had several wells drilled. Although the division is having some problems, the division hopes to see more progress this year as a new operator, Evergreen, has assumed control in the unit. The Division is prepared to issue our first shallow gas leases but is waiting for a resolution of several appeals on how surface owners rights are to be handled.

As instructed by the legislature in 2001, DO&G is drafting regulations that would outline public notice procedures for DO&G permits not covered by the ACMP.

Resource Evaluation

During FY01 lessees completed nine significant exploration and delineation wells on state lands. Although the results of all these wells have not yet been disclosed it is clear that the state's recoverable oil reserve inventory was increased by more that 150 million barrels during FY01. Particularly significant were the Unocal and Forest Oil successes at the McArthur River and Redoubt Units in Cook Inlet. When brought on-stream these fields will increase present Cook Inlet oil production rates by about 25%. Phillips Alaska, Inc. announced that five of six wells drilled within the NPR-A discovered significant quantities of hydrocarbons there. Although these are not now in production the state will receive half of the federal royalty share when production commences.

As expected in the aftermath of the April 2000 British Petroleum (BP) – Atlantic Richfield (ARCO) – Phillips Petroleum realignments, the resource evaluation section experienced an upturn in activity during FY01. The section expended substantial effort evaluating unit plans of exploration and development as operators sought means of retaining soon-to-expire leases upon which they had delayed activities pending the outcome of the merger realignments. After extensive analysis the section recommended denial of Arco Alaska's (now Phillips Alaska) application for a discovery royalty certification of the Sambuca well (Midnight Sun field). Certification would have resulted in the state's loss of approximately $23 million in royalty income. Following an appeal and hearing the commissioner upheld the director's denial of the application.

Extensive effort was also dedicated to review of activities and actions proposed by operators of the Point Thomson and Northstar units, the latter involving for the first time shared unit management responsibilities with the federal Minerals Management Service.

Approval of supplemental funds during FY01 allowed the section to quickly initiate the process of acquiring a substantial amount of 2-D and 3-D seismic data, thus reducing the backlog built up in recent years due to lack of funding. These data will allow the division to provide higher quality information to the administration, the legislature, and the public regarding the state's valuable petroleum assets.

Increased seismic exploration on the North Slope is now supporting three independent geophysical companies, two more than in recent years. In addition to the increase in activity in the short run, the division can expect additional wells to be drilled as new exploration targets are identified.

The resurgence of interest in North Slope gas reserves will have a significant impact on the division in the upcoming FY 02 - 03 periods. Only Phillips Alaska, Inc. maintained an active exploration program through the merger period. Both Alberta Energy Company and Anadarko Petroleum Company have disclosed their intent to pursue an active Alaska exploration programs; BP is a partner in some of that work. Higher natural gas prices and growing recognition of a possible future natural gas shortage in South-central has encouraged operators in the Cook Inlet and Kenai Peninsula areas to increase exploration efforts in those areas.

With industry's revitalized exploration effort, the division's involvement in activities in the NPR-A will grow as cooperative agreements with the responsible federal regulatory agencies are implemented. Similarly, joint state-federal management responsibilities are increasing as projects such as Northstar, McCovey and Liberty progress. The possible impact of ANWR remains an unknown. Over the past year the division has provided and continues to expend a significant amount of time and resources in promoting the opening of ANWR for responsible oil and gas exploration and development. Division experts have been deeply involved in the issue at many levels: locally, statewide, nationally and internationally. This has included briefing congressional delegations and other key federal officials, and being interviewed in depth by numerous national and international television, radio, and print media corporations (NBC Nightly News, BBC, Sky Network, CNN, Scientific American, National Geographic, USA Today, and many more). Additionally, the division has provided key technical illustrations and briefing material to Arctic Power, government agencies, and many national publications. Division staff made five major trips to the North Slope with a total of more than fifty members of the press to explain key technologic, environmental, and geologic issues in support responsible development in the coastal plain.

Commercial

The division's petroleum investments manager, petroleum market analyst, and commercial analysts work with other members of the division in maximizing royalties payable to the state. During FY 01 and FY 02, they initiated proceedings for redetermination of the methodologies used by BP and Exxon in valuing North Slope royalty oil; offered royalty oil for sale and initiated an offering of royalty gas; worked with the producers, the governor's policy council, and the legislature on gasline issues; and resolved a number of outstanding royalty and net profit share issues with the producers, as more specifically described below.

In the early 1990s the major North Slope oil producers and the state entered royalty settlement agreements that tied each producer's royalty obligation to a market basket of seven crudes. Subsequently, the settlements with BP and Arco (now Phillips) were amended to require royalty payments based on ANS spot prices, except where the market basket of seven crudes and ANS spot differed by more than $0.50. In late FY 01 the division compared the amounts being paid under these formulae to market value as measured by ANS sales contracts and actual receipts and found the formulae wanting. Consequently, the division has "reopened" the royalty settlement agreements with BP, Exxon, and Phillips to renegotiate a valuation methodology that better reflects the market value of ANS. As of the date of this writing, the division is nearing completion of negotiations with BP; henceforth, BP's royalties will be based on either the ANS spot price or ANS spot + $0.15/bbl, depending on the terms of the governing lease; however, the division will retain the right to once again reopen the settlement should ANS spot price no longer reflect ANS market value. Negotiations with Exxon are not as advanced, and they also entail issues of transportation costs; if negotiations fail, then the division will proceed to arbitration with Exxon. The reopener with Phillips is currently stayed, but will be reactivated as soon as the manpower is available.

The division continues to supply royalty in-kind (RIK) oil to the Alaska refining industry. Currently, about 41 percent of ANS royalty oil is sold by the division in-kind. Additionally, in response to inquiries from industry, the division offered a portion of its remaining royalty oil in kind in a competitive sale in August 2000. Although the tender yielded no bids, the sale provided the state with important market information and suggested that the state is meeting the current needs of the local refineries, although the expiration of two major ANS RIK oil contracts in 2003 suggests that another offering in 2002 or 2003 may be appropriate.

The commercial section has also devoted many hours to advance the ANS gas pipeline project. Staff has been developing in-house expertise in the marketing of gas and gas liquids in the United States and Canada, transportation economics, and rate-making. They have served both the governor's Alaska highway gas pipeline policy council and the joint legislative committee on gas pipelines. Moreover, in October 2001 they launched an ANS RIK gas sale process that may culminate in sales contracts by the end of FY02.

The remainder of the commercial section's time is devoted to developing regulations on minimum value, evaluating applications for discovery royalty and royalty reduction, and working with the units and resource evaluation sections in developing commercial terms for the formation and expansion of units and participating areas.

Royalty Accounting

With the expansion of the Electronic Data Interchange (EDI) program, several companies are now making royalty (and other) payments, and filing all necessary reports, electronically rather than by the endless stream of paper of the past. More companies will come on-line in FY 02. Ongoing improvements to the automated oil and gas royalty accounting system (OGRA) will provide benefits such as automated value verification, payment reconciliation, digital filing of supplemental documents, and sharing of oil and gas technology, data, and software with other state agencies. The division, working together with the Department of Revenue, will continue to bring oil and gas royalty and net profit share audits more current. Years 1995 through 1999 are under audit in FY 02. Our goal is to see all royalty reports and net profit share payment reports audited within three years of filing.

With realignment at Prudhoe Bay, changes in the accounting for the Initial Participating Area (IPAs) at Prudhoe Bay have been completed, but reporting and accounting for the rest of the unit is still in flux. Some of the volume reporting shows old allocation numbers, and some companies are reporting on the basis of the old ownership percentages, while others report on the basis of new percentages. Accounting programs are being re-written by the operators, lessees, and the division.

Miscellaneous

Litigation will remain a significant component of the division's workload, draining resources needed to accomplish the division's technical mission.

As with other state agencies, the division staff is aging as long tenure staff members become eligible for retirement. Attrition is expected to take a heavy toll in technical skills and institutional knowledge beginning soon. The loss of institutional knowledge is unavoidable, but will have a tremendously deleterious effect upon the division's ability to efficiently perform its mission - particularly in the areas of unit management, appeals, and litigation.

This year the legislature approved pay increases for the division’s exempt employees (director, deputy director, petroleum geologists, petroleum geophysicists, petroleum manager, petroleum market analyst, commercial analysts, and petroleum land managers). These pay increases, which brought exempt employees to parity with their federal counterparts, have stemmed the loss of exempt employees to industry, though their pay still remains below their counterparts in industry. The pay increases have also facilitated hiring of exempt employees. However, pay for the division’s non-exempt employees remains low, making it difficult for the division to recruit and retain these employees, especially with the resurgence of industry and the prospect of a gas pipeline.

Major Component Accomplishments in 2001

1) Petroleum revenue (royalty and tax) accounted for approximately 81% of general fund unrestricted revenue. Royalty revenue accounted for 35% of the general fund unrestricted revenue. Total royalty, settlement, rental, federal share and bonus revenue was $1.146 billion. Distribution was as follows: $798.8 million General Fund, $331.4 million Permanent Fund, $9.98 million Constitutional Budget Reserve Fund, and $5.7 million School Fund. Revenue increased 9.6% from FY 00 to FY 01.

2) The North Slope Foothills Areawide oil and gas lease sale resulted in the largest amount of acreage being bid upon in any state lease sale – 978,560 acres. Four lease sales held in 2001 resulted in over 1.6 million acres being leased and the state receiving over $24 million in bonus bids.

3) The Northstar development was permitted in full and the first major sealift was completed. Production commenced on October 31, 2001.

4) Alpine was successfully permitted and constructed. Production commenced in November 2000.

5) The division resolved a sizeable audit dispute with BP and closed out several long-standing audit claims with other lessees. (Among these are: 1994-1999 BP ANS marine transportation audit; 1992-95 Amerada Hess ANS royalty oil valuation litigation settlement; 1988-1997 Marathon Cook Inlet LNG royalty/transportation audit; 1987-92 Texaco Cook Inlet royalty oil.) Total revenues generated by these settlements equaled $48 million.

6) Geological reviews of industry proposals to establish or modify units, participating areas, and plans of production or operations for the following units, fields, and pools: Alpine, Badami, Borealis, Cannery Loop, Cosmopolitan, Deep Creek, Gwydr Bay, Kenai Unit, Kuparuk, Kookpik, McCovey, Meltwater, Midnight Sun, Milne Point, Ninilchik, North Middle Ground Shoal, North Trading Bay, Northstar, Polaris, Pt. Thomson, Redoubt, Sakonowyak River, SE Delta, South Ninilchik, Slugger, Sterling, Tarn, Tabasco, Tyonek Deep, West Foreland, and West McArthur River.

7) The division’s units group managed 30 active units and 50 participating areas (PAs) within those units encompassing state lands. Management of the units and PAs included review of plans of development and/or exploration for the units and PAs, negotiation of expansions and contractions to units and PAs; negotiation and monitoring of facility-sharing and production commingling agreements for the new satellites/PAs; DNR representation before various state and federal agencies regarding unitization issues; response to inquiries from the legislature, public, and the oil and gas industry regarding unitization issues; and negotiation of new unit agreements and other complex agreements regarding the development of oil and gas on state lands. Unit and PA activity levels increased after BP-ARCO merger was approved by the Federal Trade Commission.

8) Issued 183 oil and gas leases and 65 shallow gas leases.

9) Provided technical and policy support to the Governor's gas pipeline policy group and the Legislature's gas pipeline review committees.

10) The division provided comments to the BLM regarding the proposed unitization rule for NPR-A. Further rounds with comments are expected on the promulgation in unitization rules for NPR-A.

11) The division completed negotiations with BP regarding outstanding disagreements over the calculation of ANS royalty oil value. The resulting amendments to the BP and ARCO ANS Royalty Settlement Agreements resolve ANS royalty oil value issues for the period ending December 1999.

12) The Alaska Supreme Court affirmed the first legal challenge of the 1994 amendment to AS 38.05.035(e) allowing phased oil and gas lease sales. The Supreme Court also affirmed the best interest finding for Sale 85A, Cook Inlet, commenting in the opinion on the thoroughness of the DO&G finding.

13) Subsequent to the Supreme Court decision on Sale 85A, Cook Inlet, Trustees for Alaska dismissed its November 2000 Supreme Court appeal of the Beaufort Sea Areawide best interest finding.

14) The division conducted the first competitive royalty oil sale in 14 years. Although the sale attracted no bidders, streamlined sale procedures were adopted to make it possible to conduct sales in the future with less lead-time.

15) Continued "partnering" with the federal Minerals Management Service in management and oversight of jointly-owned lands in the Northstar Production Unit and the McCovey Exploration Unit. The division also "partnered" with the federal Bureau of Land Management on issues regarding management of several jointly-owned fields in the Cook Inlet/Kenai region and continued to attempt to implement a similar procedure in the event that NPR-A and state lands are combined in units in the future. In similar fashion, the division worked in close partnership with the Arctic Slope Regional Corporation to bring the Alpine field into production.

16) Substantial effort was made to evaluate, but ultimately deny, the proposal by ARCO Alaska, Inc. to certify the Sambuca No. 1 well as a discovery royalty well. Similarly, a Unocal proposal for an expansive participating area in the North Middle Ground Shoal unit was denied. Both are in litigation.

17) Division staff participated in geological field programs investigating the hydrocarbon potential of the NPR-A and North Slope Foothills in support of both proposed lease sales and the North Slope gas pipeline supply studies.

18) The content of the division's website was expanded; the website has proved to be a very successful means of distributing information to industry and the public.

19) Electronic reporting of oil and gas royalty reports was implemented for eighteen companies including full implementation using Electronic Data Interchange (EDI) for two of those companies.

20) The division participated in interdisciplinary meetings of state resource agencies (DGC, DNR, DEC, and F&G) addressing issues such as clean-up in broken ice and the critical issue of abbreviated winter drilling seasons.

21) The division worked with the legislature to amend AS 38.05.035(e), clarifying the requirement of a single written best interest finding for a disposal of an interest in state land or resources.

22) As a result of changing and added missions as well as gas pipeline related work demands, the division have re-classed several positions to commercial analysts and are in the process of hiring an additional geologist and a petroleum land manager.

23) There were 1,465 square miles of 3D seismic shot on the North Slope, about 3½ times the amount shot the previous year. A new geophysical exploration company, PGS Onshore, began operations on the North Slope, bringing the number of active companies to three.

24) Prudhoe Bay West End (aka Northwest Eileen) development was permitted and two new drill sites and related pipelines constructed.

25) Twenty-five winter exploration well approvals were issued.

26) The Meltwater North field development in the Kuparuk River Unit was permitted.

27) Continue to diligently audit oil and gas royalty payers and royalty-in-kind purchasers.

28) Continue to work with effected landowners who own property overlying state oil and gas leases proposed for exploration and/or development.

29) Process 1356 oil and gas lease assignments.

Statutory and Regulatory Authority

Alaska Const.art.VIII, sec.1-2
AS 38.05.130
AS.38.05.131
AS 38.05.135
AS.38.05.134
AS 31.05.035
AS 38.05.020
AS 38.05.030
AS 38.05.035
AS 38.05.137
AS 38.05.145
AS.38.05.177
AS 38.05.181
AS 38.05.182
AS 38.05.183
AS 38.06
AS 41.06
AS 44.19
AS 46.40
6 AAC 50
11 AAC 02
11 AAC 82.115 - 82.815
11 AAC 82.903 - 82.990
11 AAC 83.301-83.393
11 AAC 83.810
11 AAC 83.815
11 AAC 83.1020
11 AAC 89.090
11 AAC 96.210 - 96.240

Oil & Gas Development

Component Financial Summary

All dollars in thousands

	FY2001 Actuals	FY2002 Authorized	FY2003 Governor
Non-Formula Program:			
Component Expenditures:			
71000 Personal Services	3,864.5	4,643.8	5,253.0
72000 Travel	62.5	139.4	195.8
73000 Contractual	322.1	477.7	409.7
74000 Supplies	173.8	128.9	163.9
75000 Equipment	207.1	41.6	66.6
76000 Land/Buildings	0.0	0.0	0.0
77000 Grants, Claims	0.0	0.0	0.0
78000 Miscellaneous	0.0	0.0	0.0
Expenditure Totals	**4,630.0**	**5,431.4**	**6,089.0**
Funding Sources:			
1002 Federal Receipts	0.0	140.3	141.7
1004 General Fund Receipts	3,440.8	3,750.7	4,392.5
1005 General Fund/Program Receipts	48.3	49.6	50.3
1007 Inter-Agency Receipts	22.1	0.0	0.0
1053 Investment Loss Trust Fund	14.8	0.0	0.0
1055 Inter-agency/Oil & Hazardous Waste	2.5	20.0	20.0
1061 Capital Improvement Project Receipts	30.5	15.4	15.7
1105 Alaska Permanent Fund Corporation Receipts	1,065.5	1,455.4	1,468.8
1108 Statutory Designated Program Receipts	5.5	0.0	0.0
Funding Totals	**4,630.0**	**5,431.4**	**6,089.0**

Estimated Revenue Collections

Description	Master Revenue Account	FY2001 Actuals	FY2002 Authorized	FY2002 Cash Estimate	FY2003 Governor	FY2004 Forecast
Unrestricted Revenues						
General Fund Program Receipts	51060	149.8	82.0	82.0	50.0	50.0
Unrestricted Fund	68515	1,145,906.1	868,784.3	868,783.8	812,638.6	908,177.6
Unrestricted Total		**1,146,055.9**	**868,866.3**	**868,865.8**	**812,688.6**	**908,227.6**
Restricted Revenues						
Federal Receipts	51010	0.0	140.3	140.3	141.7	150.0
Interagency Receipts	51015	22.1	0.0	28.7	0.0	0.0
General Fund Program Receipts	51060	48.3	49.6	49.6	50.3	50.3
Statutory Designated Program Receipts	51063	5.5	0.0	0.0	0.0	0.0
Capital Improvement Project Receipts	51200	30.5	15.4	15.4	15.7	15.7
Interagency Recs./Oil & Hazardous Waste	51395	2.5	20.0	5.0	20.0	20.0

Description	Master Revenue Account	FY2001 Actuals	FY2002 Authorized	FY2002 Cash Estimate	FY2003 Governor	FY2004 Forecast
Restricted Total		**108.9**	**225.3**	**239.0**	**227.7**	**236.0**
Total Estimated Revenues		**1,146,164.8**	**869,091.6**	**869,104.8**	**812,916.3**	**908,463.6**

Oil & Gas Development

Proposed Changes in Levels of Service for FY2003

Changes in services are:

1) Due to competitive areawide leasing, the addition of the exploration license program, and the unexpected popularity of the shallow gas-leasing program, it is currently taking the division up to a year to conduct title reviews and issue leases. With additional title staff requested in the **Oil Safety and Development Initiative,** the division's goal is to be able to issue leases 3-4 months following a lease sale or receipt of application.

2) Shallow gas leases are currently being issued in areas where there are dense numbers of surface owners. This could lead to potential conflicts between surface owners and industry, which can be mitigated, in part, through public education and the division taking a more visible role in conducting on-site inspections. With additional staff requested in the **Oil Safety and Development Initiative**, the division expects to be more proactive in conducting inspections on the Kenai Peninsula and the Mat-Su Valley.

3) Full implementation of **electronic (EDI) royalty reporting and payment** will allow staff to focus more on value and volume verification and audit and less on data entry. It will also make the royalty value and volume data base standardized and available in digital format to all division staff for analysis and research purposes.

4) **The Shallow Natural Gas Leasing** program was originally intended to encourage exploration in rural areas where fuel costs are currently subsidized. The division is experiencing interest in developing shallow gas to compete in the commercial market as well as providing mine-mouth energy sources. If successful, this program could reduce mine operating costs in Alaska dramatically. This program will bring added costs and resource commitments to the division since it will involve communities not previously involved with oil and gas activity.

5) The division continues to manage costs by eliminating display ads for lease sales; reducing the amount of travel to the North Slope for public hearings; conduct hearings via teleconference; rely only on division's website to disseminate information; no longer print excess copies of the Five-Year Oil and Gas Leasing Program, and decrease volume of mail-outs.

6) The division's increased inventory of state-of-the-art 3D seismic data and enhanced capability to utilize those data should further improve the division's ability to monitor exploration and development activities throughout the state.

7) Statute and regulations dictate the activities and actions of the Unitization Section. Given the current level of funding and the prospect of further delays in the processing of unit, participating area applications and requests the division is struggling with increased workload demands. Review and analysis of the complex issues involved in satellite developments could suffer as the industry demands expedited approval for these projects. Already important development applications and approval requests for North Slope projects are taking more time to complete.

8) The division is seeing an increase in workload in response to the BP Amoco-ARCO merger. Lease administration will have to process lease assignments, units management activities will increase as new producers initiate new exploration and development programs, and permitting will have to respond to new construction proposals.

9) New markets for royalty gas may arise as producers, pipeline owners, and new entrants in the state's oil and gas industry plan for a **gas pipeline.**

10) Increase data accessibility on the Internet. Move towards establishing all permits and applications to be available on the Internet, as well as an **e-commerce system** for permit applications, fees, assignments and revenue billing.

11) Streamline the lease assignment process to be more efficient and provide an effective mode for reliable **electronic data transfer and exchange** between different sections, agencies, applicants and the public.

12) Oil and gas data and general information are being made available to the public and other agencies on the division's website. Fewer printed publications will be available over the counter.

13) Establish a cost effective Internet connection and e-mail system for the Prudhoe Bay office.

14) The division has reviewed BP, Exxon, and Phillips oil sales contract information and determined that existing royalty settlement formulas undervalue ANS royalty oil. Substantial staff time is being devoted to **reopening royalty settlement agreements** with these companies and renegotiation appropriate valuation methodologies.

Summary of Component Budget Changes

From FY2002 Authorized to FY2003 Governor

All dollars in thousands

	General Funds	Federal Funds	Other Funds	Total Funds
FY2002 Authorized	**3,800.3**	**140.3**	**1,490.8**	**5,431.4**
Adjustments which will continue current level of service:				
-Year 3 Labor Costs - Net Change from FY2002	47.1	1.4	13.7	62.2
-Reduce One-Time Item Funding for Gas Pipeline Marketing Study Sec 11(a) CH3 SLA2001	-75.0	0.0	0.0	-75.0
-Reduce One-Time Item Funding for Gas Pipeline Supply Study Sec 11(b) CH3 SLA2001	-30.0	0.0	0.0	-30.0
-Reduce One-Time Item Funding for Gas Pipeline Reservoir Study Sec 11(c) CH3 SLA2001	-50.0	0.0	0.0	-50.0
Proposed budget increases:				
-Royalty Valuation - Pipeline Analyst and Support Positions	250.4	0.0	0.0	250.4
-Oil Safety & Development Initiative	500.0	0.0	0.0	500.0
FY2003 Governor	**4,442.8**	**141.7**	**1,504.5**	**6,089.0**

Oil & Gas Development

Personal Services Information

Authorized Positions			Personal Services Costs	
	FY2002 Authorized	FY2003 Governor		
			Annual Salaries	4,222,621
Full-time	55	62	COLA	49,170
Part-time	0	0	Premium Pay	0
Nonpermanent	3	5	Annual Benefits	1,305,868
			Less 5.82% Vacancy Factor	(324,659)
			Lump Sum Premium Pay	0
Totals	**58**	**67**	**Total Personal Services**	**5,253,000**

Position Classification Summary

Job Class Title	Anchorage	Fairbanks	Juneau	Others	Total
Accountant III	4	0	0	0	4
Accountant V	1	0	0	0	1
Accounting Clerk II	1	0	0	0	1
Accounting Tech I	2	0	0	0	2
Accounting Tech II	1	0	0	0	1
Administrative Clerk II	4	0	0	0	4
Administrative Clerk III	1	0	0	0	1
Administrative Manager II	1	0	0	0	1
Analyst/Programmer III	1	0	0	0	1
Analyst/Programmer IV	3	0	0	0	3
Cartographer II	1	0	0	0	1
Chief Petroleum Geologist	1	0	0	0	1
Commercial Analyst	3	0	0	0	3
Division Director	1	0	0	0	1
Geographic Info Specialist	1	0	0	0	1
Geologist II	1	0	0	0	1
Geologist III	1	0	0	0	1
Land Surveyor I	1	0	0	0	1
Natural Resource Mgr I	2	0	0	0	2
Natural Resource Mgr II	3	0	0	0	3
Natural Resource Off I	2	0	0	0	2
Natural Resource Off II	6	0	0	0	6
Natural Resource Tech II	2	0	0	0	2
Operations Res Anl I	1	0	0	0	1
Petroleum Geologist I	1	0	0	0	1
Petroleum Geologist II	5	0	0	0	5
Petroleum Investments Manager	1	0	0	0	1
Petroleum Land Manager	1	0	0	0	1
Petroleum Manager	1	0	0	0	1
Petroleum Market Analyst	1	0	0	0	1
Petroleum Reservoir Engineer	2	0	0	0	2
Revenue Auditor IV	3	0	0	0	3
Revenue Auditor V	1	0	0	0	1
Senior Petroleum Land Manager	1	0	0	0	1
Student Intern I	5	0	0	0	5
Totals	**67**	**0**	**0**	**0**	**67**