May 20, 2014

United States House of Representatives, Committee on Natural Resources

Subcommittee on Fisheries, Wildlife, Oceans, and Insular Affairs

Oversight Hearing on Non-federal oil and gas development within the National Wildlife Refuge System

Testimony of Ethan G. Schutt, Senior Vice President, Land and Energy Development

Representing Cook Inlet Region, Inc.

Oil and Gas Development and Permitting on Public Lands in Alaska

I am Ethan Schutt, Senior Vice President, Land and Energy Development at Cook Inlet Region, Inc. ("CIRI"). CIRI is one of twelve Alaska Native Regional Corporations created in 1972 under the terms of the Alaska Native Claims Settlement Act of 1971 ("ANCSA"). CIRI is the regional corporation for the geographic area of Southcentral Alaska in and around the Cook Inlet. CIRI is headquartered in Anchorage and represents more than 8200 Alaska Native shareholders and their descendants. CIRI is the largest private landowner in Southcentral Alaska and owns more than 1.3 million acres of subsurface estate and more than 600,000 acres of surface land, including more than 200,000 acres of subsurface oil and gas interests within the Kenai National Wildlife Refuge ("KNWR").

By virtue of its land holdings in the Cook Inlet, an active oil and gas basin, CIRI has a long history of participating in the oil and gas business as a lessor and royalty owner. CIRI currently has 3 active lessees with oil and gas exploration, development and production activities within the KNWR. This current and historical presence in the Cook Inlet oil and gas business provides us with a well-informed perspective about the oil and gas industry as it relates to federal regulatory and land management authority, including specifically the Unites States Fish and Wildlife Service ("USFWS").

An enormous amount of Alaska is owned by the federal government. A significant amount of that federally owned land in Alaska is categorized as National Wildlife Refuge with more than 76.5 million acres of refuge land in the aggregate. Many of the National Wildlife Refuges in Alaska were designated as such under the carefully negotiated and crafted terms of the Alaska National Interest Lands Conservation Act of 1979, commonly referred to as "ANILCA". Due to the circumstances and timing of Statehood and the passage of ANCSA, many federal conservation units are intertwined with the private landholdings and interests of ANCSA corporations and with the State of Alaska. ANILCA was a grand compromise that came after statehood and ANCSA and set aside a massive geographic area in various conservation units such as National Parks and National Wildlife Refuges. But ANILCA was not drawn up in a vacuum. It was instead a carefully crafted set of compromises by and among the State of

Alaska, the ANCSA corporations, and the federal government to accommodate often competing priorities.

Although atypical in the exact manner by which CIRI acquired much of its ANCSA entitlement land holdings, the intertwined and adjoining nature of its lands with federal conservation unit lands is not atypical. In fact, intertwined, adjoining, isolated by, and in-holding are the descriptors of many ANCSA corporation- and state-owned tracts in Alaska, particularly if you consider the practical impacts of such geographic features as mountain ranges, glaciers and large bodies of water. Within the system created by these realities, land management challenges are inevitable between the USFWS in its administration of its conservation units and the rest of us. But that relationship has become more and more strained and complicated by management practices, rules and standards now required by the USFWS in the administration of its refuge system in Alaska.

Unfortunately, the land management philosophy of the USFWS and other federal land managers in Alaska appears to be evolving away from the underlying principles and compromises of ANCSA and ANILCA that created the refuges and other conservation areas. I will describe for you, as best I can, some of my recent experiences in this area.

The apparent federal management philosophy—so many ways to say "No"

The current apparent land management philosophy of the USFWS in Alaska as it relates to oil and gas exploration and development on or adjacent to the refuge system can be summed up as: "No. Not here. Not now." Unfortunately, this mantra is inconsistent with the careful compromise that was historically made in order to achieve a satisfactory, if not ideal, land ownership outcome between the competing interests of the federal government, the state government and the Alaska Native people. This grand historic compromise led to the creation of a relatively complicated land ownership pattern that includes the so-called "the checker board" pattern, subsurface-only holdings and other extensive "inholdings" within the newly created National Wildlife Refuge system of Alaska in the early 1980s.

Some 35 years later, the relationship between the ANCSA corporations and the State of Alaska, on the one hand, and the USFWS on the other, appears to be diverging. While the ANCSA corporations and the State of Alaska are intent on pursuing oil and gas exploration and development on their lands, as was promised by the grand compromise and the individual compromises that led up to the ANILCA-created refuge system, the USFWS seems intent on finding new ways to say "no" to that activity.

To be clear, the refuge managers usually do not say "no" directly when addressing issues of access to or across their refuges for oil and gas exploration and development or other activity by ANCSA Regional Corporations or other landowners with inholdings or subsurface interests. For most actions for which they are approached, they know that they may not directly and explicitly say "no". They have instead adopted more sophisticated ways to attempt to prevent otherwise authorized activity.

A good example comes from the relatively recent drilling of the Shadura Number 1 exploration well in the Kenai National Wildlife Refuge in the winter of 2010-2011. The Shadura Number 1 was an exploration well drilled by NordAq Energy, Inc., a small independent, on a CIRI oil and gas lease. The Shadura prospect lies in the northern Kenai Peninsula north of Kenai on CIRI-owned subsurface below USFWS surface estate within the KNWR. The Shadura prospect was identified from reprocessing of historical seismic data gathered in a large exploration program by ARCO in the early 1980s under an exploration license from CIRI.

In planning for the exploration well, it became clear to NordAq that the KNWR management greatly preferred an ice road/ice pad exploration program as opposed to a more traditional gravel road to and gravel drilling pad at the exploration site. NordAq therefore planned and began permitting for an ice road/ice pad exploration program. Tailoring its exploration program to an ice road/ice pad-designed program constituted a significant accommodation by NordAq to a minimum impacts approach.

Ice roads and ice pads for oil and gas exploration are common in Alaska. But they are less common in the Cook Inlet basin where the Shadura prospect is located because of the relatively shorter and less predictable winter conditions necessary for the road construction, drilling and testing program, and demobilization necessary to successfully accomplish an oil and gas exploration well. A full exploration drilling program can easily run 75 to 90 days in length, which can be a gamble in the climate of Southcentral Alaska and its maritime-influenced environment. For obvious reasons, an ice road/ice pad program requires sustained sub-freezing temperatures for construction and maintenance of the road and pad. Nevertheless, NordAq planned for an ice road/ice pad program during the fall and early winter of 2010.

But as NordAq's field program drew near, the requirements imposed on its ice road/ice pad program shifted. The common means of constructing an ice road is to permit a variety of local freshwater sources for temporary withdrawal to create the construction materials, namely—water to freeze into ice chips to create a road base. The USFWS had other ideas. They would not permit any local freshwater locations within the KNWR for NordAq's ice road. Nor would they permit the scavenging of naturally-produced ice from the surface of local lakes or ponds. This leads to the inevitable question, how does one build an ice road if access to freshwater resources is not allowed?

Fortunately, NordAq and its ice road contractor, Peak Oilfield Services Company, were not easily defeated. NordAq and Peak contracted with one of the fish processing plants in Kenai that was closed for the winter to purchase an industrial quantity of ice chips made in its ice makers—normally used to pack and process fresh fish. Peak then trucked the man-made, purchased ice in dump trucks 14 miles, one way to the job site. Even this was not without its challenges as USFWS staff raised questions about whether the water created when the "imported" ice chips melted would change the water chemistry or have any other deleterious effects.

Obviously it seems inherently unfair to require a company to perform its exploration program from an ice road/ice pad system and then subsequently deny access to the local freshwater resources necessary to reasonably construct that ice road/ice pad. It is over-the-top to then question the impact of "imported" ice chips that must be used in lieu of what should be locally sourced ice. But that is exactly what happened to NordAq at its Shadura project in 2010 and 2011. These are the sorts of inconsistencies that are now common behaviors by the USFWS in dealing with oil and gas operators working on CIRI's KNWR lands.

NordAq persevered and prevailed to successfully drill an apparent discovery well with its Shadura Number 1 well in February 2011, some 3 years ago, but it has not quite been able to get back to the discovery location to drill a confirmation well and begin production in earnest. That is a story that will continue below.

Junk science or lack of science

Land management of oil and gas activity should be premised on sound science but recent federal actions in Alaska highlight decisions premised on junk science or a lack of science. Many of these actions do not emanate from the USFWS but the impacts have an interplay with activities on or near refuges. The principal action of this nature is the designation of geographically massive critical habitat areas for endangered species.

The two species of note in this regard are the polar bear and the Cook Inlet beluga whale. Although the designation of the polar bear as endangered and its subsequent critical habitat area do not directly affect CIRI's KNWR interests, I mention it here as an analogue because of the scale, scope and practical impact on oil and gas activities on the North Slope of Alaska. I will focus instead on the designation of and critical habitat area of the Cook Inlet beluga whale.

The Cook Inlet beluga whale was designated as an endangered subspecies of the beluga whale, which is not endangered. Due to a variety of unique features of the Cook Inlet beluga whale and its habitat, very little scientific data and analysis exists about the whale, its seasonal migration and local habitat areas. The Cook Inlet beluga whale is even a species without an accurate population count or model, although this aspect has been greatly improved in the past several years, in large part due to data gathered by private companies doing work in the upper Cook Inlet. Unfortunately, little accurate counting and population modeling was performed prior to a noticeable decline in the whales' numbers in the last two decades. Thus, great uncertainty surrounds even the baseline question of what a healthy population number is for this particular whale subspecies. Nevertheless, the National Marine Fisheries Service ("NMFS") designated the Cook Inlet beluga whale as an endangered species—almost certainly a justified action. But what it did next was less justified. When designating the critical habitat area the NMFS seemingly just took a Sharpie to the map and drew a line across Cook Inlet in two places from east to west. NMFS then declared all of Cook Inlet, including all of Turnagain Arm and Knik Arm, including intertidal estuaries, river and creek mouths, tidal mudflats and all other areas up to the mean high tide mark, to be class 1 critical habitat. Between the second line and

the first was declared class 2 critical habitat. This is a massive geographical area with an enormous length of coastline—an area I often equate to the Gulf Coast for all of Texas starting at the Mexican border and running up into or beyond Louisiana. This is a massive withdrawal of water and adjoining tidelands for critical habitat, particularly without any underlying science to justify its designation as "critical" habitat.

There are direct carry over effects of the Cook Inlet beluga whale critical habitat area designation on oil and gas activities in the KNWR. At this point, I have only witnessed one impact but another is equally predictable and inevitable. The first is negative impact on seismic operations necessary to properly image CIRI's subsurface estate within the KNWR to identify good exploration targets for oil and gas. CIRI has licensed a large part of its Cook Inlet lands to Apache Alaska under an exploration agreement. Apache Alaska spent several years attempting to permit what would have been the largest 3d seismic program in the history of Alaska. This program was intended to shoot modern, 3d seismic in a continuous and robust program from offshore, through the transition zone of the tidelands and onto the uplands, including CIRI's KNWR subsurface holdings. Due to an inability of the various federal agencies to coordinate their individual permitting activities for Apache Alaska's proposed program and timely issue permits, a process greatly complicated by the Cook Inlet beluga whale critical habitat area, Apache Alaska abandoned its 3d program and replaced it with a much smaller, discontinuous 2d seismic program. Thus, a scientifically unsupported critical habitat designation impaired CIRI's ability to have an oil and gas lessee properly image its subsurface resource lands in the KNWR.

Unfortunately CIRI's experience with federal actions based on a lack of science is not its only experience of late. We have also seen issues raised by USFWS junk science. Going back to NordAq's Shadura discovery story, the USFWS also impeded its progress toward a reasonably timely development, in part by employing junk science within the permitting process for a right-of-way application. NordAq toiled for more than 30 months after its Shadura discovery to achieve the development permits necessary to construct a simple, single land gravel road and pad that is necessary to further develop the field. This permitting process took so long because the USFWS insisted that a full environmental impact statement process was required even though the activity is simple, low-impact and cannot be denied. In the process, the USFWS raised a habitat issue of note: peat pipes.

We were shocked to discover the issue of peat pipes raised in the Shadura development EIS process. The reason we were so surprised is because none of us had ever even heard of such a thing as a peat pipe. Our astonishment was well founded. As far as I know, a peat pipe has never been identified anywhere in North America.

A peat pipe is a near-surface, subsurface hydrological feature of the extensive, continuous and relatively homogenous peat bogs of northern England. It is a natural channel, or pipe, that is eroded into the surrounding peat over time by the movement of subsurface water. Peat pipes

are shallow and somewhat ephemeral features that often link surface streams and ponds with the shallow subsurface hydrological features.

Despite no identified peat pipes in the Kenai Peninsula or Southcentral Alaska, and no credible evidence that would indicate that any peat pipes exist in the KNWR, peat pipes were an issue that had to be addressed in the Shadura development EIS process. The peat pipes issue highlights the consequences of junk science as applied by the USFWS to oil and gas activities within the refuge system in Alaska—NordAq's permitting process was slowed and made substantially more expensive by addressing an imaginary issue.

Inadequate staffing and changing rules

Two practical realities dominate the interaction between oil and gas operators and the USFWS: inadequate staffing and changing rules. The USFWS is faced with too few technical experts to properly and timely process oil and gas activities on or crossing its refuge lands and many of those tasked with such activities do so without adequate technical education or training in oil and gas specific issues.

The practical impact of too few oil and gas technical experts within the USFWS has the predictable consequence of slowing down all permitting and oversight activities. But there is also a lack of oil and gas specific expertise, which has an additional consequence of permittors focusing on the wrong issues or creating imaginary issues.

The very changes being contemplated by the USFWS right now highlights the other practical problem: constantly shifting rules. I have heard numerous times from my lessees about the problem of moving goalposts.

Another example from the NordAq Shadura case study highlights this issue. As mentioned above, NordAq's Shadura development requires an access road to get back to the Shadura prospect, which is not accessible by existing roads. The Shadura access road was designed as a single-lane gravel road in order to minimize the impact on the KNWR and its surface habitat. To make the single lane design safe and serviceable, it was designed with turnouts every quarter mile to facilitate bi-directional traffic. This design was incorporated into the right-of-way design that went through the EIS evaluation process. Except after the final EIS was issued the USFWS attempted to renegotiate the design of the road to eliminate turnouts, in an apparent attempt to further limit the habitat impact of the Shadura road. Such an after-the-process attempt to change the road was a classic example of constantly changing rules and expectations from the USFWS staff. Operators are happy to comply with reasonable rules, but they need to know what the rules are—and the rules need to stay constant.

The de facto National Park Service management regime

Perhaps the explanation for the USFWS's recent behaviors lies an underlying seismic shift in management philosophies by federal land management agencies with regard to their lands in Alaska. The USFWS and other federal land managers—such as the Forest Service and the

Bureau of Land Management—in Alaska appear to be adopting a de facto National Park Service ("NPS") management regime. Many of the proposed rulemakings recently have either implicitly or explicitly been premised on, refer to, or adopt standards similar to those of the NPS. In fact, the recent proposed rulemaking by the USFWS explicitly referenced the oil and gas rules and standards of the NPS as both guidance and inspiration. Using the NPS system is inappropriate.

The problem inherent in this shift is that the NPS manages for one explicit purpose, to preserve the wild, natural and undeveloped character of its lands, with a minimal accommodation to humans for the sole, express purpose of authorized and limited visitation of the otherwise undisturbed natural environment. But other federal lands are not parks and, accordingly, those lands should not be managed as such. The National Wildlife Refuge System in Alaska, and elsewhere, has different purposes. And, importantly, the individual lands that comprise National Wildlife Refuges often have a much different and more complicated history than those within the National Park System.

In many, and perhaps most, cases in Alaska, the National Wildlife Refuge system was created with a mix of inholdings and subsurface interests included within the exterior boundaries of individual refuges in order to maximize the geographic area encompassed by that refuge. By 1980 when most of the National Wildlife Refuges in Alaska were created, there were already many competing applications for the same and adjoining lands that were due to the then-new ANCSA corporations and to the State of Alaska. Many of these lands were under competing selection by these non-federal entities. In order to carve out these very large National Wildlife Refuge areas, compromises were struck with the non-federal entities. Thus, in creating the refuges in this manner, the rights of others were necessarily stirred into the dough of the refuge system in Alaska. It is now impossible to cleanly or fairly extract those interests some 30 to 40 years after the loaf was baked. Attempting to recreate the refuges as parks does not work in Alaska.

The Alaska Paradox

I must mention one final overarching theme. Alaska is a special place, no question about it. It is beautiful, enormous and largely undeveloped: a national treasure. Alaska also holds a national treasure's worth of developed and undeveloped resources. And therein lies a set of circumstances that give rise to what I like to call "the Alaska Paradox."

The Alaska Paradox results from the convergence of two powerful and competing realities in resource development in a place like Alaska. There is an economic reality that drives the scale of resource developments in Alaska to the very large or world class in scale. This enormous project scale is necessary to justify and fund the development and permitting risk of a new resources project in a place as big, as Arctic and as undeveloped as Alaska. Where oil and gas operators in the Lower 48 may target prospective resources in the hundreds of thousands of barrels of oil equivalent, in Alaska they typically target minimums in the tens of millions of

barrels—and even more if the prospect location is far from infrastructure in an undeveloped area.

The competing reality is that world class-scale projects in an otherwise undeveloped area create significant new impacts that in turn engender enormous scrutiny.

Let me give you an example: the Red Dog Mine. The Red Dog Mine is one of the world's largest zinc deposits. It sits some 90 miles from Kotzebue, the only community of any scale within the Northwest Arctic Borough, an area the geographic equivalent of the State of Indiana with a mere 7,200 residents, fully half or more of which live in Kotzebue. The Red Dog Mine required the development and construction of its own access road, port, airport, camp and housing facilities, and power plant in addition to the ordinary mine and mine support facilities—all in an extremely remote, extremely arctic and completely undeveloped area of Alaska. Although the mine was and is extremely successful and has had an extraordinary environmental record, and its development and operation singularly supports the finances of the Northwest Arctic Borough and its communities, it is not clear to me that the Red Dog Mine could be developed today. It is simply too large and it and its attendant infrastructure have too much of an impact on the otherwise undeveloped environment around it. This is the reality of the Alaska Paradox: projects must be very large, but very large projects engender significant and sustained opposition and scrutiny.

New rules are neither authorized nor needed

The USFWS has recently proposed a set of new rules to govern oil and gas exploration, development and production on the national wildlife refuge system. These rules are neither authorized nor needed in Alaska.

The proposed rules would disturb the careful statutory balance between the ANCSA corporations, and specifically CIRI, and the State of Alaska on one hand, and the federal interests on the other. Accordingly, the proposed rules may not be implemented. Many of the proposed rules, e.g. bonding requirements, tread on the prerogative of the lessor and royalty owner and are not an appropriate action by the USFWS. Such requirements would impose an additional and unnecessary financial burden on oil and gas operators. The USFWS's proposed actions would constitute a usurping of the authority and responsibility of the landowner/lessor and are an inappropriate. The proposed rules would also constitute a unilateral rewriting of the statutorily crafted rights and duties some 30 to 40 years after many of these issues were settled. The USFWS is not authorized to upset this Congressionally-crafted balance.

Conclusion

I can think of no circumstances under which the United States Fish and Wildlife Service's proposed new oil and gas rules are needed or would be justified in their application in Alaska. The effort to rewrite these rules is at best an attempt to usurp the role of the oil and gas lessor of inholdings, adjoining tracts or subsurface oil and gas rights below Alaska refuges. It is at

worst an attempt to unilaterally rewrite the terms of a carefully crafted compromise between the Alaska Native Corporations and the State of Alaska, on the one hand, and the federal government on the other.