

**ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS**

March 18, 2004

3:25 p.m.

MEMBERS PRESENT

Representative Vic Kohring, Chair
Representative Cheryll Heinze
Representative Jim Holm
Representative Norman Rokeberg
Representative Harry Crawford
Representative Beth Kerttula

MEMBERS ABSENT

Representative Lesil McGuire

COMMITTEE CALENDAR

HOUSE BILL NO. 531

"An Act relating to natural gas exploration and development and to nonconventional gas, and amending the section under which shallow natural gas leases may be issued; and providing for an effective date."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 531

SHORT TITLE: CONVENTIONAL & NONCONVENTIONAL GAS LEASES

SPONSOR(S): RESOURCES

03/04/04	(H)	READ THE FIRST TIME - REFERRALS
03/04/04	(H)	O&G, RES, FIN
03/16/04	(H)	O&G AT 3:15 PM CAPITOL 124
03/16/04	(H)	Heard & Held
03/16/04	(H)	MINUTE(O&G)
03/18/04	(H)	O&G AT 3:15 PM CAPITOL 124

WITNESS REGISTER

REPRESENTATIVE BEVERLY MASEK
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Testified as co-chair of the House Resources Standing Committee, sponsor of HB 531.

MARK MYERS, Director
Division of Oil & Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions relating to HB 531; spoke in support of Amendment 1.

REPRESENTATIVE PAUL SEATON
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Participated in discussion of HB 531 and related issues; offered Amendment 1.

JAMES HANSEN, Title/Lease Administrator
Division of Oil & Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions relating to HB 531.

SETH LITTLE
Alaska Center for the Environment
Anchorage, Alaska

POSITION STATEMENT: Called HB 531 a good step in the right direction for the long term, but expressed concern because it doesn't address problems with the leases already issued.

ACTION NARRATIVE

TAPE 04-11, SIDE A
Number 0001

CHAIR VIC KOHRING called the House Special Committee on Oil and Gas meeting to order at 3:25 p.m. Representatives Kohring, Holm, Heinze, Crawford, and Kerttula were present at the call to order. Representative Rokeberg arrived as the meeting was in progress.

HB 531-CONVENTIONAL & NONCONVENTIONAL GAS LEASES

[Contains discussion of HB 395 and SB 312, the companion bill]

Number 0060

CHAIR KOHRING announced that the only order of business would be HOUSE BILL NO. 531, "An Act relating to natural gas exploration and development and to nonconventional gas, and amending the section under which shallow natural gas leases may be issued; and providing for an effective date."

Number 0105

REPRESENTATIVE KERTTULA advised members that she'd wanted to offer an amendment regarding notice prior to leasing, but hadn't had time to talk to the division. Thus she'd continue to work with the sponsor and the division, and would prepare an amendment for the House Resources Standing Committee.

CHAIR KOHRING emphasized the need to ensure that good legislation leaves this committee that all members are comfortable with. He said he saw no need to rush it, and if the decision is made to hold the bill to address various amendments, that would be acceptable to him. He acknowledged the arrival of Representative Rokeberg.

Number 0293

REPRESENTATIVE BEVERLY MASEK, Alaska State Legislature, spoke as co-chair of the House Resources Standing Committee, sponsor of HB 531. Indicating some amendments would be offered that day, she expressed hope that once they're addressed, the bill will move forward. She said time is of the essence; suggested there will be impacts relating to other resource-development projects statewide; mentioned creating a more sustainable atmosphere for businesses; noted that the Department of Natural Resources (DNR) had conducted workshops in the Matanuska-Susitna area and would come out with a preliminary report; said the bill highlights areas of concern by the public; and told members she hopes they'll "compromise with all the amendments and support for this bill" and pass it out as soon as possible.

CHAIR KOHRING asked why this bill would be better than HB 395, for example.

REPRESENTATIVE MASEK replied that it eliminates over-the-counter, "first come, first served" shallow gas leases, replacing those with areawide leasing or exploration licenses. It requires a best interest finding (BIF) before any oil and gas leasing or exploration licensing occurs. This will give DNR control of what land is leased, avoiding unnecessary surface-owner conflicts. Noting that best interest [findings] are a

time-tested public process, she said this also creates a gas-only section of areawide leasing and exploration licensing identified in a BIF by DNR.

REPRESENTATIVE MASEK continued, saying it differentiates between conventional and nonconventional gas resources for the purposes of lease rentals; defines conventional and nonconventional gas development, and treats each distinctively; recognizes that lease rights shouldn't be determined by depth criteria only; enhances production opportunities; encourages exploration licenses with a BIF as a method for nonconventional gas exploration outside of the areawide leasing program in rural Alaska; makes leasing and regulatory criteria fit the appropriate activity; and ensures a competitive process, thereby maximizing the state's best interests.

Number 0536

CHAIR KOHRING expressed concern about whether a BIF could be used as a tool one way or another, depending on political considerations, philosophies, and so forth.

REPRESENTATIVE MASEK deferred to Mr. Myers.

Number 0615

MARK MYERS, Director, Division of Oil & Gas, Department of Natural Resources, offered his experience through four different administrations, Republican, Democratic, and Independent, giving his overall perspective that because the state is so dependent on oil and gas leasing as a key part of the economy, all administrations have been supportive. In his experience, he said, the BIF has been truly a management tool, not a political tool. It does provide additional public notice, with the balancing test being the state's public interest. Given everything, he said, it's a successful, proven tool no matter what the philosophy of the administration is, because Alaska is an oil and gas state by nature.

CHAIR KOHRING acknowledged perhaps he shouldn't have suggested a BIF could be used for political reasons, and proposed that a better way of stating it might have been that based on philosophical grounds, a BIF could be produced that would reflect a philosophy less inclined to encourage development. He thanked Mr. Myers for his thoughts.

Number 0769

REPRESENTATIVE KERTTULA brought attention to perhaps 20 years of case law defining the process. "It's a pretty solid one at this point," she remarked.

MR. MYERS concurred, noting that the statutes have changed, perfecting the process, over those 20 years as well.

CHAIR KOHRING pointed out that HB 531 has an identical companion bill [SB 312] and again suggested there isn't an immediate need to move this forward. Stating his understanding that the industry isn't very amenable to this legislation and prefers HB 395, he asked whether [Representative Masek] had received feedback from the industry. He explained that he wants a law that will result in development in the future, one the industry looks upon as reasonable and that encourages investment and development.

Number 0913

REPRESENTATIVE MASEK answered, "They have been involved with it, yes." In further response, she said as far as she knows, the Alaska Oil and Gas Association (AOGA) supports it, as does the administration.

CHAIR KOHRING asked about individual companies such as explorers and developers, the independents.

REPRESENTATIVE MASEK said she didn't know.

Number 0941

CHAIR KOHRING, in response to Representative Heinze, explained that he'd heard objections to this legislation from "several players in the industry."

REPRESENTATIVE ROKEBERG added that he'd recently been in communication with a number of people who have an interest or to some degree have participated in the current shallow gas leasing program; they'd voiced concerns about this legislation as it relates to the current program and activities, particularly in rural Alaska. Representative Rokeberg said he has some reservations relating to activities underway; to the intention of the original bill to establish the program; and to impacts on future exploration for shallow gas or nonconventional gas in rural areas, especially.

REPRESENTATIVE ROKEBERG surmised that because of the "incendiary" nature of this legislation, people have some reluctance to voice concerns openly. He suggested the legislature needs to take a hard look at this in the context of completely deleting the shallow gas program in rural Alaska and seeing whether the exploration-licensing aspect will truly accomplish the legislature's policy objective in making lands available under the leasing programs.

REPRESENTATIVE ROKEBERG mentioned concern of people from the Red Dog Mine "shale area." He also said he'd met with people from Usibelli Coal [Mine, Inc.] who'd expressed concern because they'd used the "self-initiated shallow gas program" to let certain properties in their vicinity and had voiced concern about "the deletion of the prohibition of top leasing over existing coal leases, which is deleted in this particular bill." He also mentioned "the prospect ... by the 'Holitna LLC Corp.' that's working in the Donlin Creek area," saying it is an enormous potential hard-rock mining area where electrical power is needed but perhaps cost-prohibitive if it requires long-distance transmission lines; thus there is a need to produce low-cost energy on the site, which may be provided by shallow gas prospects.

Number 1203

REPRESENTATIVE ROKEBERG noted that one intention of the shallow gas bill was to provide a low-cost energy source to rural Alaska. He cautioned against throwing the baby out with the bathwater. Acknowledging that issues relating to surface [ownership] in semi-urban and urban places like the Matanuska-Susitna area and Homer may not be served best by the original shallow gas program, Representative Rokeberg suggested "the perfect world" would be to amend this bill to allow rural-type shallow gas activities that don't have to go all the way to the exploration licensing, which would require a BIF.

REPRESENTATIVE ROKEBERG said one factor, to his understanding, is that applying for an exploration license "basically puts that property that the applicant would nominate, if you will, on the block, and then it has to be competitively bid." He said he doesn't necessarily mind that, because it maximizes the return to the State of Alaska. However, he said, it seems to run counter to the idea of opening up low-cost power and a resource in some areas of Alaska, because of the requirement for a BIF.

REPRESENTATIVE ROKEBERG cited the Fort Yukon example again. He went on to say that if something like this were done, however, it would require sideboards to make sure public notification and those processes are carried out differently from those found inadequate under the current shallow gas leasing program. At the time of the original legislation, he said, the assumption was that "the default provisions" were in the conventional oil and gas regulations, which, he opined, are some of the toughest and most stringently controlled, environmentally, in the world. Thus it hadn't been believed there was a problem with actual production and so forth. However, it was found that the public wasn't properly informed, for example.

Number 1439

REPRESENTATIVE ROKEBERG asked Mr. Myers whether bifurcating the current program had been looked at, in particular, maintaining a shallow gas program in rural Alaska and then specifying in statute those areas applicable to areawide leasing. He mentioned possibilities such as expanding the boundaries of existing areas that are under areawide leasing or excluding larger population centers statutorily. Again mentioning sideboards if there is shallow gas leasing in rural Alaska, he asked Mr. Myers for feedback.

Number 1589

REPRESENTATIVE KOHRING said he shared Representative Rokeberg's thoughts on this and has wondered whether the program should be scrapped, perhaps an overreaction to concerns expressed in the Matanuska-Susitna and other areas this last year. He mentioned perhaps accomplishing the objectives through less radical means and using [HB] 395 as a vehicle, since it addresses issues such as public notice. He said he needs a greater justification, to raise his comfort level, before supporting the legislation in its current form. He called upon Mr. Myers.

Number 1653

MR. MYERS replied that he appreciates members' concerns about energy development in rural Alaska, a critical element of the state's energy picture that he understood to have been the intent of the legislature in passing the original shallow gas leasing program. Saying he'd spent many nights thinking about how to produce energy in rural areas where the economics aren't as good as they are closer to the infrastructure, near a higher population base, Mr. Myers also mentioned listening to the

public's concerns about notice and the balancing test used for issuing leases, which [the public] doesn't believe is balanced.

MR. MYERS pointed out that if the shallow gas program in rural Alaska is amended to provide adequate notice and more balancing in the testing, the end result is similar to the current BIF. He observed that people are upset not about public notice itself, but their lack of ability to change or impact decisions made by the department - that the balancing test hasn't had any meaning in the process. He said notifying people that there'll be leasing on their lands despite their objections gets the same result.

Number 1762

MR. MYERS said the BIF process uses "that different balancing test," has worked, and is court-tested. He told members he believes the result is that "you end up with an over-the-counter program, I think, once you amend it into something that looks like a best interest finding for every over-the-counter lease application ... in rural Alaska."

MR. MYERS observed that historically the program has been used "credibly by the folks at the Red Dog Mine, I think very credibly in the Holitna area in the applications, and very credibly in the Cantwell-Healy area." However, it has been used by speculators elsewhere who apply for leases; [the state] does the title work, and then the applicant doesn't accept the leases. He added, "We have, by far, the highest rejection rate on accepted leases in this program." Cautioning that the over-the-counter nature of the program would mean the state must do a BIF or its equivalent on every single [lease], he remarked, "Quite honestly, administratively we're not equipped to do it."

Number 1820

MR. MYERS explained that he believes exploration licensing is a better tool. He acknowledged disagreement by some of the miners, but said the industry, including Evergreen Resources ("Evergreen") and AOGA, have supported this approach. The competitive nature of the program provides more dollars for the state. A work commitment is bid on competitively; if someone wants to spend \$500,000 in an area but another wants to spend twice that, the larger amount will get the work done, and the gas will be discovered and produced that much more quickly.

MR. MYERS opined that serious applicants will bid a reasonable work commitment; that's dollars going into the ground, not to the state treasury. The application fee of \$1 per acre stays in place, and the license term usually is 7 to 10 years. He explained that shallow gas leases have been problematic because of the depth restrictions; many prospects extend beyond 3,000 feet. Furthermore, the two-year timeframe is inadequate to permit, explore for, and develop gas resources. Although it was a credible attempt, Mr. Myers said the program failed with respect to the lease terms, the depth, and the public process.

Number 1903

MR. MYERS continued, saying exploration licensing costs the applicant less "in dollars of today"; provides a longer period; involves exclusive rights over a larger area, if applied for; has a public best-interest-finding process up front; and has an exclusive right to convert to leases at an established royalty rate. If [a company] uses gas-only leasing and nonconventional gas terms and if it converts to leases, it will end up with exactly the same terms it would have under shallow gas leasing, but it will have all the rights and will have obtained the lease through a process that will withstand appeal processes and be publicly acceptable.

MR. MYERS returned briefly to the idea of an over-the-counter program, emphasizing that [DNR] could never administer it without a significant increase in staff, a request he indicated the department wasn't prepared to ask for. Again addressing exploration licensing, he said the planning, organization, and ability of applicants to solicit the license provides them flexibility. Pointing out that there wasn't competition for the four exploration licenses DNR has given out or the fifth [application], he said a single applicant has received the license with a negotiated work commitment. He remarked, "So I think it's unfounded that there's a lot of competitive risk, but there is a substantial commitment to do work ... and explore the acreage, which is, I think, in the intent of the program."

MR. MYERS summarized that he believes licensing is a better vehicle, provides better value to the applicant, and provides the upfront processes; he surmised that this is why the majority of the industry is willing to accept it. Noting that people in the "Usibelli area" are concerned, however, he explained that the shallow gas leasing program, if someone owned a coal lease, prohibited that person from getting a shallow gas lease; it prohibited getting an exploration license over the area.

MR. MYERS remarked, "Thus that person's mineral rights are actually not protected. They really have exclusive rights with respect to one program. If someone [has] a coal lease and someone else applied for an exploration license ... over that coal lease, we would have granted that license for all gas rights on that lease." He added, "They're only protected if someone tops off a shallow gas lease, on top of that coal lease, not a conventional lease or an exploration license."

Number 2025

MR. MYERS reported that there'd been similar staff discussion internally about how far to go to amend this and how to end up with something both manageable [for DNR] and acceptable to the public. The approach arrived at was that licensing is a better deal for rural Alaska. He mentioned the desire to have those same terms with respect to lower rentals and the 6.25 percent royalty for noncompeting gas, saying this could be accomplished through a showing to the commissioner or the director.

MR. MYERS noted that when geological analyses are done of basins with potential for coal bed methane for villages or mines, there are perhaps only half a dozen places where the state owns the subsurface estate in proximity to villages or reasonable proximity to a mine, and where this program might be effective. He suggested it wouldn't be unreasonable to accomplish licensing [for those].

Number 2091

REPRESENTATIVE HEINZE requested clarification about Mr. Myers' statement that someone's rights wouldn't be protected with respect to top filing.

MR. MYERS explained that under the shallow gas leasing program, if someone had a coal lease on state land, only the lessee could apply for the shallow gas lease rights under that program. Someone [else] who applied for an exploration license under the same area, however, would be allowed to get the license, which would provide exclusive rights to all gas on the lease. Although the coal lessee was protected in the program under "177" for someone top filing on a lease for limited-depth rights, [that lessee] wouldn't be included in the license, which is for all depth rights.

MR. MYERS pointed out that areas in Cook Inlet, for example, have traditional gas-only leases and coal leases as well; it hasn't really been a problem, but is a reasonable concern if coal seams are shallow in the area where the miner wants to mine, since there might be a surface conflict. The same conflict could occur under exploration licensing, however, under the current program.

MR. MYERS surmised that concerns relating to mining operations are that [those mining companies] may want to exploit the gas resources in the future under the shallow gas program; under current law, if they applied for a shallow gas lease, they'd get an exclusive right to apply and thus someone else couldn't top file on the coal lease. Under exploration licensing, though, at any point in time someone could come in and apply for a license over the top of the coal leases, which would provide an "all depths right" to all the gas, regardless of the coal lease.

Number 2211

REPRESENTATIVE ROKEBERG said it seems reasonable, as a matter of public policy, that any state leaseholder for coal exploration rights should be protected for shallow gas exploration on the same property, because there'd be subsurface conflicts if there could be top leasing under conventional or exploration licensing [as described by Mr. Myers] over an existing coal lease. He asked whether it's correct that currently someone "could exploit shallow gas" under conventional and exploration licensing.

MR. MYERS affirmed that. He explained that under Alaska law, the gas belongs to the oil and gas lessee, not the coal lessee, with an exception: if someone mining the coal lease needs to remove gas because it's a hazard, that person can take the gas. He said, "There's no royalty cost to the state. You could take the gas and you could burn it, or you ... could actually sell it. That's incidental to your mining operation and for safety purposes." If it's for any other purposes, however, that coal lessee has no rights to that gas. It actually belongs to the oil and gas lessee, or to the state.

Number 2292

REPRESENTATIVE ROKEBERG said he doesn't know what depth coal leases go to, but reiterated that it seems logical, if there is a coal lease, that anywhere there are coal deposits should be reserved or restricted in terms of exploration for gas in order to prevent conflicts between coal mining and gas mining, unless

the lessee is one and the same. He added, "That's what we did with the shallow gas, by prohibiting anyone else from top leasing unless they owned the coal. It seems to me that should also be applicable to any other kind of lessee."

MR. MYERS addressed access to the surface estate if there is a conflict with subsurface access. Noting that someone with a coal lease in place generally has a preferential right to use the surface, he explained, "Both parties are allowed, but if there's a conflict, it goes to the coal mine. So I think that really their surface rights are protected if the coal lease existed prior to the oil and gas lease." He reiterated that if it's an issue of actually producing the gas, then [the coal lessee], by Alaska law, doesn't have the right to the gas.

Number 2366

REPRESENTATIVE ROKEBERG posed a situation involving a coal lease "where the miner hadn't got to that area yet, and then you could punch ... a coal bed methane drill stem down there and production equipment, and you'd be there, and then the coal miner would want to come along ... and mine that, and then you'd be in the way." Suggesting this is just asking for a conflict, he inquired: Wouldn't it be a wise policy of the legislature to prohibit dual-leasing subsurface estates for different minerals?

MR. MYERS highlighted the need to look at the resource in terms of the state's maximizing its economic value. It depends on the area; in Cook Inlet, for example, gas probably has significantly more value. He offered his understanding that there is no depth limitation on coal leases, but said [for economic reasons] mining occurs only the first few hundred below the surface. If the gas lessee removed the gas from the coal, he noted, it would eliminate a hazard for the miner.

MR. MYERS said the only exception probably would be conflict with the surface-pad placement of the gas wells or surface facilities. He related his understanding that if the coal lease was there first, (indisc.) the state. He added that only a small percentage of coal leases are actually being produced. They last a long time and are sitting there, nonproductive. That would block any oil and gas development in an area.

Number 2451

REPRESENTATIVE HEINZE asked why the rest of the committee hasn't heard the concerns reported by the two Representatives, and wasn't brought in on the discussions.

CHAIR KOHRING replied that [the concerned parties] had come to him personally to talk about the legislation.

REPRESENTATIVE HEINZE said she could understand that, since he's the chair.

CHAIR KOHRING offered to invite them to come forth publicly to the committee, which he suggested would be prudent. "All I'm hearing is that there is not any support out there for this legislation from industry," he remarked.

REPRESENTATIVE ROKEBERG brought attention to testimony [from Representative Masek] that AOGA and Evergreen support this.

CHAIR KOHRING clarified that he was referring to "independents." Four had come to him and said they'd rather not see the bill go through and, at most, would prefer [HB] 395, he reported. Chair Kohring also said he wondered whether the objective of addressing the public's concerns about notice, input, water protection, property rights, and local-control matters could be clarified in statute, rather than changed, since the previous year's HB 69 "didn't greatly affect that issue." Thus perhaps those points could be addressed in a piece of legislation less dramatic than this.

Number 2560

REPRESENTATIVE ROKEBERG noted that HB 395 cleans up discrete issues in the current program, whereas [HB 531] is prospective; he suggested there is validity to having two separate bills. As for the original intent of the shallow gas program, he said he's "happy in the main" that rural areas are looking to take advantage of it. Unfortunately, there has been controversy in more populated areas. He said he doesn't see it as unintended consequences; rather, it relates to a "totality of things" for which he wouldn't assign blame. He maintained that the original concept is valid, and said it's up to [the legislature] to adjust it, to ensure the public is protected and has a level of comfort with it. He emphasized the desire to provide low-cost energy throughout the state.

Number 2652

REPRESENTATIVE ROKEBERG asked Mr. Myers whether there is a way to amend the legislation to prohibit exploration for shallow gas or nonconventional gas within a depth limit if there is an existing coal lease, and then allow exploration for conventional, deeper gas.

MR. MYERS replied that he thinks it possible to argue, but believes it's unlikely, for instance, to have shallow gas leasing much below 1,000 feet under the surface. Acknowledging he isn't a miner, Mr. Myers said he doesn't know of cases of conventional mining much below 200 feet under the surface, because of economics; he suggested it probably would be fine to preclude the "very shallow part" of a section in terms of limiting the rights in those areas. He noted it touches on how that gas gets produced, however. The miner doesn't have the right to produce the gas; it sits there, with no one having a mineral right to it, other than the state. He surmised that a coal miner could produce it, but only for safety reasons.

Number 2730

MR. MYERS, in response to a question from Representative Rokeberg, agreed that with a shallow gas program [a coal lessee] could apply for a shallow gas lease over the [coal] lease.

REPRESENTATIVE ROKEBERG observed, "Not if we pass this bill, is the trouble in the future."

MR. MYERS concurred, but noted that any applications received before the end of the year would be considered valid applications. He said in most cases where the coal lessees already have leases or have applied for them - such as in the Holitna area, as well as the Usibelli mine area, where there has been application in adjoining areas, but not exactly over the coal leases, and the Red Dog Mine area - those leases would remain intact. "So, realistically, you're talking about the Fort Yukon area, those few areas over ... actual, existing coal leases, which would be eligible for a license if they wanted to apply over them," he noted.

MR. MYERS again suggested this can be administered successfully through exploration licensing. Licensing does require a work effort, whereas shallow gas leasing does not, but he said he believes it's in the state's interest for a licensee to be committed to actually doing something with the lease, rather than taking it for speculative reasons or just to prevent something from happening. Mentioning "a concern of the \$5,000

payment," he said people could buy leases for lots of other reasons.

MR. MYERS said one unintended consequence of the program was an incredible amount of speculation in shallow gas leases, some in environmentally sensitive areas, some in populated areas, and some perhaps to prevent someone else from doing something. He remarked, "We have a problem there with the over-the-counter nature of the chief cost of the lease with no work commitment."

Number 2815

MR. MYERS said he guessed his recommendation would be that the current shallow gas program, even in rural Alaska, be changed to deal with public noticing and probably the balancing test, and to try to limit the rampant speculation that has occurred along with legitimate applications. He added, "Plus it has to do, I think, with the limited depth and the short period of the lease."

Number 2835

REPRESENTATIVE ROKEBERG asked how Mr. Myers characterizes "rampant speculation" and how many people have applied for leases.

MR. MYERS indicated he was obtaining a list, and said there were 25 or 26 individuals. At one time, there were 480,000 acres or so under application, to his belief; about half of those applications were for leases that weren't accepted. Noting that it was for that program, he said currently the number is zero. In further response, he clarified that more than half were approved; after the state did the title work, however, they refused to take the leases.

REPRESENTATIVE ROKEBERG questioned using the phrase "rampant speculation" for a dozen people.

CHAIR KOHRING agreed.

Number 2896

REPRESENTATIVE HOLM asked whether the shallow gas program has been an appropriate way to allow a lower threshold of leasing for developing this natural gas or coal bed methane.

MR. MYERS replied yes, saying it made lands available in rural areas where there were traditional gas-only sales, for instance. In addition, the applicant-driven nature was positive in the Red Dog Mine area in particular, and possibly at Holitna; he also mentioned the Usibelli area. He said in those cases he believed it helped to stimulate economic progress.

MR. MYERS pointed out that, to date, the only drilling he knows of on shallow gas leases has been a couple of core holes drilled this winter by Evergreen; other than that, there hasn't been a single well drilled in the years of the program. That's not to say they're not making good progress in the fractured shale up by the Red Dog Mine, at Holitna, and in the Usibelli area, he added. He also opined that it was an element in bringing Evergreen to the [Matanuska-Susitna area] in the first place; he mentioned the relatively low cost.

MR. MYERS observed that as companies have looked at using the program from a practical standpoint, however, they've had problems. For instance, the 3,000-foot depth was a major problem for just about everybody looking to use it. That's why an amendment was made a few years ago, although [HB] 395 takes it back to a solid depth floor, for example. He noted there's a lot of potential for fractured shale below 3,000 feet.

TAPE 04-11, SIDE B

Number 3003

MR. MYERS mentioned having major difficulty with unitization issues when looking at combining different shallow gas lease rights with different depth criteria. Expressing hope that the production stage will be reached, Mr. Myers said when he looks at the practical management of the program, there are real problems because of the depth criteria. The over-the-counter nature makes it difficult to try to accelerate development in a short period of time, and doesn't give the applicant much time. All in all, Mr. Myers said, he doesn't think it's very efficient or effective for an oil and gas program. He added, "We've also looked ... over the rest of the country and found no other programs like it." He said he thinks it was well-intentioned and helped stimulate initial activity, but in the longer analysis isn't a practical program.

Number 2960

REPRESENTATIVE HOLM asked what would happen to existing leases if HB 531 abolishes [the program].

MR. MYERS answered that if the leases are explored on in their primary term or if there is progress toward development, they can be extended another three years, based on the director's discretion. If something is discovered in the first three years and there is a determination that the well can pay for its operating costs, basically, [the lessee] is entitled to keep the lease and there's no time period for its expiration. Mr. Myers continued:

If they also are making good progress and they want to form an oil and gas unit with multiple leases together, they'll come to us and request a unit. ... And more than likely, if their plan of development or exploration is reasonable, we'll unitize the acreage together, and it could be together with state or ... other leases, like in the Red Dog area it's expected to be joint state-NANA [Regional Corporation] leases. Then they would hold those leases as long as they were actively pursuing development under the plan of development, or exploration under the plan of exploration.

And then, once they go into production, the area ... that's productive will be put in what's called a participating area. And as long as they're producing, that area's held, basically, forever. And that's the same progress as on a conventional oil and gas lease. ... The same procedural parts of going into normal production are there. ... The problem is their limited depth rights and the limited amount of time they have to get to that stage of exploration ... that makes a unit viable.

Number 2874

REPRESENTATIVE PAUL SEATON, Alaska State Legislature, mentioned the correlative rights problem and complications of trying to figure out who would own gas at various depths. He said [HB 531] tries to get around that by having a gas-only lease at any depth.

REPRESENTATIVE ROKEBERG pointed out that there can be different leases at different depths, and that in the Lower 48 it is common practice to have a clause in a lease that provides for the ability to "underlease." He asked Mr. Myers to comment,

offering his belief that deep gas won't be trapped under shallow gas, even in Alaska.

MR. MYERS shared his experience with segregated mineral rights, noting that he'd worked in Louisiana, where it wasn't uncommon to see different rights; however, those related to a geologic formation, not a fixed depth below the surface.

REPRESENTATIVE ROKEBERG remarked that he'd just "signed one" in Oklahoma that had a depth clause.

MR. MYERS surmised the depth is probably "subsea" or some other, better method of doing depth. In Oklahoma, he said, there isn't a lot of difference in some of the flatter areas.

REPRESENTATIVE ROKEBERG related his belief that there is a big difference in the geological formations "at depth down there."

Number 2737

MR. MYERS responded:

In my mind, it is ... very problematic, particularly in the areas where we have surface relief. And the surface relief ... reflects the geology below. So your coal seam could be flat in the subsurface; your surface could be undulating. So that 3,000-foot-depth ... owner could go in and out of the same formation, even though at depth it's flat, just because of the difference the surface elevation has.

So the way ... the program works, I think, really is problematic for correlative rights issues. Because of that reason, when we do an exploration license area, if there's shallow gas leases in the area, we actually do not allow the deeper rights to be leased, because we do think it's going to lead to correlative rights problems.

If it was ... through a geologic formation or some other mechanism, other test, other than surface depth, we ... probably would be able to sort through some of those rights. But ... the way the leases are written, ... I don't think we really can, technically, just because, again, the geological surface you're using doesn't reflect, very often, the geology underneath the surface at 3,000 feet.

Number 2682

MR. MYERS explained that if the seismic data is poor, for example, it leads to a correlative-rights argument about whether the gas below belongs to the lessee above or below. A lot of this has been avoided in Alaska by having "depth rights." He suggested it is one of the more positive attributes. Noting that he'd sat in hearings of conservation commissions in the Lower 48, he said the value of the resource, particularly for conventional gas, is "really worth the fight." He continued:

So, what happens is, ... we've decided not to license underneath it. If there's a conventional lease in the area, ... you can't do a shallow gas lease; so we don't have that conflict in our conventional lease areas. It's only where a license would overlay ... a shallow gas lease.

So I guess my recommendation would be, if you're going to keep the shallow gas lease, at minimum, give all depth rights to the shallow gas lease.

Number 2634

REPRESENTATIVE ROKEBERG asked whether it is a matter of statute, regulation, or policy to prohibit depth rights below other leases.

MR. MYERS specified it's a matter of policy that [DNR] doesn't issue an exploration license over a shallow gas lease.

REPRESENTATIVE ROKEBERG said it's a good way to avoid arguments, but questioned whether it's good public policy. He suggested it's germane if the state maintains any kind of shallow gas program. He cited the situation in Homer as an example of what might arise from having a statutory depth level and going in "hot pursuit" of a formation that might start at 3,000 feet and go deeper. He said this problem needs to be addressed.

REPRESENTATIVE ROKEBERG then remarked to Mr. Myers, "You might be able to win me over if ... you can talk me into having a short-form BIF for unconventional gas." Recalling that Mr. Myers had testified it might cost \$250,000 for a BIF, Representative Rokeberg characterized a BIF as "a study to lease a few acres out in the Bush somewhere so we can pump some gas in the town." Thus he asked whether there is a way to accommodate

that and still meet the demands of the public and the balancing test without reinventing the wheel every time or spending a huge amount of money on a BIF.

Number 2542

MR. MYERS replied that he'd thought about it quite a bit. Part of the reason BIFs have been so expensive is that typically a license is for 500,000 acres; most people go for the maximum. If the area were smaller, the finding would be easier, and thus he surmised the cost would be less. Mr. Myers reiterated that he doesn't believe there are many areas in Alaska where the state owns the subsurface and it is economically suitable for nonconventional gas - only half a dozen communities.

MR. MYERS mentioned looking at the geology carefully. Many of those areas would have underlying conventional gas, he noted, so a license would actually be a better approach. For example, he said he'd argued that Holitna has probably a better conventional gas play than a coal bed methane play. Mentioning it's applicant-driven, Mr. Myers said if he were an "explorationist," though, he'd rather have a license in that area in order to go to deeper depths and lock up a lot of that basin. He elaborated:

They're going to really have a problem if they can't show the gas at 3,000 feet's connected down below, because they'll basically have to come back and apply for a license over their same area in order to get those deeper rights. So they'll now have a shallow gas lease and a license over the area, from a practical standpoint. If they do produce the gas that's deeper that's not part of the field, then they'll owe the state 100 percent royalty on that gas, and I have no way to transfer the mineral rights to them.

MR. MYERS concluded by saying if someone wants 10,000 or 20,000 acres, he believes the BIF will be reasonably cheaper because of the limited scope. Given the limited number of areas where he actually thinks this will be applied and screening out folks who can't put together money to go ahead and drill, he suggested the opportunity will be limited to those who are out there now in the areas mentioned previously, as well as perhaps some in the Fort Yukon area or a few others.

Number 2395

REPRESENTATIVE ROKEBERG mentioned Copper Center and Bristol Bay. He remarked that he hopes there are more than half a dozen.

MR. MYERS noted that when viewing the state's land position in those areas, two things must be looked at: the geology of the coal and the associated population base.

Number 2374

REPRESENTATIVE HEINZE asked what a BIF would cost for a 5,000-acre lease in rural Alaska.

MR. MYERS pointed out that there is a minimum of 10,000 acres under current exploration licensing.

REPRESENTATIVE HEINZE asked about 10,000 acres, then.

MR. MYERS suggested a scenario with a gas-only lease.

REPRESENTATIVE HEINZE requested information for all scenarios.

MR. MYERS offered a rough estimate, including staff time, of \$50,000 to \$100,000. He added, "I will say, though, in developing the stipulations and mitigation measures and holding the public meetings that we do now, our costs aren't a whole lot less in issuing ... shallow gas leases in places like Holitna or Usibelli; that's been our experience." He mentioned the need to fly people out there and take time to do it, in order to find any local acceptance through the process at all.

MR. MYERS clarified that the state pays for the BIF. Someone with a 10,000-acre license would pay \$10,000 to the state and would have to guarantee a work commitment satisfactory to the state, including geological fieldwork or drilling a few core holes, for example. The company then would get a 7- to 10-year commitment to hold that acreage and the right to convert to a conventional or gas-only lease, depending on what was negotiated, for another period of probably 10 years "where they just pay a rental, ... no upfront bonus."

Number 2238

CHAIR KOHRING brought attention to a letter from the Alaska Miners Association, Inc. [dated March 13, 2004 from Steven C. Borell, executive director], which says eliminating the program isn't prudent at this point and that passing the bill would be

throwing the baby out with the bathwater. Chair Kohring highlighted points from the letter including elimination of the right of self-initiation, which will effectively lock out individual prospectors and gas developers from participating in business; concern that the BIF may take 18 months or more to conclude; and concern about eliminating incentive for individual entrepreneurs. Chair Kohring again opined that the committee should pass legislation that the industry is amenable to, and that laws should help accomplish the goal of resource development.

Number 2164

REPRESENTATIVE ROKEBERG said he appreciates the miners' concerns, but miners typically don't drill for gas. He suggested the time period of six years is relatively short for a new type of project. He asked Mr. Myers whether paying quantities must be under production to extend beyond six years.

MR. MYERS answered that the state standards are that a well would be drilled and would have operating costs less than the value of the gas produced; this allows holding the lease under the "paying quantity" standard. It isn't that production is required; rather, a test must demonstrate gas at a certain rate. Unitization is the other way to do this and is commonly done in the last year of a term. Mr. Myers pointed out that there are 30-some units in Alaska now for conventional oil and gas, mentioned a \$5,000 fee and the need to show a logical course of progression toward development, and said he thinks it's an appropriate statutory process for shallow gas leases as well.

Number 2017

REPRESENTATIVE ROKEBERG asked whether current leases could be extended if paying quantities were found, even in the Red Dog area.

MR. MYERS explained the three instances in which a leasehold can be extended. First, at the [director's] discretion, the three-year period can be extended another three years; that has been done in the Red Dog area, where multiple core holes were drilled on adjoining NANA [Regional Corporation] land, with good progress toward exploring "the appropriate interval that was effective on the state land as well." Second, "if you drill and you maintain quantities," it is mandatory that the director extend the lease; it's on a lease-by-lease basis. And third, if

progress toward development is being made, an oil and gas unit can be formed through combining multiple leases.

MR. MYERS said virtually all production in the state is in units. The state looks at the unit's size and shape and then negotiates a plan of exploration and development. He explained, "They hold that acreage for that period of time, and then once they actually get production, they hold the area that's productive until they stop producing." He added, "Those are all necessary because no one produces all their gas out of a lease in the primary term."

Number 1916

REPRESENTATIVE HEINZE returned attention to the BIF. She asked whether "little guys get left along the wayside timeline-wise."

MR. MYERS answered that [the state] tries to prioritize and juggle the workload. He indicated some things are scheduled on a routine basis such as areawide leases, looked at every 10 years but also when there are significant changes to the findings. He cited Bristol Bay as an example where the timeframe will be less than a year for a nearly 500,000-acre license in a brand-new area where there hadn't been a best interest finding.

MR. MYERS mentioned the Susitna area and said it depends on environmental sensitivities and how the agencies respond to the findings. With the streamlined internal state processes, he reported, things are going more quickly and being decided better at the staff level. Regarding shallow gas leases, however, he pointed out that stipulations and mitigation measures still must be put in; thus shallow gas leases aren't a whole lot cheaper to issue. The initial ones didn't involve public meetings, which was one point of contention and led to the current process. Looking forward, Mr. Myers said, he sees a process that probably will cost nearly as much for the shallow gas leases, just without producing a large document, in order to get public acceptance and deal with the realities of the program.

Number 1737

REPRESENTATIVE HEINZE again expressed concern about "the little guy, the 10,000-acre guy" being put at the bottom of the list.

MR. MYERS replied, "In reality, they are now because, again, I have to look at timing of issuing areawide leases where we're

deferring thousands or hundreds of thousands of dollars of money if we don't get the leases out." He said the priority has been getting the conventional leases out as quickly as possible and then getting the exploration licenses out; the shallow gas leases have been the slower process. Furthermore, now recognized is that a lot of the timing issues for a BIF relate to the public process, including public notification, the preliminary finding, and then going to a final BIF.

MR. MYERS said, realistically, the timeline cannot be shortened to much less than 8 to 12 months no matter what, because there are interim periods of public notice and [opportunities for] public comment provided for statutorily. He pointed out that the time was shortened for shallow gas leasing, but because of all the work required behind the scenes, the costs weren't a whole lot different except for those relating to not having to fly folks out to the public meetings, "which we're having to do now because of the public outcry."

Number 1608

REPRESENTATIVE ROKEBERG asked how many different areawide leasing programs there are, and when their expiration dates are for the purposes of having to redo the BIFs.

MR. MYERS deferred to Jim Hansen, leasing manager.

Number 1570

JAMES HANSEN, Title/Lease Administrator, Division of Oil & Gas, Department of Natural Resources, answered that the 10-year North Slope finding was done in 1998, and the ones for Cook Inlet and Beaufort Sea were done in 1999. In order to stagger these out, the scheduling will be Cook Inlet in 2007, North Slope in 2008, and Beaufort Sea in 2009. In addition, the North Slope foothills is scheduled in 2011, and for Bristol Bay the license is scheduled in 2004 and the lease sale in 2005.

REPRESENTATIVE ROKEBERG remarked that hopefully this bill, if passed, will require more BIFs.

Number 1465

SETH LITTLE, Alaska Center for the Environment (ACE), explained that ACE is a "homegrown environmental organization" with more than 7,000 dues-paying members across the state. He said this companion bill to SB 312 is a good step in a long-term solution

to fix the current problems with coal bed methane development by attempting to find a balance between industry interests and public residents. Noting that a BIF is needed for coal bed methane development, he said he's happy to see it as part of this bill such that socioeconomic and environmental impacts of development will be considered just as for conventional oil and gas development.

MR. LITTLE pointed out that the bill lacks a mechanism for leases already issued in the Matanuska-Susitna and Homer areas, however; thus it helps for future leases without fixing problems faced today. He also expressed support for the "previous notice" that Representative Kerttula was working on, and agreed landowners should be given notice prior to when leases are issued on their land. Referring to DNR's efforts to include the public, he suggested that needs to be a component for shallow gas leases, and said he believes the BIF is a way to do it.

Number 1279

REPRESENTATIVE ROKEBERG noted that Representative Seaton had an amendment to offer.

CHAIR KOHRING related his understanding that Representative Kerttula had an amendment she was still working on as well. He suggested it could be brought up at a later meeting.

REPRESENTATIVE ROKEBERG said he thought the bill should move along, though he had some reservations.

Number 1221

CHAIR KOHRING announced that he had a variety of reasons for wanting to hold the bill for now. He said there wasn't a high comfort level among several committee members, according to his private conversations. He added:

I just keep getting more and more feedback from those in the industry who say this is not a good bill. And with all due respect to the Alaska Center for the Environment, Mr. Little, and this is not derogatory toward their organization, but they seem to be in support of the bill; the industry is against the bill. So that might be saying something to those of us who are more inclined to support a more proactive approach toward gas development.

REPRESENTATIVE ROKEBERG questioned that the entire industry opposes this.

CHAIR KOHRING replied that he hadn't heard of anybody who is a player in the business who has said, "Yes, we like this bill."

REPRESENTATIVE ROKEBERG asked whether AOGA supports it.

REPRESENTATIVE MASEK answered in the affirmative.

REPRESENTATIVE ROKEBERG suggested that's a large part of the oil and gas industry. He said he didn't know whether Evergreen had weighed in, and surmised they were trying to "keep their head down."

CHAIR KOHRING answered in the affirmative, saying he'd talked to them.

REPRESENTATIVE ROKEBERG suggested any objections should be stated publicly.

CHAIR KOHRING acknowledged that point.

Number 1083

REPRESENTATIVE SEATON asked whether there were questions about Amendment 1, labeled 23-LS1818\D.2, Chenoweth, 3/17/04, which read:

Page 21, following line 10:

Insert a new bill section to read:

"* **Sec. 27.** AS 38.05.177(d) is amended to read:

(d) A lease

(1) shall be automatically extended if and for so long thereafter as gas is produced in paying quantities from the lease and the lessee continues to meet all requirements of the lease; a [. A] lease issued under this section covering land on which there is a well capable of producing gas in paying quantities does not expire because the lessee fails to produce gas unless the lessee is allowed reasonable time to place the well on a producing status; if [. IF] drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, including such operations as redrilling, sidetracking, or other means necessary to reach the originally proposed bottom hole location,

the lease is extended for one year and for so long thereafter as gas is produced in paying quantities; a [. A] gas lease issued under this section that is subject to termination by reason of cessation of production does not terminate if, within 90 days after production ceases or a longer period determined at the discretion of the director, reworking or drilling operations are commenced on the land under lease and are thereafter conducted with reasonable diligence during the period of nonproduction;

(2) issued under former (c) of this section before January 1, 2004, may be extended at the discretion of the director; a lease may be extended under this paragraph [. IN ADDITION,] upon application by the lessee; [,] the director may once extend the [A] lease [ISSUED UNDER (c) OF THIS SECTION] for a period of not more than three years; in exercising discretion to extend a lease under this paragraph, the director may not extend the lease unless the director considers

(A) the extent of the shallow natural gas exploration activity already conducted on the lease and on adjacent areas;

(B) the probability that further shallow natural gas exploration activity will occur on the lease and will lead to shallow natural gas development and production; and

(C) whether extension of the lease's primary term will accelerate the eventual production of shallow natural gas from the lease."

Renumber the following bill sections accordingly.

Page 44, line 21:
Delete "38.05.177(d),"

Page 44, line 27, following "AS 38.05.177(a)":
Insert ", (d)(1),"

Page 44, line 28:
Delete "secs. 26 and 27"
Insert "secs. 26 - 28"

Page 44, lines 29 - 30:
Delete "AS 38.05.177(b) - (h)"
Insert "AS 38.05.177(b), (c), (e) - (h)"

Page 44, line 30:
Delete "sec. 56"
Insert "sec. 57"

Number 1055

REPRESENTATIVE SEATON, in response to Chair Kohring, clarified that this amendment gives discretion to the director of Division of Oil & Gas, and specifies conditions under which the director may issue a three-year extension on shallow natural gas. It eliminates the possibility of a "takings claim" being issued against the state, he said, adding that it has all three conditions that the director had talked about, including paying quantities and whether there is work going forward. Those are the conditions under which the lease would be extended; otherwise, there wouldn't be speculative holding.

Number 0989

REPRESENTATIVE CRAWFORD requested that Representative Seaton speak further on Amendment 1. As far as Representative Kerttula's amendment, he noted that she'd said she could put it forward in the House Resources Standing Committee. Representative Crawford said he'd like to see the bill move and characterized it as a good step.

CHAIR KOHRING commended Representative Seaton's efforts in responding to constituents in Homer, and said he himself takes this matter seriously. He noted that after Amendment 1 was addressed, the bill would be held to look at other issues and solicit additional input from folks in the industry.

REPRESENTATIVE HEINZE expressed concern that some members were absent [although there was still a quorum].

REPRESENTATIVE ROKEBERG requested that Mr. Myers comment on Amendment 1.

Number 0825

MR. MYERS said DNR would support the amendment, which basically defines the discretion of the director. He explained that the director has discretion under shallow gas leasing to extend leases up to an additional three years, but how that discretion is to be used hasn't been defined. Amendment 1 defines it in a reasonable way, using criteria of the type the department uses, such as making solid progress toward exploration development.

Mr. Myers said the amendment is well written, reasonable, and follows "logical practice." He said he doesn't believe it would take away from the lessee's rights, but further explains legislative intent with regard to the director's discretion.

Number 0742

REPRESENTATIVE CRAWFORD moved to adopt Amendment 1 [text provided previously].

REPRESENTATIVE SEATON, in response to Chair Kohring, noted that [Mr. Myers] had said it would work with the current processes.

Number 0695

CHAIR KOHRING asked whether there was any objection to adopting Amendment 1. There being no objection, it was so ordered.

CHAIR KOHRING thanked Mr. Myers for his analyses. He noted that there'd be a new proposed committee substitute (CS) at the next bill hearing. [HB 531 was held over.]

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 4:55 p.m.