

ALASKA STATE LEGISLATURE  
**SENATE RESOURCES COMMITTEE**

February 27, 2002  
3:43 p.m.

**MEMBERS PRESENT**

Senator John Torgerson, Chair  
Senator Gary Wilken, Vice Chair  
Senator Rick Halford  
Senator Robin Taylor  
Senator Ben Stevens  
Senator Kim Elton  
Senator Georgianna Lincoln

**MEMBERS ABSENT**

All Members Present

**COMMITTEE CALENDAR**

CS FOR HOUSE BILL NO. 241(RES)

"An Act relating to a railroad utility corridor for extension of the Alaska Railroad to Canada and to extension of the Alaska Railroad to Whitehorse, Yukon, Canada."

HEARD AND HELD

SENATE BILL NO. 319

"An Act relating to shallow natural gas leasing; and providing for an effective date."

MOVED CSSB 319(RES) OUT OF COMMITTEE

SENATE CONCURRENT RESOLUTION NO. 28

Establishing the Joint Legislative Salmon Industry Task Force.

MOVED CSSCR 28(RES) OUT OF COMMITTEE

**PREVIOUS COMMITTEE ACTION**

HB 241 - See Transportation minutes dates 1/31/02.

SB 319 - No previous action to record.

SCR 28 - No previous action to record.

**WITNESS REGISTER**

SENATE RES COMMITTEE

-1-

February 27, 2002

Representative Jeanette James  
Alaska State Capitol  
Juneau, AK 99801-1182  
**POSITION STATEMENT:** Sponsor of HB 241.

Mr. Bill Britt  
Gas Pipeline Coordinator  
Department of Natural Resources  
400 Willoughby Ave.  
Juneau, AK 99801-1724  
**POSITION STATEMENT:** Commented on HB 241.

Mr. Dick Mylius, Director  
Division of Mining, Land and Water  
Department of Natural Resources  
400 Willoughby Ave.  
Juneau, AK 99801-1724  
**POSITION STATEMENT:** Commented on HB 241.

Mr. James Kubitz  
Vice President, Real Estate  
Alaska Railroad Corporation (ARRC)  
P.O. Box 107500  
Anchorage AK 99510-7500  
**POSITION STATEMENT:** Commented on HB 241.

Ms. Phyllis Johnson  
Vice President and General Counsel  
Alaska Railroad Corporation  
P.O. Box 107500  
Anchorage AK 99510-7500  
**POSITION STATEMENT:** Commented on HB 241.

Mr. Mark Sexton, President and CEO  
Evergreen Resources Alaska Corporation  
**POSITION STATEMENT:** Supported SB 319.

Mr. Dave Lappi, President  
Lapp Resources, Inc.  
4900 Sportsman Dr.  
Anchorage AK 99502  
**POSITION STATEMENT:** Supported SB 319.

Ms. Judy Brady, Executive Director  
Alaska Oil and Gas Association (AOGA)  
121 W. Fireweed  
Anchorage AK 99503  
**POSITION STATEMENT:** Supported SB 319.

Mr. Kevin Tabler  
Manager of Lands and Government Affairs  
UNOCAL  
P.O. Box 196247  
Anchorage AK 99510  
**POSITION STATEMENT:** Supported SB 319.

Ms. Charlotte McKay  
Senior Administrator of Environmental and Regulatory Affairs  
Tech-Cominco AK  
No address provided  
**POSITION STATEMENT:** Supported SB 319.

Mr. Ken Boyd  
Oil and Gas Consultant  
No address provided  
**POSITION STATEMENT:** Supported SB 319.

Mr. Jim Haynes, Lease Administrator  
Division of Oil and Gas  
Department of Natural Resources  
550 W 7th Ave., Ste 300  
Anchorage AK 99801-1724  
**POSITION STATEMENT:** Supported SB 319.

Mr. Ian Fisk  
Staff to Senator Austerman  
Alaska State Capitol  
Juneau, AK 99801-1182  
**POSITION STATEMENT:** Commented on SCR 28.

Ms. Sue Aspelund, Executive Director  
Cordova Fishermen United  
P.O. Box 939  
Cordova AK 99574  
**POSITION STATEMENT:** Supported SCR 28.

Mr. Chris Berns  
P.O. Box 26  
Kodiak AK 99615  
**POSITION STATEMENT:** Supported SCR 28.

Mr. Oliver Holm  
P.O. Box 3865  
Kodiak AK 99615  
**POSITION STATEMENT:** Supported SCR 28.

**ACTION NARRATIVE**

**TAPE 02-5, SIDE A**

Number 001

#HB241

**HB 241-RAIL AND UTILITY CORRIDOR TO CANADA**

**CHAIRMAN JOHN TORGERSON** called the Senate Resources Committee meeting to order at 3:43 p.m. and announced HB 241 to be up for consideration.

REPRESENTATIVE JEANETTE JAMES, sponsor of HB 241, said she filed this legislation to increase the size of the transportation and utility corridor from 300 to 500 ft. wide. A corridor from Fairbanks to Seward has been identified; this bill would create a railroad connection to the North American rail system. She has had a lot of support for this idea from the Canadians, as well as from within the state. The accelerated interest is due, in part, to Senator Murkowski's effort to support a bilateral commission to do a feasibility study at the federal level. However, the Canadians will have to do the same, so while the U.S. has appropriated \$6 million for this three-year process, no funds have been expended yet.

HB 241 authorizes the Alaska Railroad Corporation (ARRC) to survey on the ground and monument the corridor. Right now there is great interest in building a gas pipeline along the same route and she wants to be sure that neither the gas line nor the railroad exclude the other by taking a position that doesn't leave anything for the other. In discussions with the gas producers, it has become apparent that there may be some synergies between the two.

This particular legislation authorizes ARRC to investigate extension of the railroad to White Horse, Yukon Territory. She personally thought this would be a hand out to Canada. The other issue is that the White Pass Railroad could go to White Horse, but currently it only goes as far as Carcross. The Canadians have indicated to her that if the Alaska Railroad went to White Horse, they would extend their schedule to go there, too. This would open the deep-water port of Skagway to that part of Alaska and the Yukon.

The part of the bill that may be more controversial provides that once ARRC has received the funds to do the surveying, the state would transfer the state land within that corridor to ARRC.

REPRESENTATIVE JAMES said that many things have changed since an aerial survey was done 20 years ago and it may well be that some changes in the direction of the already delineated route would

have to be made. NASA did a fly-over with a high-resolution evaluation of the whole area two years ago that is currently being mapped by the Department of Natural Resources (DNR) and will soon be finished.

In 1994 a route from Fairbanks to the Seward Peninsula was authorized that excluded the requirement in Title 38 to identify the use of the lands. She reminded the committee that ARRC has eminent domain authority and that it is looking at a transportation and utility corridor wide enough to possibly include fiber optics or anything else that would need to go in the corridor in the future.

CHAIRMAN TORGERSON said the first issue he wanted to discuss was on page 2, lines 18 - 22. It gives DNR the authority to transfer the land without legislative review. He has heard rumblings that [legislators] would like to see a report when it's completed and then do the final transfer.

REPRESENTATIVE JAMES said that would not necessarily negatively affect the direction she is going in.

CHAIRMAN TORGERSON said the committee requested a legal opinion on the reference to AS 42.40.370, which transfers all subsurface rights, including the surface materials, mineral rights, the right to use the timber, etc. to the corporation, but clearly the [legislature] is not interested in giving the oil and gas to ARRC. If they happen to build a road, they don't want to transfer it and then buy the gravel back either. So, they are working on an equal access issue to where the state would take care of a lot of the right-of-way if needed, but still achieve the purpose they want for ARRC.

REPRESENTATIVE JAMES said she had no problem with that either. She never intended to include the subsurface rights with the exception of gravel, which ARRC will need. She had discussed this with ARRC and they were working on language about who would manage the gravel while giving the state access to it.

CHAIRMAN TORGERSON next questioned giving ARRC the authority to own property in Canada in the last sentence in the bill, which says, "the corporation may acquire land or interest in Canada".

4:00 p.m.

SENATOR TAYLOR said he was concerned that the fiber optic contract alone renders a significant income and that the state should manage those revenues.

REPRESENTATIVE JAMES said she shares his concerns and she would not have sponsored this bill if she didn't believe that this is going to benefit Alaska as a whole. She noted that Alaska has a lot of stranded resources that have the potential to be developed if better connections were available. It appears to her that, for safety reasons, wherever ARRC has a right-of-way, that land should be managed by ARRC.

SENATOR TAYLOR expressed concern about giving ARRC title to the 500 ft. width. He questioned, "Why don't they just have a right-of-way or easement for the use of that portion, but not an exclusive right-of-way or easement." He said that he would give ARRC the exclusive right to run the railroad on a 100 ft. corridor but cautioned, "I wouldn't give them the exclusive right to control all other uses that might be compatible with theirs."

REPRESENTATIVE JAMES said currently ARRC has fee simple title to its railroad corridor and she believes it should all be the same. She assumed that the basic minimum is 100 ft. for one track and that they would need some double tracks and ancillary things along the way. She said she didn't think the existing corridor is going to work for future needs. She added:

If there is an EIS to do for the Railroad down there, I was of the opinion that we could do the whole thing at once and so when it comes to putting a transmission line down, it'll be already done..

She said she didn't agree with Senator Taylor that it was that much of a problem and in Fairbanks ARRC is working with federal money to make separated grade crossings over 46 different at-grade crossings. She noted, "The goal is to have separated grade crossings, not at-grade crossings."

SENATOR LINCOLN commented the bill provides for "at least" a 500 ft. corridor, but that is just a minimum. She asked if there was a reason to have a minimum and no maximum.

REPRESENTATIVE JAMES replied there is a reason, that being the corridor needs to be wider in some areas to allow for turning, double tracks and other things a railroad needs, but those locations can't be determined until a survey is done.

SENATOR LINCOLN asked what the maximum could be.

REPRESENTATIVE JAMES said she didn't think they could know that until the survey is complete. She reiterated that nothing would happen until the survey and monuments were actually done on the

ground and people knew what was required and where.

SENATOR ELTON said the bill proposes that ARRC can identify a corridor (page 2, lines 18 to 23) in accordance with cited statutes and convey state land within the railroad utility corridor. He asked who will negotiate if there are prior claims on that land, whether they be mineral claims or farm leases.

REPRESENTATIVE JAMES replied that it is her understanding that if DNR were to transfer any land to anyone for any reason, it would have to identify the existing rights, whatever they happen to be. Generally, if a piece of property that has existing rights on it is purchased, you either make an agreement of compensation or provide satisfaction or you accept the land with the existing rights. She assumed this transfer would be handled in the same way, but it needs to be clearer in the statute.

SENATOR ELTON said he understood then that it wouldn't be up to DNR. It would be up to ARRC to extinguish those previous existing rights that might conflict with ARRC's use and ARRC would incur any costs associated with extinguishing those rights.

REPRESENTATIVE JAMES responded that she thought that is how it would work.

SENATOR TAYLOR asked what was meant by "associated rail land" on line 17 and in several other places.

REPRESENTATIVE JAMES said she understood that to mean sites and other kinds of facilities along the line, including passenger and freight stations.

SENATOR TAYLOR asked if they would be outside the corridor.

REPRESENTATIVE JAMES said she thought it would be part of the corridor.

SENATOR TAYLOR asked if there was a definition of "associated rail land" and whether it could go beyond the intended 500 ft. He wondered if "associated rail land" meant lands beyond 500 ft.

REPRESENTATIVE JAMES replied that they can't specifically describe what they need until the legislature authorizes the on-the-ground survey.

CHAIRMAN TORGERSON said he thought that is the reason the legislature wants to review the findings. He said he would set the bill aside and work with the sponsor to resolve some of the issues.

SENATOR LINCOLN asked if DNR would testify today.

MR. BILL BRITT, Gas Pipeline Coordinator, said that a majority of DNR's concerns had already been identified. He explained:

First, there is likely to be some overlap between the railroad corridor and the gas pipeline right-of-way as has been indicated. Any gas pipeline right-of-way lands transfers the railroad would stake [indisc.] authorization, construction, operation, maintenance and [indisc.] of the gas pipeline. The transfer would also reduce the lease payment and may also affect the tariff.. This is not an abstract concern, given that the railroad [indisc.] about 10 times what the state does for fiber optics right-of-way.

Having the contract returned for review should be considered so that other state interests can be identified. The bill should also make conveyance subject to third party interests, a concern that Senator Elton brought up. The state's mineral rights need to be protected as well and the transfer should be made subject to AS 38.05.125. The bill does not protect public use and access within and across the corridor. At a minimum, the bill should make the transfer subject to AS 38.05.127, retaining access along navigable waterways. He suggested the committee might want to do more. The bill also needs to clarify who will bear the expense associated with the conveyance and there doesn't appear to be an upper limit on the amount of land that can be conveyed.

CHAIRMAN TORGERSON asked him the difference between AS 38.05.125 and AS 38.05.035.

MR. DICK MYLIUS, Director, Division of Mining, Land and Water, Department of Natural Resources (DNR), answered that AS 38.05.125 is language DNR uses when conveying land out of state ownership while it retains the mineral rights.

CHAIRMAN TORGERSON asked if he agreed that AS 42.43.070 transfers mineral rights.

MR. MYLIUS said that is DNR's understanding of it.

SENATOR ELTON noted that the only fiscal note in the packet affects DCED and was written by the staff to the Senate Transportation Committee. He thought DNR should prepare one also.

SENATOR TAYLOR asked if ARRC's purpose could not be just as well provided for with an easement within a declared utility corridor that was retained and owned by the state.

MR. JIM KUBITZ, Alaska Railroad Corporation, replied that depends

on what you want to accomplish. ARRC hopes this business will be profitable or it may need to do other things on the land until it is. He also explained that every once in a while you have to turn a train around and that can't be done in a 500 ft. corridor. So, every fifty miles or so ARRC will need a bigger piece of land on which to do that.

SENATOR TAYLOR asked if that could also be accomplished by an easement.

MR. KUBITZ said it could probably be accomplished by an exclusive easement.

SENATOR TAYLOR said he wanted ARRC to stay in the railroad business. He maintained, "I don't intend to give you I don't how many thousand acres of land and resources and mineral rights so you can go into the oil drilling business or go into the land selling business or the land leasing business..."

MS. PHYLLIS JOHNSON, general counsel to the Alaska Railroad Corporation, added:

From the Railroad's perspective, certainly we don't have to have full fee title. It's an administrative convenience to treat all the land we're involved with the same way, but we can certainly differentiate. What we would need to be especially careful about, though, is in crafting or defining the language that creates this easement interest, even if we don't say exclusive - because I know that raised a few eyebrows just a second ago when Jim said exclusive - we feel the need to be able to have a very strong say about other activities. Again, we get back to the safety sort of angle of things. So, even if we have an easement, we would need to be careful about how we define it so the Railroad can protect both itself and the public and the environment and all the interests there from those kind of peculiar railroad hazards that goes along with the kind of business we're in...You can call it an easement or a duck as long as we're able to protect those important public interests.

CHAIRMAN TORGERSON asked why the legislature would want to give ARRC authority to own land or interest in Canada. He asked if it is an important provision.

MR. KUBITZ replied that all ARRC is after is to be able to control its corridor and right-of-way for its own reasons.

MS. JOHNSON asked them to envision the border and the interchange

with other rail lines and other activities; ARRC would need a fairly spread out area to work in there. ARRC envisions buying a little additional land to make it work out right at the border.

CHAIRMAN TORGERSON said they would work on language with them.

SENATOR TAYLOR asked if she could draft a paragraph indicating what the essential elements are of an easement providing for a priority of use by the railroad, but not an exclusive use.

MS. JOHNSON said she could take a stab at it and use the Federal Transfer Act as her guide, because that would cover the most important interests that need to be protected.

CHAIRMAN TORGERSON said they would hold this bill for further work.

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4:30 p.m.

#SB319

#### **SB 319-SHALLOW NATURAL GAS: LEASING & DISCHARGES**

CHAIRMAN TORGERSON announced SB 319 to be up for consideration.

MR. DARWIN PETERSON, staff to Senator Torgerson, told members:

SB 319 is an act related to shallow natural gas leasing. Shallow gas leasing was originally proposed as a program that would enable exploration and production of shallow natural gas deposits. One of the features of the program is to encourage a new energy supply to villages, mines and other rural users. The program is fully operational with over 100 leases processed and nearly 200 more pending. The program has become a vehicle for commercial gas development in Fairbanks, Big Delta, Mat-Su Valley and the Lower Kenai Peninsula. SB 319 is intended to advance the program into a more robust and viable commercial program that should benefit all parties. Because the program has become more commercial in nature, increasing revenues from application fees and annual rental fees is appropriate. The program will still neither involve competitive bidding nor require bonus bids. However, application fees for shallow gas leases have been increased from \$500 to \$5,000 and an annual rental fee has been increased from \$0.50 to \$1.00 per acre. The increased fees are designed to increase revenue and pay for the program costs while not discouraging parties of genuine

interest and ability from developing shallow natural gas resources.

The requirement that DNR annually notify a lessee by certified mail of rent due has been deleted. Rent would automatically be due on the date determined in the lease. Deadlines have proved to be unworkable and do not recognize the work required by DNR to prepare leases in areas that are populated and may have complex land ownership patterns. The limitation on depth to 3,000 ft. has been replaced with the requirement that some portion of the field must be within 3,000 ft. The total amount of acreage that may be held by shallow natural gas lessees has been increased from 46,080 acres to an aggregate of 100,000 acres. The acreage increase reflects the fact that large acreage may be necessary as a shallow gas program. The requirement that the applicant conduct a title search will be removed. DNR routinely conducts a title search for land before leases are issued. Additionally, there are no title companies that will conduct a thorough title search of the subsurface estate and warranty title. These changes will improve reservoir management...

**TAPE 02-5, SIDE B**

MR. PETERSON continued:

New bonding provisions would demonstrate lessees are fiscally responsible and would help protect surface owners. The lessee must secure the bond as a precondition to obtaining the lease. In the event that the surface estate is owned by a private property, an additional bond may be required if the lessee and the private party cannot reach an agreement. Lessees will have from July 1, 2002 through September 30, 2002, approximately 90 days to convert leases from the existing program to the new program if they so choose.

MR. MARK MYERS, Director, Division of Oil and Gas, Department of Natural Resources (DNR), said that DNR strongly supports SB 319, which recognizes that the original intent of shallow gas leasing was to provide rural energy in remote areas. It would take many leases to provide sufficient energy to the rural villages. That was the original intent, but the program quickly evolved into a commercial program. Right now there are pending leases on 1.3 million acres of land. The leases are clustered near fairly large residential areas and communities of Fairbanks, the Big Delta area, the northern Mat-Su area and in the Homer area. Those

leases are appropriated for fairly large-scale commercial gas development, assuming there is shallow gas or coal bed methane or both. DNR looks at the program in terms of what it needs to be an effective commercial program as well as to maintain the original intent if it is used by villages in rural and remote areas. About 1.5% of the leases are in higher density population areas.

DNR tried to come up with some changes to balance everyone's needs and, to that end, worked with AOGA, Cominco, and other folks who have an interest in seeing a successful exploration or the shallow gas leasing program.

MR. MYERS told members that amending the 3,000 ft. depth is a big issue. The problem with 3,000 ft. is that geologic formations for coal or shallow gas typically tip at an angle and often start at 3,000 ft., and continue on below that level. There are fights with the AOGCC over proving the state's rights to get that gas. Another problem is that the 3,000 ft. depth is a surface depth rather than a fixed depth based on sea level, but the terrain undulates. This creates a huge problem from a reservoir management standpoint and furthermore, the coal seams for coal bed methane might extend from a few hundred feet down to depths of 4,500 ft. DNR feels it is fair for the lessee to be able to capture all the reserves in an entire area. For logical development and to maximize production, DNR feels that mineral rights, if the field starts above 3,000 ft., should be for the whole field's accumulation. All parties share this concern.

Regarding changing the fee to \$5,000, it costs DNR \$2,000 to do the title per lease. The current bill does not require DNR to do the title work, but DNR has found that it has to. Private parties cannot get insurance on title work so they have no way to verify the title was done in a reasonable manner without actually retracing it anyway. He pointed out that \$5,000 is less than \$1 per acre for a lease, which is well under any of DNR's competitive leasing terms. They feel the terms are reasonable and affordable.

MR. MYERS said DNR also wants to increase the total acreage from 46,000 acres under the old bill to 100,000 acres maximum per company. The reason is that a coal bed is typically produced in fairly large units of about 70 to 80,000 acres to maximize production. Around a small village this wouldn't be necessary, but in a commercial sense a company typically needs to acquire more acreage.

In terms of raising the rents from \$.50 to \$1 per acre, this is as cheap as they get. The original lease starts at \$1, but accelerates \$.50 each year for the term of the lease. This stays at \$1, which is affordable and provides more revenues to the state. They feel that the state's oil and gas programs should at

least pay for themselves.

MR. MYERS said DNR is concerned that a lot of the current shallow gas leases are in areas where the private land ownership is more complicated than on the North Slope or in some areas of Cook Inlet. DNR is concerned about getting an applicant who has a tradition of oil and gas development that may not understand the process of approvals and may actually enter the land or do damage to it without getting the landowner's agreement. Putting the bond amount up front gives extra protection to the surface owners that the department feels is appropriate. The bond would screen out folks who would not be able to afford the leases and who might cause incidental damage by not getting a final operations permit. This is an assurance to private landowners that they do have some protection, partly necessary because this is an over-the-counter program, not a program where the state selects which areas it's leasing. People apply to DNR and a lease is then granted based on the application.

SB 319 provides a chance for someone to convert from the old program that limits rights to 3,000 ft. to this new program. Several companies want to utilize these leases for commercial development. He stressed that this is an important program to the state in terms of providing energy to Fairbanks and the Homer area.

SENATOR ELTON asked why DNR made the change on page 3, lines 13 and 14, that allows the director to terminate the lease if the renter fails to pay.

MR. MYERS replied that he thought the issue was whether the state has the obligation to be sure to mail out the request or whether it is the lessee's responsibility to make sure to pay the rent. He explained:

We felt that we're not in the mail order business of doing that. We don't do that with our conventional program. So this is an extra expense on the department that a responsible lessee should have no problem in fulfilling in the existing oil and gas program.

SENATOR ELTON asked if DNR still has the authority to terminate a lease if rent is not paid.

MR. MYERS replied that it does.

CHAIRMAN TORGERSON asked him to explain the \$500,000 bonding requirement on page 16.

MR. MYERS responded that the \$500,000 is a statewide bond for oil and gas activities. DNR feels that requiring it upfront assures,

since there are no other qualifications that the lessee has the wherewithal to cover any surface damage caused. If a lessee already has a \$500,000 statewide bond, it shows they are responsible and that recourse is available so the lessee is exempted from the extra \$50,000 requirement.

SENATOR TAYLOR noted that language on page 5, line 23 refers to \$25,000 per incident. He asked if he were to go into the shallow gas leasing business, whether he would have to come up with the \$5,000, pay the \$1 per acre annual fee and also come up with a \$500,000 bond.

MR. MYERS replied that he wouldn't. He added that there are multiple bonds in the state and this bill deals with some of them in addition to adding another one. However, the additional bond on page 5 is a DEC bond that is based on cuttings and weights and other issues that are related to the operation of drilling, not acquiring a lease.

SENATOR TAYLOR repeated his question that if he came up with \$5,000 and the \$1 per acre fee, would he need to have additional bonding before he could get the permits to actually drill a hole.

MR. JIM HAYNES, Permitting, explained that there are three agencies within state government that have bonding requirements. The Alaska Oil and Gas Conservation Commission (AOGCC) requires a \$200,000 statewide bond to plug an abandoned well that may be left improperly in place. DEC's bonding requirements range from a low of \$25,000 to as high as \$121 million, depending on the type of facility. DNR requires a \$100,000 bond for a single well and \$500,000 for a statewide bond, which would include shallow gas. The bill says if you have the \$500,000 bond in place, such as UNOCAL does, no additional bond is required for shallow gas operation.

CHAIRMAN TORGERSON asked if the \$500,000 statewide bond requirement is existing law and the legislation provides an exemption if a company already has one. They indicated that was correct. He asked if they didn't think that was a little low.

MR. HAYNES replied that it hadn't been low so far.

SENATOR TAYLOR clarified if he was going to lease to drill for shallow gas, he would need a \$200,000 bond for the AOGCC to make sure he would plug up any holes that he would leave, a \$25,000 per incident bond, and a \$121 million bond to DEC for whatever it construes the risks to be and then, if he was going to drill more than one single hole, he would have to come up with another \$500,000 for a statewide bond for DNR, which would include this gas.

MR. HAYNES replied that is correct, although he couldn't speak for DEC. The per incident language, if you drill a well with one drilling rig and move it to another hole, is another incident. If you have three drill rigs running, that could probably be construed as three incidents, but he didn't know how DEC would interpret that. He stated, "We're concerned with \$500,000."

SENATOR TAYLOR said the very least he could get by with is \$725,000 in bonding before he could drill a shallow gas hole.

MR. HAYNES said that is correct.

SENATOR TAYLOR indicated that was maybe too much.

MR. HAYNES replied that the question is what is being bonded. Some of the bonds are to make sure the well is abandoned properly, some of them are to protect the surface estate, and others are to deal with oil spill clean-up issues. He explained, "It's not a combined pool that's usable for all these purposes. They are individual bonds for specific purposes that are all different."

MR. MARK SEXTON, President and CEO, Evergreen Resources Alaska Corporation, said that currently Evergreen has 46,080 acres of shallow gas lease applications located in the Willow area pending with DNR. He supports SB 319, which removes obstacles to Evergreen's ability to explore for and develop shallow natural gas. He told members:

Evergreen Resources Alaska's functional specialties extend to Alaska the main focus of Evergreen Resources, which is unconventional natural gas extraction such as coal bed methane extraction and other shallow natural gas development. These activities require at least 100,000 acres to establish the necessary economies of scale for an initial developing program. We strongly support increasing the depth limitation to one that relies on science and geology for the specific geologic play in concept. We're certain we can drill, complete and produce natural gas wells below 3,000 in a safe and environmentally responsible manner using the currently existing technologies that we already employ every day.

Finally, Mr. Chairman, the shallow natural gas program is the primary reason Evergreen is in Alaska and we're grateful that the legislature is making this program possible as well as improving it. The changes proposed in this bill do provide us the necessary latitude to operate in an economically sound and environmentally safe manner and we acknowledge the Division of Oil and

Gas for collaborating with us and other stake holders. This is in our mind an excellent example of how state agencies and industry can work together to the benefit of all interested parties, including and particularly the public. Thank you for allowing me to testify today.

MR. SEXTON said John Kanegawa, Alaska Projects Manager, and Jack Engstrom, Public Affairs, would be in Juneau Thursday and Friday to provide further information.

SENATOR TAYLOR asked if he could give the committee a comparison of the bonding requirements required from a company like his in other states where there is shallow gas.

MR. SEXTON replied that it varies from state to state and in general it's quite a bit less in Colorado, which requires a \$25,000 statewide bond. There is a separate \$25,000 bond for operating within federal units.

SENATOR TAYLOR asked if the requirements in other states are that dramatically less than in Alaska where the minimum bonding requirement to punch the first hole is \$725,000.

MR. SEXTON said that is right:

But it really has come down to the fact that even as large as those numbers are, when you look at the cost of bonds, bonding really represents a small portion, just a few percent of the total cost to drill, complete and produce a shallow gas well. If an operator cannot afford a bond, even if it's just a \$500,000 statewide oil and gas bond, it's probably unlikely that they will have the financial resources to successfully drill and produce a single exploration well, much less implementing a full multi-well program in an orderly development way I think the state wants to see.... The operators who can afford to do this type of program could easily afford this type of bonding.

SENATOR TAYLOR said that is why he is concerned, because through this guise, the state may very well be excluding this activity to a limited club of operators who can afford to do the drilling. He understands that over 30% of the oil produced in the United States today comes from wildcatters and a higher percent than that comes from wildcatters drilling for gas. He didn't think it encouraged them to go out there if the only boys that can play in the game have to have a million dollar check before they can show up.

MR. SEXTON responded that it is going to be more costly to do

business in Alaska. Evergreen has taken the approach that to do this right, it has to plan to develop at least 100,000 acres to get the proper economies of scale. He said that in populated areas such as the Mat-Su, infrastructure and services are generally available as opposed to the effort that would be required to drill a few wells in outlying villages where the market is limited. Alaska should deal with well-financed ethical companies that are going to be able to do it right, because while the cost for Alaska can be quantified relative to drilling wells in Oklahoma or Kansas, the reality is the cleanup costs in Alaska, especially in remote areas if someone doesn't do it right, would be greater than down south where services and equipment are more readily available. He reminded members that Evergreen is planning to bring in specialized drilling rigs and specialized fracture stimulation and completion equipment to do the work in Alaska, which currently doesn't exist.

CHAIRMAN TORGERSON said that Senator Taylor is making a comparison to one well and there is no such thing as a one well methane shallow gas field that he knows of. He offered, "There's maybe 1,500 wells to a field... and \$500,000 is a bargain."

MR. SEXTON said that he was looking forward to proving that statement true.

MR. DAVE LAPPI, President, Lapp Resources, Inc., supported SB 319 and said:

The proposed bonding to cover damages to the surface will reduce the cost to the Division of Oil and Gas in administering these provisions while providing good protection to local resources.

The 100,000-acreage limitation will allow companies to establish the larger acreage positions necessary to justify the risks and expenses in developing the new resource. He discussed raising the fees to cover the increased administrative costs with the division and he thought it would be nice if monies to cover the increased costs could be raised closer to the source of the expense (the drilling and production phase) rather than at the application stage. He thought it was in the best interest of the state not to shortchange the Division of Oil and Gas, which manages the source of the vast majority of our state's income.

He supported changing the exploration level to below 3,000 ft. because it will increase the potential gas resource available under this program while reducing the cost of developing the deeper horizon. He supported language on page 5 that would eliminate reclassifying shallow gas wells to oil and gas wells on leases other than shallow gas leases. He thought the same language should be used on page 6, line 26, to prevent increased

bonding costs.

MS. JUDY BRADY, Executive Director, Alaska Oil and Gas Association, supported this bill for all the reasons previously heard.

MR. KEVIN TABLER, Manager of Land and Government Affairs, UNOCAL, supported SB 319 and told members:

UNOCAL is conducting an aggressive gas exploration program in the Cook Inlet area and is very interested in any legislation dealing with gas and gas exploration. The shallow gas leasing program augments the existing area wide leasing program and enhances the access to development of the state's natural gas resources. We're very supportive of this program and other leasing programs providing access to the state's mineral wealth. I have listened today to the remarks of Director Myers at the Division of Oil and Gas testifying in support of this bill and wish to lend UNOCAL's support in passage of this legislation..

MS. CHARLOTTE MCKAY, Senior Administrator, Environmental and Regulatory Affairs, Tech-Cominco of Alaska, said Tech-Cominco is partners with NANA Regional Corporation. She wanted to talk about the potential for shale bed methane gas around the Red Dog mine. They employ 400 people, about 60% are NANA shareholders and they produce over one million tons of zinc and lead concentrates per year. She said:

To crush the ore and make the concentrate requires about 28 megawatts of power using approximately 18 million gallons of diesel per year that we transport to the port and then up the road by truck on a daily basis. Replacing the diesel consumption with gas would reduce our air emissions by half as well as reduce the risks of the oil transport to the port, the storage and the transfer up to the mine site.

She showed the committee a picture of the terrain at the Red Dog Mine, which is not flat like Mat-Su or Prudhoe Bay. It is very rugged and they need a more flexible determination for the depth limitation for the shallow gas lease. It would be very difficult to follow a surface depth at Red Dog.

MS. MCKAY said that currently, Tech-Cominco holds four state shallow gas leases for about 23,000 acres and NANA has the adjoining land to the east where there is nearly 100,000 acres. The current lease limitation of 46,000 acres to any one company is not sufficient for the project and they support the 100,000-

acre limit as well as the fee changes, if the monies remain within the shallow gas program. Otherwise, they would find it an expenditure that would not be good for business.

Development of shallow gas fields in Northwest Alaska have many impediments and location is the major one due to access and the ability to bring large equipment in and out only in the summer months. They do not have access by ice roads in the winter months. She explained:

It's very difficult, if not impossible, to test a shallow gas lease within the three years provided in the current lease when work is so seasonal. Logic would say a lease should be at least five years for a primary term with renewal options as provided in the current lease. Although this is not provided in the legislation, we would support a five-year term with renewal options. Development of a shallow gas field is much different than a conventional field in Cook Inlet or on the Slope. Instead of 2 to 5 holes to develop a gas field, it would take 50 to 100 holes and the cost per hole needs to be kept at a minimum or a field becomes uneconomic quickly.

To date, Cominco has opportunistically piggy-backed on the mineral exploration effort in the Red Dog area as a tool to defray the costs and delineate the areas for potential gas resource. The methane gas we have found is low pressure and is located lateral to and underlying the ore zones. Extensive work has been completed to date using the mineral exploration tools, but the next phase is to conduct the flow test to see if that gas will let loose. This flow test cannot be supported until the depth below the surface of a field is better defined. We have already found gas down 2 - 3,000 ft. and we know it's at least that deep and the geologic structure indicates it will go considerably deeper. Arctic operations will always present numerous challenges not present elsewhere. Tech-Cominco Alaska and NANA address these each and every day at Red Dog. By passing this legislation, you will help us address some more.

SENATOR TAYLOR asked if she wanted a five-year term.

MS. MCKAY replied yes.

SENATOR TAYLOR explained that the legislature does not have the ability to dedicate funds so keeping the revenues within the

shallow gas program may be beyond their capacity. Even program receipts are subject to the appropriation by the next legislature.

SENATOR LINCOLN said the bill addresses wells "within" 3,000 ft. of the surface and asked if that language is a problem.

MS. MACKAY replied that this bill would allow a well to go deeper if they are within the same resource unit.

MR. MYERS said that there is also discretion to add three years to the five-year term. He said that production on a larger scale would be from unitized production, particularly in their area where there are two different subsurface owners.

**5:10 p.m.**

MR. KEN BOYD, Oil and Gas Consultant, said he was representing himself, but that he was director of the Division of Oil and Gas when this program was originally established in 1996. He supported the changes in the bill. Extending the 3,000 ft. depth and increasing the number of acres just increases the opportunity to use the bill. The increase in fees is appropriate and the bonding may help by giving the landowners more comfort.

**5:12 - 5:16 AT-EASE**

SENATOR HALFORD said his concern is that in these kinds of operations, multiple rigs are operating in fairly high densities. He is worried that a \$500,000 bond for surface damage will not be enough. He wanted to hear what the Division has to say about the level of the bond when it's applied statewide, because he thought there would be more and more conflicts between the people who own the surface estate and the subsurface. Most people don't understand that they don't control authority over the subsurface estate. He noted, "In fact, it's reversed."

MR. MYERS replied that they should keep in mind that the risk wouldn't occur all at once. The \$500,000 has to be replenished if there are multiple, simultaneous draws on that individual bond. He thought the bonding issue needed to be reviewed in the sense of their overall oil and gas program where there's oil risk as well. He explained, "I think we're comfortable with the current levels, but if we do look at more, I think it needs to be looked at in regards to the conventional program as well." He said they have the authority to request larger bonds if there is unusual risk.

SENATOR HALFORD said there is a difference in the kind of expectations from parcels and the expertise of the people involved when you're dealing with small subdivision lots in small

parcels of land.

MR. MYERS concurred with that and said DNR needs to be concerned about the economic effect on the industry as well.

SENATOR HALFORD asked what he thought the cost of a \$500,000 bond would be for a reasonable sized independent company.

MR. MYERS replied that he thought it was about 20% of the bond amount. He added that depended on market conditions that change.

SENATOR HALFORD asked if that is a cost that is annually earned or an amount that has to remain in escrow.

MR. MYERS replied that it is an annual premium.

**TAPE 02-6, SIDE A**

SENATOR ELTON asked if reservations were expressed during the public comment period that the director or the department would be able to negotiate the bond price.

MR. HAYNES replied that under AS 38.05.130(a), a surface owner (either party) who cannot come to terms with proposed activity on his land has the right to request a hearing by the director of the Division of Oil and Gas. They had experience with that a few years ago and it was peacefully resolved. They hoped the new legislation with \$500,000 in place would allow them to tell someone who wanted a hearing that they are entitled to it, but \$500,000 is a pretty high bond and it's in place for the surface owner's benefit.

SENATOR TAYLOR asked if they are allowed to exceed that amount if they determine there is a greater risk.

MR. HAYNES replied yes. He said that Alaska's oil and gas business is changing and for the first time [companies] are going into areas that are not only residential, but areas with complicated ownership patterns. DNR is aware of it and is dealing with it.

SENATOR HALFORD asked if determinations are all made on a very large area before the actual location of where somebody is going to drill is even considered.

MR. HAYNES replied no and that there is no best interest finding as the state does with conventional sales or with its exploration licenses. The environmental requirements are adjusted area by area; the bonding requirements are more specific and are geared toward the risks of a particular operation. The lease operation approval process that occurs looks at each individual activity

whether it is putting a road in or drilling a well or shooting seismic.

SENATOR HALFORD asked if a site could be in a 10-acre lot within a 100,000 acre area wide activity.

MR. HAYNES replied that one of the concerns is that the surface owner, should it be different than the state, needs to have clear protection. The up-front bonding requirement provides some protection against surface damage if a person got on that site prematurely with his bulldozer and decided he wanted to clear a path to his well. Secondly, when they went to their final operations, they would have enough protection for that surface owner in addition to the other bonds to deal with the other risks.

SENATOR HALFORD commented, "I hope they never get to the point where they end up draining some large recreational lake, because I think they're going to have a lot more money involved."

SENATOR TAYLOR moved to delete "competition" and insert "completion" on page 3, line 1. There were no objections and the amendment was adopted.

SENATOR TAYLOR moved to pass CSSB 319(RES) from committee with individual recommendations. There were no objections and it was so ordered.

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#SCR28

**SCR 28-JOINT LEGIS SALMON INDUSTRY TASK FORCE**

CHAIRMAN TORGERSON announced SCR 28 to be up for consideration.

MR. IAN FISK, staff to Senator Austerman, sponsor of SCR 28, said:

I know that the Senate Resources Committee is well aware of the crisis in Alaska's salmon industry and well aware of the gravity of that crisis. What this resolution does is allow the legislature to step up to the plate and provide some real leadership to find solutions to the salmon industry's problems. Previous summits, there have been three of them, that the Administration organized on this issue made some strides and members of the industry put some good effort into those. We will review the findings of those summits, but they have essentially amounted to a strike out. We're going to step up to the plate and we might

not hit the homerun that wins that game, but we'll at least get a few men on base.

MR. FISK reviewed the changes in the committee substitute.

SENATOR TAYLOR moved to adopt the CS, Version L\Utermohle 2/27/02, to SCR 28. There were no objections and it was so ordered.

SENATOR HALFORD said they might want to find people who are in a broad sense involved in the commercial salmon industry for the public members. He wanted to make sure that was the intent, because they might be excluding people that might be worthwhile to have on it.

MR. FISK agreed and said that is the intent.

SENATOR ELTON said he thought it would be important to have some one from the transportation industry involved, because that contributes to the cost effectiveness of the industry. He said the language on lines 15 and 16 on page 3 could be construed by some to be in conflict with the further resolved provision on lines 27 - 29 where it says the task force shall be appointed to represent the statewide salmon industry as a whole and not just a particular region or harvesting sector of the industry.

MR. FISK said he was correct and that there wouldn't necessarily be solutions that would affect the industry across the board as each region of the state has particular issues. The intent of the sponsor and this language is to make sure that in selecting members for this task force they don't select people who have a narrow interest in the industry.

SENATOR HALFORD agreed with narrowing the focus to commercial fisheries issues from where it was initially, but said there is one WHEREAS clause that tweaks the other interests unnecessarily - "Whereas allocation issues between commercial fishers and sport fishers are becoming more problematic all the time."

MR. FISK replied that the sponsor wouldn't have any objection to deleting it. He added the intent of the membership is to focus on the commercial industry and to make sure it is well represented on the task force. They would be able to contract out and bring in information from other sources.

CHAIRMAN TORGERSON said he agreed with Senator Halford.

SENATOR HALFORD moved to delete lines 8 and 9 on page 2 and asked for unanimous consent. There were no objections and Amendment 1 was adopted.

SENATOR WILKENS said he has heard a lot about the threat of farmed fish to our salmon industry, but that issue is not addressed and he wondered if it would be appropriate, "Or are we just whistling past the graveyard by not addressing it."

MR. FISK replied that salmon farming is responsible to a large degree for what has changed the market place for our salmon and the task force needs to consider what we can learn from that industry. But there is broad based consensus that it should focus on the strengths of the wild salmon industry to help it better compete. Starting on the bottom of page 2 there is language to that affect.

SENATOR LINCOLN said she didn't have a fiscal note.

MR. FISK replied that they would have a fiscal note before the bill gets to the Finance Committee.

SENATOR HALFORD recommended that the fiscal note be substantial enough to get the kind of expertise it would take to work on this issue. He thought they would need at least \$200,000 and maybe considerably more than that.

CHAIRMAN TORGERSON said there had been some discussion about \$500,000 being available.

SENATOR STEVENS said that they tried to delineate seats on the task force to be held by all the industries. They didn't want to exclude anyone. He stated, "The most important thing is that we get people that understand the business."

SENATOR ELTON said he thought the discussion was on point and that the Legislative Council has approved requests that lead to the kind of purchase of knowledge that we need to make reasonable and rational decisions. He remarked:

Quite frankly, this task force is going to need some staff that is dedicated only to this and I don't think we can go down to the Department of Fish and Game and ask to borrow their people. I don't think they've got people to lend.

MS. SUE ASPELUND, Executive Director, Cordova District Fishermen United (CDFU), supported CSSCR 28(RES). It provides CDFU with the opportunity to begin the very important discussions on how to restructure the evaluation of their industry. They feel that a successful approach will involve three components:

- it must be on a statewide basis and be controlled by Alaskans in Alaska;

- representatives of the salmon industry - fishermen, tenders and processors - must be involved throughout the process from the beginning and at the most basic levels;
- a funding mechanism is necessary to help them move forward since the industry does not have the resources and infrastructure necessary to facilitate the broad based and far reaching considerations that have to occur in order to achieve success.

MS. ASPELUND said she thought it was important to recognize that in order to enable the participation of the processors in these discussions, this process will have to be convened by government in order to address antitrust concerns and the committee substitute does a good job of outlining most of the problems of the industry.

MR. CHRIS BERNS, Kodiak fisherman, supported SCR 28.

MR. OLIVER HOLM, Kodiak fisherman, said he has fished since the sixties and supported SCR 28. He said that the salmon market is world wide and a major cause of the crisis is the price of farmed fish. There are some fair trade issues to look into and there is Japanese and U.S. corporate involvement in Russian salmon hatcheries and processing and Japanese workmen involved in Chilean farms and Alaska salmon processing. SCR 28 should include the examination of these issues. He supported Sue Aspelund's comments about work being done on a statewide basis and involving everyone in the industry.

SENATOR TAYLOR moved to pass CSSCR 28(RES) from committee. There were no objections and it was so ordered.  
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CHAIRMAN TORGERSON adjourned the meeting at 5:45 p.m.