

**ALASKA STATE LEGISLATURE  
HOUSE RESOURCES STANDING COMMITTEE**

April 23, 2004

2:15 p.m.

**MEMBERS PRESENT**

Representative Beverly Masek, Co-Chair  
Representative Cheryll Heinze, Vice Chair  
Representative Carl Gatto  
Representative Bob Lynn  
Representative Nick Stepovich  
Representative Kelly Wolf  
Representative Beth Kerttula  
Representative David Guttenberg

**MEMBERS ABSENT**

Representative Nancy Dahlstrom, Co-Chair

**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 CSSSHB 364(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  
 04/01/04 (H) Moved CSSSHB 364(O&G) Out of Committee  
 04/01/04 (H) MINUTE(O&G)  
 04/05/04 (H) O&G RPT CS(O&G) NT 2DP 1NR 3AM  
 04/05/04 (H) DP: KERTTULA, CRAWFORD; NR: MCGUIRE;  
 04/05/04 (H) AM: HOLM, ROKEBERG, KOHRING  
 04/14/04 (H) FIN REFERRAL REMOVED  
 04/19/04 (H) RES AT 1:00 PM CAPITOL 124  
 04/19/04 (H) Scheduled But Not Heard  
 04/23/04 (H) RES AT 1:00 PM CAPITOL 124

**WITNESS REGISTER**

REPRESENTATIVE PAUL SEATON  
 Alaska State Legislature  
 Juneau, Alaska

POSITION STATEMENT: Spoke as the sponsor of SSHB 364.

SEAN PARNELL, Deputy Director  
 Division of Oil & Gas  
 Department of Natural Resources  
 Anchorage, Alaska

POSITION STATEMENT: During discussion of SSHB 364, answered questions.

**ACTION NARRATIVE**

**TAPE 04-25, SIDE A**  
 Number 0001

**CO-CHAIR BEVERLY MASEK** called the House Resources Standing Committee meeting to order at 2:15 p.m. Representatives Masek, Gatto, Lynn, Stepovich, Wolf, and Kerttula were present at the call to order. Representatives Heinze and Guttenberg arrived as the meeting was in progress.

HB 364-NATURAL GAS LEASES NEAR KACHEMAK BAY

[Contains discussion of HB 531 and HB 312.]

CO-CHAIR MASEK announced that the only 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."

Number 0123

REPRESENTATIVE PAUL SEATON, Alaska State Legislature, spoke as the sponsor of SSHB 364. Representative Seaton explained that originally HB 364 was buy-back legislation. However, SSHB 364 is a moratorium on reissuance of the shallow natural gas leases in the Homer area if those are forfeited or aren't renewed. The current version, CSSSHB 364(O&G), removed the findings from the legislation and added criteria by which the director of the Division of Oil & Gas can reissue oil and gas leases. Representative Seaton informed the committee of the circumstances that created the legislation. In 1976 the state bought back the offshore oil and gas leases in the Kachemak Bay area and placed a moratorium on any future offshore leases. The valuable renewable resources of the area were cited as part of the reasoning. In 1996 the state created the shallow natural gas program, which provides low-cost, over-the-counter leases for shallow natural gas at less than 3,000 feet. The main benefit to the aforementioned is the low cost lease. The program was created to stimulate shallow natural gas [leases] in rural areas. However, in 1999 the Cook Inlet areawide lease sale area was created, which allowed for oil and gas leases to be offered every year. The [Kachemak Bay area] was excluded from the areawide lease sale, although it has the same gas potential as the rest of [the Cook Inlet]. He noted that there was no best interest finding specifying why it was excluded because the area was excluded for political reasons. Therefore, the reason [the Kachemak Bay area] is available for shallow natural gas leasing while nothing else in Cook Inlet is available is because of its original exclusion from the aforementioned oil and gas leasing program.

Number 0455

REPRESENTATIVE SEATON informed the committee that June 1, 2003, the state issued the shallow natural gas leases for the subsurface rights in the land just north of Kachemak Bay within the same region that was excluded from the areawide lease sales. He specified that it includes areas underneath the Paul Banks school, the hospital, the watershed and reservoir for the Homer area. Representative Seaton related that the shallow natural gas leases are noncompetitive leases granted at a cost of \$500 per nine square miles and there was no specific best interest

finding for [the Kachemak Bay area]. However, in 1996 there was a general best interest finding, which specified that it was in the best interest of the state to develop shallow natural gas wherever it is found. He noted that no consideration was given to local comments. One of the problems with the shallow natural gas program is that it specifies that if there is any benefit of shallow natural gas to the local area, then the director of the Division of Oil & Gas has to issue the leases. Therefore, all the comments received with regard to impacts can't be considered under the shallow natural gas program. Furthermore, there was no effective notification in the Homer area nor any operational guidelines or regulations in place.

REPRESENTATIVE SEATON specified that the goal of SSHB 364 is to ensure that the current leases in the Homer area aren't extended or reissued and to exclude the lands and waters of Kachemak Bay from future leases under the shallow natural gas program. In no way does this legislation complicate future leasing in this area under other programs. In fact, the inability for an extension or reissuance simplifies things because with shallow natural gas there is the ability to recover the gas above 3,000 feet and if part of the field occurs above 3,000 feet, conventional gas could be [recovered] below 3,000 feet. Under the shallow natural gas program, one must demonstrate that part of the field is contiguous with the upper shallow natural gas field, which isn't necessarily the case. In fact the greatest value for the state could lay in the deeper areas, although the state policy is to not offer that area for conventional gas leases if there is shallow natural gas above it. The reasoning has been the notion that there would be a lawsuit regarding who owns what gas. Therefore, this legislation simplifies the possibility of future conventional gas in the Cook Inlet area, which is more profitable to the state.

Number 0805

REPRESENTATIVE SEATON reviewed the sectional analysis of the legislation, which is included in the committee packet. Section 1 excludes certain lands in the vicinity of Kachemak Bay from leasing under the shallow natural gas program. Anything that could've been leased is excluded from the moratorium on reissuance of leases. Section 2 amends the statute by establishing the discretionary guidelines for the director of the Davison of Oil & Gas when making a decision regarding whether to reissue the leases. The leases have a three-year term and are renewable for an additional three years. One of the problems has been that the statute doesn't specify on what

basis the director is to reissue the leases. Therefore, currently if the director decides not to reissue the leases, it could be seen arbitrary and result in a takings claim against the state. By incorporating the discretionary guidelines in the statute, the state is no longer liable for such a claim so long as the director [follows those guidelines]. Section 3, he related, amends the uncodified law to prohibit the reissuance of these shallow natural gas leases issued before the effective date of this act. Although the director is allowed to not reissue those leases, the conditions are such that there can't be any development on the leases and very little potential that development will take place.

REPRESENTATIVE SEATON highlighted that the fiscal note is zero, although there is a question concerning the indeterminate lack of revenue. The aforementioned isn't the case because the only condition under which these won't be reissued is if the director has determined that the probability is extremely low that anyone will produce gas within the next three years. He noted that the committee packet should include supportive resolutions from the City of Homer, Kachemak City, and the Kenai Peninsula Borough, all of which are the local government units of the area.

Number 1122

REPRESENTATIVE SEATON, in response to Representative Stepovich, confirmed that the current version of the legislation prohibits the extension of the leases in the area excluded from the best interest finding for the areawide lease sale.

REPRESENTATIVE STEPOVICH mentioned his desire to entertain an amendment to this legislation.

REPRESENTATIVE WOLF inquired as to the size of the area this legislation would impact.

REPRESENTATIVE SEATON answered that it's 22,000 square acres of state land of which approximately 18,000 acres are non-state owned subsurface rights. Therefore, in total it amounts to about 40,000 acres, which is eight leases of nine square miles each. He noted that the area is a patchwork of state and private subsurface rights.

REPRESENTATIVE WOLF inquired as to the average depth of the water wells in the area.

REPRESENTATIVE SEATON related his knowledge of some wells that are in the 150-200 foot range. He further related that much of the area has very poor water, and therefore the water comes from the municipal delivery services. He noted that there are coal seams in the area. There isn't good ground water in the area to the east. He indicated that in some areas almost all of the water is delivered by truck from the reservoir, where the city has extraterritorial powers. Towards Anchor Point is where one finds shallow wells that are 20-25 feet, although most financed homes in the area require a drilled well of over 100 feet.

REPRESENTATIVE WOLF recalled hearing concern with contamination of water wells due to shallow natural gas development in the Kachemak Bay area. However, if much of the water is trucked into the area, he questioned from where the concern stems.

REPRESENTATIVE SEATON said that water wells aren't the only problem. Part of the problem is related to the procedures in which shallow natural gas leases were let without public comment. There wouldn't have been problems in a rural area, however, what was available was urban Homer. Homer has traditionally had an economy based on eco-tourism, tourism, and fishing, which is why the state bought back the Kachemak Bay oil and gas leases back in 1976. "This is within that same area. In fact, we're using the same line; those were all sub-tidal and this is the uplands," he explained.

Number 1534

REPRESENTATIVE GUTTENBERG inquired as to why only the Kachemak Bay area is addressed. He noted that there are leases in downtown Healy as well as the Matanuska-Susitna Valley area.

REPRESENTATIVE SEATON highlighted that the Kachemak Bay area has some specific peculiarities. First, it was in the area of an oil and gas buyback and was specifically excluded from the areawide lease sale best interest finding, which made that area available. The aforementioned conditions didn't occur in the other areas mentioned by Representative Guttenberg. Furthermore, there has been no activity on the leases, which is also different than the other areas mentioned. Under this legislation, the discretionary terms are whether "they are paying quantities of gas, which means if you're getting more gas out of the well than it costs you to produce that gas ... the leases are automatically extended." Under the conditions of DNR if there is any production or significant planned production, the leases would be extended. Representative Seaton clarified

that this legislation merely stops speculative holding of leases if the director of the Division of Oil & Gas determines those aren't going to be put into production. Furthermore, it keeps the state from doing a best interest finding for all gas as does an oil and gas sale due to correlative rights.

Number 1711

REPRESENTATIVE KERTTULA declared a conflict of interest with the Matanuska-Susitna Valley area [because of her family's land holdings in that area].

REPRESENTATIVE STEPOVICH asked if SSHB 364 is related to HB 531 and HB 312.

REPRESENTATIVE SEATON clarified that SSHB 364 only relates to the shallow natural gas program. The passage of HB 531 or HB 312 would eliminate the shallow natural gas program. The legislation before the committee today, SSHB 364, speaks to leases issued before and now being held and not developed. He reminded the committee that if the shallow natural gas wells are being developed, production is taking place, or there is a production plan the director views as a plan for development, the director will reissue the leases. The aforementioned is the discretionary provision. The only time the director of the Division of Oil & Gas wouldn't reissue those leases for the second three years is if the leases appear to be held speculatively and it doesn't appear that there will be production on the leases. Representative Seaton emphasized that the aforementioned is the case in the Homer area.

Number 1840

REPRESENTATIVE STEPOVICH inquired as to the length of the moratorium.

REPRESENTATIVE SEATON explained that the leases, which have a three-year term, were issued in June 2003. This legislation specifies that if there is no development on those leases and no plan for development, then the lease expires at that three years. Therefore, there would never be another shallow natural gas lease on that property, although there could be another gas lease or oil and gas lease on that property. In further response to Representative Stepovich, Representative Seaton explained that if these leases weren't reissued and there wasn't a moratorium, another individual/entity could come along and start the process again.

Number 1940

SEAN PARNELL, Deputy Director, Division of Oil & Gas, Department of Natural Resources, turned to Representative Guttenberg's inquiry regarding whether there are any other areas of the state where this [lease] program is available under the same scenario. He related his understanding that this legislation proposes a moratorium on shallow natural gas leases in the Homer area. Therefore, this legislation could be extended to any area in which other leases have been issued. Mr. Parnell informed the committee that [the division/department] supports Section 2 of [CSSSHB 364(O&G)], which limits the discretion of the Division of Oil & Gas director for extending shallow natural gas leases. However, [the division/department] doesn't support Section 1 and 3, which would implement a moratorium and prevent DNR from reissuing leases. He related that DNR actually supports the broader statewide approach offered in HB 531.

REPRESENTATIVE SEATON noted that he supports HB 531 as well, but no one knows if that legislation will pass. Therefore, Sections 1 and 3 of [CSSSHB 364(O&G)] take care of the program if HB 531 doesn't pass. Moreover, if HB 531 doesn't pass and Section 2 of [CSSSHB 364(O&G)] is in place and the leases aren't extended, anyone can apply for the leases on a noncompetitive basis under the same program. He explained:

And so, that's what this is to prevent and so that's what Sections 1 and 3 do, and they would, of course, just apply to this and [HB] 531 would take care of the entire shallow natural gas program. If [HB] 531 passes, [Sections] 1 and 3 are moot. Because if these weren't extended, the shallow natural gas program goes away anyway and so you couldn't issue leases under the shallow natural gas program because HB 531 would eliminate the shallow natural gas program. And this only addresses termination and reissuances of leases under shallow natural gas; this does not prevent, in any way, the formation ... a Cook Inlet areawide lease sale, or the issuance, under [HB] 531, of all gas leases.

Number 2168

REPRESENTATIVE HEINZE asked if [DNR] could make it work. "How bad would this be if this bill went through ...," she asked.

MR. PARNELL said that it depends upon HB 531. He explained that [DNR] is trying to address issues on a statewide basis and if CSSSHB 364(O&G) passes, it may take care of Representative Seaton's area. However, there would still be statewide issues with the program. He informed the committee that there will be other leases that expire in the Matanuska-Susitna Valley and near Fairbanks. Therefore, [DNR] is focusing on addressing this issue on a statewide basis rather than in a piecemeal fashion.

REPRESENTATIVE HEINZE asked whether [DNR] could make it [Sections 1 and 3 of CSSSHB 364(O&G)] work if HB 531 is taken off the table.

MR. PARNELL explained that if Sections 1 and 3 of CSSSHB 364(O&G) pass, uncertainty will be created about the state's leasing program, both the shallow natural gas program and any other program. He predicted that there will be problems statewide if the state is carved up as is the case under [CSSSHB 364(O&G)] rather than approaching the problem statewide in a best interest finding process. If [CSSSHB 364(O&G)] passes, a moratorium would be imposed on leasing in the Homer area and would have statewide implications with regard to uncertainty with the state's leasing program. Furthermore, passage of [CSSSHB 364(O&G)] could [prevent] future industry investment in the state if [the industry] thinks other areas of the state might be at risk. He noted that this would go beyond shallow natural gas.

REPRESENTATIVE KERTTULA surmised then that if HB 531 passes, Sections 1 and 3 would be "wiped out" because there is no more shallow natural gas program. She noted that Section 2 of [CSSSHB 364(O&G)] is already included in HB 531. Therefore, the question is if the shallow natural gas program doesn't go away as planned in HB 531, then this legislation would exempt only the Kachemak Bay area rather than the entire state and Section 2 would add in the protection for the entire state.

MR. PARNELL indicated agreement with Representative Kerttula's understanding.

Number 2384

REPRESENTATIVE GUTTENBERG asked if [CSSSHB 364(O&G)] provides [DNR] the technical tools to implement the moratorium.

MR. PARNELL replied, "For the Homer area, yes."

Number 2424

REPRESENTATIVE GATTO inquired as to Mr. Parnell's thoughts on an amendment to include the entire state.

MR. PARNELL said whether to impose a moratorium on shallow natural gas throughout the state would be a policy call.

REPRESENTATIVE STEPOVICH questioned why Kachemak Bay received a buyback, but not the Matanuska-Susitna Valley area.

REPRESENTATIVE SEATON reiterated his earlier testimony regarding the unique situation of the Kachemak Bay, which resulted in this legislation.

REPRESENTATIVE STEPOVICH related that the state does buyback leases in which a mistake was made by issuing the lease. He noted that he owns leases. He inquired as to why the state bought back the leases originally.

REPRESENTATIVE SEATON noted that it was an entirely contentious situation between the state and the Kachemak Bay area for quite some time. Ultimately, the state decided that it wasn't in its best interest to have those leases, and therefore bought back the leases in [the Kachemak Bay area]. He pointed out that the best interest finding that excluded this area from oil and gas leases was the establishment of the Cook Inlet areawide lease sale.

REPRESENTATIVE STEPOVICH indicated that he may offer a conceptual amendment to include the Matanuska-Susitna Valley in the buyback.

CO-CHAIR MASEK clarified that the legislation before the committee isn't buyback legislation.

REPRESENTATIVE SEATON reiterated that [CSSSHB 364(O&G)] is a moratorium on the reissuance of leases that weren't extended because they were nonproductive.

The committee took an at-ease from 2:58 p.m. to 3:02 p.m.

CO-CHAIR MASEK informed the committee that Representative Stepovich had provided the committee with an amendment during the at-ease.

Number 2777

REPRESENTATIVE STEPOVICH said that his amendment would broaden the legislation. Representative Stepovich moved that the committee adopt Amendment 1 [23-LS1464\S.1, Chenoweth, which read:

Page 1, line 5 following "lease;":

Insert **"directing the commissioner of natural resources to reacquire shallow natural gas leases in the Matanuska-Susitna Borough;"**

Page 3, following line 30:

Insert a new bill section to read:

**"\* Sec. 4.** The uncodified law of the State of Alaska is amended by adding a new section to read:

REACQUISITION OF CERTAIN SHALLOW NATURAL GAS LEASES. (a) The commissioner of natural resources shall enter into negotiations to reacquire, by purchase in the name of the state, the title to or accountable interests in shallow natural gas leases entered into under AS 38.05.177 before the effective date of this Act within the boundaries described in (d) of this section.

(b) In lieu of cash payment for a negotiated repurchase of a leasehold interest described in (a) of this section, the commissioner of natural resources may authorize a credit of the purchase price plus interest at the rate prescribed in AS 09.30.070 to be granted to the seller, to be applied against future lease bonus or rental payments, permit fees, royalties, or oil and gas taxes that may become owing on new production from other leases or property held by the seller for oil and gas development, including shallow natural gas development. The commissioner may also negotiate to reimburse, in like manner by credit provision a reasonable amount to compensate the lessee for expenses and other costs incurred by the lessee.

(c) If the commissioner of natural resources is unable to negotiate a satisfactory price for repurchase of a leasehold interest described in (a) of this section, the commissioner may acquire a leasehold interest described in (a) of this section through exercise of the power of eminent domain.

(d) The provisions of this section apply to shallow natural gas leases issued under AS 38.05.177 before the effective date of this Act on land and water described in the Matanuska-Susitna Borough."

Renumber the following bill section accordingly.

REPRESENTATIVE HEINZE objected.

CO-CHAIR MASEK related what Amendment 1 would do to Mr. Parnell who didn't have a copy to review. She asked Mr. Parnell if he believes Amendment 1 should be added to the legislation.

MR. PARNELL replied no, he reiterated [DNR's] opposition to a buyback, which could be expensive and could shut down exploration for rural energy alternatives. The approach in HB 531 is preferred, he reiterated.

Number 2880

REPRESENTATIVE STEPOVICH related that constituents have asked for [what is proposed in Amendment 1].

REPRESENTATIVE SEATON highlighted that Amendment 1 changes the entire character of the legislation. He noted that Amendment 1 would've been appropriate with the original HB 364, which was buyback legislation. With [the changes to the current version of HB 364], the accompanying fiscal note has become zero.

**TAPE 04-25, SIDE B**

REPRESENTATIVE SEATON indicated that Amendment 1 would require a large fiscal note. Representative Seaton related his opposition to Amendment 1.

Number 2918

REPRESENTATIVE GATTO inquired as to what would happen if, instead of the buyback, the same language was extended "that called for a moratorium on inactive nonrenewal of inactive leases to other areas besides Kachemak [Bay]." He surmised that doing the aforementioned would maintain a zero fiscal note while allowing inactive leases not to be extended or bought.

REPRESENTATIVE SEATON agreed that "in one way" Representative Gatto is correct. However, there are rural leases that are nonproductive because individuals haven't gotten their permits in line. He related that through this legislation he has no intention of shutting down Healy or Pogo, a couple of the areas of the state in which the shallow natural gas leases were

ongoing but hadn't yet become productive. Representative Seaton reiterated his earlier testimony regarding the unique situation of Homer, which is an area opposed to the shallow natural gas program and where it isn't underway at all. Therefore, extending it into areas where there are developmental wells could result in a situation in which the Division of Oil & Gas is in more of a quandary regarding which [leases] should be extended. He reiterated that such isn't the case in the [Kachemak Bay] area where it's completely speculative. The purpose of this legislation, he clarified, is to not extend speculative leasing, although it doesn't intend to stop leasing that's under development. However, if "it's expanded out throughout the state, that could well be the intent," he said.

REPRESENTATIVE STEPOVICH agreed that he didn't want to shut down any more leasing either. He said he wouldn't want to impose a moratorium in other areas unless it was brought to the attention of the area and those in the area wanted it. Representative Stepovich asked if the administration has discussed a buyback in the Matanuska-Susitna Valley.

Number 2730

MR. PARNELL related that the governor, on a number of occasions, has said that a buyback should be a last resort. In this case, [DNR] believes a buyback would be very expensive, would be a disincentive to the development of rural energy alternatives, and undermines the state's leasing programs. Mr. Parnell opined that there is a better statewide solution. The desire, he related, is to include the public in a best interest finding process and move through a competitive process rather than through the over-the-counter program that currently exists. Therefore, he related opposition to Amendment 1.

REPRESENTATIVE KERTTULA declared a conflict of interest with regard to Amendment 1 [because her family owns property in the Matanuska-Susitna Valley area].

The committee took an at-ease from 3:12 p.m. to 3:15 p.m.

REPRESENTATIVE GATTO declared a conflict of interest.

REPRESENTATIVE STEPOVICH withdrew Amendment 1.

Number 2621

REPRESENTATIVE HEINZE moved to report CSSSHB 364(O&G) out of committee with individual recommendations and the accompanying fiscal notes. There being no objection, it was so ordered.

**ADJOURNMENT**

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 3:16 p.m.