

CS FOR HOUSE BILL NO. 394(RES)

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE HOUSE RESOURCES COMMITTEE

Offered: 3/14/96
Referred: Finance

Sponsor(s): REPRESENTATIVES OGAN AND ROKEBERG, James, Kohring

A BILL

FOR AN ACT ENTITLED

1 "An Act authorizing shallow natural gas leasing from sources within 3,000 feet
2 of the surface; relating to regulation of natural gas exploration facilities for
3 purposes of preparation of discharge prevention and contingency plans and
4 compliance with financial responsibility requirements; and adding, in the exemption
5 from obtaining a waste disposal permit for disposal of waste produced from
6 drilling, a reference to shallow natural gas."

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

8 * **Section 1.** LEGISLATIVE FINDINGS AND PURPOSE. (a) The legislature finds that
9 (1) there exist throughout the state sizeable reserves of coal and small but
10 commercially significant amounts of natural gas located close to the earth's surface that are
11 usually, though not always, associated with and emitted from coal reserves;
12 (2) the methane derived from this coal and other sources and that is found in
13 reservoirs at depths of less than 3,000 feet could be tapped to serve as a principal or a chief

1 supplemental energy source of benefit to residents of areas in which they are found;

2 (3) the methane derived from this coal and other shallow gas reservoirs could
3 be developed without interfering with the development and transportation of the state's vast gas
4 reserves available for interstate and foreign markets; and

5 (4) it is in the best interests of the state and its people that this natural gas should
6 be identified and developed, especially to serve as a source of natural gas for use in rural
7 communities and remote locations within the state, especially when this natural gas can be
8 delivered to consumers at less cost than alternative energy sources.

9 (b) In authorizing a program of leasing shallow natural gas from state land, it is the
10 legislature's purpose to provide both a means and an incentive by which that gas may be
11 identified and developed at low cost for the direct benefit of residents of remote or sparsely
12 populated areas for which connection to the in-place gas pipeline transmission and distribution
13 system serving population centers in Southcentral Alaska is not economically feasible.

14 * **Sec. 2.** AS 38.05 is amended by adding a new section to read:

15 Sec. 38.05.177. SHALLOW NATURAL GAS LEASES. (a) The provisions of
16 this section

17 (1) apply to gas, whether methane associated with and derived from coal
18 reserves or otherwise, developed from a source that is within 3,000 feet of the surface;
19 and

20 (2) do not apply to authorize lease of

21 (A) land described in AS 38.05.131(b) in which oil and gas
22 exploration licenses and leases may not be issued;

23 (B) the land

24 (i) that is or becomes subject to an oil and gas exploration
25 license or lease issued under AS 38.05.131 - 38.05.134;

26 (ii) that is leased under AS 38.05.180; or

27 (iii) that is described in and is part of the proposed oil
28 and gas leasing program prepared under AS 38.05.180(b), but the
29 commissioner may waive this limitation; or

30 (C) the land that, on the effective date of this Act, is held under
31 a coal lease entered into under AS 38.05.150.

32 (b) For the purpose of exploring for and developing shallow natural gas

1 reservoirs, upon application, the director may lease to a person land for which the state
2 owns the subsurface rights. A person applying for a lease under this subsection

3 (1) shall specify the area to be leased; the area to be leased may not
4 exceed 5,760 acres; a lessee may not hold more than 23,040 acres of land under leases
5 entered into under this section;

6 (2) may not be required to pay an application fee or any other form of
7 payment as a condition of submitting or processing the lease application or obtaining the
8 lease.

9 (c) Unless the lease application is for land described in (a)(2) of this section that
10 may not be leased or unless otherwise prevented by law from entering into a lease for
11 land described in the lease application, promptly after receipt of a lease application, the
12 director shall give notice of receipt of the lease application and call for comments from
13 the public. The director's call for public comments must provide opportunity for public
14 comment for a period of 60 days. If, on the basis of public comments received, the
15 director determines to enter into a lease for the area described in (b) of this section, the
16 director shall execute the lease within 90 days after the close of the public comment
17 period or, if review is required under AS 46.40, within 30 days after the final consistency
18 determination is made under AS 46.40. A lease entered into under this subsection gives
19 the lessee the exclusive right to explore for, develop, and produce, for a term not to
20 exceed five years, natural gas on the state land described in the lease; the right to explore
21 for, develop, and produce is limited to gas derived from natural gas within 3,000 feet of
22 the surface.

23 (d) A lease shall be automatically extended if and for so long thereafter as gas
24 is produced in paying quantities from the lease. A lease issued under this section
25 covering land on which there is a well capable of producing gas in paying quantities
26 does not expire because the lessee fails to produce gas unless the lessee is allowed
27 reasonable time to place the well on a producing status. If drilling has commenced on
28 the expiration date of the primary term of the lease and is continued with reasonable
29 diligence, including such operations as redrilling, sidetracking, or other means necessary
30 to reach the originally proposed bottom hole location, the lease continues in effect until
31 90 days after drilling has ceased and for so long thereafter as gas is produced in paying
32 quantities. A gas lease issued under this section that is subject to termination by reason

1 of cessation of production does not terminate if, within 60 days after production ceases,
2 reworking or drilling operations are commenced on the land under lease and are
3 thereafter conducted with reasonable diligence during the period of nonproduction. In
4 addition, upon application by the lessee, the director may once extend a lease issued
5 under (c) of this section for a period of not more than five years if the director
6 determines that during the period described in (c) of this section, the lessee

7 (1) has conducted reasonably diligent exploration activities in the area
8 covered by the lease;

9 (2) has not been able to determine the commercial productivity of the
10 natural gas occurring on the lease; and

11 (3) wishes to continue to conduct exploration activities in the area
12 described in the lease.

13 (e) The director

14 (1) shall annually make a determination under this subsection that the
15 lessee has diligently developed and continued to operate under the lease; if the director
16 determines that the lessee has not diligently developed or continued to operate under the
17 lease, the director, after giving notice and opportunity for hearing to the lessee, may
18 terminate the lease;

19 (2) may adjust the boundaries of a lease entered into under this section
20 as may be necessary to ensure development of natural gas within a reasonably compact
21 area; a lease as adjusted under this paragraph remains subject to the acreage limitations
22 set out in (b)(1) of this section.

23 (f) For the privilege of exploring for and producing gas from a lease, the lessee
24 shall pay rent to the state in the amount of 50 cents per acre. The rent is due and
25 payable on the dates determined in the lease. If rent is not paid when due, the director
26 shall mail the lessee written notice of nonpayment at the end of each month, while the
27 rent remains unpaid, for a period of two months. The lessee may cure the failure to pay
28 rent when due within 90 days after the rent payment becomes due and payable by paying
29 to the director the amount of rent due together with a penalty of the greater of \$50 or
30 five percent of the amount of rent in default. If the lessee fails to remedy the lessee's
31 failure to pay rent, the director shall terminate the lease.

32 (g) The royalty payable on natural gas produced from a lease is 6.25 percent of

1 the value of the production removed or sold from the lease.

2 (h) A lease issued under this section is subject to the following terms and
3 conditions and may be terminated by the director in the event of a breach of a term or
4 condition:

5 (1) the lessee may surrender or relinquish the lease at any time;

6 (2) the lease may not be transferred or assigned until after the date of
7 initial commercial production of gas from the area within the lease; however, this
8 paragraph does not prohibit the lessee from entering into a farm out agreement or similar
9 arrangement with a third party under which the third party assists in exploration and
10 development of production from the lease if the agreement or arrangement does not
11 require a payment of consideration by the third party to the lessee, except that the lessee
12 may retain an overriding royalty interest in the lease or may retain a net profit or other
13 production payment;

14 (3) gas produced from the lease may not be sold or otherwise made
15 available for insertion into the in-place gas pipeline transmission or distribution system
16 serving population centers in Southcentral Alaska, except that the director may waive this
17 limitation to permit the exchange of the gas produced for other gas that may be
18 distributed in rural communities and remote locations within the state.

19 (i) The applicant for a lease shall conduct a title search for the area described
20 in the lease application.

21 (j) The acreage limitations of AS 38.05.140(c) and 38.05.180(m) do not apply
22 to a lease.

23 (k) A lease does not give the lessee the right to produce oil or to produce gas
24 from sources that are not within 3,000 feet of the surface. If an onshore well drilling for
25 natural gas under a lease authorized by this section penetrates a formation capable of
26 producing gas below 3,000 feet of the surface, the owner or operator

27 (1) shall notify the department and the Alaska Oil and Gas Conservation
28 Commission; and

29 (2) may not conduct further operations in the drilled well until the facility
30 complies with all applicable laws and regulations relating to oil and gas production;
31 however, this paragraph does not prevent the owner or operator from conducting
32 activities that may be required by the Alaska Oil and Gas Conservation Commission to

1 plug, plug-back, or abandon a well.

2 (l) The commissioner of natural resources may adopt only the regulations that
3 are reasonable and that are necessary to implement, interpret, or make specific the
4 provisions of this section or to establish procedures to govern application of the
5 provisions of this section.

6 (m) In this section, "lease" means a shallow gas lease authorized by this section.

7 * **Sec. 3.** AS 38.05.035(e)(6) is amended to read:

8 (6) before a public hearing, if held, or in any case not less than 21 days
9 before the sale, lease, or other disposal of available land, property, resources, or
10 interests in them other than a sale, lease, or other disposal of available land or an
11 interest in land for oil and gas under (5) of this subsection, the director shall make
12 available to the public a written finding that, in accordance with (1) of this subsection,
13 sets out the material facts and applicable statutes and regulations and any other
14 information required by statute or regulation to be considered upon which the
15 determination that the sale, lease, or other disposal will best serve the interests of the
16 state was based; however, a written finding is not required before the approval of

17 (A) a contract for a negotiated sale authorized under
18 AS 38.05.115;

19 (B) a lease of land for a shore fishery site under AS 38.05.082;

20 (C) a permit or other authorization revocable by the
21 commissioner;

22 (D) a mineral claim located under AS 38.05.195;

23 (E) a mineral lease issued under AS 38.05.205;

24 (F) a production license issued under AS 38.05.207;

25 (G) an exempt oil and gas sale under AS 38.05.180(d) of
26 acreage offered in a sale that was held within the previous five years if the sale
27 was subject to a written best interest finding, unless the commissioner
28 determines that new information has become available that justifies a revision
29 of the best interest finding; [OR]

30 (H) a lease sale under AS 38.05.180(w) of acreage offered in
31 a sale that was held within the previous five years if the sale was subject to a
32 best interest finding, unless the commissioner determines that new information

1 has become available that justifies a revision of the best interest finding; or
2 **(I) a shallow gas lease authorized under AS 38.05.177 in an**
3 **area for which leasing is authorized under AS 38.05.177;**

4 * **Sec. 4.** AS 38.05.180(f) is amended to read:

5 (f) Except as provided by AS 38.05.131 - 38.05.134 **and 38.05.177**, the
6 commissioner may issue oil and gas leases on state land to the highest responsible
7 qualified bidder determined by competitive bidding under regulations adopted by the
8 commissioner. Bidding may be by sealed bid or according to any other bidding
9 procedure the commissioner determines is in the best interests of the state. Whenever,
10 under any of the leasing methods listed in this subsection, a royalty share is reserved
11 to the state, it shall be delivered in pipeline quality and free of all lease or unit
12 expenses, including but not limited to separation, cleaning, dehydration, gathering, salt
13 water disposal, and preparation for transportation off the lease or unit area. Following
14 a pre-sale analysis, the commissioner may choose at least one of the following leasing
15 methods:

16 (1) a cash bonus bid with a fixed royalty share reserved to the state of
17 not less than 12.5 percent in amount or value of the production removed or sold from
18 the lease;

19 (2) a cash bonus bid with a fixed royalty share reserved to the state of
20 not less than 12.5 percent in amount or value of the production removed or sold from
21 the lease and a fixed share of the net profit derived from the lease of not less than 30
22 percent reserved to the state;

23 (3) a fixed cash bonus with a royalty share reserved to the state as the
24 bid variable but no less than 12.5 percent in amount or value of the production
25 removed or sold from the lease;

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

28 (5) a fixed cash bonus with a fixed royalty share reserved to the state
29 of not less than 12.5 percent in amount or value of the production removed or sold
30 from the lease with the share of the net profit derived from the lease reserved to the
31 state as the bid variable;

1 (6) a cash bonus bid with a fixed royalty share reserved to the state
2 based on a sliding scale according to the volume of production or other factor but in
3 no event less than 12.5 percent in amount or value of the production removed or sold
4 from the lease;

5 (7) a fixed cash bonus with a royalty share reserved to the state based
6 on a sliding scale according to the volume of production or other factor as the bid
7 variable but not less than 12.5 percent in amount or value of the production removed
8 or sold from the lease.

9 * **Sec. 5.** AS 46.03.100(f) is amended to read:

10 (f) This section does not apply to discharges of solid or liquid waste material
11 or water discharges from the following activities if the discharge is incidental to the
12 activity and the activity does not produce a discharge from a point source, as that term
13 is defined in regulations adopted under this chapter, directly into any surface water of
14 the state:

15 (1) mineral drilling, trenching, ditching, and similar activities;

16 (2) landscaping;

17 (3) water well drilling, geophysical drilling, or coal bed methane
18 drilling **or other natural gas drilling to recover gas from a reservoir at a depth of**
19 **less than 3,000 feet**; or

20 (4) drilling, ditching, trenching, and similar activities associated with
21 facility construction and maintenance or with road or other transportation facility
22 construction and maintenance; however, the exemption provided by this paragraph does
23 not relieve a person from obtaining a permit under (a) of this section if

24 (A) the drilling, ditching, trenching, or similar activity will
25 involve the removal of the groundwater, stormwater, or wastewater runoff that
26 has accumulated and is present at an excavation site for facility, road, or other
27 transportation construction or maintenance; and

28 (B) a permit is otherwise required by (a) of this section.

29 * **Sec. 6.** AS 46.04.030(b) is amended to read:

30 (b) A person may not cause or permit the operation of a pipeline or [AN
31 EXPLORATION OR] production facility in the state **or, except as provided in**

1 AS 46.04.050(c) for a well that has not penetrated a formation capable of
2 producing oil, may not cause or permit the operation of an exploration facility in
3 the state unless an oil discharge prevention and contingency plan for the pipeline or
4 facility has been approved by the department and the person is in compliance with the
5 plan.

6 * **Sec. 7.** AS 46.04.030 is amended by adding a new subsection to read:

7 (s) If an onshore well drilling for gas under a lease authorized by
8 AS 38.05.177 penetrates a formation capable of producing oil, the owner or operator

9 (1) shall notify the department and the Alaska Oil and Gas
10 Conservation Commission; and

11 (2) may not conduct further operations in the drilled well until the
12 facility complies with all applicable laws and regulations relating to oil and gas
13 production; however, this paragraph does not prevent the owner or operator from
14 conducting activities that may be required by the Alaska Oil and Gas Conservation
15 Commission to plug and abandon a well.

16 * **Sec. 8.** AS 46.04.040(b) is amended to read:

17 (b) A person may not cause or permit the operation of a pipeline or an
18 exploration or production facility in the state unless the person has furnished to the
19 department, and the department has approved, proof of financial ability to respond in
20 damages. Proof of financial responsibility required for

21 (1) a pipeline or an offshore exploration or production facility is
22 \$50,000,000 per incident;

23 (2) an onshore production facility is

24 (A) \$20,000,000 per incident if the facility produces over
25 10,000 barrels per day of oil;

26 (B) \$10,000,000 per incident if the facility produces over 5,000
27 barrels per day but not more than 10,000 barrels per day of oil;

28 (C) \$5,000,000 per incident if the facility produces over 2,500
29 barrels per day but not more than 5,000 barrels per day of oil;

30 (D) \$1,000,000 per incident if the facility produces 2,500 barrels
31 per day or less of oil;

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(3) an onshore exploration facility is

(A) \$25,000 per incident for a facility used solely to explore for shallow natural gas by means of drilling a well when authorized by AS 38.05.177; and

(B) except as provided by (A) of this paragraph, \$1,000,000
per incident.

* **Sec. 9.** AS 46.04.040 is amended by adding a new subsection to read:

(n) If an onshore well authorized under AS 38.05.177 to recover shallow natural gas penetrates a formation capable of producing oil, the owner or operator may not conduct further exploration activity. However, this subsection does not prevent the owner or operator from conducting activities that may be required by the Alaska Oil and Gas Conservation Commission to plug and abandon a well.

* **Sec. 10.** AS 46.04.050 is amended by adding a new subsection to read:

(c) Except as provided in AS 46.04.030(s), the provisions of AS 46.04.030(b) do not apply to an onshore exploration facility used solely to explore for natural gas by means of drilling a well when authorized under AS 38.05.177.

* **Sec. 11. RELATION TO RIGHTS GRANTED UNDER EXISTING COAL LEASES.**

The provisions of AS 38.05.177, added by sec. 2 of this Act, may not apply to impair or infringe upon the rights of a lessee of a coal lease entered into under AS 38.05.150 on or before the effective date of this Act and that is in effect on the effective date of this Act to recover the coal bed methane and other gas held in association with the coal under the lease unless recovery by the lessee of coal bed methane and other gas in association with the coal is prohibited by the coal lease.