

CS FOR HOUSE BILL NO. 394(FIN)

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE HOUSE FINANCE COMMITTEE

Offered: 4/15/96

Referred: Today's Calendar

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

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; addressing the relationship
5 between shallow natural gas and other natural resources; and adding, in the
6 exemption from obtaining a waste disposal permit for disposal of waste produced
7 from drilling, a reference to shallow natural gas."

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

9 * **Section 1.** LEGISLATIVE FINDINGS AND PURPOSE. (a) The legislature finds that
10 (1) there exist throughout the state sizeable deposits of coal and small but
11 commercially significant amounts of natural gas located close to the earth's surface that are
12 usually, though not always, associated with and emitted from coal deposits;
13 (2) the methane derived from this coal and other sources and that is found in

1 reservoirs at depths of less than 3,000 feet could be tapped to serve as a principal or a chief
2 supplemental energy source of benefit to residents of areas in which they are found;

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

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

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

15 * **Sec. 2.** AS 38.05.035(e)(6) is amended to read:

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

25 (A) a contract for a negotiated sale authorized under
26 AS 38.05.115;

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

28 (C) a permit or other authorization revocable by the
29 commissioner;

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

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

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

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

6 (H) a lease sale under AS 38.05.180(w) of acreage offered in
7 a sale that was held within the previous five years if the sale was subject to a
8 best interest finding, unless the commissioner determines that new information
9 has become available that justifies a revision of the best interest finding; **or**

10 **(I) a shallow gas lease authorized under AS 38.05.177 in an**
11 **area for which leasing is authorized under AS 38.05.177;**

12 * **Sec. 3.** AS 38.05.140(a) is amended to read:

13 (a) A person may not take or hold coal leases or permits during the life of coal
14 leases on state land exceeding an aggregate of 46,080 acres, except that a person may
15 apply for coal leases or permits for acreage in addition to 46,080 acres, not exceeding
16 a total of 5,120 additional acres of state land. The additional area applied for shall be
17 in multiples of 40 acres and the application shall contain a statement that the granting
18 of a lease for additional land is necessary for the person to carry on business
19 economically and is in the public interest. On the filing of the application, **except as**
20 **provided by AS 38.05.177(a)(2)(B)**, the coal deposits in the land covered by the
21 application shall be temporarily set aside and withdrawn from all other forms of
22 disposal provided under AS 38.05.135 - 38.05.181.

23 * **Sec. 4.** AS 38.05.150 is amended by adding a new subsection to read:

24 (f) Notwithstanding AS 38.05.177, a lease entered into under this section gives
25 the lessee the right to vent or remove methane and other gas held in association with
26 the coal in the land covered by the lease to ensure safe coal mining operations.

27 * **Sec. 5.** AS 38.05 is amended by adding a new section to read:

28 Sec. 38.05.177. SHALLOW NATURAL GAS LEASES. (a) The provisions of
29 this section

30 (1) apply to gas, whether methane associated with and derived from coal
31 deposits or otherwise, developed from a source that is within 3,000 feet of the surface;
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(2) do not apply to authorize lease of

(A) the land (i) that is or is proposed to be subject to an oil and gas exploration license or lease issued under AS 38.05.131 - 38.05.134; (ii) that is leased under AS 38.05.180; or (iii) that is included in the final findings of a proposed oil and gas leasing program prepared under AS 38.05.180(b); however, the commissioner may waive the limitations of this subparagraph; or

(B) the land that is held under a coal lease entered into under AS 38.05.150, unless the applicant for a shallow natural gas lease is also the lessee under AS 38.05.150 of that land.

(b) For the purpose of exploring for and developing shallow natural gas reservoirs, upon application, the director may lease to a person land for which the state owns the subsurface rights. A person applying for a lease under this subsection

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

(2) may be required to pay a reasonable application fee, as the commissioner may determine, as a condition of submitting or processing the lease application or obtaining the lease.

(c) Within 20 days of receipt of a lease application, the director shall give notice of receipt of the lease application and call for comments from the public. The director's call for public comments must provide opportunity for public comment for a period of 60 days. If, after review of available information, the director determines it is in the state's interest to enter into a lease for the area described in (b) of this section, the director shall execute the lease within 90 days after the close of the public comment period or, if review is required under AS 46.40, within 30 days after the final consistency determination is made under AS 46.40. A lease entered into under this subsection gives the lessee the exclusive right to explore for, develop, and produce, for a term of three years, natural gas on the state land described in the lease; the right to explore for, develop, and produce is limited to gas derived from natural gas within 3,000 feet of the surface.

(d) A lease shall be automatically extended if and for so long thereafter as gas is produced in paying quantities from the lease. A lease issued under this section

1 covering land on which there is a well capable of producing gas in paying quantities
2 does not expire because the lessee fails to produce gas unless the lessee is allowed
3 reasonable time to place the well on a producing status. If drilling has commenced on
4 the expiration date of the primary term of the lease and is continued with reasonable
5 diligence, including such operations as redrilling, sidetracking, or other means necessary
6 to reach the originally proposed bottom hole location, the lease is extended for one year
7 and for so long thereafter as gas is produced in paying quantities. A gas lease issued
8 under this section that is subject to termination by reason of cessation of production does
9 not terminate if, within 90 days after production ceases or a longer period determined at
10 the discretion of the director, reworking or drilling operations are commenced on the land
11 under lease and are thereafter conducted with reasonable diligence during the period of
12 nonproduction. In addition, upon application by the lessee, the director may once extend
13 a lease issued under (c) of this section for a period of not more than three years.

14 (e) The director may, following the procedures described in (c) of this section,
15 adjust the boundaries of a lease entered into under this section as may be necessary to
16 ensure development of natural gas within a reasonably compact area; a lease as adjusted
17 under this paragraph remains subject to the acreage limitations set out in (b)(1) of this
18 section.

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

28 (g) The royalty payable on natural gas produced from a lease is 6.25 percent of
29 the value of the production removed or sold from the lease, the production to be
30 delivered in pipeline quality and free of all lease expenses, including but not limited
31 to separation, cleaning, dehydration, gathering, salt water disposal, and preparation for
32 transportation off the lease.

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

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

6 (2) the lease may not be transferred or assigned until a well capable of
7 commercial production of gas has been drilled on the lease; however, this paragraph does
8 not prohibit the lessee from entering into a farm out agreement or similar arrangement
9 with a third party under which the third party assists in exploration and development of
10 production from the lease if the agreement or arrangement does not require a payment
11 of consideration by the third party to the lessee, except that the lessee may retain an
12 overriding royalty interest in the lease or may retain a net profit or other production
13 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) A lease does not give the lessee the right to produce oil. A lease does not
22 give the lessee the right to produce gas from sources that are not within 3,000 feet of the
23 surface. If an onshore well drilling for natural gas under a lease authorized by this
24 section penetrates a formation capable of producing gas below 3,000 feet of the surface,
25 the owner or operator

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

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

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

5 (l) A lessee obtaining a lease under this section may exercise the rights
6 authorized by this section and the lease. The rights granted by the lease must be
7 exercised in a manner that does not unreasonably interfere with eventual development
8 of the coal deposit on the land leased. Consistent with the principle of reasonable
9 concurrent uses as set out in art. VIII, sec. 8, of the state constitution, the state may
10 also lease the land under AS 38.05.150. However, in a lease entered into under
11 AS 38.05.150 for land that is already leased under this section, coal may not be mined
12 or extracted by the coal lease from the coal lessee without prior agreement with the
13 lessee holding the lease issued under this section.

14 (m) Except as otherwise specifically provided in this section, the provisions
15 of AS 38.05.135 - 38.05.184 apply to leases entered into under this section.

16 (n) In this section, "lease" means a shallow gas lease authorized by this section.

17 * **Sec. 6.** AS 38.05.180(f) is amended to read:

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

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

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

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

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

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

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

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

22 * **Sec. 7.** AS 46.03.100(f) is amended to read:

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

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

29 (2) landscaping;

30 (3) water well drilling, geophysical drilling, or coal bed methane
31 drilling or other natural gas drilling to recover gas from a reservoir at a depth of

1 **less than 3,000 feet**; 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.

11 * **Sec. 8.** AS 46.04.030(b) is amended to read:

12 (b) A person may not cause or permit the operation of a pipeline or an
13 exploration or production facility in the state unless an oil discharge prevention and
14 contingency plan for the pipeline or facility has been approved by the department and
15 the person is in compliance with the plan. **This subsection does not apply to an**
16 **onshore exploration facility used solely to explore for shallow natural gas by**
17 **means of drilling a well on a lease authorized under AS 38.05.177.**

18 * **Sec. 9.** AS 46.04.030 is amended by adding a new subsection to read:

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

21 (1) shall notify the department and the Alaska Oil and Gas
22 Conservation Commission; and

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

28 * **Sec. 10.** AS 46.04.040(b) is amended to read:

29 (b) A person may not cause or permit the operation of a pipeline or an
30 exploration or production facility in the state unless the person has furnished to the
31 department, and the department has approved, proof of financial ability to respond in

1 damages. Proof of financial responsibility required for

2 (1) a pipeline or an offshore exploration or production facility is
3 \$50,000,000 per incident;

4 (2) an onshore production facility is

5 (A) \$20,000,000 per incident if the facility produces over
6 10,000 barrels per day of oil;

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

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

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

13 (3) an onshore exploration facility is

14 **(A) \$25,000 per incident for a facility used solely to explore**
15 **for shallow natural gas by means of drilling a well to explore for and**
16 **develop gas, whether methane associated with and derived from coal**
17 **deposits or otherwise, from a source that is within 3,000 feet of the**
18 **surface; and**

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

21 * **Sec. 11.** AS 46.04.040 is amended by adding a new subsection to read:

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

27 * **Sec. 12.** AS 46.04.050 is amended by adding a new subsection to read:

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