

**ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE**

February 23, 2004

3:38 p.m.

TAPE(S) 04-14, 15

MEMBERS PRESENT

Senator Scott Ogan, Chair
Senator Thomas Wagoner, Vice Chair
Senator Ralph Seekins
Senator Ben Stevens

MEMBERS ABSENT

Senator Fred Dyson
Senator Kim Elton
Senator Georgianna Lincoln

COMMITTEE CALENDAR

SENATE BILL NO. 312

"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: SB 312

SHORT TITLE: CONVENTIONAL & NONCONVENTIONAL GAS LEASES

SPONSOR(S): RESOURCES BY REQUEST

02/09/04	(S)	READ THE FIRST TIME - REFERRALS
02/09/04	(S)	RES, FIN
02/23/04	(S)	RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

Mr. Mark Myers, Director
Division of Oil and Gas
Department of Natural Resources
400 Willoughby Ave.
Juneau, AK 99801-1724

POSITION STATEMENT: Supports SB 312.

Mr. Carrol Martin
Soldotna AK

POSITION STATEMENT: Opposes SB 312.

Mr. Doug Carney
Sleetmute AK

POSITION STATEMENT: Supports SB 312.

Ms. Michelle Church
Palmer AK

POSITION STATEMENT: Opposes SB 312.

Jeanne Walker
Homer AK

POSITION STATEMENT: Opposes SB 312.

Mr. Ken Boyd, Chairman
Alaska Oil and Gas Association (AOGA)

POSITION STATEMENT: Supports SB 312.

Mr. Jeff Arnot
Palmer AK

POSITION STATEMENT: Commented on SB 312.

Ms. Roberta Highland
Homer AK

POSITION STATEMENT: Commented on SB 312.

Mr. Myrl Thompson
Palmer AK

POSITION STATEMENT: Commented on SB 312.

Mr. Robert Archibald
Homer AK

POSITION STATEMENT: Commented on SB 312.

Mr. Chris Rose
Palmer AK

POSITION STATEMENT: Opposes SB 312.

ACTION NARRATIVE

TAPE 04-14, SIDE A

^#SB312

SB 312-CONVENTIONAL & NONCONVENTIONAL GAS LEASES

CHAIR SCOTT OGAN called the Senate Resources Standing Committee meeting to order at 3:38 p.m. Present were Senators Wagoner, Stevens, Seekins and Chair Ogan. Senators Elton, Dyson and Lincoln were excused. The first order of business to come before the committee was SB 312. He announced that the hearing had been noticed on February 12, one week longer than the minimum requirements to give people adequate time to respond.

SENATOR THOMAS WAGONER moved to adopt CSSB 312(RES), version \S. There were no objections and it was so ordered.

MR. MARK MYERS, Director, Division of Oil and Gas, said the administration very much supports CSSB 312.

The following is a verbatim transcript on CSSB 312.

MR. MYERS: The bill, in essence, repeals or eliminates the current over-the-counter shallow gas leasing program and provides a vehicle to replace it with existing programs, including the competitive leasing program and the exploration licensing programs.

I guess the first question is why would you want to do that. There are multiple reasons we recommend this approach. The first is one of the criticisms of the shallow gas program has been its public process. Up prior to leasing, it is an applicant driven over-the-counter program. It was originally passed in 1996 by the Legislature with the intent of providing rural energy opportunities in rural remote parts of Alaska. It was anticipated to be a relatively small program used only on occasion surrounding bush Alaska communities that could benefit from natural gas. Most of these communities are currently still using fuel oil. So, it's seen as an environmentally preferable option.

In order to make the program as simple as possible, it created an over-the-counter program thinking again relatively small usage in areas of low population density surrounding rural Alaska.

The program was a success; the program had some unintended consequences. One of those unintended consequences was that it allowed leasing any place that didn't have a current areawide lease sale in it, which meant in areas adjoining areawide sales, in relatively high-populated areas like the Mat Valley, down by

the Homer area, it allowed people to apply for the over-the-counter leases. It led to confusion over the notification, because the original shallow gas [legislation] did not contemplate a long-term up front public process prior to leasing.

Folks really were caught kind of by surprise even though it was noticed properly by the law. The notice [requirement] isn't nearly as rigorous as it is under the other leasing programs. Therefore, the leasing that occurred was driven by the applicant rather than in a planned and organized fashion in these areas. What we ended up with is the current issues we have in the Mat Valley and the Homer area. This bill steps back and recognizes that we need a more robust systematic type approach in these areas of higher population densities.

The other part of the equation was in rural Alaska at the time those passed, there were other than areawide sales, which have the finding and the major process and are competitive in nature. We didn't have another vehicle for leasing. So, it was restricted to places where sales were on the five-year schedule, went to this robust process.

At the same time in '96, another program was passed that was called "Exploration Licensing." That program allows exclusive licensing in rural areas up to 500,000 acres to a single licensee. It is a competitive process in the sense that folks bid a work commitment for that exploration. But in retrospect, we believe the combination now of the exploration licenses in rural areas outside our areawide sales combined with the areawide sales will bring, in fact, a better up front public process and ultimately allow for development of resources in rural areas as well as in areas close into the current areawide sales.

One of the other problems we recognize in the shallow gas program was for shallow gas, but using a 3,000 ft. depth cutoff or a modified version of that, as the bill later was modified to allow for, part of the field was above 3,000 ft. Then they could produce down further. It still isn't a very good solution in terms of resource development. It will work in some cases for coalbed methane - maybe, for some shallow gas - maybe; but it isn't an economical, reasonable way to explore and produce for oil and gas. You'd like them to be able to produce all the gas off a given lease just for the economics of it and for maximizing the benefit to the people of the state.

So, the concept of limited depth is problematic. The lack of public process up front in the leasing has been problematic and, quite honestly, a lack of competitive process, has been problematic with the program. In areas other than - there's a few areas in rural Alaska where it has been used pretty effectively. So, this program recognizes those limitations. This bill recognizes those limitations and replaces the existing program with this program.

We think - the first thing was - we used the best interest finding process. Why is that important? Again, it allows for enough up front public planning and notification so no one should be caught off guard. Local communities will have full input into the process and do under those two programs. It's a better balancing test. Under the shallow gas program, basically the Legislature assumes that if the gas in the area benefited the folks in the region, it was a goal that you had to lease it. The best interest finding is a more robust process. It weighs all the environmental effects; it weighs the subsistence effects; and it comes out with a conclusion. Rather than being applicant driven, it allows the DNR to customize the lease sale to do more, to have environmental safeguards associated with responsible development. So, again, the best interest finding process is integral to that.

In your packets there are several pieces of information. The first compares - this spread sheet - as you can see - I won't go through it in detail, but it compares the processes involved with issuing a shallow gas lease versus an exploration license or an areawide lease. You can see on the top the shallow gas lease is non competitive over-the-counter; it's applicant driven as opposed to competitive in the areawide and the exploration licensing and more of a coherent determination of where the acreage is actually acquired for the lease.

The process of the fees - shallow gas leasing has a filing fee; areawide sales have a minimum bid per acre and a licensing fee. The best interest finding, again, is one of the major differences present in exploration licensing and areawide lease sales. There is a difference in the way ACMP (Alaska Coastal Management Plan)[consistency] determinations are done; the public notice is much more extensive in the areawide process. A lot of that [indisc.] and the exploration license, a lot of that related to the best interest finding. So, you can then, a lot of the concerns we are seeing addressed in the Mat Valley and Homer and other areas concerning this program are addressed, in fact, in the process of going to a best interest finding. So, we think

it's a better public process; it's a better management tool. The competitive nature of the program, I think, will ultimately bring in more money for the state. So, we see this having positive fiscal effect.

The leases issued are typically longer than three-year leases. There are a number of 7 to 10-year leases in the competitive sale. Exploration licenses go from 5 to 10 years and then the applicant is allowed to lease after that. So, it has benefits to the industry as well. All of the BIFs (best interest findings) are available rather than limited to 3,000 ft. or deeper if some of the gas is above 3,000 ft. and the term is longer.

In areas, particularly adjoining conventional lease areas, unlimited depth makes for better management when shallow gas leases are produced in adjoining areas to conventional leases in production. So, it's better for oil and gas management. So, all in all, we have a much better program.

One of the other features - the concern was that for non conventional gas, for coalbed methane, for gas hydrates, fractured shales, these projects do have potentially different economics. So, it was their mechanism available to support less economically viable projects as these may be. This bill has that mechanism in there. Basically, the lease terms on the rentals normally start at a \$1 and normally go up to \$3 over time. They are accelerated 50 cents at a time per year. There is a way under this bill that if someone has a gas-only lease and they can reasonably estimate that the gas presently leased is non conventional to the commissioner, he can keep that rental rate at \$1 and then also can use the 6.25 percent lower royalty terms not competing with other gas in the market. So, it preserves a lot of the economic incentives present in the shallow gas leasing program for that potential production of non conventional gas.

It also, as I mentioned, has a term that is not available currently to the commissioner on either exploration licenses or areawide leases - that of a gas only lease. In certain areas, because of the concern about oil spills or risk or some unique environmental conditions, it may be appropriate to use the gas only terms; in other areas we pretty much know there's no oil potential. So, it allows the commissioner at the time to issue that lease as a gas only lease. It's just another good management tool that's present that's not available under the current two programs.

So, what we've tried to do, and what I believe Senator Ogan has tried to do in his bill, is to meld the best parts of the shallow gas leasing program into the areawide and the exploration licensing programs.

A couple more sheets - I won't go into great detail - but the best interest finding, it shows the contents of the best interest findings are 11 different things. It is truly a balancing test. I have an example here if people want to see it. It's a pretty thick document. But it balances things like the petroleum potential versus the fish and game and wildlife resources, the subsistence resources, economic effects of the area. It develops the stipulations and mitigation measures appropriate to the lease; it allows for customizing the size and shape of leases - for instance, limiting surface access to certain areas, allowing the producer the oil or gas underneath that area. So, it gives the state a tremendous amount of tools. It also has multiple points of public access and entry for comments. The document isn't produced as a final document; there's an initial call for comments that goes out - that is noticed. Then there's a preliminary document, which is developed in which the public is free to comment on and is actually urged to comment on. All those comments from the public, no matter who it comes from, has to be answered in the final best interest finding. So, again, lots of public process.

There are two other pages here that show the areawide leasing public process and the exploration licensing public process that show all those points of public input. So, anyway, that's a long-winded version of what's sort of in this bill, what it's intended to do. To summarize it - it replaces the shallow gas leasing program with programs that are more tried and tested and it has better public input and has a different balancing test. It also provides for financial lease payments and royalty rates that are commensurate with non conventional gas. Also, by using the term 'non conventional gas,' I think, it puts us back on the right track. We were separating shallow gas leasing. It's really the activity you want to look at - whether it's coal bed methane or it's hydrates or those are the production techniques. The depths really aren't material in the sense of a strict depth limitation. So, it gets us kind of back into the mainframe where you regulate the activity, not the lease type. Does that make sense? The use of the term 'non conventional' - defining that - helps in that. So, it cleans up some of the confusions we've allowed to creep into our statutory and regulatory framework over time and put this back on a course. It also - we have taken seriously the public process that's occurring out in the Valley

and many of those comments do relate to public notice prior to leasing and helps much in those areas.

If you're interested, the comments being developed in those workshops are all available on our website to look at. With that I would answer any questions, Mr. Chairman.

CHAIR OGAN: Any questions from the committee members? [no questions] I have a couple. Let's talk a little bit about some of the unintended consequences. The original program was designed to attract the industry here and primarily focused on rural Alaska. Since then, there has been an increasingly high awareness of a coming gas shortage in Cook Inlet and then the associated price increases. Maybe you can talk about what the price of gas has gone to and where it's at now and where we think it's going and what the short-term and long-term gas shortage supply issues are in the Cook Inlet basin.

MR. MYERS: Mr. Chairman, a lot of different questions there. The first thing is the need to determine whether we have commercial coal bed methane is very important, particularly in Southcentral Alaska. As we look at the conventional gas supply, we are seeing that supply being stretched very hard. You can see that the Agrium Plant is operating at about half capacity now due to a lack of supply in the short term. If we look out longer term, we have about a nine-year reserve life left in the known reserves in the Cook Inlet. If that reserve supply isn't maintained, if that life isn't maintained through pretty aggressive exploration and development of what resources may be there, then we'll start seeing effects in the market. For instance, in the winter we use a lot more gas for commercial and residential uses. That supply is determined by not storing a lot of gas in the ground and having it ready; it's determined by having more production capacity. So, the first pinch you'll see is potential production supply or shortages in the winter months when we really need the gas. To accommodate that, that requires industrial users to cut back on their supply and the first [indisc.] we'll see coming back are the people who can afford to pay the least for the gas. And that's what we're seeing happening to the Agriums of the world - particularly in the winter months, they are losing supply.

The next bite happens to the LNG export plant. If the gas is there available for local use in 2009, the federal government has to renew the LNG export license. I would say with the existing reserve base, if that reserve base isn't replaced, there's very little chance of them approving that. So, the next

thing we would see is the shutdown of the LNG plant and huge effects to the economy on the Kenai and to Southcentral Alaska.

Next we would see effects with shortages outboard of that with the remaining supply for local use in Cook Inlet. Without a supply of gas, we're going to see a real pinch in any future growth in industrial users in Southcentral Alaska. So, we see a tremendous pinch - it's interesting in the area where the coalbed methane potential - although not proven commercial - appears to be the best in the area where the population growth is the highest. Again, a lot of those areas are not plumbed and are not available to the current ENSTAR system and we need some expansion to the north, in particular to the north Mat-Su Valley area. Again, that is the area of current exploration interest.

So, it's interesting that the gas aligns with a lot of the local population growth needs, as well. So, it would be very important and probably the first place that that gas would be used - would be to supply that local use, which would take pressure off the gas that's closer to the LNG and the fertilizer market.

When you look at it out in 2009, 2010, and 2011, for instance, ENSTAR's charts show they have most of their gas supply they need is unaccounted for at this time. Aggressive commercial exploration onshore is being successful to some degree, but it's not offsetting - not finding these very large fields that will offset that for much a period of time. So, for Southcentral to be in a position where we know actually how much gas is going to be available and what our other options are we really have to understand what's there in terms of coalbed methane. It's crucial. If it is there, it will probably be some of the real upside potential for residential users in the area in the vicinity of the coalbed exploration itself. We consider it a very important resource - it needs to be explored and exploited if it works. That's the first question.

The second question was on the shallow-gas leasing program I think did lead to a recognition of the potential in Alaska, which brought companies like Evergreen. The availability of land was an important issue with them and they were able to acquire significant land position. Enough so that if it were to be commercial, they could make - if it were to be technically possible they could make a commercial go of it - because you do need fairly large-scale operation to justify it on a commercial basis. Cuz the wells are generally fairly low productivity for each well.

So, the program did help stimulate industry interest. I think, by-and-large, when we look at the areas in the northern valley though, we have outgrown it. Again you have the public notice and process problems, but we're better served by an extension, I believe, in that area of our competitive leasing program. That way truly you get the most value for the leases. The leases are longer term. If there is conventional gas at deeper depths, then that can be exploited as well in those areas. So, by-and-large, the value to the industry, I think, is increased. The competition will lead to more revenue to the state. The planning process will be more suitable for the local residents of the region. So, that I think is the evolution of why this bill is here.

CHAIR OGAN: Could you possibly clear up some issues? Tell you what; maybe we'll touch base on some of those a little bit later.

Maybe you could talk a little bit about your experience of what you saw that was good when you traveled in other parts of the country about coalbed methane and what you saw that was bad and what we can do to make sure that it's done right in Alaska.

MR. MYERS: Mr. Chairman, I think, again, first of all it's particularly to Southcentral Alaska and in some areas of Rural Alaska - you know, coalbed methane could be the most viable, the most economic and in some areas, maybe the only available source of gas. Which again, environmentally, is probably the preferred fuel for us, or certainly for residential and commercial home use. So, we need to find, I believe we need to find a way to make it work if it, in fact, is commercially viable.

When we looked at coalbed methane operations elsewhere and we've done quite a lot of extensive work including visiting the areas in Wyoming and Colorado, which it's very - are currently under active coalbed development. You could see things that were done well and things that were done not as well. One of the biggest issues down there is surface land use management; that facilities need to be done in an orderly fashion. Look on the North Slope. We try; we use large-unit units. One of the reasons for those large units is to minimize, for environmental reasons, to minimize the amount of surface impact. You do that by having a single operator over a relatively large area and that single operator has limited facilities. They maximize the use of existing infrastructure and minimize its footprint. There aren't redundant pipelines running here and there. They use a systematic orderly approach of expanding the existing pipelines.

Pad sizes are kept to the minimum, they're located - compressors and stations are shared and used to the maximum extent possible. When a new field comes online, they try to share that same facility when it's in close proximity with the new participating [indisc.] reservoir's brought on line.

So, by maximizing existing infrastructure, you minimize the surface use. Some places in the Lower 48, they hadn't done such a good job of that. You had an operator - you know operator A, B, C and D operating the same area. They would use different pipelines; they would have more surface impact. So one of the lessons we learned was to minimize the surface impact, to bury pipelines underneath existing roads and the infrastructure rather than have separate pipelines.

There are cases where a company would put the road in, but would then opt to put the pipeline parallel to it [and] off a ways. That doesn't make any sense. These are low pressure, low volatility lines at a few psi. They're not like the big TAPS line or a big high-pressure gas line. So, you can bury most of those pipes underneath the roads. In the good developments they've done exactly that. They've minimized the impact working well with landowners. The good operators work well with the landowners to provide an uplifted value to the landowner. They compensate them where appropriate and they operate responsibly. So encouraging that activity becomes really important.

Produced water is an issue down there. A lot of times the ranchers want to use the produced water. Sometimes it's a different - it doesn't meet drinking standards. It has more dissolved salts of various types. Often it's not terribly toxic, but over a long term in agricultural uses it can change the PH and value to the soil. So it has to be monitored very carefully.

In Alaska we really don't have that shortage of water. We don't have the need for the water and the plan would be to reinject the water. Again, we don't have the same issue they do in the semi-arid West with the water production. But that was one takeaway lesson; make sure produced water is run adequately. Aquifer protection is important and again, Alaska has pretty good standards for protection of underground aquifers.

When we went to the checklist of issues, the number one issue was to maximize efficiency, the use of facilities, facility placement. The good operators would take their compressor stations, they would sound insulate them - they would put them in closed buildings and they would put them in the valleys. The

bad operators stick them on top of the ridge and have an open framework facility. So, how the operators manage the facility, design of structure is a probably the number one takeaway message.

In Alaska we have a great record of doing that in a way that minimizes environmental impact. Unitization, we do have a fair amount of say over that. So one of the takeaway messages - the good operators really minimize impact. The state has a role there. We have to make sure we protect the water supply and the aquifers. A lot of the issues, though, with water aren't the same as down there because we'll see the water reinjected here and we don't have a lot of surface demand for use of that water.

CHAIR OGAN: What comes up in the water with the produced water - at least with the wells that have been drilled so far. I think there is a lot of fear about it and like you said, in other areas the water has been oftentimes put in holding ponds or evaporation techniques. You know, they run a pipe up in the air and they spray it out like a big sprinkler. It's supposed to evaporate in and those kinds of things. And there's been some water issues in the Lower 48 that are contentious and problematic.

What's in produced water and how will that be handled here?

MR. MYERS: Generally the produced water can vary from very fresh potable water to water that has elevated levels of chloride - saltier. Along with that water can be elevated levels of potassium or sodium or ratios of potassium/sodium that are different than the surface water. That seems to be the most dominant affect to the water.

Basically, it's not toxic in the sense of what we typically think of toxic substance, but over a long term, can have affects to the plant growth if discharged in large amounts to the surface - depending on the water quality. Because the operations in Alaska - the wells are drilled a deeper depth. In Wyoming they're only drilled a few hundred feet. We're looking at over a thousand feet typically - in the three thousand, four thousand feet depth here. The water will be inherently saltier - as you move down the water gets progressively saltier.

It also means the water from production - of course, the water from the Mat Valley will be significantly separated from what is normally the aquifers. So, one of the big differences down there is they're producing the shallow gas from the same zones that

are sometimes used as aquifers. The coals are actually dewatered - used for drinking water. Here, that is very much of a rarity and the actual zones from any coals - produce any water from coals - I guess there are a few cases, but it's very rare in the Valley. They're producing from the sandstones, not from the coal so the coalbed methane wouldn't be in conflict.

The second part is the zones they're producing from are much deeper here than are normally the aquifers. So, again I don't expect the same level of problems, it doesn't mean you don't want to monitor and have good water quality data. But it's truly a manageable issue up here. I think particularly because we're not looking at surface discharging the same way they are down there.

CHAIR OGAN: I think that's all the questions I have. Oh, there is one more. It's come to my attention there is some information being distributed about a development in Rifle, Colorado. It's being portrayed as though it's coalbed methane and that's what it will look like in Alaska. Have you done any research on the Rifle Colorado and what they do there and what that development actually is?

MR. MYERS: I believe the developments in question, the fields in question, are conventional type sands gas. So they're gas sands that are being produced from very low-quality reservoirs. Because of the nature of the reservoirs, the size and shape of the reservoirs are very linear in shape rather than being widespread over an area. They require a well into each one of the individual sands. Because of the low quality of the reservoir, the wells have to be relatively closely spaced.

The better quality reservoirs require less wells to produce. So, I believe, in that area they are producing wells fairly close spaced for conventional gas at depths in the 6,000 to 7,000 foot range. But they're requiring wells that are fairly closely spaced. I believe they are directionally drilling them from a more centralized pad. So, in an area you'll see a bunch of heads but they're spread out to an area. But the spacing of those wells are relatively close - 10 to 20 acre type spacing is my understanding.

CHAIR OGAN: What do you anticipate spacing to be in say, the Mat Valley for coalbed methane?

MR. MYERS: I would expect development - again, if it's commercial, we don't know that. They haven't demonstrated that,

yet. If it were commercial, probably typically about five wells per square mile would be the initial - and about 160 acre spacing would be where they would start. It might go down to 80 acre spacing, but we certainly don't anticipate anything in that 10 acre, 20 acre kind of spacing.

CHAIR OGAN: About one well per 20 acres?

MR. MYERS: That's initially where I believe they would start. They may go down to 80 acre spacing.

CHAIR OGAN: That would be eight per square mile. Okay. Any other committee members have anything? A number of people want to testify on the bill and I just want to say up front that we are going to limit the testimony to the bill only. If you have any other issues, those are maybe issues for another day and another place, but if you stray off the bill, I'll ask you to come back and talk about the bill. I'll start with Carol Martin in Soldotna. I'm going to skip around the state and try to let the various people....

MR. CARROL MARTIN: This is Carrol Martin in Soldotna. I'm interested in this and really quite surprised that this has become such a controversy, because I grew up in Colorado and still own property in Colorado, three parcels. There is a methane well on all three parcels, plus there is a disposal well on one parcel. In all cases, the BP Amoco and Evergreen, whether they had to by law, I don't know, but they did ask me exactly where I wanted the well placed so that I could get the most benefit from the improved road. In all cases, they gave one free domestic hookup. So, instead of having to burn coal, my brother doesn't have to burn coal and wood anymore. He's got free gas and so that well [was] placed on a high rocky spot above the main house. It was close and didn't mess up any pastures. I think they had actually paid me well over \$50,000 in the last six years and they have probably done even more than that in road improvements. Right now, you can't hardly see where they ever were and the actual sites they come back in and revegetate those and improved gravel roads, which used to be a muddy road and free gas. I think there's 4,000 wells in the [indisc.] county and of the three on my property, only two of them are actually being used for domestic purposes. My neighbor has 80 acres and I've got 80 acres and on that well I'm not using it, but he is for his household gas [indisc.]. The other one, the disposal well, there's nobody close enough to have a well to qualify for a hookup to it.

If we had to wait for some gas company like ENSTAR to come in and deliver gas, it would never ever happen. The high pressure gas line that El Paso Natural Gas has runs east and west from L.A. to St. Louis is 14 miles south of there and nobody - none of the smaller communities [indisc.] has domestic gas, because it's not feasible to tap in to that big line. Because of that big line and the shortage of gas, they drill all of these wells putting gas into that line and everybody between the well and the main pipeline is tied in [indisc.] to gas.

It is interesting if it would be true in Homer or Wasilla and the Valley. Twenty years from now, everybody is going to be thanking old Scott Ogan for his long-range insight and they're going to be burning gas and not having to chop wood. I've lived in Alaska for forty-some years and I chopped wood, I worked for Unocal in the gas field, on the edge of the gas field and had to chop wood and burn coal for years because it was too expensive to bore under [indisc.] Beach Highway. Anyway, we've got enough people on my side of the highway to bore under the highway and we finally got natural gas.

CHAIR OGAN: Thank you, Mr. Martin. Do you support the legislation?

MR. MARTIN: I support development of the gas. I think people who are opposed to it in their own back yard would be happy if they had natural gas [indisc.]. On the properties I have down there, I don't get royalty on two of them because the rights were sold or went with the previous owner and were sold. So, even in Rifle, where my wife's family has property - oil shale development there, they ruled that oil shale was oil and not coal, because on that property we didn't have the coal rights, but we had the oil rights. And so, those royalties were held up for years and years and years before they finally paid on that.

The same way in Kansas - the helium was held up for years and years and years and we finally got paid for the helium. So, here people don't have the oil and gas rights under them. The Native corporations, the state and federal governments got them. It surprises me that people didn't know that.

CHAIR OGAN: I think it surprised a lot of people. Thank you, Mr. Martin. Do you have anything else you wanted to add?

MR. MARTIN: Just that I'm sure that it's going to happen and after it does, everybody is going to forget who was opposed to it.

CHAIR OGAN: Do you think it's appropriate to have a better public process to lease these leases given the fact that a lot of people aren't aware that they might not own the subsurface?

MR. MARTIN: I don't think so. I look back 30 some years ago when everybody in Homer wanted to force the state to buy back the [indisc.] gas or oil leases or whatever, and there's been [indisc.] trying to get gas into Homer and there's ARCO and [indisc.] all over the North Fork. There's gas down there - the [indisc.] center has been used in shallow bed methane gas [indisc.] Homer for years and I can't believe that all these people don't want shallow gas. It could be used if they tap into it, but they'll never lay a pipeline from Ninilchik to Homer.

CHAIR OGAN: About 29 years ago I came to Homer and went to a friend's house out in the East End Road and I didn't smoke, but he warned me not to smoke in the bathtub while I was using his bathroom, because I could blow up. I said, 'What do you mean?' He went over and lit his faucet and I was amazed, but I guess that's kind of a standard occurrence out there and other places where the coals are pretty shallow. Anyway, thank you very much for testifying today.

Also, I wanted to announce that Jim Hanson is here with the Division of Oil and Gas, but he's not here to testify. He is here to answer questions. Jim, for the record was the person that worked on the original legislation and could have some insight on why we're there and what happened. Let's see. We'll go to Doug Carney in Sleetmute.

MR. DOUG CARNEY: Can you hear me?

CHAIR OGAN: How's the weather out in Sleetmute today?

MR. CARNEY: I don't know; I'm in Anchorage. I'm concerned about these gas leases [indisc.] They haven't been approved, yet. There's a moratorium. However, DNR was going to issue - Nana Energy applied for land use permits to do core drilling, but the people in the area from several of the villages - Sleetmute, Cripple Creek and on down the river are real concerned. This is a high subsistence area, critical habitat for migratory waterfowl, moose and salmon spawning streams. We're concerned about the dewatering process. We have reports from down in the western states on how even processed water has affected the ecoculture and egg hatching - things like that. We think it's a good bill, what you're doing here, but I think it should apply,

certainly statewide and the best interest findings should be required on all state lands and include the lands where the leases have been approved and also the ones where they've been applied for and not yet approved. So, we have the people who are part of the process on whether this was done or not, especially considering the wording about local communities that left out the commissioner, I believe. People got wind out there, particularly because they want the benefits of - I mean there's plenty of lumber out there - they're concerned for firewood and things like that and the animals, also. They're worried about the habitat. Reinjection, we believe, I believe, should be mandatory - what to do about the water, the produced water.

We wouldn't want to see bad judgment used out here in these areas neither. We want the people to be part of the process, although it's definitely a rural area. Most of this area is state land, also. So, I guess I have a couple questions about the best interest finding and would that apply to rural areas and also if this doesn't apply to - I see this bill doesn't apply to the approved leases or to the ones that have been applied for and not yet approved. I would urge you to include those areas in those leases in this legislation.

CHAIR OGAN: Thank you. The best interest finding under the bill for future leases would be statewide whether it be exploration license or in the areawide leasing program. You're correct. The bill does not include the existing leases that have been applied for or granted.

MR. CARNEY: So, what about the - I mean is there a problem there - particularly I don't understand why they couldn't be [indisc.] for the ones that have been applied for. There's no problem, yet, but there will be a problem if they go in there without public input.

CHAIR OGAN: I hear what you're saying.

MR. CARNEY: Okay, I hope they amend this bill to include that.

CHAIR OGAN: Okay, Mr. Carney. Let's go to Mat-Su - Michelle Church.

MS. MICHELLE CHURCH: Thank you. My name is Michelle Church and I'm a resident of the Mat-Su Valley. And in regards to SB 312, I am - first of all I'd like to say that we're very happy that Senator Ogan has finally recognized that coalbed methane development in the Mat-Su Valley is likely to have negative

consequences on the lives of those of us who live here and, therefore, needs to be a regulated industry. Unfortunately, this realization in the form of SB 312 comes too late for Senator Ogan's constituents and, in fact, comes too late for all the constituents of all Mat-Su legislators who, in my mind, stand equally culpable of allowing the legislative process to be so grossly manipulated for allowing the public process to be so grossly avoided in the interests of benefiting one industry at the expense of all competing industries and interests in the Mat-Su Borough and throughout the state of Alaska where coalbed methane extraction takes place.

Senator Ogan states that this bill intended to undo unintended consequences of earlier actions in regards to the coalbed methane industry and it, in fact, does not do that. It does not undo anything. The reality is that the unintended consequences of Senator Ogan's earlier legislative action are that valley property owners lost the right to control our own property. The unintended consequence is that there's loss of control over activities occurring on private properties, happened without public notice and without any ability to participate in development of the regulatory regime that would have required a best interest finding to be conducted before those leases were let. While SB 312 provides the beginnings of protection for future coalbed methane (CBM) leases, SB 312 is unacceptable as it's written and it's unacceptable as it has been amended because it provides nothing for the leases that occurred when Senator Ogan, Representative Kohring and Evergreen Resources were huddled in the backrooms of the state capitol crafting legislation that would allow unfettered CBM development across the state of Alaska.

In order for CBM legislation on the coalbed methane issue to be acceptable, it must include a complete remedy for the property owners [indisc.]. It must include a best interest finding for those leases for the residents of the Mat-Su Borough and for the residents of the Kenai Peninsula. And those best interest findings need to be conducted prior to any leases being relet. It must include provisions for state supported local control over the industry; it must include base line data collection and adequate bonding for damages that are almost certainly to occur somewhere due to the technology used in extracting coalbed methane. I do have some questions regarding statements that Mr. Myers made as far as the gas supply and how this relates to the state's pursuit of a gasline from the North Slope. With 35 trillion cubic feet of gas available on the North Slope right now, it seems that this cry of we're running out of gas is

simply a ruse to get people to support an industry that may cause major damage to the community.

ENSTAR has told us that they will not be hooking up to our communities outside of where they already have their lines laid. We're not going to see any local benefits from this gas. So, all of the work that DNR has undertaken in reviewing the realities of coalbed methane have been after the current leases are let and the community became aware of the extent of this.

I have another concern that in this legislation, there is no fiscal note. I do not understand how a bill that's going to provide protection from an industry that has the potential for that kind of [indisc.] impacts cannot have a fiscal note to it. What is going to insure that there is going to be adequate funds to monitor and enforce. In fact, every day we read about budget cuts that are coming down that will affect DNR [indisc.] and other regulatory agencies that are going to supposedly implement the things that are in here. I am curious to see that addressed - how can this have no fiscal note.

TAPE 04-14, SIDE B

MS. CHURCH: No, I asked you a question. I wanted you to address how this cannot have a fiscal note.

CHAIR OGAN: Well it does have a fiscal note.

MS. CHURCH: [Indisc.].

CHAIR OGAN: Right. Have you read it?

MS. CHURCH: I'm looking at it right now.

CHAIR OGAN: I think they explain it there.

MS. CHURCH: Well can you explain it to me then? I guess I don't understand it.

CHAIR OGAN: I think that's the appropriate thing to have the director explain, however, we're not - this is - I'm taking comments for now and I'm sure you can contact him and if you have questions at the next hearing, if your questions aren't answered, but I'd like to take...

MS. CHURCH: Is your committee then going to not take any action on this until after I've spoken with....

CHAIR OGAN: Yea. I'm sorry. I apologize. I meant to announce that I do not intend to pass the bill out today. Senator Seekins?

SENATOR SEEKINS: Mr. Chairman, I noticed that the fiscal note that I have has an analysis attached to it that's self-explanatory.

CHAIR OGAN: Correct.

MS. CHURCH: Well, I guess I'm not very bright and so I was just asking as a member of the public for you to explain it to me.

SENATOR SEEKINS: The only thing you can do is read it. Mr. Chairman, I would - I think it's self-explanatory.

CHAIR OGAN: I couldn't - I'm afraid I couldn't....

SENATOR SEEKINS: It's contained within the four corners of the document.

CHAIR OGAN: Thank you Senator Seekins. I don't think I could explain it better than it's written. Does that conclude your testimony?

MS. CHURCH: Yea. Do you have any questions for me, Senator Ogan?

CHAIR OGAN: No, I don't. Thank you. Next let's go to Johnny Walker - Jenny Walker, I'm sorry. I might have made a Freudian slip - or Jeannie Walker.

MS. JEANNE WALKER: Hello, this is Jeanne Walker.

CHAIR OGAN: I really haven't had any Johnny Walker today so...

MS. WALKER: That's good - maybe after the meeting.

CHAIR OGAN: Although I feel a little punch drunk sometimes down here.

MS. WALKER: Right. I live in the Homer area and I appreciate the opportunity to address the committee about this bill. My home is one of the properties that's been leased for shallow gas development and that brings me to why I'm so interested in the public process part of this bill. My husband and I bought our property this summer in July. The property was leased at that

time and we didn't know it was leased. Not only did we not know it was leased; we presumed the owners didn't know. Our realtor didn't know and the title company that did the title search didn't know. Now I should make it very clear that we understood that we didn't own the subsurface of the property we were buying but, nevertheless, we did not know that it had been leased for natural shallow gas development. I think that this bill helps kind of redress some of the public notification issues that earlier legislation had led us into a real mess with but I don't feel that the expedited public process in the last notice that earlier legislation created is being taken far enough with this bill. I really feel that individual surface owners should be notified and I feel the state really needs to take responsibility here and make sure that all individual surface owners are notified so they can actually take part in the public process that will be partially fixed for future leases by this bill. The problem, of course, as I see it is this bill doesn't help those of us in the Homer community because of the mess that's already been created by earlier legislation. So I really almost feel that allowing the Homer community to have a best interest finding, even at this late stage, may only mean through a buyback to start the whole process over again. And that's all I have to say.

CHAIR OGAN: Thank you and if anybody has any testimony in writing it would be really helpful if we could get that and that way we can have time to thoughtfully consider your remarks so if anybody has it in writing that'd be great. If you could get it to my committee aide Linda Hay. Okay, let's see - let's go back to Anchorage - Ken Boyd.

MR. KEN BOYD: Thank you Mr. Chairman. Mr. Chairman, members of the committee, for the record my name is Ken Boyd and I chair the Lands Exploration and Operations Committee for the Alaska Oil and Gas Association. AOGA, as you well know, is a private trade association of 19 member companies representing the majority of oil and gas operators in the state. AOGA supports the concepts embodied in SB 312. Our only hesitation in not giving absolute approval is the lands committee simply hasn't had a chance to review the large number of - the amount of conforming language within the bill but I think this is really a minor point. We fully support the major concepts of the bill and I think these concepts are fully outlined in the chairman's sponsor statement.

In particular, returning to the established leasing and licensing programs with their best interest findings creates a

comprehensive, coherent and legally defensible process that has been used successfully by the state for many, many years. The best interest finding allows the state to incorporate all public input into a single document that addresses all the concerns in a comprehensive manner. This is preferable to addressing issues one at a time and drafting a process that satisfies nobody. We hope SB 312 [will] be passed and that this [indisc.] be given the opportunity to address all the issues in the finding process. It will take some time but, in the end, should accomplish all of the goals necessary to satisfy both industry and the public. That concludes my testimony, Mr. Chairman, and I'd be happy to answer any questions.

CHAIR OGAN: Thank you. Does anyone have any questions for Mr. Boyd? Hearing none, let's move to Mat-Su. Eddie Grasser.

[The LIO moderator noted Mr. Grasser had to leave suddenly.]

CHAIR OGAN: Okay - Jeff Arnot?

MR. JEFF ARNOT: Yes. My name is Jeff Arnot. I'm representing Friends of Mat-Su and all of our members. We're more than 300 strong. I'm working on coalbed methane issues right now and the first thing I want to tell you is that I'm getting calls every single day. I'm going to all the meetings that we can go to, in terms of DNR, community council and the borough assembly meetings and there's a couple themes that are very predominant - they emerge again and again. You've heard it a couple of times today. You're going to hear it again and again until you make the changes that need to be made.

As far as Senate Bill 312 goes, I think there's a lot of great things in there but it's maybe 50 percent and I'm looking at some figures - 300,000 acres of the Mat-Su, 80,000 acres applied for, 22,000 acres leased in Homer and 47,000 in Healy, 20,000 in Chulitna, 20,000 in Red Dog. This is a - even for Alaska amounts to a vast amount of acreage that your bill does not apply to. These are already leased lands. You've got to do something about this. You've got to make it retroactive - you've heard buyback and I know you guys are sick to death of hearing - let's say nullify the leases, however you want to put it, but you guys have got to address all this land that has been leased that your bill does not apply to. It's never, ever, ever going to go away.

We've just heard recently that the multiple listing service, which, if any of you folks don't know, is something that realtors use to list property and right now in the Mat-Su Valley

the multiple listing service has a CBM code. What this means is that they have a way of designating a perspective property that's going to be for sale in a CBM leased area so that's how big it's getting here. They've done some studies down at San Juan County in Colorado and they found that one in four people are not interested in purchasing property that is leased by CBM so that's a pretty big thing. This is going to be something in the Valley with many, many possible downsides in property values and the perception among residents and prospective residents that this is not a good place to raise a family and send children to school so you guys have got to address all these properties right now that have been leased, which SB 312 does not address. Thank you very much.

CHAIR OGAN: Thank you very much, Jeff. I appreciate your testimony. Let's go back to Homer - Roberta Highland.

MS. ROBERTA HIGHLAND: Hello, can you hear me?

CHAIR OGAN: Loud and clear.

MS. HIGHLAND: All right. This is Roberta Highland and I'm actually representing the Kachemak Bay Property Owners' Alliance. There are approximately 800 private properties that have been leased. We've got about 1,000 signatures so far on the buy back. I think - looking at what legislation is going on right now, I do believe it's a recognition that there is a problem and I certainly appreciate the work that has gone on. I attempted to read SB 312 and, to be honest, I got pretty confused so I have got the other one - I haven't had time to look at it - that gives a better summary. But, they are pretty difficult to read. I believe the others have made it kind of clear that this one still does not cover the problem that we've got right now, and that is with the property that has already been leased. And I just ask of you to try, if there's anything you can think of, to fix that. I'm trying to think of it and I haven't come up with anything yet but a retroactive date. And I guess there's a hope that industry would not really want to come and get into, shall we call it a mess, so there would be that hope that maybe something horrible wouldn't happen but I do think a retroactive date somehow, someway, and - so that these leases can be taken care of that have already happened and as the prior person just mentioned that we're talking thousands and thousands and thousands of acres across the state.

I think that's a major issue. Other ones are the bill not going far enough for water rights and just some thoughts - I keep

worrying the state is being shortsighted. In the long range, we've got to look that way too. I know we're in a financial crunch but if we just continue to go down the road of resource development over and above so many other things, I think we're going to have a big loss for us in the future and I think we're going to be sorry. We have to look at this in a long-sighted way. Diversification - we've been told to do that. Homer, I believe, has done a quite good job on diversifying our economy - marine education, arts, recreation, fishing. We've made ourselves a special - we're quite specially known across the nation for what we have down here and I don't think it would be in our best interests, which kind of brings back the best interest findings. Maybe that is one idea that we could stop everything and do a best interest finding and get back to the drawing board for public process. So thank you.

CHAIR OGAN: Thank you Roberta. I appreciate you taking time to come down and testify today. Let's see. Let's go back to Mat-Su. Myrl Thompson?

MR. MYRL THOMPSON: Hello.

CHAIR OGAN: We can hear you.

MR. THOMPSON: Okay, great. My name's Myrl Thompson. I'm a property owner and I sell land out here in the Valley and I also represent about 2200 registered voters from District H and we have a number of problems with this bill as basically being inadequate in its totality and the exclusion of the already leased lands and already applied for lands. It doesn't do us any good out here in the Valley. I think it is probably pretty good that you guys are starting to figure out that there were some major problems with the HB 69, or actually [indisc.] SR 69. And we gotta get that straightened out you guys. I mean it's an uproar out here in the Valley and it's gonna get worse if you guys are just going to get watered down bills and half issues on stuff like this, it's never gonna get fixed. Probably, I don't know how many of you have even contacted DNR about the workshops that have been going out here but you could probably get a pretty good drift of where we're coming from.

As far as a couple of things that I've heard in testimony that low supplies of gas for Agrium, I think that's a red herring. You guys know quite well that Agrium gets subsidized gas at low prices and nobody wants to give them that subsidized gas anymore and that's the reason they're having problems with that [indisc.] that we have to do this out here in the Valley. We're

shipping most of our gas out of state so if you want to save gas for the Alaskans and ship it to the Alaskans and not to out of state - and you guys know darn well that a lot of this gas is projected to go to Taiwan and Japan and the Lower 48 and the big business and actually a very, very small amount of it is going to the Alaska market and we have enough gas underground to last Alaskans for probably 1,000 years but if you guys are going to ship all out of the state and then come back 15 years later and say that we have a shortage, we're going to have to import gas at even a higher price, it's going to be a nightmare. I'll let you go with that, boys.

CHAIR OGAN: Does that conclude your testimony?

MR. THOMPSON: Yes.

CHAIR OGAN: Thank you sir. We really appreciate you coming in. Robert Archibold?

MR. ROBERT ARCHIBOLD: Good afternoon. Can you hear me okay down there?

CHAIR OGAN: Yes sir, loud and clear.

MR. ARCHIBOLD: Well thank you for taking this - what we have to say. My name is Robert Archibold and I've been a citizen of the State of Alaska since, well, since a few years after the earthquake I've been here. Back in those days everybody used to pull together. That's what kept this state alive and working. I'd like to say a couple of words. I don't think we're pulling together on this one. We're fractured. The community down here is finding it highly appalling and your bill, in its present form, does not cover some of the things that are true to my heart. I heard earlier that they were speaking of a single [indisc.] acre parcel possibly. Well, there's a lot of parcels around here that have been leased and we were talking about that [indisc.] earlier that maybe somebody at DNR was nipping at some of that because why else would you lease the land out of Homer's drinking water reservoir or the LDS church? So I think DNR needs to do a little homework before they even come up with a lease area.

It's too bad somebody didn't take a little time to do a best interest finding and see what they were leasing. The environmental protection that is being drawn up by you folks - I think there's a lot of things that are taken for granted. Down in Colorado you can look at that operation and think that it'll

be safe here. Coalbed methane up in this area is probably going to be considerably different than down there. Our roads in the Homer area are pretty sensitive to weight loads. If we let coalbed methane develop and use our roads, we're not going to have much for roads so I guess we've got to think about that one. And I have a real - a lot of heartburn about the areas that have been leased that are not being covered in this bill so I think you need to go back to work on some of this. Thanks for letting me talk to you.

CHAIR OGAN: You're welcome sir, and thanks for taking time out of your day to come and let us know your views and we're - again, I'm not intending to move this bill out today and as far as Roberta's comment about how she read it and it's kind of hard to read, basically what we did is we took Title 38.05.177, which was the shallow gas leasing, and we transposed a lot of those things into 180, which is the areawide leasing. And so, a lot of the language is existing language and the highlighted language, the darker language, is the new language that was inserted into the existing language. So, that's why it looks as long as it is but most of it's what we call conforming language, which basically makes it work. But we're taking the shallow gas leasing program and pretty much doing away with that and then making it, you know, under this best interest finding. Anyway, so I thought I'd save the best for last and Mr. Chris Rose - are you still with us Chris?

MR. CHRIS ROSE: I'm sorry, the LIO person wasn't here to press the right button for me. My name's Chris Rose. I live in Sutton and I'm testifying on behalf of myself. I wanted to just put into context some of the things that were spoken about earlier in terms of gas supplies that Mr. Myers was talking about. I agree that about two-thirds of Cook Inlet gas is currently exported either to the Agrium plant or as LNG, which means only one-third of our current gas being produced in Cook Inlet is used domestically, which I think - it's a distribution problem. That's not to say that jobs at the LNG plant and the Agrium plant are not important but I think that there shouldn't be any fear that we don't have enough gas right now.

The other thing I wanted to put into context is just how much gas coalbed methane, if it were viable, could produce in this area. Evergreen has stated numerous times that they're talking about perhaps 1 trillion cubic feet. Now to put that into context, every year Municipal Light and Power, Chugach Electric, and Enstar use almost 120 billion cubic feet of gas in the Anchorage area so that means the trillion cubic feet that

Evergreen might get is a little under 10 years worth of supply of gas for our area. So, even though that might happen, it's only a real short-term solution and when we're talking right now about having only nine years left of Cook Inlet gas, a trillion cubic feet just doesn't do a lot more for us. Over the course of the 25-year coalbed methane field, we're only going to get about, at the most, 40 billion cubic feet of gas out of the coalbed methane in this area. That's about one-third of what we use currently in the Anchorage area. So, you can see that in context, coalbed methane is not going to put a dent in our energy future. I think that goes to the point of not being so myopic and looking only at oil and gas as sources of energy. We have lots of renewable energy resources in this area that we should be looking at.

Now, to get to the bill itself, generally I'm real happy that the best interest finding process is going to be used if this bill is passed for all future coalbed methane leases. However, as has been stated by many people earlier, it doesn't help that several hundred thousand acres have already been leased. And, to be honest, I don't know whether or not there's any other big areas that have coalbed methane potential that haven't been leased because this program was so wide open for a while that the companies have pretty much moved in and they have already leased, or have applied for leases, in areas where there's coalbed methane potential. So, even if this bill applies to the future leases, it's probably going to be a very tiny percentage of the total coalbed methane that could possibly be developed in the state. It really doesn't help us at all unless these leases are completely reissued under the new best interest finding if this passed.

A couple of specifics - I really believe that there should be higher royalties and higher rents. We're dealing with this right now with, you know, the arguments about whether or not we should tax oil companies more or less but, you know, if you look at the amount of royalties the state's giving out on coalbed methane - 6 $\frac{1}{4}$ to 12 $\frac{1}{2}$ percent, it may barely cover the cost of administrating these programs. And the reason is that there's so much more infrastructure involved in these kinds of wells. As Mr. Myers put it earlier, you know, usually these wells are generally of low productivity, meaning that we get 1 to 1 $\frac{1}{2}$ billion cubic feet out of each coal bed methane well. Compare that to a typical conventional well that's gonna get well over 100 billion cubic feet. You can see that there's 100 times the infrastructure necessary to get that same 100 billion cubic feet of gas if you use coalbed methane and the technology to get at

it. And that's not even to mention the concerns about getting water problems because of the dewatering process but just the sheer infrastructure because each one of these wells has to have a road and has to have pipelines. And so, per well, we're just not going to get enough gas out of each well to make it something that's in the state's best interest unless we are charging a lot of money up front so I would like to see higher royalties and higher rents.

Another point that I'd like to make to support that is the Mat-Su Borough has recently determined that over 12,000 private lots have been leased, excuse me, 12,000 lots have been leased and they have not all been private but a high percentage of them are private land out there in the Valley. Over 12,000 of those lots have been leased under this program. The assessed value - we all know the assessed value is low compared to the appraised value or fair market value - the assessed value of this property is \$235 million and Evergreen leased those lands for \$30,000 - 60 leases at \$500. Of course they have to pay the yearly rent of \$1 per acre per year but, essentially, what Evergreen got was \$235 million worth of surface value for \$30,000. That is a travesty and that's the kind of thing that we have to be able to look at in the best interest finding to determine whether or not it is in the best interest of the community or the state in general to be leasing this land out because as property values go down in the borough, it's going to quickly erase any kind of economic gains that we can get from coalbed methane.

I also think that there should be more public comment period and I understand that that would have to apply to the conventional oil and gas too, if that were increased. I don't know if there's a way to break it out but I think because coalbed methane can happen in places where there are homes and neighborhoods that it cannot hurt to increase the days that people have to comment. I also believe there should be higher bonding requirements. There is still only a \$25,000 per incident bonding requirement in this bill and that just doesn't cut it and there has to be a lot more put up by these companies. If they are so careful and they do it right then they shouldn't have any problem putting that money up.

There's also a few things that really would never apply to conventional gas, and I'm sure I'm not going to cover them all. There has to be included somehow in the analysis when a best interest finding is done concerning coalbed methane or shallow gas, of course one of them was already mentioned by Mr. Myers and that is the same source drilling, which has occurred in the

Lower 48 where shallow gas wells are drilled right into areas where aquifers - where people get their water wells. Another thing that can occur with conventional oil and gas, but it's of great concern to people about coalbed methane is methane seepage. It's particularly a concern in areas that have fractured and tilted geology like we do out in the Sutton area where basically you have thousands of communications to the surface from deep below because all of a sudden [indisc.] layers have been tilted up so it's not sedimentary layers way below the ground. And the methane, once released, once the de-watering process occurs, is [indisc.] into people's wells and their homes and other buildings. So, methane seepage is something else that I'm hoping will be particularly analyzed.

I also think that the concern about how much money stays in the state has got to be part of this best interest finding. Right now, the company that has most of the leases in the Mat-Su area is a company that's based in Denver and they're going to be taking 92 to 88 percent of the profit out of the state and that has to be looked at because we are the owner state. We do have a lot of natural resources. We want to make sure that we have a good deal for the people of the state that if there is going to be anything like this done, we've got to make sure that a lot of this money stays in the state.

And another issue that I hope would be analyzed in the best interest finding is how much infrastructure of ours do they use. It's clear that what happened here is somebody swooped in and leased these areas where taxpayers like myself maintain the roads, rather than having to pay for those roads themselves. Mr. Myers mentioned earlier how things are done on the North Slope to minimize the infrastructure because it's costly. We've already got a lot of infrastructure and I hope that the impact on our infrastructure, including our public safety and our emergency services and our water supplies and sewer systems and our roads are all taken into account when these kinds of things are anticipated and analyzed in residential areas.

In conclusion I'd just like to say that unfortunately this bill admits all the faults of the original House Bill 394, which was the original shallow gas program. There are many and some of them were identified by Mr. Myers earlier. And it's unfortunate that this bill is not aimed at really helping those people who have been impacted by those faults because it does not apply retroactively. And it is amazing to me that the drafting errors of 394 were not found because it could have easily been written so that this kind of thing would have been precluded because

everybody back in 1996 was talking about rural areas and the sloppy drafting of that bill has basically put us in the position now where we have to deal with a mistake that was made 18 years ago and we are dealing with it in a big way and we're not going to stop dealing with it until all these leases are reissued and then analyze those best interest findings. Thank you.

CHAIR OGAN: Thank you Mr. Rose. Does anyone have any questions? Hearing none, is there anybody else that's not signed up on the teleconference network that wishes to testify? Hearing none, is there anybody here in the audience? We didn't have anybody sign up to testify today. Is there anybody in the audience? Mr. Myers, do you care to address us? We'll close public testimony today however we'll leave the option open for, you know, future work done on the bill and whatnot, for people to comment. Mr. Myers?

4:55 p.m.

MR. MYERS: Mr. Chair, I heard a lot of concerns over the statements made about the gas supply in Cook Inlet. I think that's, again, important to put in perspective. In the same way 1 trillion cubic feet - and, you know, that's not an unreasonable number for the Mat Valley part alone - needs to be looked at as a significant amount of gas for the same arguments that you've heard of - whether the Arctic National Wildlife [Refuge] replaces all of the potential Iranian or [Iraqi] oil. You've heard that argument and you heard it's only a six-month supply. There is no single point source that magically supplies the energy needs. Certainly if there were a trillion cubic feet, it would be a huge boost to the energy supplies. As to the issue of replacing those supplies - using those supplies only domestically, that's not our right to dictate. We can't dictate that the gas the lessees have doesn't go to Agrium or it doesn't go to the LNG export plant. That is the right of the lessee; a contract right to sell their gas where they think is appropriate. So again, we don't control that distribution of gas in government. That's a lessee contract right. They will review the LNG export license in 2009 but that's really the determination [indisc.] made. So from that perspective, an additional 40 bcf per year would be substantial.

As for North Slope gas, first of all, we're in the process under the Stranded Gas Act of negotiating with separate entities. I cannot guarantee you we're going to end up with a successful project at the end of the day. I cannot guarantee that if we had

a successful project, the project will end up with export of gas to Southcentral Alaska. That is an unknown, which we're working hard to achieve but we simply cannot count on that. So, again, you're looking at hypothetical resources but certainly the distribution and placement of that gas ultimately controls how and where it gets used. And again, I think as you heard one of the first gentlemen testify, maybe Enstar for a small number of consumers won't extend their pipeline system but if that coalbed gas is produced in that local area, it's generally almost pure methane. It generally takes very little conditioning. It's very likely that that gas would be used locally. It makes the most sense that another local distribution company would take over and provide that service in that area and it would be the most economic market because it would have the lowest transportation costs. So, again, I think it's very probable that you would see the gas used in the local area as the best and highest value market for that production company and, secondly, it wouldn't necessarily have to be Enstar.

CHAIR OGAN: Thank you. Senator Wagoner had some questions.

SENATOR WAGONER: While you're there I'm glad you addressed that. I was going to say something before the meeting was over just so there's no misunderstanding. Why don't you explain to these folks that are listening in the breakdown of the gas that Agrium gets and where it comes from and what percentage is the state required - what prices on the price structure.

MR. MYERS: Senator Wagoner, through the chair, the third breakdown is approximately correct. Of course it's less now, significantly less from the Agrium side. Agrium buys its gas through contract relationships. The state royalty share is kept in-value as a proportion, typically 12 ½ percent of that gas going to the market. The gas you say is low subsidized is not at all. That is gas that - another way to look at it Agrium paid for it in advance when they bought the plant. They bought the plant from Unocal with a guarantee of supply from certain leases at a price. But that price, the value of that gas, versus the value of the gas in the market in the future, was included in that sales price. So it's like they prepaid at the pump for part of that gas, is a way to look at it, or at least part of the price of that gas, and then they were guaranteed a certain price from gas from those leases.

Any future gas - Agrium - they have to go to the market like anyone else, go out to the lessees and try to buy it and they're buying it on an as-needed basis from folks. They try to buy it

as cheaply as possible because the financial condition of the fertilizer plant can't pay the full market value because they can't pass the price on directly as a residential or a commercial gas consumer could. So they end up inherently being the lower end of the market with the LNG market falling between the new Enstar type contract and the Agrium. But, it's a free market system we operate on. Those lessees are entitled to sell their gas. The state can use its royalty gas but it's only 12 ½ percent of that gas so it's not the bulk of that supply.

CHAIR OGAN: Thank you Mr. Myers. One of the concerns I have is some of the speculation that's gone on with the existing leasing program and some of the areas that were leased with virtually little to no economic resource there, you know, Lazy Mountain. I've been all over Lazy Mountain with the geologists and found out I have a fault directly behind my house. That was good news. The nice little canyon I have that provides my view - I could end up at the bottom of it one of these days. But, in fact, I've been told that it will be used if there's a gas seep test - methane seeping test that they'll use Lazy Mountain as the baseline because there's not coal up there so - and other areas have tremendous amount of overburden. And you're a Ph.D. in geology, correct?

MR. MYERS: Yes, Mr. Chairman.

CHAIR OGAN: There's a lot of overburden in Sutton and, you know, obviously the geology uplifts where the coals are and surfaces and daylight, but in Sutton proper, in downtown Sutton and where most of the people live, there's thousands of - millions of years of overburden and glacial junk, boulders and all kinds of things dumped there. So there were some concerns about how we address the leases that are already issued and those are very legitimate concerns. Some of them aren't economic and never will be. Is there a way that we can work on a bill so that at the end of that lease cycle if they're uneconomic or the geology is poor that we can - you have some authority or there's some motivation for the lessee to give them back to the state? And then obviously, if it's a best interest finding deal you'll look at the geology to see if there's anything there worth leasing but do you care to comment on that?

MR. MYERS: Yes I would, Mr. Chairman. I think when you step back and look at the bigger perspective historically, no matter which leasing program - most leases never get an exploration well. Of those that get an exploration well, the majority of those leases never see production because it's a risky business. So we look

historically that, under this program, our expectation is that most of those leases will never see exploration drilling, let alone development drilling. That's just historical fact. So, as those leases - those are 3-year leases, as those leases expire under this bill, they could only be reoffered under an exploration license or as part of a competitive areawide sale so the public process the folks are saying won't affect them will affect them. So the expectation is the majority of the area of the Valley at the end of the day would fall under these programs. And actually a majority of the area currently in the Pioneer Unit, where some of the coalbed pilots are going on, are within a conventional oil and gas area with a finding and within an existing unit. Once the unit is formed, if a unit is formed, then there has to be a plan of development. If the plan of development isn't met, acreage contracts out of that unit.

So, you will see either successful development and right now there are many areas of the Valley that do not look, based on the pilot work done, do not look commercially viable for coalbed methane that those leases will contract out. And in the case of the shallow gas leases, under this bill they would not be re-let or you could not reapply for a new lease application. So by and large, your bill corrects, I think, for the most part a successful mechanism to convert those areas into an area with a finding and that's the process you'll see.

Now there is the director's ability, the discretion, to extend those leases three years but you have to see positive movement toward development and, if the legislature wanted to they could restrict - right now the discretion is pretty loosely defined. They could restrict my authority through DNR to extend those leases and then could describe those circumstances.

5:05 p.m.

CHAIR OGAN: Okay, and one of the other things was the fiscal note but maybe I could hit on one thing. So, in your opinion, many of these leases, and I know it's probably impossible to tell how many, will probably go back within - so they've been leased about year now or a little bit less, so within two years a lot of these leases will be off the table.

MR. MYERS: Mr. Chairman, that's what I believe unless we see activity. Drilling activity takes time to do. Then you'd also want to be able to test and evaluate and that takes time. So, given that, a three-year lease is a very short time to use unless you see early development activity, you're probably not

likely to see it with this particular type of lease. Folks could ask to expand units. Then they would need an organized plan for development as well. So, again, my belief is that most of these shallow gas leases will go away. And, in fact, you've seen that process. We had a whole bunch of leases applied for in the Big Delta area in the Fairbanks area and many of those leases were not accepted so there is a high probability, a high rate historically, of turnover of these leases. And, quite honestly, you mentioned there - I believe a lot of them were bought for speculation.

CHAIR OGAN: Yea. I'm going to hit on two other things while we have your expertise here. H₂S - there was a rather scathing article in one of the papers that talked about hydrochloric acid gas and this person emphatically stated that coalbed methane companies, and they named one in particular, uses hydrochloric acid gas to enhance production of coalbed methane and that in the town that they lived in nine people were killed by this gas that slipped out in the middle of the night and people were killed in their beds and, you know, there were bodies in the yard and, you know, really put the fear of God in a lot of people about living next to anything related to this stuff. I did some research on it and found out which well it was. The incident did indeed happen and it wasn't hydrochloric acid gas, it was hydrogen sulfide. I think the source of that fear was the fact that the company announced that they used hydrochloric acid to wash the cement out of the casing. So, maybe it would be two things - what's the hydrochloric acid used [for] and what happens to it when they put it down hole. Is there such a thing as hydrochloric acid gas and talk about what the actual thing, H₂S, hydrogen sulfide, actually is and does and whether or not it's associated with Cook Inlet and coalbed methane at all.

MR. MYERS: Mr. Chairman, the hydrochloric acid is used to dissolve out some of the cement that's in there. When they drill a well, they pump cement down the outside of the well casing to cement it in and separate it from the zone - from the surrounding rock layers and so there's a pipe laid - multiple layers actually, of pipe laid down in various stages down to the producing zone. That pipe then is cemented into the surrounding ground so there's no way for fluid to escape around the pipe on the outside of the pipe. Then when they want to get the coal open to production, they use what's called a perforation gun. They bring a device down there that shoots holes into the casing. At the same time they might then - later they come in and they fracture the rock. They bring in sand grains down and put them in a slurry under high pressure to fracture the holes.

In order to clean up - again, when they perforate, they shoot the cement guns through the pipe through the cement. In order to clean those holes up they will put in very dilute - it's usually 10 percent or 10 [indisc.- molal] hydrochloric acid. It's very dilute. What that does is it dissolves out the cement and it is very quickly neutralized under that. It's the same thing a geologist uses in an outcrop with a bottle to see if the rocks contain calcium carbonate. Cement is basically calcium carbonate, as is limestone and other rock types. So, it's very dilute hydrochloric acid. It's almost immediately neutralized and it's used in relatively small quantities.

So that's totally separate - that process is totally separate from the process that produces H₂S or sulfuric acid. That is in certain types of crude oils. Through biodegradation you can create sulfuric acid. Sulfuric acid is a deadly poison. It actually occurs on the North Slope in a few cases - in the Lisbourne formation in particular. I think it is extremely rare in Cook Inlet and I think it's very unlikely to encounter in Cook Inlet Basin generally and specifically in the shallow coalbed methane section. When they drill, the equipment has to have, if there's any chance of encountering, equipment to monitor for sulfuric acid. Again, it's very deadly. It can kill - it's a pretty dense gas and can kill in pretty small quantities. So it is a hazard but it is a hazard that has to be taken into account for conventional oil and gas in particular and particularly in the North Slope or in areas where there might be what's called sour crude and there's specific monitoring equipment on the rigs to handle it.

CHAIR OGAN: But, people I've talked to in the industry and regulators from other states to the best of my knowledge have never heard of hydrogen sulfide being associated with coalbed methane and shallow gas.

MR. MYERS: Mr. Chairman, I'm not aware of it either at all.

CHAIR OGAN: I just wanted to put that on the record in case anyone was curious. Anything else? Senator Seekins?

SENATOR SEEKINS: Let me clarify in my mind - Mr. Myers you said something about the findings already being available or having been completed in certain of these areas. Are you talking - what kind of findings particularly are you looking at? These are best interest findings?

MR. MYERS: Senator Seekins, through the chair, yes and in part of the Mat Valley there was a best interest finding done because the leases actually Evergreen owns are part of a conventional oil and gas unit. Again, those leases were leased back, most of them over 10 years ago so it's on an earlier best interest finding. But, then, in the northern part of the unit, the northern part just north of the Pioneer Unit, north of Wasilla, there are additional shallow gas leases that were not part of the best interest finding. So it's a mixture. The current best interest finding did not - the area considered did not go as far south as Homer. It sort of just [indisc.] a point area. South of that was not considered in the finding so no decision was made - determination of leasing and no finding down in that area. The process of limiting the area in the best interest finding created an opportunity in the shallow gas leasing to lease everything outside of that area so in the Mat Valley we have some part of the area under the best interest finding, some not.

SENATOR SEEKINS: Mr. Chairman?

CHAIR OGAN: Senator Seekins.

SENATOR SEEKINS: When the state looks at this resource and considers it in terms of potential income, and maybe this goes to the heart of the question on the fiscal note, what's the greatest potential - the lease income or royalty income?

MR. MYERS: Senator Seekins, through the chair, royalty income far exceeds the potential value of the initial bonus bids and the rentals historically. Of the \$1.3 billion collected last year on the royalty side - royalties, bonuses and leases, the majority of that, well over \$1 billion, was on the royalty side. What you really want is the production. The advantage of the competitive process though is you get the highest value for the lease at the time of leasing because you get the most optimistic person. I should back off. When folks do geologic assessments, they vary based on the quantity of data.... [END OF TAPE]

TAPE 04-15, SIDE A

5:13 p.m.

MR. MYERS: In that case, the one who sees it is going to pay more for that lease than someone who assesses there is any less potential. It's a function of the data; it's a function of the interpreters. The advantage of the competitive process though, is you generally - you always get the bidder who has the most

optimistic view. So that puts, more, so we'd expect to see significantly more dollars bid up-front than you would under a straight filing fee type system.

CHAIR OGAN: That's a zero fiscal note, right?

MR. MYERS: Yes, the zero fiscal note actually is indeterminate positive. There are two aspects. Will this cost us more to administer? Are there, basically more administrative costs with this? I think given the time and the effort put into the process in the Valley, given the effort dealing with folks with the speculative leases, that didn't take them doing all the title work for that. With the best-interest finding, it's a lot of work, but it's probably no more work than we've done with the conventional shallow gas program. So I don't think our finding or up-front costs are going to be substantially more than we've historically seen on the revenue generation side because of the competitive nature of the process. We would see a higher bonus, we believe, for those leases. If there is both conventional and non-conventional gas potential, the rentals would be higher than under the coal bed program. So there is additional revenue there. And then finally, if the [indisc.] gas, the royalty rates will be the same. We also think ultimately, this will accelerate the opportunity for development by true operators and limit speculation, bringing in more money as well.

SENATOR SEEKINS: Would you believe that a great number of these leases that are out there, and we talk in terms of the huge amount of acreage that's around it, most of that is just speculative to try to - they don't really have an idea that there's a great gas deposit there, but there just might be, so we'll tie it up for a little while, and hopefully somebody else will find something that will benefit us?

MR. MYERS: If I look at the majority of shallow gas leases, the folks purchasing them are not traditional oil and gas operators. They've been folks doing exactly, buying the lease and hoping to sell them to someone else for uplifted value or percent of production of it occurs. So we have seen a tremendous amount of speculation under the program. I think there are a lot of folks buying leases without a lot of background in geology, without a lot of expertise, and just buying on the hope that they may be right. Buying in proximity to other leases without doing much assessment work. Generally companies will do, have done assessment work and they buy it at least on a geologic concept or pattern. Here we approach folks who could afford the \$500 and who just thought, "I'll take the risk and if I can turn it

to someone else, maybe I can." So it's highly likely that many of these were bought in areas that don't have a lot of geologic potential.

SENATOR SEEKINS: If title companies have a requirement to register on their title report, or report on their title report if there is a subsurface lease on the land.

MR. MYERS: I believe there is no requirement. There is no single recording office either, for this information. I think again, that a diligent title company ought to have checked with DNR, would find out where and why we don't have leases applied for, or in issuance. I can't speak to the fact that realtors would or wouldn't do that. I don't think they're required to. I would like to address the issue even of surface ownership. The title is not required to be recorded in Alaska, for land ownership, a title transfer. In some cases we have tax records. When folks ask us to notify the folks, we notify a resident who lives there or the absentee landlord who owns the property or which owner has 20 percent or 30 percent of the property. So you can see the issue of trying to actually notify the surface landowners in all cases. How do we do it? Do we send a certified letter to the tax owner, which again, may not be the person actually living on or owning the property. How current are the records? In unorganized boroughs, there aren't really even tax records. So we have a tremendous problem in the state of not having adequate or accurate data to notify surface owners. That's one of the reasons we don't do it. And the cost is probably \$1 per mailing, as well. Effectively, this is a very difficult process. As an alternative, we notify anyone [who] sends in a request to DNR, to be notified for actions in their area. We're totally willing to do it, but we have to rely on some voluntary compliance by the folks to let us know, "Hey this is where I live and if there is anything happening in my area, let me know."

SENATOR SEEKINS: Any lack of notification, or in a title report, is not at the fault of the state because it's not required, and it's just something that you would hope that a title company would exercise the due diligence to check with you guys before they issued the report.

MR. MYERS: Senator Seekins, that's exactly right. Also in the Valley, for instance, less than half the subsurface of the state is owned by the state. If it's private parties, we have no record of it as well.

CHAIR OGAN: I want to state, for the record, that when I bought my property, I was informed and very aware that I was only buying the surface rights and remembers thinking that nobody will drill a well or [indisc.] gold mine under my property, so, maybe it was naïve thinking at the time, but I was aware that I wasn't buying the subsurface. I think more people are aware today, so we can thank this issue for educating the folks, for better or for worse. Thank you very much.

ANNOUNCEMENTS

CHAIR OGAN: There will be a very interesting meeting on Wednesday; [MidAmerican] will be here presenting, from 3:30 - 5:00. So stay tuned and don't touch that dial.

ADJOURNMENT

CHAIR OGAN adjourned the meeting at 5:15 p.m.
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