# HB 394

(11) HOUSE COMMITTEE REPORT

Date Referred to Committee: March 14, 1996 FURTHER REFERRALS:

Date of Committee Action: 4/11/96 pm

The FINANCE Committee considered: HB 394

HOUSE BILL NO. 394 GAS & COAL METHANE LICENSES & LEASES

"An Act authorizing a program of natural gas and coal bed methane development licensing and leasing; relating to regulation of certain natural gas exploration facilities and coal bed methane exploration facilities for purposes of preparation of discharge prevention and contingency plans and compliance with financial responsibility requirements; amending the duties of the Alaska Oil and Gas Conservation Commission as they relate to natural gas exploration activities and coal bed methane exploration activities; and amending the exemption from obtaining a waste disposal permit for disposal of waste produced from coal bed methane drilling."

recommends it be replaced with the following committee substitute SHB 394 (FIN) | ] the same title | ✓ a new title

| ] additional referral to _____ Committee

| ] attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(s): (Dept) APPROVES PREVIOUS: (Dept/Date)

| ] fiscal note(s) _____ | ✓ fiscal note(s) Dnr 2/23/96

| ] zero fiscal note(s) _____ | ✓ zero fiscal note(s) Dec 4/3/96

| SIGNING WITH RECOMMENDATIONS | | DP | DNP | NR | AM |
|---|---|---|---|---|---|
| Mark Hanley | Vice Chair | X | | | |
| Richard Foster | Member | X | | | |
| Terry Martin | Member | X | | | |
| | Member | X | | | |
| Bob Davidson | Member | | | X | |
| Peter Kott | Member | X | | | |
| Pete Kelly | Member | X | | | |
| Richard Foster | Member | X | | | |
| | | | | | |
| | | | | | |
| | | | | | |

CHAIR'S SIGNATURE Mark Hanley Richard Foster

# FISCAL NOTE

**STATE OF ALASKA** **BILL NO. CSHB394(RES)**

**1996 LEGISLATIVE SESSION**

Revision Date: 26-Mar-96 Dept Affected Natural Resources

Title: An Act authorizing a program of natural gas and coal bed methane development licensing and leasing... BRU: Resource Development

Component: Oil & Gas Development

Sponsor: Rep(s) Ogan, Rokeberg, James, Kohring

Requestor: House Resources **Component Serial No.** 439

Expenditures/Revenues (Thousands of Dollars)

| OPERATING EXPENDITURES | FY97 | FY98 | FY99 | FY00 | FY01 | FY02 |
|---|---|---|---|---|---|---|
| PERSONAL SERVICES | | | | | | |
| TRAVEL | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 |
| CONTRACTUAL | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| SUPPLIES | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| EQUIPMENT | | | | | | |
| LAND & STRUCTURES | | | | | | |
| GRANTS, CLAIMS | | | | | | |
| MISCELLANEOUS | | | | | | |
| TOTAL OPERATING | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 |
| CAPITAL EXPENDITURES | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| CHANGE IN REVENUES ( ) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

FUND SOURCE (Thousands of Dollars)

| | | | | | | |
|---|---|---|---|---|---|---|
| 1002 Federal Receipts | | | | | | |
| 1003 GF Match | | | | | | |
| 1004 GF | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 |
| 1005 GF/Program Receipts | | | | | | |
| 1006 GF/MHTIA | | | | | | |
| Other | | | | | | |
| TOTAL | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 |

Estimate of any current year (FY96) cost: $ None

POSITIONS

| | | | | | | |
|---|---|---|---|---|---|---|
| FULL-TIME | 0 | 0 | 0 | 0 | 0 | 0 |
| PART-TIME | 0 | 0 | 0 | 0 | 0 | 0 |
| TEMPORARY | 0 | 0 | 0 | 0 | 0 | 0 |

ANALYSIS: (Attach a separate page if necessary)

Travel costs include costs for staff to attend public hearings concerning the issuing of leases, and for inspecting drilling operations to verify operator is adhering to lease stipulations.

Contractual costs include printing and publishing of public notices and display ads.

Supplies costs include costs for paper, pens, computer discs and other miscellaneous supplies.

Prepared by: Ken Boyd, Director Phone : 269-8800

Division: Oil & Gas Date : 26-Mar-96

Approved by Commissioner: Date: 26-Mar-96

Agency: Natural Resources

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# FISCAL NOTE

STATE OF ALASKA

BILL NO. HB 394(RES)

## 1996 LEGISLATIVE SESSION

Revision Date: 18-Mar-96
Title: Shallow Natural Gas Leasing

Department Affected: Environmental Conservation
BRU: Spill Prevention & Response
Component: Industry Preparedness & Pipeline Program

Sponsor: Ogan, Rokeburg, James and Kohring
Requestor: House Finance Committee

COMPONENT SERIAL NO. 1922

Expenditures/Revenues: (Thousands of Dollars)

| OPERATING EXPENDITURES | FY 97 | FY 98 | FY 99 | FY 00 | FY 01 | FY 02 |
|---|---|---|---|---|---|---|
| PERSONAL SERVICES | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| TRAVEL | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| CONTRACTUAL | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| SUPPLIES | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| EQUIPMENT | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| LAND&STRUCTURES | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| GRANTS,CLAIMS | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| MISCELLANEOUS | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **TOTAL OPERATING** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** | **0.0** |
| **CAPITAL EXPENDITURES** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **CHANGE IN REVENUES ( )** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **FUND SOURCE** | | | | | | |
| 1002 Federal Receipts | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 1003 GF Match | 0.0 | 0.0 | 0 0 | 0.0 | 0.0 | 0.0 |
| 1004 GF | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 1005 GF/Program Receipt | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 1006 GF/MHTIA | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **TOTAL** | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

Estimate of any current year (FY96) cost: $ 0.0

POSITIONS:

| | | | | | | |
|---|---|---|---|---|---|---|
| FULL-TIME | 0 | 0 | 0 | 0 | 0 | 0 |
| PART-TIME | 0 | 0 | 0 | 0 | 0 | 0 |
| TEMPORARY | 0 | 0 | 0 | 0 | 0 | 0 |

ANALYSIS:

Prepared by: Lynn J Tomich Kent
Division: Acting Director, Division of Spill Prevention & Response
Phone : 465-5390
Date : 3/19/96

Approved by Commissioner:
Agency: Department of Environmental Conservation
Date: 3/20/96

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(REV 1/96) I:\legislat\documents\hb394fn4.xls

9-LS1463\R
Chenoweth/Crawford
4/2/96

Adopted 4/13/96
* change to pg 4 adopted #9

**CS FOR HOUSE BILL NO. 394( )**

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

**BY**

**Offered:**
**Referred:**

**Sponsor(s): REPRESENTATIVES OGAN AND ROKEBERG, James, Kohring**

**A BILL**

**FOR AN ACT ENTITLED**

**"An Act authorizing shallow natural gas leasing from sources within 3,000 feet of the surface; relating to regulation of natural gas exploration facilities for purposes of preparation of discharge prevention and contingency plans and compliance with financial responsibility requirements; addressing the relationship between shallow natural gas and other natural resources; and adding, in the exemption from obtaining a waste disposal permit for disposal of waste produced from drilling, a reference to shallow natural gas."**

**BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

* **Section 1.** LEGISLATIVE FINDINGS AND PURPOSE. (a) The legislature finds that

(1) there exist throughout the state sizeable deposits of coal and small but commercially significant amounts of natural gas located close to the earth's surface that are usually, though not always, associated with and emitted from coal deposits;

(2) the methane derived from this coal and other sources and that is found in

reservoirs at depths of less than 3,000 feet could be tapped to serve as a principal or a chief supplemental energy source of benefit to residents of areas in which they are found;

(3) the methane derived from this coal and other shallow gas reservoirs could be developed without interfering with the development and transportation of the state's vast gas reserves available for interstate and foreign markets; and

(4) it is in the best interests of the state and its people that this natural gas should be identified and developed, especially to serve as a source of natural gas for use in rural communities and remote locations within the state, especially when this natural gas can be delivered to consumers at less cost than alternative energy sources.

(b) In authorizing a program of leasing shallow natural gas from state land, it is the legislature's purpose to provide both a means and an incentive by which that gas may be identified and developed at low cost for the direct benefit of residents of remote or sparsely populated areas for which connection to the in-place gas pipeline transmission and distribution system serving population centers in Southcentral Alaska is not economically feasible.

* **Sec. 2.** AS 38.05.035(e)(6) is amended to read: Previously See. 3

(6) before a public hearing, if held, or in any case not less than 21 days before the sale, lease, or other disposal of available land, property, resources, or interests in them other than a sale, lease, or other disposal of available land or an interest in land for oil and gas under (5) of this subsection, the director shall make available to the public a written finding that, in accordance with (1) of this subsection, sets out the material facts and applicable statutes and regulations and any other information required by statute or regulation to be considered upon which the determination that the sale, lease, or other disposal will best serve the interests of the state was based; however, a written finding is not required before the approval of

(A) a contract for a negotiated sale authorized under AS 38.05.115;

(B) a lease of land for a shore fishery site under AS 38.05.082;

(C) a permit or other authorization revocable by the commissioner;

(D) a mineral claim located under AS 38.05.195;

(E) a mineral lease issued under AS 38.05.205;

(F) a production license issued under AS 38.05.207;

(G) an exempt oil and gas sale under AS 38.05.180(d) of acreage offered in a sale that was held within the previous five years if the sale was subject to a written best interest finding, unless the commissioner determines that new information has become available that justifies a revision of the best interest finding; [OR]

(H) a lease sale under AS 38.05.180(w) of acreage offered in a sale that was held within the previous five years if the sale was subject to a best interest finding, unless the commissioner determines that new information has become available that justifies a revision of the best interest finding; **or**

**(I) a shallow gas lease authorized under AS 38.05.177 in an area for which leasing is authorized under AS 38.05.177;**

* **Sec. 3.** AS 38.05.140(a) is amended to read:

(a) A person may not take or hold coal leases or permits during the life of coal leases on state land exceeding an aggregate of 46,080 acres, except that a person may apply for coal leases or permits for acreage in addition to 46,080 acres, not exceeding a total of 5,120 additional acres of state land. The additional area applied for shall be in multiples of 40 acres and the application shall contain a statement that the granting of a lease for additional land is necessary for the person to carry on business economically and is in the public interest. On the filing of the application, **except as provided by AS 38.05.177(a)(2)(B),** the coal deposits in the land covered by the application shall be temporarily set aside and withdrawn from all other forms of disposal provided under AS 38.05.135 - 38.05.181.

* **Sec. 4.** AS 38.05.150 is amended by adding a new subsection to read:

(f) Notwithstanding AS 38.05.177, a lease entered into under this section gives the lessee the right to vent or remove methane and other gas held in association with the coal in the land covered by the lease to ensure safe coal mining operations.

* **Sec. 5.** AS 38.05 is amended by adding a new section to read: previously sec. 2

Sec. 38.05.177. SHALLOW NATURAL GAS LEASES. (a) The provisions of this section

(1) apply to gas, whether methane associated with and derived from coal deposits or otherwise, developed from a source that is within 3,000 feet of the surface; and

(2) do not apply to authorize lease of

(A) the land (i) that is or is proposed to be subject to an oil and gas exploration license or lease issued under AS 38.05.131 - 38.05.134; (ii) that is leased under AS 38.05.180; or (iii) that is included in the final findings of a proposed oil and gas leasing program prepared under AS 38.05.180(b); however, the commissioner may waive the limitations of this subparagraph; or

(B) the land that is held under a coal lease entered into under AS 38.05.150, unless the applicant for a shallow natural gas lease is also the lessee under AS 38.05.150 of that land.

(b) For the purpose of exploring for and developing shallow natural gas reservoirs, upon application, the director may lease to a person land for which the state owns the subsurface rights. A person applying for a lease under this subsection

(1) shall specify the area to be leased; the area to be leased may not exceed 5,760 acres; a lessee may not hold more than 23,040 acres of land under leases entered into under this section;

(2) may not be required to pay an application fee or any other form of payment as a condition of submitting or processing the lease application or obtaining the lease.

(c) Within 20 days of receipt of a lease application, the director shall give notice of receipt of the lease application and call for comments from the public. The director's call for public comments must provide opportunity for public comment for a period of 60 days. If, on the basis of public comments received, the director determines to enter into a lease for the area described in (b) of this section, the director shall execute the lease within 90 days after the close of the public comment period or, if review is required under AS 46.40, within 30 days after the final consistency determination is made under AS 46.40. A lease entered into under this subsection gives the lessee the exclusive right to explore for, develop, and produce, for a term of three years, natural gas on the state land described in the lease; the right to explore for, develop, and produce is limited to gas derived from natural gas within 3,000 feet of the surface.

(d) A lease shall be automatically extended if and for so long thereafter as gas is produced in paying quantities from the lease. A lease issued under this section covering land on which there is a well capable of producing gas in paying quantities

does not expire because the lessee fails to produce gas unless the lessee is allowed reasonable time to place the well on a producing status. If drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, including such operations as redrilling, sidetracking, or other means necessary to reach the originally proposed bottom hole location, the lease is extended for one year and for so long thereafter as gas is produced in paying quantities. A gas lease issued under this section that is subject to termination by reason of cessation of production does not terminate if, within 90 days after production ceases or a longer period determined at the discretion of the director, reworking or drilling operations are commenced on the land under lease and are thereafter conducted with reasonable diligence during the period of nonproduction. In addition, upon application by the lessee, the director may once extend a lease issued under (c) of this section for a period of not more than three years.

(e) The director may, following the procedures described in (c) of this section, adjust the boundaries of a lease entered into under this section as may be necessary to ensure development of natural gas within a reasonably compact area; a lease as adjusted under this paragraph remains subject to the acreage limitations set out in (b)(1) of this section.

(f) A shallow gas lease must provide for payment to the state of rental in the amount of 50 cents per acre. The rent is due and payable on the dates determined in the lease. If rent is not paid when due, the director shall mail the lessee written notice of nonpayment at the end of each month, while the rent remains unpaid, for a period of two months. The lessee may cure the failure to pay rent when due within 90 days after the rent payment becomes due and payable by paying to the director the amount of rent due together with a penalty of the greater of $50 or five percent of the amount of rent in default. If the lessee fails to remedy the lessee's failure to pay rent, the director shall terminate the lease.

(g) The royalty payable on natural gas produced from a lease is 6.25 percent of the value of the production removed or sold from the lease.

(h) A lease issued under this section is subject to the following terms and conditions and may be terminated by the director in the event of a breach of a term or condition:

(1) the lessee may surrender the lease or relinquish part of the lease at

any time;

(2) the lease may not be transferred or assigned until a well capable of commercial production of gas has been drilled on the lease; however, this paragraph does not prohibit the lessee from entering into a farm out agreement or similar arrangement with a third party under which the third party assists in exploration and development of production from the lease if the agreement or arrangement does not require a payment of consideration by the third party to the lessee, except that the lessee may retain an overriding royalty interest in the lease or may retain a net profit or other production payment;

(3) gas produced from the lease may not be sold or otherwise made available for insertion into the in-place gas pipeline transmission or distribution system serving population centers in Southcentral Alaska, except that the director may waive this limitation to permit the exchange of the gas produced for other gas that may be distributed in rural communities and remote locations within the state.

(i) The applicant for a lease may conduct a title search for the area described in the lease application.

(j) A lease does not give the lessee the right to produce oil. A lease does not give the lessee the right to produce gas from sources that are not within 3,000 feet of the surface. If an onshore well drilling for natural gas under a lease authorized by this section penetrates a formation capable of producing gas below 3,000 feet of the surface, the owner or operator

(1) shall notify the department and the Alaska Oil and Gas Conservation Commission; and

(2) may not conduct further operations in the drilled well until the facility complies with all applicable laws and regulations relating to oil and gas production; however, this paragraph does not prevent the owner or operator from conducting activities that may be required by the Alaska Oil and Gas Conservation Commission to plug, plug-back, or abandon a well.

(k) The commissioner of natural resources may adopt only the regulations that are reasonable and that are necessary to implement, interpret, or make specific the provisions of this section or to establish procedures to govern application of the provisions of this section.

(l) A lessee obtaining a lease under this section may exercise the rights authorized by this section and the lease. The rights granted by the lease must be exercised in a manner that does not unreasonably interfere with eventual development of the coal deposit on the land leased. Consistent with the principle of reasonable concurrent uses as set out in art. VIII, sec. 8, of the state constitution, the state may also lease the land under AS 38.05.150. However, in a lease entered into under AS 38.05.150 for land that is already leased under this section, coal may not be mined or extracted by the coal lease from the coal lessee without prior agreement with the lessee holding the lease issued under this section.

(m) In this section, "lease" means a shallow gas lease authorized by this section.

* **Sec. 6.** AS 38.05.180(f) is amended to read: previously Sec. 4

(f) Except as provided by AS 38.05.131 - 38.05.134 **and 38.05.177**, the commissioner may issue oil and gas leases on state land to the highest responsible qualified bidder determined by competitive bidding under regulations adopted by the commissioner. Bidding may be by sealed bid or according to any other bidding procedure the commissioner determines is in the best interests of the state. Whenever, under any of the leasing methods listed in this subsection, a royalty share is reserved to the state, it shall be delivered in pipeline quality and free of all lease or unit expenses, including but not limited to separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation off the lease or unit area. Following a pre-sale analysis, the commissioner may choose at least one of the following leasing methods:

(1) a cash bonus bid with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease;

(2) a cash bonus bid with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease and a fixed share of the net profit derived from the lease of not less than 30 percent reserved to the state;

(3) a fixed cash bonus with a royalty share reserved to the state as the bid variable but no less than 12.5 percent in amount or value of the production

removed or sold from the lease;

(4) a fixed cash bonus with the share of the net profit derived from the lease reserved to the state as the bid variable;

(5) a fixed cash bonus with a fixed royalty share reserved to the state of not less than 12.5 percent in amount or value of the production removed or sold from the lease with the share of the net profit derived from the lease reserved to the state as the bid variable;

(6) a cash bonus bid with a fixed royalty share reserved to the state based on a sliding scale according to the volume of production or other factor but in no event less than 12.5 percent in amount or value of the production removed or sold from the lease;

(7) a fixed cash bonus with a royalty share reserved to the state based on a sliding scale according to the volume of production or other factor as the bid variable but not less than 12.5 percent in amount or value of the production removed or sold from the lease.

* Sec. 7. AS 46.03.100(f) is amended to read: previously Sec. 5

(f) This section does not apply to discharges of solid or liquid waste material or water discharges from the following activities if the discharge is incidental to the activity and the activity does not produce a discharge from a point source, as that term is defined in regulations adopted under this chapter, directly into any surface water of the state:

(1) mineral drilling, trenching, ditching, and similar activities;

(2) landscaping;

(3) water well drilling, geophysical drilling, or coal bed methane drilling **or other natural gas drilling to recover gas from a reservoir at a depth of less than 3,000 feet**; or

(4) drilling, ditching, trenching, and similar activities associated with facility construction and maintenance or with road or other transportation facility construction and maintenance; however, the exemption provided by this paragraph does not relieve a person from obtaining a permit under (a) of this section if

(A) the drilling, ditching, trenching, or similar activity will

involve the removal of the groundwater, stormwater, or wastewater runoff that has accumulated and is present at an excavation site for facility, road, or other transportation construction or maintenance; and

(B) a permit is otherwise required by (a) of this section.

* **Sec. 8.** AS 46.04.030(b) is amended to read: previously Sec. 6

(b) A person may not cause or permit the operation of a pipeline or an exploration or production facility in the state unless an oil discharge prevention and contingency plan for the pipeline or facility has been approved by the department and the person is in compliance with the plan. **This subsection does not apply to an onshore exploration facility used solely to explore for shallow natural gas by means of drilling a well on a lease authorized under AS 38.05.177.**

* **Sec. 9.** AS 46.04.030 is amended by adding a new subsection to read: previously Sec. 7

(s) If an onshore well drilling for gas under a lease authorized by AS 38.05.177 penetrates a formation capable of producing oil, the owner or operator

(1) shall notify the department and the Alaska Oil and Gas Conservation Commission; and

(2) may not conduct further operations in the drilled well until the facility complies with all applicable laws and regulations relating to oil and gas production; however, this paragraph does not prevent the owner or operator from conducting activities that may be required by the Alaska Oil and Gas Conservation Commission to plug, plug-back, or abandon a well.

* **Sec. 10.** AS 46.04.040(b) is amended to read: previously Sec. 8

(b) A person may not cause or permit the operation of a pipeline or an exploration or production facility in the state unless the person has furnished to the department, and the department has approved, proof of financial ability to respond in damages. Proof of financial responsibility required for

(1) a pipeline or an offshore exploration or production facility is $50,000,000 per incident;

(2) an onshore production facility is

(A) $20,000,000 per incident if the facility produces over 10,000 barrels per day of oil;

(B) $10,000,000 per incident if the facility produces over 5,000 barrels per day but not more than 10,000 barrels per day of oil;

(C) $5,000,000 per incident if the facility produces over 2,500 barrels per day but not more than 5,000 barrels per day of oil;

(D) $1,000,000 per incident if the facility produces 2,500 barrels per day or less of oil;

(3) an onshore exploration facility is

**(A) $25,000 per incident for a facility used solely to explore for shallow natural gas by means of drilling a well when authorized by AS 38.05.177; and**

**(B) except as provided by (A) of this paragraph,** $1,000,000 per incident.

*** Sec. 11.** AS 46.04.040 is amended by adding a new subsection to read: previously Sec. 9

(n) If an onshore well authorized under AS 38.05.177 to recover shallow natural gas penetrates a formation capable of producing oil, the owner or operator may not conduct further exploration activity. However, this subsection does not prevent the owner or operator from conducting activities that may be required by the Alaska Oil and Gas Conservation Commission to plug and abandon a well.

*** Sec. 12.** AS 46.04.050 is amended by adding a new subsection to read: previously Sec 10

(c) Except as provided in AS 46.04.030(s), the provisions of AS 46.04.030(b) do not apply to an onshore exploration facility used solely to explore for natural gas by means of drilling a well when authorized under AS 38.05.177.

9-LS1463\R.12
Chenoweth
4/9/96

No objection

AMENDMENT I adopted

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 10, lines 9 and 10:

Delete "**when authorized by AS 38.05.177**"

Insert "**to explore for and develop gas, whether methane associated with and derived from coal deposits or otherwise, from a source that is within 3,000 feet of the surface**"

9-LS1463\R.13
Chenoweth
4/11/96

adopted NO|OBJ

**AMENDMENT** 2

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 6, line 15:

Delete "may"

Insert "shall"

9-LS1463\R.16
Chenoweth
4/11/96

adopted No Obj

**AMENDMENT** 3

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 5, line 28, following "lease":

Insert ", the production to be delivered in pipeline quality and free of all lease expenses, including but not limited to separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation off the lease"

9-LS1463\R.17
Chenoweth
4/11/96

adopted NO. 0B)

**AMENDMENT** 4

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 7, following line 9:

Insert a new subsection to read:

"(m) Except as otherwise specifically provided in this section, the provisions of AS 38.05.135 - 38.05.184 apply to leases entered into under this section."

Reletter the following subsection accordingly.

9-LS1463\R.5
Chenoweth
4/8/96

adopted
No Obj

**AMENDMENT** 5

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 4, lines 16 - 18:

Delete all material and insert:

not to exceed $500

"(2) may be required to pay a reasonable application fee, ~~as the commissioner may determine, as a condition of submitting or processing the lease~~ application or obtaining the lease."

Not offered

withdrawn

9-LS1463\R.11
Chenoweth
4/9/96

**AMENDMENT** XX

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 4, line 6:

Delete "or"

Page 4, line 9, after "land":

Insert "; or

(C) submerged land and shoreland designated as the Bristol Bay Fisheries Reserve by AS 38.05.140(f)"

4/11/96 pm

9-LS1463\R.19
Chenoweth
4/11/96

withdrawn

**AMENDMENT** 6

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 6, line 9:

Delete ";"

Insert "."

Page 6, lines 10 - 14:

Delete all material.

9-LS1463\R.18
Chenoweth
4/11/96

Failed 2-6

**AMENDMENT** 7

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 3, line 31, following "otherwise":

Insert ", exclusive of gas found in association with oil"

9-LS1463\R.15
Chenoweth
4/11/96

Failed 3-6

**AMENDMENT** 8

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 5, lines 20 - 22:

Delete "If rent is not paid when due, the director shall mail the lessee written notice of nonpayment at the end of each month, while the rent remains unpaid, for a period of two months."

9-LS1463\R.6
Chenoweth
4/8/96

adopted as amended as

**AMENDMENT 9**

OFFERED IN THE HOUSE

TO: CSHB 394( ) "R" version

Page 4, line 22, after "determines":

Insert "that it is in the best interests of the state"

HB 394

# CHANGES FROM VERSION (O) TO VERSION (R)

- **GREEN HIGHLIGHTER denotes new language**
- **BLUE HIGHLIGHTER denotes sections that have been renumbered**

**New Language and where it occurs:**

1. pp. 1, lines 4-5: New language is added to the title. "addressing the relationship between shallow natural gas and other natural resources;"

2. pp. 3, lines 12-26: Both section 3 & 4 are new sections to this bill. This addition is made, so that the holder of a coal lease will not have to face a competing application for a shallow natural gas lease for the same tract. Please refer to the memorandum dated March 29, 1996 from Legislative Counsel, Jack Chenoweth for a more detailed analysis.

3. pp. 4, line 2: "is proposed to be" inserted in the place of the word "becomes".

4. pp. 4, line 4: The words "included" and "in the final findings" are added.

5. pp. 4, line 6: "of this subparagraph" is inserted by request of DNR. This allows the commissioner to waive all limitations of this subparagraph rather than just (iii).

6. pp. 4, lines 8-9: The line "unless the applicant for a shallow natural gas lease is also the lessee under AS 38.05.150 of that land." is added. This change is a part of the overall changes having to do with coal mines and gas leases.

7. pp. 4, line 19: "Within 20 days of" is inserted here replacing language that exists in version O. This is a request made by DNR.

8. pp. 4, line 27: "of three" replaces "not to exceed five" This is a request made by DNR.

9. pp. 5, line 5: "is extended for one year" replaces "continues in effect until 90 days after drilling has ceased" This is a request made by DNR.

4/3/96
Attachment 1

10. pp. 5, line 8: "90" replaces "60". This is a request of DNR.

11. pp. 5, line 8-9: "or a longer period determined at the discretion of the director" is inserted.

12. pp. 5, line 13: "following the procedures described in (c) of this section" is included so that the public forum process must be adhered to if boundaries are adjusted.

13. pp. 5, line 18-19: This language replaces the language which exists in version O. This is a cosmetic change. The version R language mimics the existing language in oil and gas statutes. This is a DNR request.

14. pp. 5, line 32: "the lease" and "part of" are inserted here in order to address the concerns of the private sector. This allows the private entities to surrender parts of a lease that are unproductive, so that the private entities may enter into other leases.

15. pp. 6, line 2: "a well capable of" replaces "after the date of initial". This is a change requested by DNR.

16. pp. 6, line 3: "has been drilled" replaces "from the area" This is a change requested by DNR.

17. pp. 6, line 15: "may" replaces "shall" This is a change requested by DNR.

18. pp. 6, lines 17-18: The two sentences on these lines, in version O, had been only one sentence. They are separated to further clarify their intent. "A lease does not give the lessee the right to produce oil."

19. pp. 7, lines 1-9: This subsection (l) is a part of the new language that deals with the relationship between coal mine leases and shallow gas leases. This subsection allows for the possibility of the overlapping development of the shallow natural gas and the coal resources.

20. pp. 9, line 21: "plug-back, or" is inserted in order to remain consistent with language found in Sec. 5 (j), on pp. 6 line 28.

3/15/96

# SECTIONAL ANALYSIS CSHB 394
# VERSION O

**Bill Section 1** sets out legislative findings, a statement of purpose, and a statement of intent for the measure.

**Bill Section 2** authorizes a shallow natural gas leasing program. Its key components are:

- The program is made applicable to recovery of natural gas, from any source, located within 3000 feet of the surface, but is inapplicable to (1)areas that cannot be leased under the oil and gas exploration licensing and leasing program (i.e. North Slope and Cook Inlet), (2) land under an exploration license or lease, or already leased under AS38.05.180, or part of the state's five year proposed oil and gas lease program, and (3) land under coal lease under the effective date of the Act

- The leases have no minimum size requirement. A maximum lease size of 5,760 acres is established, and total land leased cannot be more than 23,040 acres

- A public comment period is established

- A lease will be automatically extended if production of gas at paying quantities continues

- Rent and royalty rates are set out in AS38.05.177(f) and (G)

- There are several conditions and restrictions on the shallow gas lease, including limitations on lease assignment and on insertion of the gas into the in-place transmission system generally serving the population centers of southcentral Alaska; the rights of the state and of the lessee to terminate or surrender the lease are spelled out

- The commissioner of natural resources is given the ability to adopt only those regulations that are absolutely necessary to these operations

**Bill Section 3** exempts the requirement of a best interest finding

**Bill Section 4** exempts shallow gas leases from competitive bidding requirements based on the choice of leasing methods specified in that section for oil and gas leases

**Bill Section 5** includes natural gas drilling of depths less than 3,000 feet as an activity under AS46.03.100.

**Bill Section 6:** There is a general requirement in law that pipelines and exploration and production facilities may not be operated unless an oil discharge prevention and contingency plan has been developed and is in place for the pipeline and for the exploration and production facility. The amendment made by this section establishes an exception from that requirement for an onshore well drilling for shallow natural gas so long as that facility does not encounter a formation capable of producing oil.

**Bill Section 7** sets out the steps that the owner or operator of a shallow natural gas well must take if the operation encounters a formation capable of producing oil.

**Bill Section 8** sets the financial responsibility requirement applicable to an onshore exploration facility exploring for shallow natural gas at $25,000.

**Bill Section 9** requires the operator or owner to stop operating, with exceptions, when a formation capable of producing oil is encountered.

**Bill Section 10** sets out exemptions from the laws establishing oil discharge prevention and contingency plans and financial responsibility requirements. This bill section notes the additional exemption from these provisions for shallow natural gas exploration facilities except as may be required when that well penetrates a formation capable of producing oil.

**Bill Section 11** affirms that persons holding coal leases in effect on the effective date of this Act have the right to develop coal bed methane and related gas held in association with the coal.

NAKNEK ELECTRIC ASSOCIATION, INC.

POST OFFICE BOX 118 • NAKNEK, ALASKA 99633 • PHONE 246-4261 • FAX (907) 246-6242

**Testimony Before the House Finance Committee On HB394**
**April 3, 1996**

Honorable chairman and members of the House Finance Committee, thank you for this opportunity to testify in favor of HB394.

I am the General Manager of Naknek Electric Association, Inc. We generate and distribute electricity for the communities of Naknek, King Salmon, and South Naknek. We use about 1.4 million gallons of diesel annually, which we buy in bulk and store in a 1.6 million gallon tank farm.

For many years we have sought alternative sources of energy. But it is hard to compete with diesel - first, because the initial cost of generation equipment is low - less than $500 per kilowatt, even for relatively small generators - and secondly because diesel is plentiful. Maybe expensive sometimes, but always plentiful.

In 1987, NEA commissioned a study to analyze the viability of natural gas for electric generation. A geologist was retained to do an analysis of available records on oil and gas exploration efforts in our area. As you know, Bristol Bay has been the focus of great interest by oil and gas developers in the past and over $90 million were paid in oil leases twenty years ago. A lot of exploratory and seismic work was done back then but unfortunately all of it was either offshore or southwest along the Alaska Peninsula.

The analysis determined that natural gas was highly likely to be present in our area in quantities sufficient for local energy needs. However, the cost to develop it, using prevailing technology and methods, was discouraging as long as diesel fuel was available at a relatively reasonable rate.

A lot has transpired since then. Now, affordable exploration tools such as thermal imagery and radar photography make it feasible to paint that "x" on the ground at vastly less cost than seismic analysis. Shallow well coiled-tube drilling techniques cost a fraction of what conventional drilling does. Exploration and development of gas in small communities is no longer cost prohibitive. If we are successful in our search for gas, we will be demonstrating the newly commercialized fuel cell technology in Naknek in 1999.

4/3/96
Attachment 2

The area surrounding Naknek is mostly state owned. We need the support of the state in our efforts to switch to a local energy source. When I have approached the Department of Natural Resources in the past, the first response I have gotten is "Well, there's no identified gas source in your area." That is true. But then, there has been no exploration activity in our area at all so there is no way of knowing whether there is or isn't gas here. Another response I have gotten is "How do you plan to deal with the drilling wastes?" For the depth and diameter of hole that we contemplate, the drilling wastes could be used by a medium size colony of ants for a potential dwelling.

I believe this bill will go a long way to make feasible the small-scale development of gas sources in our remote communities. For too long, our stance has been to let the big boys do the work because only they are capable, financially and expertise-wise, to fulfill the regulatory and bureaucratic requirements. This bill will make it feasible for the little guys - the communities and utilities serving the smallest areas - to not have to wait for a benevolent big brother to come and rescue them from their diesel bondage.

I urge this committee to pass this bill and I would be happy to answer any questions that you may have.

Thank you again for the opportunity to testify.

Sincerely,

Meera Kohler

Meera Kohler
General Manager

# LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
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130 Seward S eet, Suite 409
Juneau, Alas a 99801-2105

**MEMORANDUM** April 3, 1996

**SUBJECT:** Draft CSHB 394 ( ), relating to shallow bed natural gas leasing -- sectional analysis (Work Order No. 9-LS1463\R)

**TO:** Representative Scott Ogan
ATTN: Hans Neidig

**FROM:** James P. Crawford
Assistant Revisor of Statutes

This is a revision of the bill that incorporates amendments prepared by this office and revisions requested by your office after consultation with the Department of Natural Resources. As a preliminary matter, note that this sectional summary should not be considered an authoritative interpretation of the bill, and the bill itself is the best statement of its contents.

**Bill section 2 (AS 38.05.035(e)(6))** exempts from the requirement of a written best interest finding shallow bed gas development leases under AS 38.05.177.

**Bill sections 3 and 4** incorporate amendment 9-LS1463\O.2, prepared by Legislative Counsel Jack Chenoweth, which appears in this version without significant change other than adjusting cross-references to reflect the renumbering occasioned by other changes requested by you and the Department of Revenue. Incorporating this amendment caused an addition to the bill title to express the treatment in this version of the relationship between shallow natural gas and other natural resources. Additionally, incorporating this amendment added language to AS 38.05.177 at subsection (a)(2)(B) and added new subsection (l) to that section.

In his 29 March 1996 memorandum (attached), Jack very ably analyzed the impact of amendment O.2; and I direct your attention to Jack's discussion. Note, however, that in Jack's memo reference to AS 38.05.177(a)(2)(C) should now be read as AS 38.05.177(a)(2)(B) and reference to subsection (m) should now be read as subsection (l).

**Bill section 5 (AS 38.05.177)**, the heart of the bill, authorizes a shallow bed natural gas leasing program. Among the key features of the leasing program:

-- The program is made applicable to recovery of natural gas, from coal deposits or any other source, located within 3,000 feet of the surface at the drill site, but is inapplicable to land under or proposed to be under an exploration license or lease, to land already leased under AS 38.05.180, or to land that is part of the state's five-year proposed oil and gas lease program as reflected in final findings. However, the commissioner may waive these exceptions to the reach of AS 38.05.177 so that the provisions of this section would authorize leasing of these lands. The program is unavailable to land under coal lease unless the shallow bed natural gas lease applicant is the lessee of land subject to that coal lease;

-- The leases may be awarded to cover areas not greater than 23,040 acres; lease applicants may not be required to pay a fee for the application or its processing;

-- Following a public comment period for a lease application, the director is authorized to provide the lease applicant an initial shallow bed gas development lease giving the exclusive right, for a period of three years, to explore for, develop, and produce shallow bed natural gas;

-- The initial shallow bed gas development lease may be extended for so long as gas is produced in paying quantities; lessees are allowed a reasonable time to put wells capable of producing in paying quantities into producing status; if drilling has at least commenced on the lease expiration date, the lease may be extended for one year on a showing of diligent efforts; if a lease is terminable for cessation of production and production in fact ceases but operations commence on the lease within a certain period, lease termination is avoided if operations are conducted diligently; additionally, on application by the lessee, the director may extend a lease one time only for three years or less;

-- The shallow bed natural gas lessee is required to pay rent in the amount of 50 cents per acre and royalty at 6.25 percent of the value of the production removed or sold from the lease;

-- There are several conditions and restrictions on the shallow bed gas development lease, including limitations on lease assignment and on insertion of the gas into the in-place transmission system generally serving the population centers of southcentral Alaska;

-- An applicant is permitted to conduct title searches;

-- The limitations of a lease granted under this program are spelled out with respect to the production of oil and to the production of gas from sources not within 3,000 feet of the surface;

-- The authority of commissioner of natural resources to adopt regulations is spelled out;

-- Overlapping development of shallow natural gas and coal resources is possible.

**Bill section 6 (AS 38.05.180(f))** exempts shallow bed gas development leases from competitive bidding requirements.

**Bill section 7 (46.03.100(f))** adds shallow bed natural gas drilling to the exemptions from obtaining a waste disposal permit for disposal of waste produced from drilling.

**Bill section 8 (AS 46.04.030(b))** incorporates 9-LS1463\O.14, another amendment drafted by Jack Chenoweth. There is a general requirement in law that pipelines and exploration and production facilities may not be operated unless an oil discharge prevention and contingency plan has been developed and is in place for the pipeline and for the exploration and production facility. The amendment establishes an exception from that requirement for an onshore exploration facility used solely to explore for shallow bed natural gas by drilling a well on an authorized lease.

**Bill section 9 (AS 46.04.030(s))** sets out the steps that a shallow bed natural gas operator must take if the operation encounters a formation capable of producing oil.

**Bill section 10 (AS 46.04.040(b))** sets the financial responsibility requirement applicable to an onshore exploration facility exploring for shallow bed natural gas at $25,000 per incident.

**Bill section 11 (AS 46.04.040(n))** requires the operator of a shallow bed natural gas operator to cease operating, with exceptions, when the operator penetrates a formation capable of producing oil while exploring for gas.

**Bill section 12 (AS 46.04.050(c))** adds to the provisions of AS 46.04.050, which sets out exemptions from the laws establishing oil discharge prevention and contingency plans and financial responsibility requirements. This bill section notes the additional exemptions from these provisions for shallow bed natural gas exploration facilities except as may be required when that well penetrates a formation capable of producing oil.

JPC:klb
96-253.klb

Enclosure

# LEGAL SERVICES

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Juneau, Alaska 99801-2105


COPY

**MEMORANDUM** March 29, 1996

**SUBJECT:** Amendment O.2 to CSHB 394(RES)
(Work Order No. 9-LS1463\O.2)

**TO:** Representative Scott Ogan
ATTN: Hans Neidig

**FROM:** Jack Chenoweth
Legislative Counsel

Amendment O.2 generally addresses the relationship that you asked to be defined between lessees under a shallow natural gas lease and lessees under a coal lease.

As a preliminary note, I indicated that, in my judgment, the changes that you were requesting would have a continuing or ongoing effect and should be incorporated as part of the permanent law. Consequently, in this amendment, I added and amended permanent law provisions and removed the bill's last section, the temporary law provision that outlined the relationship between shallow natural gas leases and coal leases in effect on this bill's effective date.

**As to coal and the rights of coal lessees:**

The addition of (f) to AS 38.05.150 in proposed bill section 3 follows the language you presented. It affirms that, notwithstanding anything provided in AS 38.05.177 authorizing shallow natural gas leasing, coal lessees have the right to vent gas held in association with coal to ensure a safe coal mining operation.

*

CSHB 394(RES), in its AS 38.05.177(a)(2)(C), currently precludes issuance of a shallow natural gas lease on land that is already the subject of a coal lease. The amendment made to the bill at page 2, line 30 and page 2, line 31 modifies that prohibition by giving a holder of a coal lease the opportunity to obtain a shallow natural gas lease for the tract.

The corollary of that is the amendment made to AS 38.05.140(a). Under current law, when an application is filed for a coal lease, coal deposits are withdrawn "from all other forms of disposal provided under AS 38.05.135 - 38.05.181." The application for the coal lease

makes exploration and mining of the coal exclusive. Without the exception provided in proposed new bill section 2, the holder of a coal lease would be unable to also obtain a shallow natural gas lease under AS 38.05.177 for the same tract.

The net effect of these changes is to say, in effect, that the holder of a coal lease will not have to face a competing application for a shallow natural gas lease for the same tract.

**As to shallow natural gas and shallow natural gas lessees:**

The material added in new subsection (m), page 6, following line 5, considers the relationship between the shallow gas lessee and the ultimate opportunity to develop the coal resources of the tract after extraction of the gas. In line with our discussion, relying on the "concurrent use" principle of the state constitution's resource article, this subsection allows for the possibility of the overlapping development of the shallow natural gas and the coal resources.

As drafted, the holder of a shallow natural gas lease faces the possibility of a competing application for issuance of a coal lease on the same tract. In the case of land in which the shallow gas lessee holds the older interest, while the land may also be leased for its coal potential, mining and extraction of the coal by the coal lessee cannot proceed without the prior agreement of the shallow natural gas lessee.

Due to these changes, the amendment proposes to insert an additional clause in the bill's title.

JBC:glc:klb
96-195.glc

Enclosure

## Version O Deletions

pp. 2, lines 21-22 delete all material

pp. 3, lines 9-11 delete all material to "receipt" on line 11

pp. 4, lines 5-18 delete all material after the word "years" on line 5.

pp. 5, lines 21-22 delete all material

pp. 10, lines 17-23 delete all material

# ALASKA RURAL ENERGY INITIATIVE

Division of Energy
Department of Community and Regional Affairs
State of Alaska

June 1995

## EXECUTIVE SUMMARY

There are over 150 small villages in rural Alaska that are not accessible by road, that are characterized by severe climate and widespread poverty, and that are heavily dependent on fuel oil for power generation and heat. The average population per village is about 250 residents, mostly Alaska Natives.

### Bulk Fuel Storage

In most cases, the village fuel supply must be delivered by barge during a brief ice-free shipping season and stored throughout the year. Every village relies on above-ground tank farms for essential fuel storage though few of these facilities presently meet minimum standards of safety or environmental protection. Most lack adequate foundations, dikes, and piping systems as well as basic security fences. Many are rusted, improperly sited, and violate electrical codes.

An increasing number of villages now face the possibility that fuel will not be delivered because of these deficiencies. Fuel carriers are threatened with liability for environmental damage if they fill village tanks that subsequently leak. Most recently, the U.S. Coast Guard, with regulatory jurisdiction over fuel transfer facilities between the delivery barge and the storage tank, has sent letters to the owners of nearly 80 fuel storage facilities threatening to deny fuel deliveries unless deficiencies are corrected.

The estimated cost for repair and renovation of fuel storage facilities in rural Alaska is $200 million, excluding future inflation. This does not include remediation of contaminated soil and groundwater.

### Electric Utilities

Approximately 80 communities in rural Alaska are served by small, single-village electric utilities; roughly the same number are served by larger, multi-village utilities. Most of these communities have no transmission link to any other community and are entirely dependent on local diesel generators for their power supply. The cost of power in rural Alaska is high, roughly 4 to 5 times the average elsewhere in the United States.

Particularly in the single-village utilities, power plant and distribution systems often do not meet accepted utility standards for safety, efficiency, reliability, and environmental protection. These villages require adequate electric service, however, for economic advancement and for support of other community facilities. Upgrading the physical plant of the electric utility to meet minimum standards is a pre-condition for utility self-reliance, as well as community self-reliance, in the future.

The estimated cost to upgrade the single-village utilities is $25 million, excluding future inflation. Upgrade costs for the multi-village utilities have not been systematically estimated.

### Proposal for Funding

Policies, programs, and expenditures of both the State and Federal governments have contributed over the years to the relative permanence of remote Native villages in Alaska. Resolving the problem of deteriorating fuel tanks and substandard electric utility systems

is beyond the means of village residents. A joint State/Federal effort is needed to bring these facilities to the point where they no longer represent a safety or environmental hazard, and can be maintained and replaced as necessary without further long-term government support. To this end, the following is proposed:

1. The State and Federal governments will together make available for expenditure $25 million per year -- $12.5 million each -- until, in combination with local match contributions, a total investment of $250 million is reached. While the number of years required to reach this investment total will not exceed 10, the actual number of years may be less depending on the size of the local match contributions. The $250 million total includes the estimate of $200 million for bulk fuel storage, $25 million for upgrading single-village electric utilities, and an allowance of $25 million for additional electric utility upgrades and for inflation.

   It is proposed that the Federal contribution be appropriated to the Rural Utilities Service in the U. S. Department of Agriculture and, from there, channeled to the Division of Energy in the Alaska Department of Community and Regional Affairs, which will administer the program.

2. The funds will be expended as grants. Cash or in-kind match from participants will be required. The Division of Energy will retain authority to approve project design.

3. For bulk fuel storage facilities, a key objective will be to consolidate existing tank farms into a smaller number of code-compliant fuel storage facilities. The Division of Energy will meet with tank farm owners to develop consolidation agreements which will identify, for each consolidated facility, a single entity to assume ownership and operating responsibility, and which will set out each participant's rights and obligations. Each participant will be assured the right to solicit competitive bids for fuel delivery in the future.

   Grant agreements with the designated facility owners will incorporate the consolidation agreements, will provide assurances with regard to long-term operation and maintenance of the facilities, and will establish requirements for periodic facility inspection and reporting.

4. For electric utility upgrades, project approval will be contingent on local commitment to professional utility management in the future. The Division of Energy will meet with utility boards and managers to define the upgrade projects and to negotiate utility management agreements. In these agreements, utilities may commit to joining a consolidated utility organization or to other arrangements that will ensure capable utility management.

   Grant agreements will incorporate the utility management agreements and will include a utility pledge not to seek additional State or Federal grants for ordinary capital improvements such as normal renewal and replacement of diesel generating plant.

5. For the first year of this initiative, the State is seeking $16 million in federal funds to match a prior commitment of $16 million in State funds: $10 million for bulk fuel storage and $6 million for electric utility upgrades.

# 3. REMOTE VILLAGE ELECTRIC UTILITIES

## 3.1 Electric Utilities in Rural Alaska

There are over 150 small communities in rural Alaska with electric utility service provided mostly by local diesel generators, and without any electrical interconnection outside the community. These communities are served by roughly 100 separate electric utility organizations. Some of these utilities have developed sufficient scale economies and expertise to operate with reasonable efficiency, to maintain accepted utility standards, and to be capable of financing their own plant requirements. These utilities typically serve a regional center or serve a number of small communities. In most rural Alaska communities, however, the electric utility operates generation and distribution plant that does not comply with accepted utility standards, and government assistance is required to finance capital improvements as well as on-going operations.

The cost of power provided by these village utilities is exceptionally high: median residential rates are in the range of 40-45 cents per kWh, 4 to 5 times the average elsewhere in the United States. For this reason, since 1981 the State has funded a power cost equalization program under which the State pays a portion of the monthly electric bill for customers of rural electric utilities, and has spent about $200 million on the program to date. While this has enabled residents of remote villages to afford basic electrical service, the current annual program cost of $20 million cannot be sustained by the State indefinitely as oil production from Prudhoe Bay and associated State revenues continue to decline.

Most of these isolated village utilities provide their own management, administrative services, maintenance and operations, constituting a very high burden of fixed costs per unit of electricity sold. Because competent mechanical and electrical expertise is often difficult to maintain in these organizations, generator maintenance is often sporadic and unorganized -- a situation which leads directly to catastrophic and expensive breakdowns. Merger with a larger utility organization offers the opportunity to benefit from sufficient scale economies to overcome some of these disadvantages. However, before such consolidation can be considered, the physical plant of the village utility must be improved to the point that it meets accepted industry standards.

Reliable electric service is needed in the villages not only as a prerequisite for economic advancement but also to support other necessary community infrastructure, including water and sewer systems. For the continuation of electrical service over the long-term in these isolated communities, electric utility plant and operations must be upgraded to the point that government support is no longer needed. Ideally, by bringing the physical plant up to standards either of the Rural Utilities Service (RUS, formerly the Rural Electrification Administration), or of the National Electrical Safety Code (NESC) and the National Electrical Code (NEC), the isolated village utilities can be merged into new or established regional utilities that are self-reliant with respect to operations and capital financing. These regional organizations may be cooperatives, investor-owned utilities, or regional governmental entities.

### 3.2 State Effort to Upgrade Rural Utilities

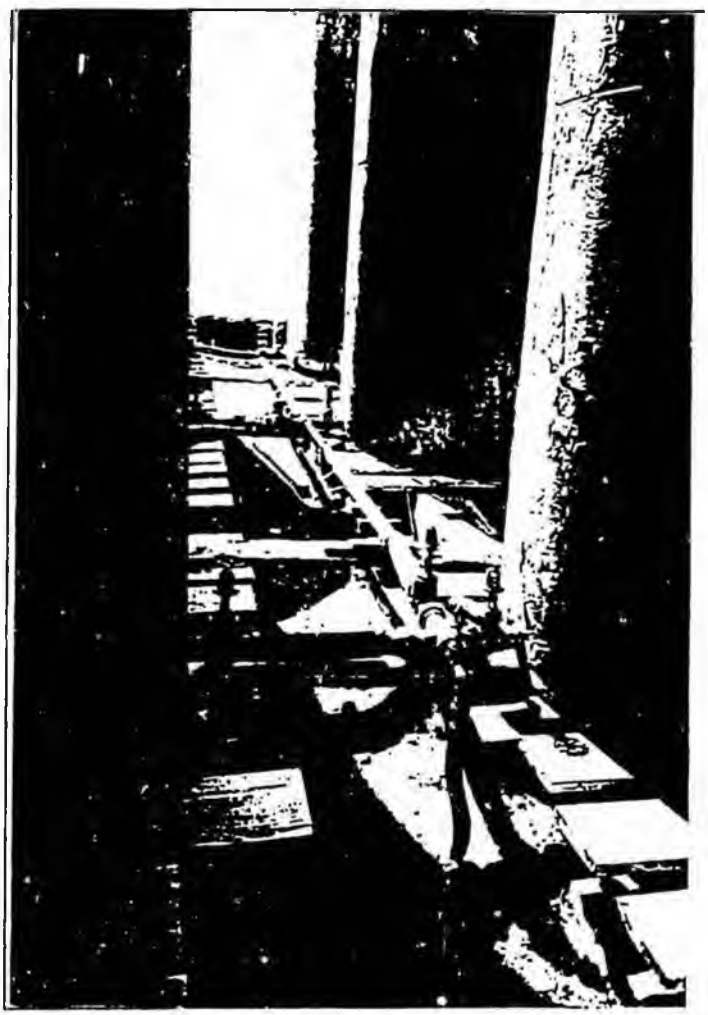
Since 1990, the State has expended over $10 million for upgrade of electric utility systems in rural communities receiving power cost equalization payments, excluding expenditures for evaluation and construction of alternatives such as rural hydroelectric projects. Included in Attachment 3 is appropriation and expenditure detail for $6 million committed by the State for this purpose in fiscal years 91-93.

### 3.3 Estimated Cost to Upgrade Rural Utility Systems to Industry Standards

Approximately 80 rural villages are each served by their own electric utility organization. For 52 of these villages, cost estimates totaling $16.2 million have recently been prepared to upgrade generation and distribution systems in accordance with minimum accepted utility standards. Appendix B includes the system evaluation and cost estimate summaries for each of these 52 village electric utilities. Based on these results, the estimated upgrade cost for the 80 independent, single-village utility systems is approximately $25 million, excluding any adjustment for future inflation. Detailed estimates of required upgrade costs have not been systematically prepared for the additional communities that are served by regional utility organizations, or for the larger communities that serve as regional centers.

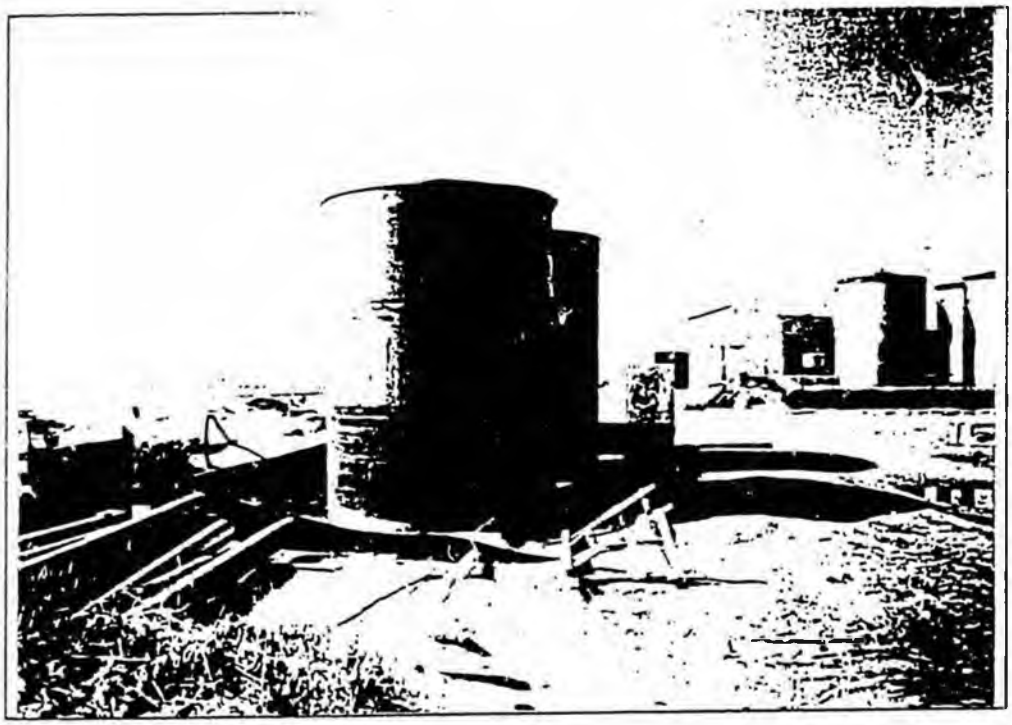
The estimates presented for the 52 single-village utilities in Appendix B provide only for code compliance of diesel dependent remote utilities, and do not include any additional amount for funding alternatives to local diesel generation such as small hydro or wind generation where appropriate resources are available, or transmission lines linking villages where feasible. Implementing these alternatives throughout rural Alaska is estimated to require considerably more capital resources. The State will continue to support such alternatives over the long term, but is seeking in this proposal the more limited objective of meeting basic utility standards as a prerequisite for energy self-reliance.

**Photograph A.1**
Severely corroded tanks connected by rubber hose. Evidence of fuel spillage thoughout area.



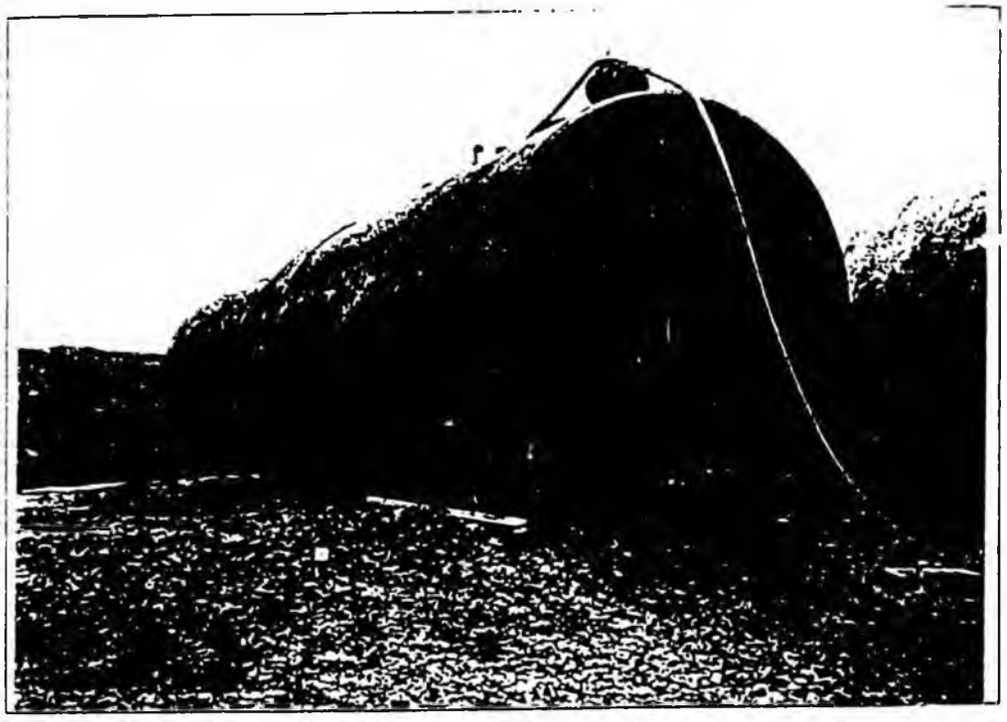
**Photograph A.2**
Severely corroded tanks on improper foundations (small dimension wood cribbing).

**Photograph A.3**
Tanks on improper foundations with no means of secondary containment. Facility located in close proximity to a river.

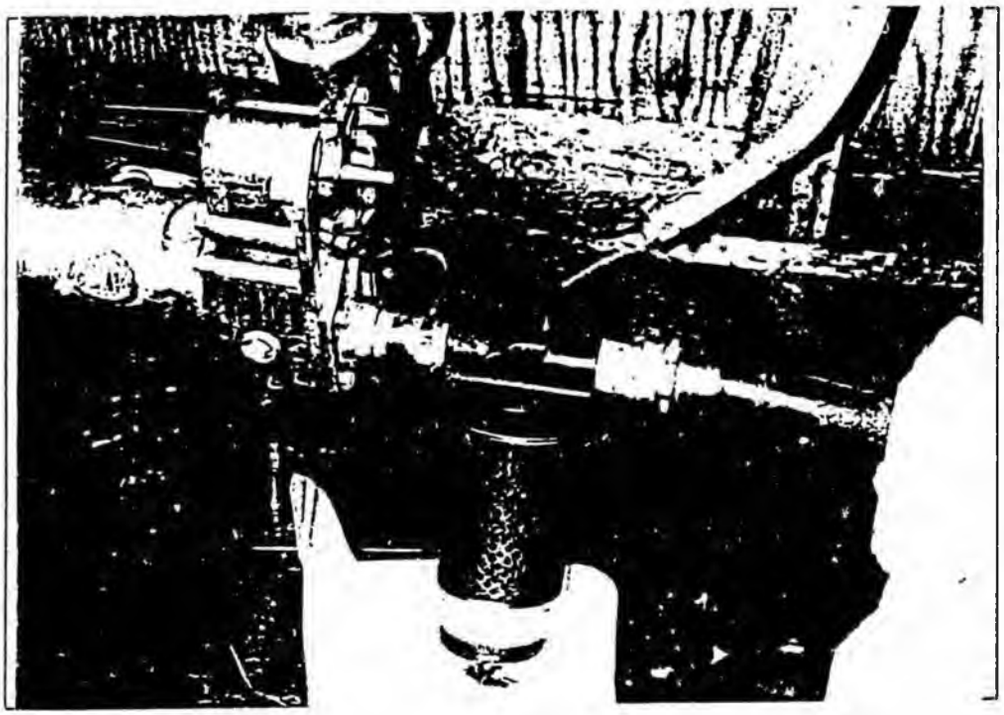


**Photograph A.4**
Corroded tanks located immediately adjacent to ocean. Steel dike completely rusted out and useless as secondary containment.

**Photograph A.5**
Tanks scattered along river bank with no dikes, no security, and improper foundations.

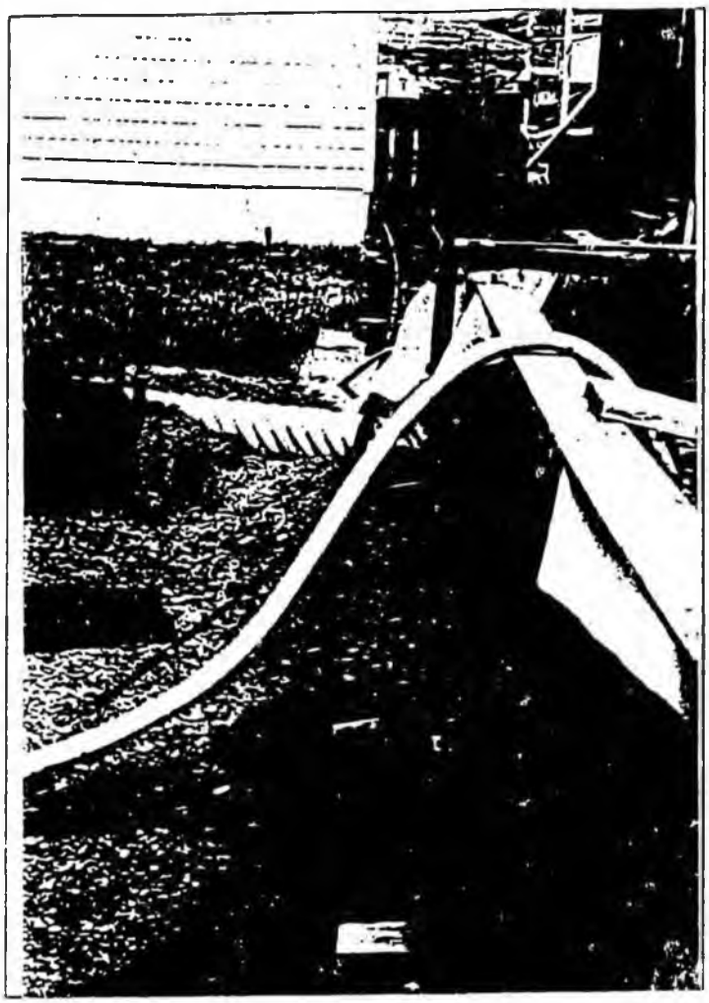


**Photograph A.6**
Severely dented tank with no foundation. Placed at edge of beach with no dike. Gravity dispensing of fuel. No security.



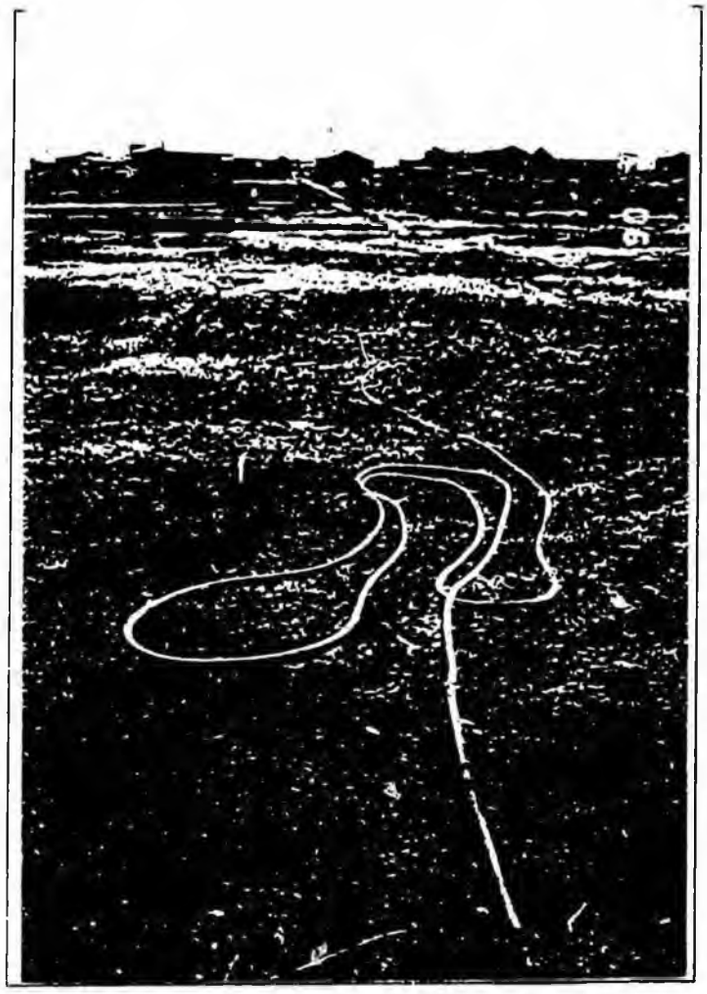
**Photograph A.7**
Improper wiring adjacent to leaking gasoline piping.


**Photograph A.8**
Improper piping system and poor operational procedures resulted in explosion of tank.

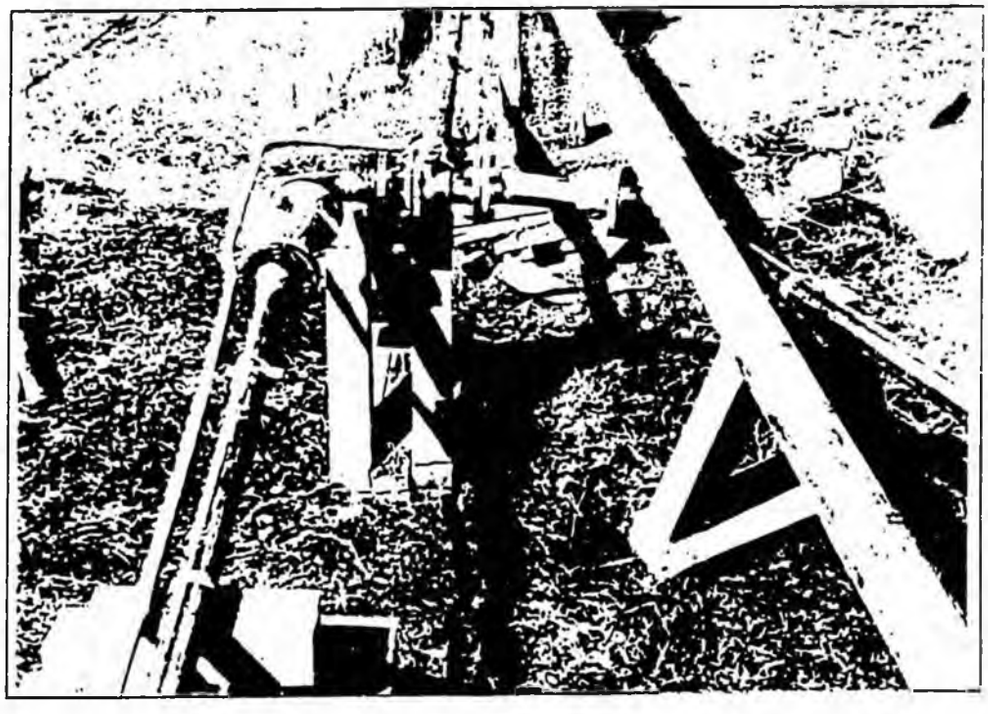


**Photograph A.9**
Fuel stain on ground caused by leaking piping joints.

**Photograph A.10**
Faulty piping system reportedly broke during winter, spilling an estimated 50 gallons of fuel.

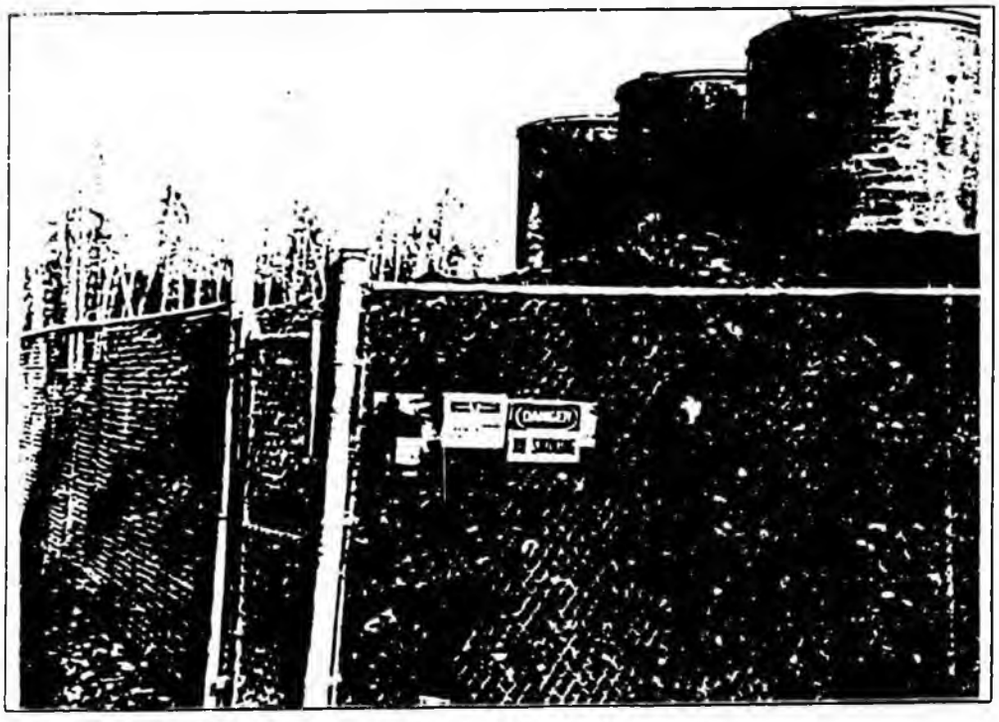


**Photograph A.11**
1200' long hose used to transfer diesel fuel from storage tanks to power plant on a weekly basis.



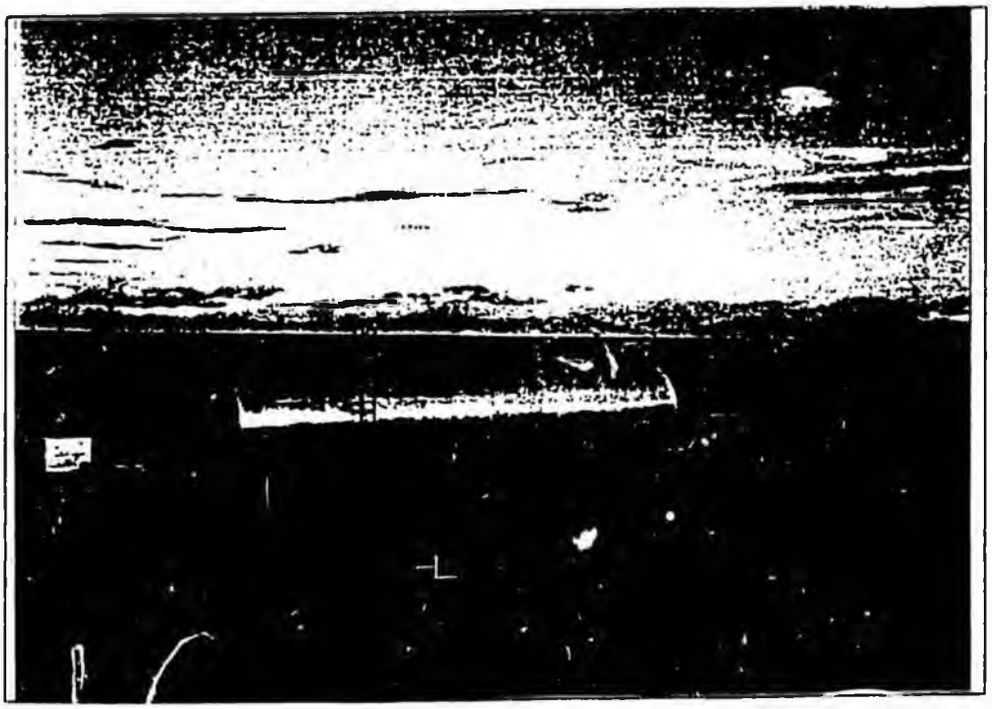
**Photograph A.12**
Hose replaced with proper welded steel pipeline by AEA with Bulk Fuel Emergency Repair program funds.

**Photograph A.13**
Tank farm located within a flood plain. Tanks tipped over and facility severely damaged by flood.




**Photograph A.14**
Tanks placed in new lined dike on gravel pad above flood stage. Facility repaired to meet applicable code and regulation requirements. Construction administered by AEA, supported by State and Federal disaster relief funds.

**Photograph A.15**
Tank installed in improper dike with no foundation. Due to poor installation, facility was never used.



**Photograph A.16**
Tank refurbished and installed on proper foundations in new dike. Construction administered by AEA using capital appropriation funds.

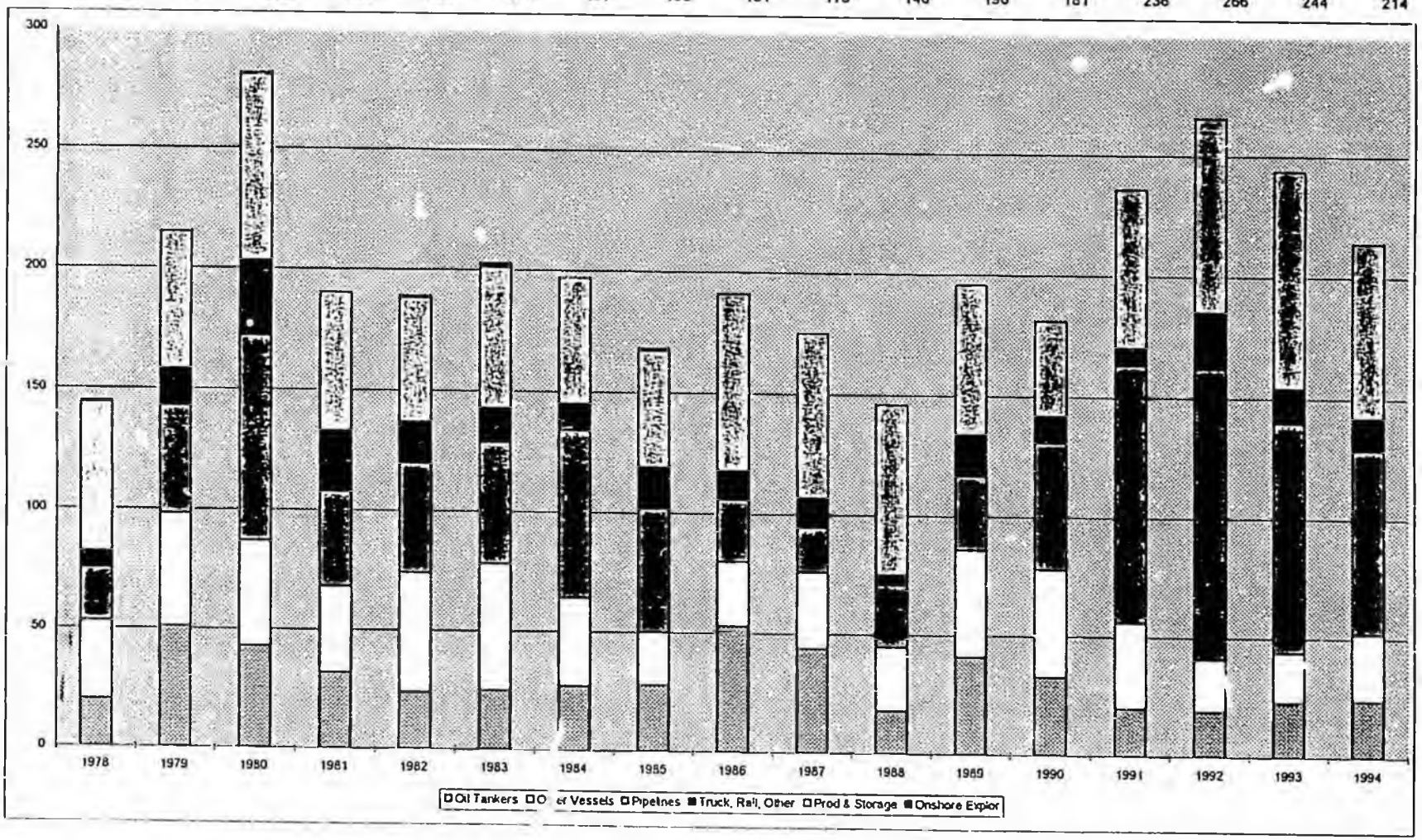
D. Leppi



Worldwide Numbers of Oil Spills
Greater than 10,000 gallons

Source: Cutter Information Corp's annual "Oil Spill Intelligence Report"

| Year | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Oil Tankers | 20 | 51 | 43 | 32 | 24 | 25 | 27 | 28 | 53 | 44 | 18 | 41 | 33 | 20 | 19 | 23 | 24 |
| Other Vessels | 33 | 47 | 44 | 36 | 50 | 53 | 37 | 22 | 27 | 32 | 27 | 45 | 45 | 36 | 22 | 21 | 28 |
| Pipelines | 22 | 45 | 85 | 40 | 46 | 51 | 70 | 52 | 26 | 19 | 26 | 31 | 53 | 107 | 121 | 96 | 77 |
| Truck, Rail, Other | 7 | 15 | 31 | 25 | 17 | 14 | 11 | 17 | 12 | 12 | 4 | 17 | 11 | 7 | 23 | 14 | 13 |
| Prod & Storage | 62 | 57 | 78 | 57 | 51 | 58 | 52 | 48 | 73 | 68 | 71 | 62 | 39 | 66 | 81 | 90 | 72 |
| Onshore Explor | 1 | 0 | 1 | N/A | 1 | 2 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Totals: | 145 | 215 | 282 | 190 | 189 | 203 | 197 | 168 | 191 | 175 | 146 | 196 | 181 | 236 | 266 | 244 | 214 |



# RURAL BULK FUEL TASK FORCE

## Preliminary Report to the Governor

*Policy Recommendations*

November 25, 1993

# FINANCE

## *Issues:*

- The *Rural Alaska Bulk Fuel Assessment Program, Summary Report and Recommendations*, March 1992, prepared by the Alaska Energy Authority, the *Noncrude Facility Survey, January 1992, and the Small Noncrude Oil Terminal Report, Task One: Facility Identification and Inventory*, November 1992, prepared for the State of Alaska, Department of Environmental Conservation, are testimony to the extreme costs related to repairs, improvements, new construction and remediation for Alaska's many rural bulk fuel storage facilities. Preliminary estimates range from between $155.0 M to $200.0 M for facility improvements and another $200.0 M for remediation!

- Access to funding for communities is extremely limited and practically non-existent for small "for-profit" private sector operators.

- Funding that is available has few conditions attached for ensuring long range commitment by grantee or borrower for proper construction or continued facility maintenance or operator training programs.

- Remediation costs are often extraordinary. Existing funding programs require neither planning nor commitment to necessary facility clean up. Consequently, public health and safety are under continual threat.

- There is little access to federal funding, even when federal agencies acknowledge previous ownership of non-compliant facilities. The state receives no direct federal funding at this time for coordinated resolution of fuel storage problems.

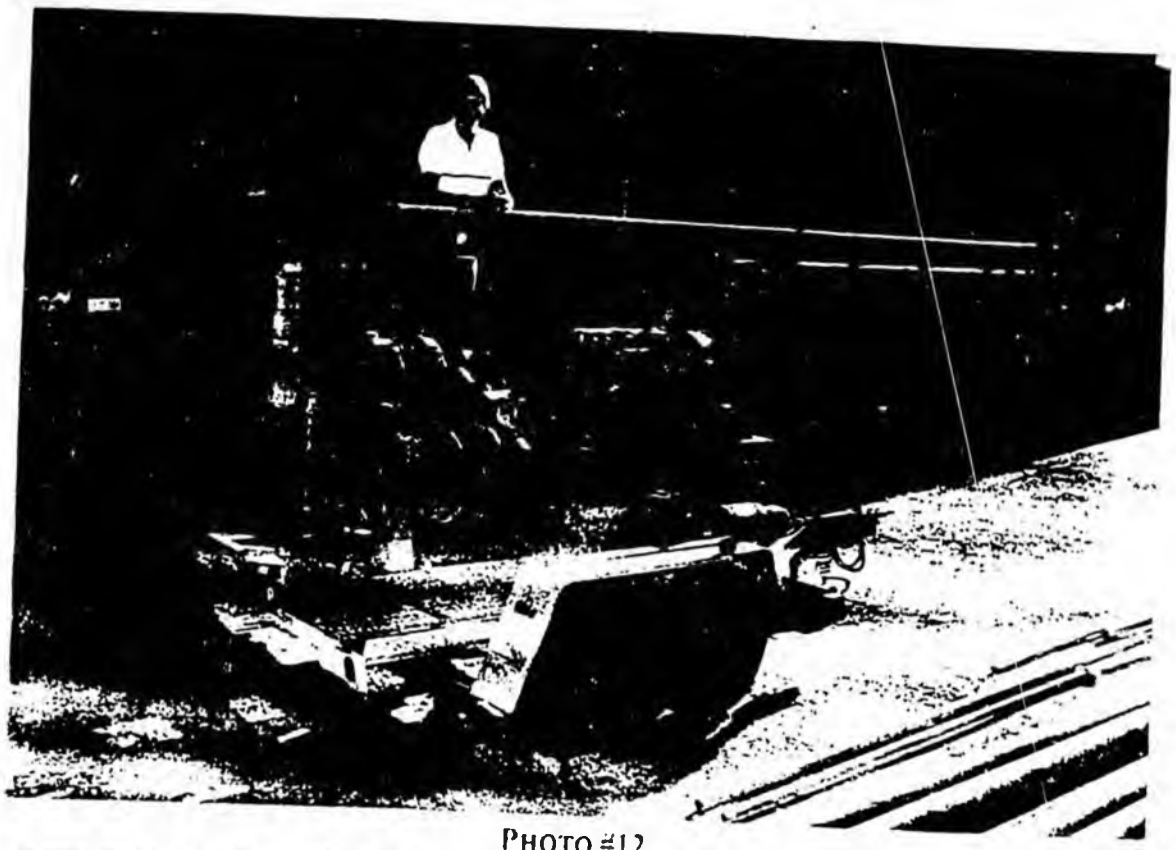


PHOTO #12

*Lapp Resources' portable drill rig, used for exporatory drilling for coal bed methane.*
*courtesy, Lapp Resources, Inc. 1995*

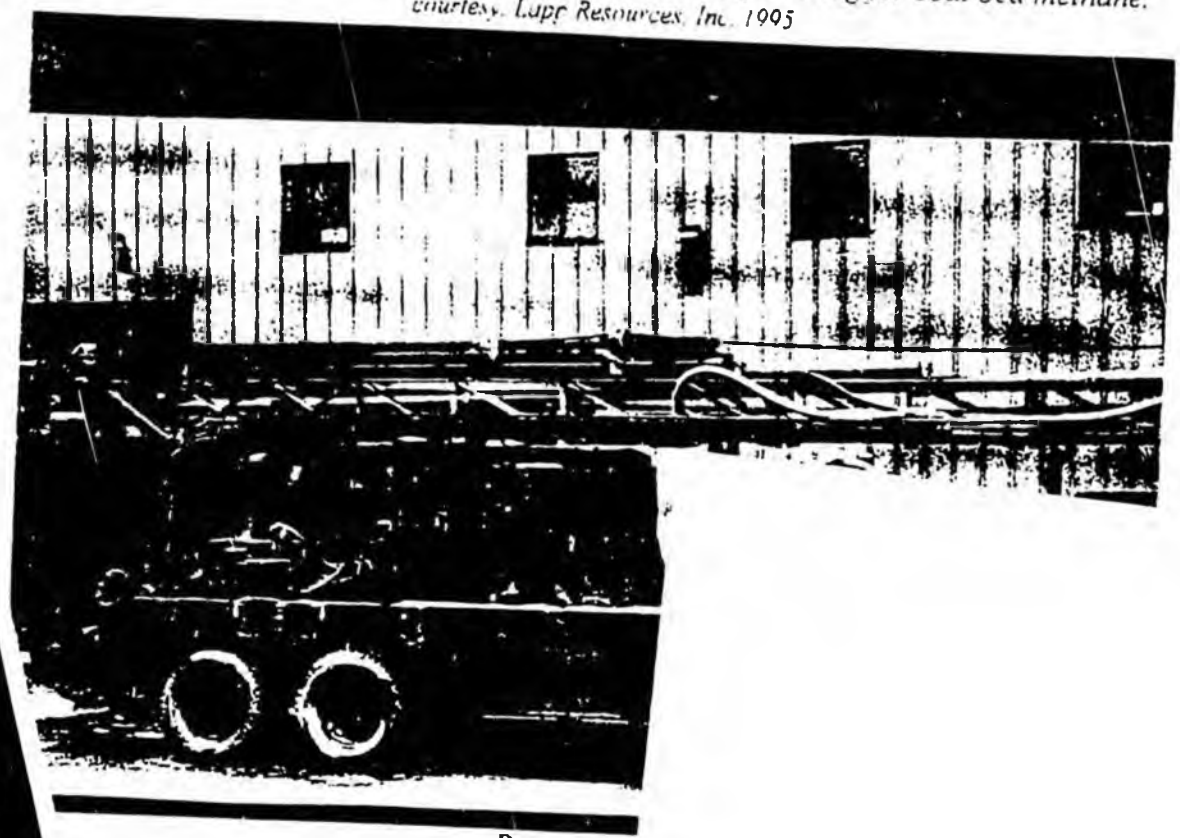


PHOTO #1

*Ambler Drilling's rotary-h*
*courtesy, Ambler Dri*

# Alaska Oil and Gas Association

121 West Fireweed Lane, Suite 207
Anchorage, Alaska 99503-2035
Phone: (907) 272-1481 Fax: (907) 279-8114

March 6, 1996

The Honorable Scott Ogan
Alaska State House of Representatives
State Capitol
Juneau, Alaska

HB 394, Gas and Coal Methane Licenses & Leases

Dear Representative Ogan:

The Alaska Oil and Gas Association (AOGA) is a trade association whose 19 member companies account for the majority of oil and gas exploration, production, transportation, refining and marketing activities in Alaska.

On February 7, 1996, the Association expressed its concern about provisions in HB 394, which also were embodied in CSSB 176, exempting natural gas exploration facilities from compliance with financial responsibility requirements.

The Association has reviewed the Oil and Gas Committee Substitute for HB 394 and believes Section 9 of CSHB 394 which establishes financial responsibility requirements for onshore shallow bed natural gas exploration facilities addresses its concern. AOGA strongly supports retention of adequate financial responsibility requirements in subsequent versions of the bill.

AOGA supports Section 12 of CSHB 394, which prohibits use of the "470 Fund" for clean up of releases attributable to shallow bed natural gas operations, and prefers that it be retained if possible.

The Association continues to believe that it is in the state's best interest to require that consistent, equitable and adequate financial responsibility requirements be met by all persons/companies conducting oil and gas exploration operations in Alaska.

Sincerely,

JUDITH M. BRADY
Executive Director

Alaska State Legislature

Resources, Vice Chair
State Affairs, Vice Chair
House Special Committee on Oil & Gas, Vice Chair
House Special Committee on Fisheries

State Capitol
Room 409
Juneau, Alaska 99801-1182
(907) 465-3878
Fax (907 465- 3265

Representative Scott Ogan
House District 27

# Sponsor Statement HB 394

The purpose of this bill is to encourage shallow gas development for use within the state. HB 394 succeeds in this task by relieving the tremendous monetary and regulatory burdens that currently plague independent gas developers in Alaska.

HB 394 specifically addresses such issues as high bond requirements, lease issuance, application and processing fees, and royalties. It creates an economic environment where small independent gas companies can thrive, and be allowed to develop a resource that is truly important to the state.

Why is this bill so important to the state? In order to grasp the answer to this question, one must first look at our current situation. In June of 1995, the Department of Community and Regional Affairs presented an initiative known as the *Alaska Rural Energy Intitiative* in which they report on the existing energy problems in the rural communities of Alaska.

The *Alaska Rural Energy Initiative* reports that it will cost $200 million, excluding future inflation, to repair and renovate the fuel storage facilities of rural Alaska. In a report done by the *Rural Bulk Fuel Task Force* (1993), the cost of remediation of contaminated soil and ground water adds another $200 million. The *Alaska Rural Energy Initiative* also states that another $25 million will be needed for upgrading single-village electric utilities. An allowance of $25 million more is needed for additional electric utility upgrades and for

inflation. Also, the state currently spends $20 million annually on the power cost equalization program, a program that has cost the state $200 million since its creation. All of these numbers point to one thing, and that is that Alaska has a serious energy problem in its rural communities, and it is going to cost a lot of money to fix.

In these days of budget cuts and reduced oil revenue, it is not reasonable to think that remediation, renovation, and power cost equalization will be easy to pay for in the future. This is why HB 394 is so important.

HB 394 would allow independent gas companies to explore for and develop shallow bed gas without being hindered by unreasonable regulations and requirements. With reasonable regulatory oversite, independent gas companies would be able to develop gas for use in rural communities. Communities with deposits of gas nearby would be able to pipe the gas directly to their converted generators, and they could use it to heat their homes.

Natural gas is a low-cost and environmentally safe form of energy that, in all likelihood, exists in many parts of the state. It could serve as an independent fuel source for many communities, but because of existing stringent regulations and bonding requirements, it is not economically feasible for independents to attempt to develop this valuable resource.

The merits of HB 394 are evident, and the benefits are far reaching. I ask for your support as we attempt to allow shallow natural gas to be used as an economically and environmentally sound alternative fuel source.