

ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON OIL AND GAS

April 1, 2004

3:25 p.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 364

"An Act establishing a moratorium on the issuance of state shallow natural gas leases in the vicinity of Kachemak Bay, and precluding the commissioner of natural resources from reissuing or otherwise extending leases within the moratorium area if the leases fail to produce gas in paying quantities within the terms of the lease or if there is a breach of a term or condition of the lease; and providing for an effective date."

- MOVED CSSH B 364 OUT OF COMMITTEE

PRESENTATION BY XTO ENERGY - "COOK INLET OIL AND GAS"

- HEARD [See 3:35 p.m. minutes for this date]

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."

- MOVED CSHB 531(O&G) OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

BILL: HB 364

SHORT TITLE: NATURAL GAS LEASES NEAR KACHEMAK BAY
SPONSOR(S): REPRESENTATIVE(S) SEATON

01/12/04	(H)	PREFILE RELEASED 1/2/04
01/12/04	(H)	READ THE FIRST TIME - REFERRALS
01/12/04	(H)	O&G, RES, FIN
02/19/04	(H)	SPONSOR SUBSTITUTE INTRODUCED
02/19/04	(H)	READ THE FIRST TIME - REFERRALS
02/19/04	(H)	O&G, RES, FIN
03/09/04	(H)	O&G AT 3:15 PM CAPITOL 124
03/09/04	(H)	Heard & Held
03/09/04	(H)	MINUTE(O&G)
04/01/04	(H)	O&G AT 3:15 PM CAPITOL 124

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
03/18/04	(H)	Heard & Held
03/18/04	(H)	MINUTE(O&G)
03/22/04	(H)	RES AT 1:00 PM CAPITOL 124
03/22/04	(H)	<Pending Referral>
04/01/04	(H)	O&G AT 3:15 PM CAPITOL 124

WITNESS REGISTER

REPRESENTATIVE PAUL SEATON

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Testified as the sponsor of SSHB 364.

ERIC MUSSER, Staff

to Representative Vic Kohring

Alaska State Legislature

Juneau, Alaska

POSITION STATEMENT: Explained CSHB 531, Version Q, and the proposed amendments.

JOHN K. NORMAN, Commissioner

Alaska Oil and Gas Conservation Commission (AOGCC)

Anchorage, Alaska

POSITION STATEMENT: Testified on CSHB 531, Version Q, and offered Conceptual Amendment 3.

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

POSITION STATEMENT: Testified on CSHB 531, Version Q, and answered questions.

ACTION NARRATIVE

[The beginning of the meeting wasn't tape recorded, but was reconstructed from the committee secretary's log notes.]

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

HB 364-NATURAL GAS LEASES NEAR KACHEMAK BAY

CHAIR KOHRING announced that the first order of business would be SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 364, "An Act establishing a moratorium on the issuance of state shallow natural gas leases in the vicinity of Kachemak Bay, and precluding the commissioner of natural resources from reissuing or otherwise extending leases within the moratorium area if the leases fail to produce gas in paying quantities within the terms of the lease or if there is a breach of a term or condition of the lease; and providing for an effective date." [In packets was a new proposed committee substitute (CS), Version 23-LS1464\S.]

[Tape recording began at this point.]

TAPE 04-12, SIDE A
Number 0006

REPRESENTATIVE PAUL SEATON, Alaska State Legislature, sponsor of SSBH 364, explained that this legislation applies to conditions under which the director of the Division of Oil & Gas may extend leases that aren't producing paying quantities of gas. It allows the director the option to not issue leases for another three years if they're just being held speculatively. If the director just didn't renew those leases based on his/her own

judgment, there could be a takings claim that it was arbitrary and capricious; however, if the director follows the statute [proposed in this bill], if there is a work plan in place and so forth, then the extension would be made. In addition to preventing a takings claim against the state, this prevents releasing of those leases to someone else under the shallow natural gas program.

REPRESENTATIVE SEATON said nothing in the bill prevents those leases from being incorporated into an areawide lease sale if the new gas-only program goes forward. It makes incorporation into an areawide lease sale more likely, he suggested; currently, if there is a shallow natural gas lease on top of a deeper gas find, there is a difficult situation in Alaska relating to correlative rights, and the Division of Oil & gas has a policy of not issuing two sets of leases, one atop the other, with the shallow natural gas program. This bill allows the director to determine whether it's in the best interests of the state to extend those leases; if they're not extended, that specific area wouldn't be available for additional shallow natural gas leases.

Number 0285

REPRESENTATIVE ROKEBERG said he didn't have an amendment prepared, but voiced concern about these lands' being off-limits to development. Suggesting these lands should be covered by areawide leasing but aren't, he said he'd be reluctant to support this legislation "if we're just going to lock up lands again."

REPRESENTATIVE SEATON responded that if this legislation or similar provisions don't go forward, it would preclude areawide lease sales from incorporating this area; this will be under a shallow natural gas lease, and the division has a policy of not doing an areawide lease sale if there is a shallow natural gas lease, for reasons relating to correlative rights because of the various depths.

Number 0560

REPRESENTATIVE ROKEBERG said he thinks it's a bad policy, even though he could understand Mr. Myers' position because there is some gray area about the depth and so forth.

CHAIR KOHRING noted that he'd promised to bring this bill up for a vote, said he respected where the sponsor was coming from, but

expressed concern that this legislation isn't the most conducive to development of resources.

Number 0623

REPRESENTATIVE McGUIRE moved to report CSSSHB 364, Version 23-LS1464\Q, Chenoweth, 3/4/04, out of committee with individual recommendations and the accompanying zero fiscal notes. There being no objection, it was so ordered.

REPRESENTATIVE KERTTULA pointed out the new proposed CS, Version 23-LS1464\S.

Number 0684

REPRESENTATIVE McGUIRE moved to rescind the committee's action in reporting the bill from committee. There being no objection, it was so ordered.

Number 0722

REPRESENTATIVE HOLM moved to adopt the proposed CS, Version 23-LS1464\S. There being no objection, Version S was before the committee.

Number 0782

REPRESENTATIVE McGUIRE moved to report CSSSHB 364, Version 23-LS1464\S, out of committee with individual recommendations and the accompanying zero fiscal notes.

CHAIR KOHRING announced that CSSSHB 364(O&G) was reported from the House Special Committee on Oil and Gas.

CHAIR KOHRING called an at-ease at in order to prepare for the Presentation by XTO Energy - "Cook Inlet Oil and Gas."

[The minutes for the overview can be found under the 3:35 p.m. minutes for this date. See tape 04-13.]

CHAIR KOHRING reconvened the regular meeting after an at-ease following the overview. [Tape 04-12 continues.]

HB 531-CONVENTIONAL & NONCONVENTIONAL GAS LEASES

CHAIR KOHRING announced that the final 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 0870

REPRESENTATIVE ROKEBERG moved to adopt Version 23-LS1818\Q, Chenoweth, 3/31/04, as a work draft. There being no objection, Version Q was before the committee.

Number 0903

ERIC MUSSER, Staff to Representative Vic Kohring, Alaska State Legislature, explained that Version Q largely incorporates the state's existing shallow gas leasing program into the areawide oil and gas program. During the last hearing, several questions were raised, and he said modifications have been made to address some of those concerns.

MR. MUSSER advised members that throughout the bill the term "shallow gas" is replaced with "nonconventional gas"; it is defined in statute as well. Section 4, page 6, line 18, adds new authority to the Alaska Oil and Gas Conservation Commission (AOGCC) to regulate the production of gas separately from water sources, and to regulate the disposal of waste from activities related to drilling. [Section 6] page 8, line 5, retains the state's "overriding interest authority" as it relates to nonconventional drilling activities. And Section 26, page 20, retains the existing nonconventional leasing program for rural Alaska; he said he'd explain how that is delineated shortly.

CHAIR KOHRING added that the aforementioned is to address Representative Rokeberg's concerns expressed at the last hearing about the "bifurcation issue." Calling it a good thing, Chair Kohring said it "enables us to accomplish the objective that Representative Masek is seeking to do, but it separates out rural Alaska so that we can continue with the initial objective in '96 with that legislation to acquire cheap energy sources for rural areas of Alaska."

Number 1129

MR. MUSSER continued with Version Q. He said Sections 27-34 bring back and retain the existing "'nonconventional' language that would have been repealed," incorporating all of the existing program into the conventional oil and gas exploration program. Page 25, lines 14-27, puts the responsibility on a

lessee who is unable to negotiate a reasonable access agreement with a property owner "to both compensate them not only for actual damages that may incur, but reasonable compensation for the loss of use of the property." Furthermore, it requires the department to provide notice and an opportunity to be heard by an affected party prior to setting a bond amount and issuing a lease for nonconventional activities.

MR. MUSSER explained that Section 36 [page 25, line 28] requires the department to advise and assist municipalities that are seeking to adopt ordinances and regulations to regulate within their boundaries some activities that may exist relating to nonconventional activities. And [Section 49] page 41, line 26, bifurcates the program; this applies only to the Municipality of Anchorage, the Kenai Peninsula Borough, the Matanuska-Susitna Borough, and the Fairbanks North Star Borough, shifting those into the conventional gas program and taking them outside the existing nonconventional leasing program. It retains existing statutes, but only as they apply outside of those boundaries.

Number 1325

REPRESENTATIVE HOLM asked whether anyone had talked to the Fairbanks North Star Borough about this.

MR. MUSSER replied no, although both the city and borough had been sent a fax at about 9:30 a.m.

REPRESENTATIVE HOLM emphasized the need to hear from those who will be affected, noting that there are 7,400 square miles in the borough, with a small city in area.

MR. MUSSER indicated agreement, saying this bifurcation is a policy call and that there hadn't yet been debate about whether the boundaries should be set narrowly or broadly in scope.

REPRESENTATIVE ROKEBERG remarked, "We could just delete the [Fairbanks] North Star Borough from it and put them under the shallow gas program. Think about it."

REPRESENTATIVE HOLM replied that he'd thought about it. He agreed [this bifurcation] appears the right thing to do, but reiterated the need to discuss such things with the people who would be affected.

MR. MUSSER remarked that it was a good question.

Number 1491

MR. MUSSER turned attention to written amendments that began at the bottom of the first page of a two-page document labeled "CSHB-531, LS1818\Q." He offered Amendment 1, which read [original punctuation provided]:

Page 25, Line 28. Section 36. Delete Section 36.

MR. MUSSER, noting that Section 36 requires the commissioner to advise and assist municipalities as to local ordinances and regulations that may apply, explained the reason for deleting this section: those concerns would be addressed by placing the state's larger municipalities and boroughs under the state's conventional oil and gas exploration program through the best interest finding process.

Number 1558

REPRESENTATIVE ROKEBERG returned attention to the "area situation." He recalled recently hearing a presentation from British Columbia's Minister of Energy, who'd said there might be 10 billion barrels of oil offshore there. Representative Rokeberg expressed some skepticism about the amount, but said northern British Columbia does have gas. He asked whether there had been exploration for coal and/or gas in Southeastern Alaska; he suggested perhaps expanding the scope within the legislation. In addition, he questioned having the Lake and Peninsula Borough included when an areawide lease is going forward there.

CHAIR KOHRING brought attention back to Amendment 1. He requested confirmation that [Section 26] is redundant language that doesn't need to be there as a result of modifications in [Version Q].

MR. MUSSER affirmed that.

Number 1780

REPRESENTATIVE KERTTULA declared she may have a conflict, since she has seen a map that may place property owned by her parents in the Matanuska-Susitna area into the leasing areas.

REPRESENTATIVE ROKEBERG declared he is member of a limited liability corporation that owns property in the Matanuska-Susitna area and in the Municipality of Anchorage.

REPRESENTATIVE HOLM declared he owns lots of property in the Fairbanks North Star Borough.

Number 1853

REPRESENTATIVE ROKEBERG moved to adopt Amendment 1 [text provided previously]. There being no objection, it was so ordered.

Number 1870

MR. MUSSER offered Amendment 2, also found in the document labeled "CSHB-531, LS1818\Q," which read [original punctuation provided but some formatting changed]:

Add. Sec. 48. AS 38.05.180(n).

AS 38.05.180(n) is amended to read:

(n) The commissioner may establish by regulation that after a well has been plugged and abandoned, the rental rate which was in effect during the year of abandonment is maintained for the remainder of the term. Rental is payable in advance and continues until income to the state from royalty or net profit share exceeds rental income to the state for that year. Under this section,

(1) [OIL AND GAS] leases for oil and gas or for gas only shall provide for payment to the state of rental on the following basis:

- (A) [(1)] for the first year, \$1.00 per acre;
- (B) [(2)] for the second year, \$1.50 per acre;
- (C) [(3)] for the third year, \$2.00 per acre;
- (D) [(4)] for the fourth year, \$2.50 per acre;
- (E) [(5)] for the fifth and following years, \$3.00 per acre;

(2) if the lessee under a gas only lease demonstrates to the commissioner that the potential resources underlying the lease area are reasonably estimated to be only nonconventional gas, the rental payment is \$1.00 per acre until the lease expires or paying quantities of conventional oil or gas are discovered underlying the lease.

Renumber sections accordingly. This amendment would return language to the bill that needs to be there. It was inadvertently omitted during revisions to the current version.

MR. MUSSER explained that the foregoing language, inadvertently omitted in drafting, sets out the base lease rate established by the commissioner for "spud wells." That would be inserted on page 41, line 8, [following] Section 47.

Number 1912

REPRESENTATIVE ROKEBERG moved to adopt Amendment 2 [text provided previously]. There being no objection, it was so ordered.

Number 1969

MR. MUSSER began discussion of Conceptual Amendment 3. He explained that someone was on teleconference from AOGCC, which had requested the amendment. He referred to page 43, line 31 [Section 53], the new definition in Version Q that amends AS 38.05.965 by adding a new paragraph (25) to read:

"nonconventional gas" means coal bed methane, shale containing gas, or gas hydrates.

MR. MUSSER related his interpretation of what AOGCC wants, as follows:

"nonconventional gas" means coal bed methane, gas contained in shale from gas hydrates.

CHAIR KOHRING called on Mr. Norman and Mr. Seamount of AOGCC.

Number 2091

JOHN K. NORMAN, Commissioner, Alaska Oil and Gas Conservation Commission, noted that also on teleconference was senior geologist Bob Crandall. Calling this fine-tuning with regard to the definition, he said Conceptual Amendment 3 would be such that the language would read:

"nonconventional gas" means coal bed methane, gas contained in shale, or gas from gas hydrates.

CHAIR KOHRING asked whether the following was the correct wording for Conceptual Amendment 3:

"nonconventional gas" means coal bed methane, gas contained in shale for gas from gas hydrates.

MR. NORMAN answered in the affirmative.

Number 2173

REPRESENTATIVE MCGUIRE moved to adopt Conceptual Amendment 3 as stated. There being no objection, it was so ordered.

CHAIR KOHRING invited Mr. Norman and Mr. Seamount to address Version Q. He asked that they speak closer to the microphone in order to help the sound quality.

Number 2227

MR. NORMAN referred to new language in Section 4, beginning on page 6, and said AOGCC has reviewed this and believes it is workable, can be administered, and can be overseen. Turning to page 8, Section 6, he said:

With the recognition that this is already in law as a result of last year, I'd raise a question as to whether this properly belongs within Title 31, because it relates to the commissioner of natural resources' making certain determinations. And it did overlap with Section 36 on page 25, where the commissioner was also advised to assist municipalities. As I understand, ... Amendment 1 addressed that. But this ... leaves this section here. And I just raise the question about whether that's the proper place for it, because there's no role for the Alaska Oil and Gas Conservation Commission here, and yet within Title 31 that carves out our powers and duties and responsibilities.

MR. NORMAN addressed Section 7, page 8, which would amend AS 31.05.170 by adding a new paragraph (16) to read:

"nonconventional gas" has the meaning given in AS 38.05.965.

MR. NORMAN, noting that the definition in Title 31 is tied to the definition in Title 38, just discussed and amended, pointed

out that within nonconventional gas there is a category called "tight gas". He explained:

That's where a reservoir has very low permeability and the gas won't flow without some extraordinary efforts being made. And I just point that out here, as we're focused on the definition of nonconventional gas, because this definition goes back to Section 53 on page 43, where the definition appears. And then we talked about coal bed methane, gas contained in shale, and gas from gas hydrates. And there is a fourth category that, in the general parlance of the industry, is ... thought also as being nonconventional gas, and that's "tight gas."

And I don't know that we have an opinion at all as to whether you should incorporate that, but thought that we would want to at least bring it to your attention so that if you do exclude it, which it is here, you'd know that you are excluding it from what's generally understood to be nonconventional gas.

[Mr. Seamount informed members that he had nothing to add.]

MR. NORMAN, in response to Chair Kohring, said, "From the perspective of what the AOGCC needs to be prepared to administer, we're comfortable with the legislation."

Number 2463

REPRESENTATIVE HOLM asked what would happen under the bill if he owned a coal lease as well as gas underneath that.

Number 2475

MARK MYERS, Director, Division of Oil & Gas, Department of Natural Resources (DNR), answered:

If you own a coal lease, you do not own the gas. You only own the gas if you need to vent it for safety issues with the mining; then you have to tie it to actually produce the gas, rather than to vent it ... and then use it for local use or to sell it. ... The gas in that coal belongs to the oil and gas lessee unless the coal is actively being mined and ... it's proven to be a hazard.

REPRESENTATIVE HOLM asked what would happen if he owned a gas lease underneath and in conjunction with a coal bed methane lease.

MR. MYERS replied that someone who has a shallow gas lease under current law would have the right to all gas within 3,000 feet of the surface and, in some cases, deeper, if part of the field, depending on the lease. He added that with this bill, if passed as is, for nonconventional gas and the new leases that would be granted, "you would own the rights to all of the gas within any coal on your lease, regardless of depth and regardless of whether you mined them or not." He noted, however, that such a person wouldn't own the rights to conventional gas.

REPRESENTATIVE HOLM asked whether, if conventional gas were found underneath a coal lease, none of it would be owned by the coal lessee unless a conventional gas lease had been purchased.

MR. MYERS affirmed that. Under this bill, he said, a person could have either a gas-only lease or an exploration license that could be converted to a conventional lease. Under those two circumstances, the person would own the gas that wasn't associated with coal or hydrates, or gas contained in fractured shale.

Number 2580

CHAIR KOHRING said he'd like to hear from the co-chairs of the House Resources Standing Committee, sponsor of this legislation, about Representative Holm's concerns and whether they'd heard from the areas to be most affected. He said what [Version Q] was intended to accomplish basically relates to the bifurcation issue. However, he expressed concern with the original legislation in terms of placing the urban areas, as noted, in the areawide leasing program and hence making them subject to the best interest findings; he opined that this would be counterproductive to developing shallow gas resources.

AN UNIDENTIFIED SPEAKER said from the audience, "We weren't aware you put that in the bill, Mr. Chairman, until this afternoon."

CHAIR KOHRING said he was talking about part of the original bill that remains in Version Q and how it affects areas of the state including Fairbanks, Anchorage, the Matanuska-Susitna Borough, and so forth.

MR. MUSSER added that the legislation would turn the entire state back under the conventional oil and gas exploration program. By bifurcating it this way and only putting the larger urban centers into the program, he said there are two things to consider. Since enactment of the existing shallow gas bill, there had been no activity until the last couple of years. By returning those urban centers to the areawide program, he suggested, nothing will be gained or lost with regard to those affected boroughs and municipalities up to this point.

Number 2723

REPRESENTATIVE HOLM noted that he'd received a letter from a coal company which relates the belief that, under current law, the underlying, existing coal leases would be at risk if this new program were put in place, and that the current shallow gas leasing program, authored in 1996, was intended to allow the coal lessee the sole right to that gas.

MR. MUSSER responded that he, too, had seen that correspondence "and addressed it." Saying the key is the shallow gas, he added, "If they have obtained under the existing permit ... a nonconventional gas permit, they have the rights ... to that shallow gas under the existing program. They don't lose it under the existing program if they have a lease."

REPRESENTATIVE HOLM said he wanted to make it clear that this legislation doesn't change that.

MR. MUSSER replied, "No, sir, not for those that hold an existing lease."

CHAIR KOHRING referred to concerns brought up by Representative McGuire during a hearing on HB 395. He asked where she stood with the current legislation.

REPRESENTATIVE MCGUIRE surmised that further work would be done in other committees of referral, but said she believed everything looked good [in this legislation], and that it's what she was envisioning.

Number 2842

MR. MUSSER turned attention to Amendment 4, the third amendment in the two-page document labeled "CSHB-531, LS1818\Q," which read [original punctuation and capitalization provided]:

Page 22, line 1 and 3. change the work [sic] nonconventional to "gas only". This is a conforming language change.

MR. MUSSER explained that this change was pointed out by the Division of Oil & Gas.

MR. MYERS clarified that he no longer wished to have that change; after further analysis of the bill, he believed the current language was correct. He explained that he'd misunderstood, thinking there was a separate nonconventional lease type in Version Q.

MR. MYERS brought attention to the fact that Section 35, subsection (3)(B) [page 25], provides for compensation if there is loss of surface use or enjoyment. [Not on tape, but taken from the Gavel to Gavel Alaska recording on the Internet, was that current state law only allows for damages.]

TAPE 04-12, SIDE B

Number 2950

MR. MYERS observed that this would be an additional right.

MR. NORMAN remarked that there are obvious policy considerations from a land-management standpoint, which are within the purview of the legislature and Mr. Myers. From the standpoint of a regulatory agency, however, he said [AOGCC] believes the bill is workable.

Number 2899

REPRESENTATIVE McGUIRE moved to report CSHB 531 [Version 23-LS1818\Q, Chenoweth, 3/31/04], as amended, out of committee with individual recommendations and the accompanying zero fiscal notes. There being no objection, CSHB 531(O&G) was reported from the House Special Committee on Oil and Gas.

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Oil and Gas meeting was adjourned at 4:59 p.m.