

CS FOR HOUSE BILL NO. 394(O&G)

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE HOUSE SPECIAL COMMITTEE ON OIL AND GAS

Offered: 2/28/96

Referred: Resources, Finance

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

A BILL

FOR AN ACT ENTITLED

1 "An Act authorizing shallow bed natural gas leasing; relating to regulation of
2 natural gas exploration facilities for purposes of preparation of discharge
3 prevention and contingency plans and compliance with financial responsibility
4 requirements; exempting response and prevention activities associated with shallow
5 bed natural gas leasing as a use for which money in the oil and hazardous
6 substance release prevention and response fund is authorized; and substituting in
7 the exemption from obtaining a waste disposal permit for disposal of waste
8 produced from drilling a reference to shallow bed natural gas for a reference to
9 coal bed methane."

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

11 * **Section 1.** LEGISLATIVE FINDINGS, PURPOSE, AND EXPRESSION OF INTENT.

12 (a) The legislature finds that

1 (1) there exist throughout the state sizeable reserves of coal and small but
2 commercially significant amounts of natural gas located close to the earth's surface that are
3 usually, though not always, associated with and emitted from coal reserves;

4 (2) the methane derived from these coal reserves and other shallow bed natural
5 gas sources could be tapped to serve as a principal or a chief supplemental energy source of
6 benefit to residents of areas in which they are found;

7 (3) the methane derived from these coal reserves and other shallow bed natural
8 gas sources that are generally close to the surface could be developed without interfering with
9 the development and transportation of the state's vast gas reserves available for interstate and
10 foreign markets; and

11 (4) it is in the best interests of the state and its people that this natural gas should
12 be identified and developed, especially to serve as a source of commercial quality natural gas
13 for use in rural communities and remote locations within the state.

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

19 (c) In enacting this Act, it is the intent of the legislature

20 (1) that the Department of Natural Resources implement this Act promptly and
21 without adoption of administrative regulations to implement, interpret, or make specific this Act
22 or to establish procedures to govern application of provisions of this Act; and

23 (2) that, to the extent it is necessary for the Department of Natural Resources to
24 adopt constructions that implement, interpret, or make specific this Act or to establish procedures
25 to govern application of provisions of this Act, the commissioner of natural resources may
26 recommend legislation for consideration by the First Session of the Twentieth Alaska State
27 Legislature to amend or add to the provisions of this Act that will adopt those constructions or
28 establish those procedures.

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

30 Sec. 38.05.177. SHALLOW BED NATURAL GAS. (a) The provisions of this
31 section

32 (1) apply to gas, whether methane associated with and derived from coal

1 reserves or otherwise, developed from a source that is within 3,000 feet of the surface
2 at the drill site; and

3 (2) do not apply to authorize lease of

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

6 (B) the land

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

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

10 (iii) that is described in and is part of the proposed oil
11 and gas leasing program prepared under AS 38.05.180(b); or

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

14 (b) For the purpose of exploring for and developing shallow bed natural gas,
15 upon application, the director may lease to a person land of the state. A person applying
16 for a lease under this subsection

17 (1) shall specify the area to be leased; the area to be leased may not
18 exceed 23,040 acres and may not be less than 640 acres;

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

22 (c) Unless the lease application is for land described in (a)(2) of this section or
23 unless otherwise prevented by law from entering into a lease for land described in the
24 lease application, promptly after receipt of a lease application, the director shall enter into
25 an initial shallow bed gas development lease. The initial shallow bed gas development
26 lease entered into under this subsection gives the lessee

27 (1) the exclusive right to explore for, develop, and produce, for a term
28 not to exceed two years, shallow bed natural gas on the state land described in the lease;
29 the right to explore for, develop, and produce is limited to gas derived from shallow bed
30 natural gas within 3,000 feet of the surface at the drill site; and

31 (2) unless the lease is earlier terminated under (f) or (h)(1) of this section,
32 the option to convert the lease for all or part of the state land into a shallow bed gas

1 lease of unlimited duration.

2 (d) Upon application by the lessee, the director

3 (1) may once extend an initial shallow bed gas development lease issued
4 under (c) of this section for a period of not more than two years if the director
5 determines that during the period described in (c)(1) of this section, the lessee

6 (A) has conducted reasonably diligent exploration activities in the
7 area covered by the initial shallow bed gas development lease;

8 (B) has not been able to determine the commercial productivity
9 of the shallow bed natural gas occurring on the lease; and

10 (C) wishes to continue to conduct exploration activities in the
11 area described in the initial shallow bed gas development lease;

12 (2) may adjust the boundaries of a lease entered into under this section
13 as may be necessary to ensure development of shallow bed natural gas within a
14 reasonably compact area or as a single unit; a lease as adjusted under this paragraph
15 remains subject to the acreage limitations set out in (b)(1) of this section.

16 (e) Each lease established by conversion under (c)(2) of this section shall be for
17 an indeterminate period upon condition of diligent development and continued operation
18 for the purpose of producing shallow bed natural gas in commercial quantities. The
19 director shall annually make a determination under this subsection that the lessee has
20 diligently developed and continued to operate under the lease.

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

31 (1) until the initial commercial production of gas from the area within
32 the shallow bed gas development lease, 25 cents per acre; and

1 (2) after the initial commercial production of gas from the area within
2 the shallow bed gas development lease, 50 cents per acre.

3 (g) The royalty payable on natural gas produced from a shallow bed gas
4 development lease is 6.25 percent of the value of the production removed or sold from
5 the lease.

6 (h) A shallow bed gas development lease issued under this section is subject to
7 the following terms and conditions and may be terminated by the director in the event
8 of a breach of a term or condition:

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

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

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

23 (i) When a search is required to verify a title to an area described in a shallow
24 bed gas development lease application, the applicant may conduct the title search.

25 (j) The acreage limitations of AS 38.05.140(c) and 38.05.180(m) do not apply
26 to a shallow bed gas development lease.

27 (k) A shallow bed gas development lease does not give the lessee the right to
28 produce oil or to produce gas from sources that are not within 3,000 feet of the surface
29 at the drilling site. If the lessee's operation under the lease results in the production of
30 oil or of gas in violation of this subsection, the director shall immediately suspend the
31 lessee's operation under the lease and may terminate the lease.

32 (l) Notwithstanding AS 38.05.020(b)(1) and AS 44.62.010 - 44.62.300, the

1 commissioner of natural resources may not adopt regulations to adopt constructions
2 that implement, interpret, or make specific the provisions of this section or to establish
3 procedures to govern application of the provisions of this section.

4 (m) In this section, "lease" means a shallow bed gas development lease
5 authorized by this section.

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

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

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

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

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

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

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

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

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

29 (H) a lease sale under AS 38.05.180(w) of acreage offered in
30 a sale that was held within the previous five years if the sale was subject to a
31 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 bed gas development lease authorized under
3 AS 38.05.177 in an area for which leasing is authorized under
4 AS 38.05.177;

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

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

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

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

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

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

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

1 state as the bid variable;

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

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

10 * **Sec. 5.** AS 38.05.180(h) is amended to read:

11 (h) The commissioner may include terms in any oil and gas lease, **except a**
12 **shallow bed gas development lease issued under AS 38.05.177,** imposing a minimum
13 work commitment on the lessee. These terms shall be made public before the sale,
14 and may include appropriate penalty provisions to take effect in the event the lessee
15 does not fulfill the minimum work commitment. If it is demonstrated that a lease has
16 been proven unproductive by actions of adjacent lease holders, the commissioner may
17 set aside a work commitment. The commissioner may waive for a period not to
18 exceed one two-year period any term of a minimum work commitment if the
19 commissioner makes a written finding either that conditions preventing drilling or
20 exploration were beyond the lessee's reasonable ability to foresee or control or that the
21 lessee has demonstrated through good faith efforts an intent and ability to drill or
22 develop the lease during the term of the waiver.

23 * **Sec. 6.** AS 46.03.100(f) is amended to read:

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

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

30 (2) landscaping;

31 (3) water well drilling **or** [,] geophysical drilling [, OR COAL BED

1 METHANE DRILLING]; [OR]

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

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

10 (B) a permit is otherwise required by (a) of this section; **or**

11 **(5) the discharge or disposal of waste material or water from**
12 **activities associated with gas exploration drilling under a shallow bed gas**
13 **development lease authorized by AS 38.05.177.**

14 * **Sec. 7.** AS 46.04.030(b) is amended to read:

15 (b) A person may not cause or permit the operation of a pipeline or [AN
16 EXPLORATION OR] production facility in the state **or, except as provided in**
17 **AS 46.04.050(c) for a well that has not penetrated a formation capable of**
18 **producing oil, may not cause or permit the operation of an exploration facility in**
19 **the state** unless an oil discharge prevention and contingency plan for the pipeline or
20 facility has been approved by the department and the person is in compliance with the
21 plan.

22 * **Sec. 8.** AS 46.04.030 is amended by adding a new subsection to read:

23 (s) If an onshore well drilling for gas under a lease authorized by
24 AS 38.05.177 penetrates a formation capable of producing oil, the operator of the
25 facility

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

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

1 Commission to plug and abandon a well.

2 * **Sec. 9.** AS 46.04.040(b) is amended to read:

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

7 (1) a pipeline or an offshore exploration or production facility is
8 \$50,000,000 per incident;

9 (2) an onshore production facility is

10 (A) \$20,000,000 per incident if the facility produces over
11 10,000 barrels per day of oil;

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

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

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

18 (3) an onshore exploration facility is

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

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

24 * **Sec. 10.** AS 46.04.040 is amended by adding a new subsection to read:

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

30 * **Sec. 11.** AS 46.04.050 is amended by adding a new subsection to read:

31 (c) Except as provided in AS 46.04.030(s), the provisions of AS 46.04.030(b)

1 do not apply to an onshore exploration facility used solely to explore for natural gas
2 by means of drilling a well when authorized under AS 38.05.177.

3 * **Sec. 12.** AS 46.08.040 is amended by adding a new subsection to read:

4 (e) Money from the fund may not be used to take action under (a) of this
5 section as to the release or threatened release of oil or a hazardous substance from a
6 shallow bed natural gas development well authorized under AS 38.05.177.

7 * **Sec. 13.** RELATION TO RIGHTS GRANTED UNDER EXISTING COAL LEASES.

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

14 * **Sec. 14.** CORRECTIVE LEGISLATION INVITED. If the commissioner of natural
15 resources believes it is necessary to adopt constructions that implement, interpret, or make
16 specific the provisions of AS 38.05.177 or to establish procedures to govern application of
17 provisions of AS 38.05.177, the commissioner of natural resources may recommend legislation
18 for consideration by the First Session of the Twentieth Alaska State Legislature to amend or
19 add to the provisions of AS 38.05.177 that will adopt those constructions or establish those
20 procedures.