THE STATE of ALASKA
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AOGCC

May 1, 2019

Dear Commissioners:

Please accept the following as written commentary regarding implementation of the recent changes to 20 AAC 25.025 (the "Regulation"), signed into law by the Lieutenant Governor. As your office ponders "next steps" regarding implementation of this new Regulation, the Department of Natural Resources ("DNR") respectfully brings the following concerns to your attention.[1] Our two agencies have shared goals in the proper winding down of oil and gas operations, whether it is dismantlement, removal, and restoration ("DR&R") or plugging and abandonment of wells ("P&A"). These shared goals can be enforced more effectively and efficiently if our two agencies work together.

In short, DNR respectfully recommends rescinding this new Regulation and replacing it with thoughtful changes that meet AOGCC's (the "Commission") goals for ensuring plugging and abandonment activities may be completed when companies fail to perform while preserving Alaska's competitiveness as a target for oil and gas investments. DNR agrees that the prior state-wide level of bonding for P&A at $200,000 was too low to adequately protect the State's interest. Notwithstanding, this Regulation goes too far, by orders of magnitude, to correct that deficiency and creates a barrier to investment.

Instead, AOGCC should rescind and rewrite this Regulation in a manner that (1) codifies into regulation a collaborative approach that requires the Commission to work with DNR and consider whether other, overlapping agreements exist with a producer that satisfy and properly collateralize the P&A requirements called for in the Commission's regulations, (2) does not create new and unduly burdensome requirements on DNR's oil and gas leaseholders, and (3) does not interfere with our shared goals of attracting new investment to our State.

Our analysis follows.

I. The Commission Should Work with DNR to Account for Overlap in Requirements.

DNR requires a producer to have a statewide bond of $500,000 for surface operations.[2] The Commissioner, in her discretion, may require additional financial assurances from companies being assigned interests in oil and gas leases if the Commissioner determines that assignee should provide further assurances. Often, after such an analysis, DNR enters into financial assurances agreements with producers providing reasonable coverage

[1] DNR respectfully notes that it has standing before AOGCC to raise all issues relating to State-owned land without regard to the type of proprietary interest held by the State in that land. AS 31.05.026(a)
[2] 11 AAC 83.160(c).

for liabilities associated with their development. These agreements often cover proper P&A as part of the DR&R requirements.

If AOGCC rewrites this Regulation, DNR suggests (a) a more reasonable, baseline level of bonding that (b) may be adjusted up or down based upon the circumstances and (c) considers potentially overlapping financial assurance agreements DNR may have in place. Although the Regulation, as written, allows for flexibility to an extent,[3] this flexibility starts from an unreasonably high baseline level of bonding and is limited to only four discreet factors. The Regulation does not require AOGCC to collaborate with DNR to determine whether it has overlapping obligations and has already secured potentially enough financial assurances.

Although the specific mandates and jurisdictional authority of DNR and AOGCC are different, there are undoubtedly shared goals in protecting the State's interests during the operational life of a field as well as proper wind down. Our two agencies can accomplish more toward these shared goals by working together.

II. The Regulation Creates Unduly Burdensome Requirements for Existing Oil and Gas Producers.

DNR Division of Oil and Gas analyzed, generally, the potential commercial impacts for its lease holders, particularly smaller operators. In some instances, compliance with this new Regulation will lead to a significant hardship for existing producers in Alaska. In other instances, it may force smaller operators to discontinue operations in Alaska altogether. The Regulation's new bonding levels run the risk of reversing the State's efforts over the last decade to encourage smaller and mid-size operators to invest in Alaska. Many of these investments by such operators have led to the discovery of significant new oil and gas reserves. DNR encourages the Commission to exercise its discretion to slow implementation of, if not immediately rescind, the new Regulation so the Commission can consider this new information and prevent severe unintended consequences.

The Regulation contains a vesting schedule for existing producers to come into compliance in four annual installments.[4] The first installment for existing operators to come into compliance is due August 16, 2019. This first installment is a minimum of $500K or one-quarter of the difference between the operator's existing level of bonding and the new level required, whichever is greater. For some operators, this triggers a significant increase very soon. As indicated above, this increase will be felt most acutely by the small and mid-size operators in Alaska. Tying up large amounts of working capital in certificates of deposit or other forms of personal surety to meet a compliance schedule harms any company but is particularly impactful to small and mid-size operators. We note that many small and mid-size operators are responsible for a significant portion of the natural gas production in Cook Inlet.

III. The Regulation Detracts New Investment in Alaska.

The Regulation imposes new bonding requirements that exceed those of other states by orders of magnitude. While DNR recognizes the added cost to P&A wells in Alaska compared to other states, the increase in bonding requirements under the new Regulation are completely misaligned with those modest, additional costs associated with P&A in Alaska. Further, the Regulation does not consider how P&A costs may differ between a

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[3] 20 AAC 25.025(b)(3). The flexibility offered within this subsection of the Regulation is limited to considerations of engineering, geotechnical, environmental and location to adjust the bonding levels up or down. The adjustments are anchored off the new, significantly higher bonding levels in the Regulation.

[4] 20 AAC 25.025(c)(1)-(4).

well in the Cook Inlet, on the Kenai Peninsula along the road system or in a remote portion of the North Slope. This all has the net effect of significantly increasing entry and operating costs in Alaska, and with no increased assurance by the Regulation of a company's long-term fiscal durability. A model similar to DNR's under 11 AAC 83.160(b)-(c), which has a reasonable baseline bonding amount that can be increased on a case-by-case basis by the Commissioner as circumstances warrant, would be more appropriate.

As this Commission knows, the costs of production in Alaska far exceed costs of production in the Lower 48. Alaska competes with these other states for new investment, but not on a level playing field. The new Regulation further exacerbates the challenges faced by our State in attracting new investment and adds to the significant barriers to entry new oil and gas producers face coming to Alaska. Although the Regulation has a three-year vesting schedule for current producers to come into compliance, no such courtesy is given to new, incoming producers bringing new investment to our State – they must immediately comply.

IV. Conclusion

In sum, DNR respectfully requests that AOGCC rescind and rewrite 20 AAC 25.025 in a manner consistent with the foregoing. The goals between our two agencies are similar in this regard. Let's pursue a regulatory scheme that sufficiently protects the State's interests in a collaborative, efficient, and more effective manner. DNR stands ready to collaborate with AOGCC in crafting a solution that protects the interests of the State without slamming the door on investment in Alaska's oil industry.

Sincerely,

Sara W. Longan
Deputy Commissioner