The Future of Oil and Gas Development: What’s Cost Got to Do With It?  

By Judy Brady, Alaska Oil & Gas Association

Alaska’s North Slope is the most expensive oil and gas basin in the world, according to a study by the international consulting firm Wood Mackenzie (WoodMac). Of the 60 oil and gas areas in 50 countries included, Alaska ranks as the highest in costs – 60 out of 60. For Alaskans, this ranking has profound implications for the future.

Moreover, for every dollar generated from Alaska oil and gas production, the state and federal governments combined take approximately 64 percent of industry’s gross revenues through taxes and royalties.

The WoodMac study, and others like it, are a “heads up” that Alaska needs to re-examine its public policy about oil and gas. For the next few years public policy is going to play as important a role as technology in deciding Alaska’s economic future.

What makes cost so important now? Analysts are recognizing that a dramatic shift in global exploration spending is taking place. Cost is driving the industry from upstream North America – where finding and development costs doubled from 1999 to 2002 – to less expensive plays in Asia, the Pacific, Africa and the Middle East where costs are up to two-thirds less.

In this globalization of oil and gas, Alaska gets hit with a double whammy: the state is more dependent on revenues from oil and gas than any other in the nation, and it is the highest cost oil and gas province in the world.

Not only is Alaska dependent on oil and gas revenues for 70 to 80% of its unrestricted general fund revenues in the foreseeable future. With Alaska’s super giant fields in decline, that revenue stream will depend on additional production in mature fields, as well as production from new fields, which in turn depends on whether companies will make larger investments in Alaska.

Since 2002 the Department of Revenue has been forecasting oil production of just under 1 million barrels per day through 2015. These forecasts all rely on continued annual billion dollar investments in the mature and declining Prudhoe and Kuparuk fields, as well as multi-million dollar investments in new fields.

“What are the chances that production levels may fall short of our forecast? The answer depends in large part on the amount of money exploration and production companies spend to develop oil resources that have already

(Continued to page 4)
Alaskans will have to wait at least another year before any tangible progress is made to address the State’s structural budget imbalance. Despite an aggressive push by Governor Murkowski and his staff for a solution this year, $40 oil and the upcoming legislative campaign season conspired to keep any proposal to solve the fiscal imbalance from moving forward.

As another opportunity for action slips past, it is easy to become frustrated with the process and lack of progress. Many wonder if we have made any headway at all in addressing our fiscal issues. While I am disappointed our elected officials were not able to formulate a plan this session, I believe we have inched closer to a solution. What is the source of my optimism?

First, more and more Alaskans have come to understand the nuances of the issue. The Conference of Alaskans, convened by Governor Murkowski in February, and the legislative hearings held most prominently by the House Ways and Means Committee and Senate Finance Committee provided an unprecedented level of public exposure to the details of Alaska’s fiscal situation. Polling numbers indicate a growing sense among Alaskans that something must be done to address the State’s fiscal imbalance.

Second, a diverse collection of Alaskan organizations have begun to work together to educate their respective members, to engage elected officials and to seek common ground on this issue. Organizations representing communities, businesses, laborers, educators, health providers and many others have worked to build relationships and to identify areas of agreement. This network of organizations can be a powerful positive force in future public and legislative fiscal deliberations.

Finally, over the past several months the Governor and many legislators demonstrated a willingness to bring new ideas to the debate. Fresh proposals allow all of us to view the matter from a different angle and build the possibilities for consensus. Only through open dialogue will Alaskans have the proper chance to weigh the pros and cons of prospective solutions against each other. Given an honest and vigorous debate, I believe the best public policy will rise to the top in our Legislature and will be supported by a majority of the public.

In October 2003 RDC joined with more than twenty other business and community groups and pledged to the Governor and members of the Legislature our assistance in resolving the State’s fiscal imbalance in a manner that will do the most good for the greatest number of Alaskans over the long term. RDC remains committed to this pledge.

As part of our commitment to resolving this matter we have proposed a basic framework for a long-term fiscal solution. This framework consists of three recommendations — enforce budget discipline, incorporate new uses of Permanent Fund earnings and, if necessary, institute a broad-based tax. While each of these steps encompasses a multitude of possible variations, RDC remains convinced they are the basic building blocks of a long-term solution.

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The Environmental Protection Agency has issued a draft Clean Water Act permit for Coeur Alaska’s Kensington Mine project.

The gold mine, with reserves of 1.4 million ounces, is expected to employ 300 workers during construction, with annual payroll and benefits of $16 million, and create an additional 180 indirect jobs. Direct purchases to the Juneau economy are estimated at $7.5 million. During the operational phase, the mine will employ 200 workers.

The 45-day public comment period ends August 5th.

In addition, the Army Corps of Engineers published notice of Coeur’s application to discharge dredged and fill materials, and the State Department of Natural Resources has prepared draft decisions on several state leases and permits related to the project.

Kensington is an underground mine located 45 miles northwest of Juneau. Coeur proposes to process approximately 2,000 tons of ore per day, with a tailings storage facility at Lower Slate Lake. Milling operations would be located in the Johnson Creek drainage. Access to the site would be via marine ferries which would transport workers across Berner’s Bay.

“This is another major breakthrough for mining in Alaska,” said Governor Frank Murkowski. “Kensington is on its way to becoming a reality, just like the Pogo, Red Dog and Greens Creek mines. We can have a healthy, productive mining sector, and the permits for Kensington are a huge step in the right direction.”

(Continued to Page 10)
been discovered on the North Slope and to discover additional oil. Those spending decisions depend—in great part—on world oil prices and government regulatory and fiscal policies. The key in all this is that producers need to spend money so that the state can make money from its oil resources.” (State of Alaska Department of Revenue [DOR], Fall 2002 Revenue Sources Book)

The observation that producers need to spend money so that the state can make money from its oil resources was underscored in a DOR April briefing to legislators. According to DOR, the billion-dollar-plus investments being made each year by companies in Alaska are not enough to reverse the declining production by 2010. DOR believes companies will have to double their capital investments in 2006 through 2008 just to keep production close to the 1 million barrels per day level.

Is Alaska the best place for companies to invest?

The WoodMac study objective was to provide a clear comparison of the relative attractiveness for future E&P investment in 61 oil and gas provinces in 50 countries and to evaluate “Government Take” (taxes, royalties, etc.) in each of the provinces. Based on actual data, rather than standardized model fields, the study concludes:

1. Alaska has somewhat higher than average total taxes and royalties than other oil and gas provinces. Alaska ranks 36 out of 61 provinces worldwide. The Total Government Take (federal and state) is calculated to be 64%. The State’s share is approximately 47% and includes royalties, production tax, corporate income tax, property tax and net profit shares. The actual and projected Economic Limit Factor (ELF), based on field size, is used in these calculations.

### New Oil Production, Revenue Forecast Depend on Investments Yet to Be Made

(Continued from page 1)
The economic assumption of the 2002 study was a Brent marker price of $19.50 per barrel (per/bbl), increasing 2.5% per year. For comparison purposes, that price assumption aligns with the ANS West Coast spot price of $17.70 from December, 1990 to February 2003, and the State of Alaska’s long-term forecast to 2015 of $22 per/bbl.

2. Alaska has the highest total costs of all other oil and gas provinces. The sobering news for Alaska, according to the WoodMac study, is that the costs associated with Alaska’s 17 new fields developed since 1995 were highest of all the 60 areas in 50 countries included in the 2002 study. Alaska ranked dead last in total costs of new field development.

This ranking is the weighted average of all North Slope fields starting production since 1995. The study notes that the costs for Prudhoe and Kuparuk are among the highest in the world. Costs include operating, cost of capital, and all transportation, including pipeline and marine.

3. Alaska is challenged in terms of profitability. When aggregating Alaska’s Government Take, which is somewhat higher than average, with the weighted average total costs, which are the highest of the 60 worldwide oil and gas provinces included in the study, the average value of remaining production on the North Slope ranks 55 out of 61. Alaska is considered “moderately profitable.”

In the oil industry “moderately profitable” is akin to describing a blind date as “having a nice personality.”

What does this mean for future investment? The oil industry is not where it was 15 years ago; Alaska’s competitive position as an oil and gas province is not where it was 15 years ago. Future decisions will be all about cost.

The globalization of the oil and gas industry, with more choices of places to invest at less cost, along with the increasing cost of doing business in Alaska because of maturing fields and exploration outside the range of existing infrastructure, provides a wholly different context for company decision-making and for public policy decision-making.

The oil and gas companies operating in Alaska must use every tool in their technology toolboxes to lower costs. The State of Alaska must use every tool in its public policy toolbox to lower costs. Alaska must become more competitive for oil and gas investment dollars.

What about $40 oil? Right now both the State of Alaska and the companies operating here are benefiting from a spike in oil prices, but so are the Gulf of Mexico, Qatar, Indonesia and every place else in the world that has oil and gas reserves – and those places have much lower costs. The spike helps make up for $8 and $12 per/bbl crashes, but it is the short and long-term price averages that count.

Both the State of Alaska and the oil companies avoid the rush to judgment of daily or even monthly price fluctuations. No one is planning on $40 per/bbl oil for sustained periods but that price is accounted for in the $22 average forecast to 2015 by the WoodMac study, which is some-what higher than the $20 per/bbl marker price of $19.50 per/bbl oil for sustained periods but that price is accounted for in the $22 average forecast to 2015 by the WoodMac study, which is somewhat higher than the $20 per/bbl.

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RDC Board members attending the Annual Meeting gather at the Sheraton Anchorage Hotel. John Shively, Holland America Line, was re-elected President while Mark Hanley, Anadarko Petroleum Corporation, was re-elected as Senior Vice President. Rick Rogers, Chugach Alaska Corporation, was elected Vice President, Tom Maloney, Voco Corporation, was elected Secretary and Stephanie Madsen, Pacific Seafood Processors Association, was re-elected Treasurer.

EPA’s John Iani, speaking at the Annual Meeting Luncheon, said “this state is blessed with natural resources, and those resources need to be extracted.”

EPA Administrator Mike Leavitt met with the RDC Board on the eve of the Annual Meeting. Leavitt returned to Washington early for President Reagan’s funeral, but addressed the RDC luncheon via a live internet audio-video connection.

At left, RDC Board members Patty Bielawski and Sharon Anderson attend to business. At right, Board members Jim Cloud and Teresa Imm join 40 other Board members on a discussion of Alaska’s economy.

At far right, Paul Glavinovich, Rick Rogers, Jeanine St. John and Elizabeth Rensch examine the new 2004 RDC Board Handbook. St. John, Lynden, Inc., is one of eleven newcomers to the Board this year.

At left, President John Shively opens the Annual Meeting Luncheon which drew 500 attendees. Above, the RDC Board meets prior to the luncheon. At right is outgoing (20-year) Board member George Wuerch.
29th Annual Meeting

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(907) 276-0700  July 2004 Resource Review  Page 7
Numbers can be deceptive, particularly when they come without context. That’s what happened when the Environmental Protection Agency (EPA) recently published its annual Toxic Release Inventory (TRI). The Red Dog Mine heads the list as the nation’s largest releaser due to the amount of rock moved in the mining process and changes in the reporting criteria.

The fact is that federal regulations do not distinguish between natural materials locked away in rock, which is safely stored on the plant site, from hazardous releases of man-made chemicals into the environment. As a result, the TRI numbers paint an inaccurate and misleading picture of what actually happens at one of the most regulated mines in the world.

More than 99 percent of what EPA considers a “release to land” consists of naturally occurring substances found in the rock at Red Dog. This rock never leaves the mine site and is properly contained in systems regulated by federal, state and local agencies.

Court decisions also contributed to Red Dog’s ranking. Some mine operators were able to lower the numbers they must report this year by excluding waste rock that contains less than 1 percent metals. Red Dog does not qualify for this court-ordered exemption because its waste rock contains enough metal that it barely exceeds the minimum standard.

TRI is an annual reporting program that covers about 650 chemicals and substances listed by the EPA. It was authorized under the Emergency Response and Community Right to Know Act of 1986 and was intended to provide the public with information about what toxins manufacturers and chemical plants were releasing into the environment. In 1998 the EPA expanded TRI due to the huge quantities of materials mining operations move in the course of doing business. While the numbers are large, the risk is virtually non-existent.

TRI is a weight-based report that has nothing to do with risk or actual toxicity. According to EPA, “Users of TRI information should be aware that TRI data reflect releases and other waste mining poisons” and “largest toxic polluter” to grab headlines. What they ignore is what actually goes on at the mine.

We’re proud of our operation at Red Dog. We move a lot of rock – and we move it carefully. We store our waste rock under stringent regulation and we clean up the water we use before returning it to nature. In fact, Red Dog Creek is much cleaner than when the water ran over the naturally exposed ore prior to the mine’s existence.

Every step we take is highly regulated. We operate under 155 permits, regulations, agreements and environmental plans that contain more than 2,700 individual stipulations that we must meet on a daily, weekly, monthly and annual basis.

We keep trying to do our job better: more than 300 studies have been conducted, on virtually every subject, including 20 under way right now.

Red Dog Mine is a partnership that works for Alaska, the residents of the Northwest Arctic Borough, and the shareholders of NANA and Teck Cominco.

By Jim Kulas
The 53rd BP Statistical Review of World Energy showed 2003 was a year of exceptional strength in energy markets with oil and natural gas prices reaching new 20-year highs. World primary energy consumption increased by a relatively strong 2.9 percent on the back of global economic recovery and the ongoing boom in China.

In a presentation to the RDC and Alliance Boards of Directors last month, BP’s Senior Economist Mark Findley noted that even with the recent surge in oil prices to $40 a barrel, the price of crude oil in real terms is only half the level reached in 1980.

Findley outlined a number of key findings the report illustrated:

- The geographic pattern of the energy market is changing, led by the doubling of oil demand for some 40 years and to meet natural gas demand for well over 60 years. Reserves are expected to keep rising in Russia and elsewhere. Reserves globally have grown over time. In 1980, oil reserves stood at 29 years.

- The geographic pattern of the energy market is changing, led by the doubling of oil demand for some 40 years and to meet natural gas demand for well over 60 years. Reserves are expected to keep rising in Russia and elsewhere. Reserves globally have grown over time. In 1980, oil reserves stood at 29 years.

- Primary energy consumption in all areas of the world in 2003 with the strongest rise in Asia Pacific, up 6.3%, while North America recorded the weakest growth at 0.2%. Coal was the fastest-growing fuel, rising 6.9% globally. Oil consumption was also strong, but the growth of natural gas use was held back by a steep, price-induced fall in U.S. consumption. U.S. industrial consumption of gas fell 9.5% as many facilities switched to coal as gas prices increased.

- Oil consumption grew strongly in 2003, despite high prices. Consumption grew by almost 1.5 million barrels per day (b/d) or 2.1%, above the 10-year average growth rate of 1.6%.

- OPEC oil production increased substantially by 1.88 million (b/d). Saudi Arabia’s output rose by more than 1 million b/d to hit a 22-year high of over 9.8 million b/d. Oil production outside OPEC grew by 830,000 b/d, somewhat above the 10-year average. Russia, where production grew by 840,000 b/d, accounted for essentially all of the increase.

- OPEC’s share of global oil production is 41%, and the cartel accounts for 77% of proven oil reserves. Saudi Arabia holds 23% of proven reserves.

- World natural gas consumption grew by a relatively weak 2% in 2003 as gas consumption in the U.S., the world’s largest market, contracted by almost 5%. Outside the U.S., gas consumption growth was generally robust, averaging 4%.

- Sales of liquefied natural gas grew especially fast last year, rising by over 12%. U.S. LNG imports more than doubled.

- For the second year running, North America was the only region to see a decline in gas production.

- Nuclear power production fell 2% last year, led by a 27% fall in Japan.

- Findley pointed out that both 2003 and 2004 make for a dramatic period in energy markets. Oil prices in particular are being driven by a strong global economy, the war in Iraq, concerns over terrorism, ongoing strikes and civil unrest in Venezuela and Nigeria, and a continuing surge in Chinese oil usage.

- Findley noted the booming economy in China is driving energy consumption there while in Russia its surging energy production that is sparking economic growth. Russia is the dominant source of non-OPEC oil production. Meanwhile, China has expanded coal production and use in the face of rising oil imports.

“The Chinese economy is entering an energy intensive phase with global energy consumption migrating to China,” Findley said. “China saw double-digit growth in oil, natural gas, coal and nuclear energy consumption last year.”

Findley said renewable energy grew at a rapid pace in 2003, but since that growth was from a very small base, it had virtually no impact on the energy market as a whole.

Editor’s Note: The BP Statistical Review of World Energy is available at www.bp.com/statisticalreview2004
To start off this month I would like to thank the board for their confidence in electing me to a second term as President. It is an honor to serve in this position.

In my previous column I discussed the situation surrounding the last minute appeal filed by the Northern Alaska Environmental Center (NAEC) against the Pogo mine. By the time our newsletter went to press, NAEC had dropped its appeal after both the state and EPA stepped in to negotiate a resolution. The fact that the appeal was dropped is good news for those of us interested in responsible development of the state’s resources.

However, the fact that the appeal was dropped does not negate the main point I addressed in my previous column – there is no balance in the appeal process. All of the risk is on those who wish to help expand Alaska’s economy. There is no risk on those who make use of the tangled processes of government to oppose responsible development. There needs to be risk on both sides of the appeal process equation. One of my goals for the next year is to see if we can find some means of “leveling the playing field.”

Some might argue that I should be happy with the outcome of the Pogo appeal and let this issue go. To those “don’t worry, be happy” souls I would just say that we need to learn from history, and the history lesson here is the appeal process will continue to be abused unless there is some risk to those who wish to develop resources and those who find any change to the ecological status quo repugnant.

Those of us who support a growing economy need look only as far as the proposed Kensington mine to understand my concerns about the one-sided nature of the appeal process. This mine, located north of Juneau, would create 200 long-term jobs and be another boost to our economy. The main challenge for the mine has been how and where to dispose of its tailings. EPA has released a draft of a Clean Water Act permit which is subject to public comment through August 4th.

Environmental organizations have already announced they intend to oppose this project. Such a position will surely mean those organizations will avail themselves of the appeal process and ultimately the judicial system. And why shouldn’t they? The current appeal process virtually beseeches them to attempt to derail the project.

When EPA Administrator Mike Leavitt visited Alaska recently the issue of the lack of balance in the appeal process was raised with him. Although he was sympathetic to the concern, he felt the system for appeals was established in the early 1970s and would be very difficult, if not impossible to change.

Difficult – yes; impossible – no; at least from my perspective. Companies such as Teck-Cominco and Coeur Alaska develop mines in our state. Companies ranging in size from our big three (BP, ConocoPhillips, and ExxonMobil) to smaller new comers such as Pioneer, Encana, and Armstrong explore for and develop oil fields. These activities take place in the most difficult of both ecological and governmental environments.

If these companies can undertake those daunting but surmountable challenges, then surely an organization with the strength and resources of RDC can take on the unfair nature of the appeal process. We will be working over the next several months to develop legislation for consideration in next year’s legislative session to address this situation. Our long-term goal is also to get the issue addressed at the national level. Tilting at windmills – perhaps, but well worth the effort, in my opinion.

Now some may consider this column an attack on the environmental community. It is not. In my experience in both the public and private sectors there are many in the environmental movement with whom one can come to a reasonable meeting of the minds on resource development projects. At the very least, the issues can be reduced to rational disagreements.

However, there are also those in the environmental community for whom the only answer to any resource development project is “NO WAY!” It is these zealots who most often abuse the process, because they have nothing to lose and everything to gain by exploiting the tactic of needless delay.

RDC welcomes a discussion of approaches anyone might have to address the problem of the lack of balance in the appeal process.

EPA ISSUES DRAFT PERMIT FOR KENSINGTON MINE PROJECT

(Continued from Page 3)

Rich Richins, project director for Coeur Alaska, said the draft permits are a significant milestone for the project. “We’ve been working long and hard to get to this point and we’re extremely excited,” Richins said. He hopes the permits will be approved by the EPA and the Corps this fall. The Forest Service would then issue a final record of decision on the project. If approved, Coeur could begin construction on the mine this year.

“The Kensington Mine project, like other resource development projects, benefits from sensible, protective environmental standards that reassure the public that progress will not be at the expense of environmental quality,” said Ernesta Ballard, Commissioner of the Alaska Department of Environmental Conservation. “Release of the Kensington draft permit package is an indication that a commitment to protecting air, land and other resources goes hand in hand with resource development. We commend the work of all the state and federal agencies for their contributions to reach this milestone in the permitting process.”
The Bureau of Land Management (BLM) is proposing to amend its 1998 plan for the Northeast Planning Area of the National Petroleum Reserve-Alaska (NPR-A) to make additional land available to oil and gas leasing. The public comment period for the draft plan will close August 2.

The plan outlines four alternatives about if and how the area should be opened and under what conditions. Alternative A is the no action alternative, which retains approximately 87% of 4.6 million acres for oil and gas leasing and calls for no change to the 1998 Record of Decision.

Alternative B, the BLM’s preferred alternative, would open 96% of the planning area to leasing.

Alternative C, which RDC supports, makes 100% of the planning area available for leasing, whereas the existing plan opens only 56% of the high potential areas.

Natural and cultural resources would be protected under all alternatives, but the nature, number and scope of mitigation requirements would vary between alternatives.

Alternative C would utilize the same performance-based standards and required operating procedures developed for the preferred alternative to mitigate impacts of energy development. In addition, seasonal stipulations and other measures would be applied to protect sensitive areas.

The areas currently off-limits to exploration may contain more than two billion barrels of recoverable oil. NPR-A is estimated to hold 5.9 billion to 13.2 billion barrels of oil.

Under Alternative C, potential daily oil production from the reserve would rise from 60,000 barrels per day to 200,000 barrels. At $22 a barrel, America would save $1.56 billion annually in imported oil.

The revenues and employment generated by oil and gas development under Alternative C would be significantly greater than under the existing plan.

Up to an eight-fold increase in property tax revenues and a doubling in state severance tax collections would occur as compared to the current plan. In addition, Alternative C would generate over five times the number of direct and indirect jobs – up to 9,000 – than the no action alternative.

RDC members are urged to submit written comments by August 2 supporting Alternative C. Comment points and other details are available on RDC’s web site which can be found at www.akrdc.org.

A copy of the draft plan is available at www.ak.blm.gov.
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