

**HB**

**394**

# FISCAL NOTE

No. 2  
 Bill Version: CSHB 1941TSH  
 (H) Publish Date: 2/28/96

## STATE OF ALASKA 1996 LEGISLATIVE SESSION

Revision Date: Original Dept Affected: Natural Resources  
 Title: An Act authorizing a program of natural gas and coal bed methane development licensing and leasing OAU: Resource Development  
 Sponsor: Representative(s) Dean, Roseberg Component: Oil & Gas Development  
 Requestor: House Oil & Gas Component Serial No.: 429

Expenditures/Revenues	(Thousands of Dollars)					
	FY97	FY98	FY99	FY00	FY01	FY02
<b>OPERATING EXPENDITURES</b>						
PERSONAL SERVICES	312.0	312.0	312.0	312.0	312.0	312.0
TRAVEL	11.0	11.0	11.0	11.0	11.0	11.0
CONTRACTUAL	15.0	15.0	15.0	15.0	15.0	15.0
SUPPLIES	8.0	8.0	8.0	8.0	8.0	8.0
EQUIPMENT	8.0	8.0	8.0	8.0	8.0	8.0
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
<b>TOTAL OPERATING</b>	<b>352.0</b>	<b>352.0</b>	<b>352.0</b>	<b>352.0</b>	<b>352.0</b>	<b>352.0</b>
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES	32.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE	(Thousands of Dollars)					
	FY97	FY98	FY99	FY00	FY01	FY02
1002 Federal Receipts						
1003 OF MAINT						
1004 OF	288.0	282.0	282.0	282.0	282.0	282.0
1005 Of Program Receipts						
1006 OF AMTUA						
Other						
<b>TOTAL</b>	<b>288.0</b>	<b>282.0</b>	<b>282.0</b>	<b>282.0</b>	<b>282.0</b>	<b>282.0</b>

Estimate of any current year (FY98) cost: \$ \_\_\_\_\_

POSITIONS	FY97	FY98	FY99	FY00	FY01	FY02
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)

Do new positions within OCAO will be required to implement the gas and coal bed methane licensing and leasing program.

One Geologist II to determine areas for potential bed leasing and licensing, evaluate licensing proposals and the geologic justification for conversions of leases to leases. Represent OAU before ADGCC in determinations of all potential for lease/licensing areas.

One Petroleum Economist II to perform the economic analysis required under AS 20.05.030 and AS 20.05.035 for potential bed methane leasing and leasing.

Prepared by: Ken Beck, Director Phone: 335-2000  
 Division: Oil & Gas Date: 6 Feb 96  
 Approved by Commissioner: [Signature] Date: 6 Feb 96  
 Agency: Natural Resources

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**Analysis continued**

**MO394**

One Cartographer II to prepare maps and graphics for the best interest findings and ACMP analyses, as well as for license offerings.

One Natural Resource Officer II to research, write and regularly revise best interest findings and Alaska Coastal Management Program (ACMP) analyses.

One Natural Resource Officer II to perform the land title and status reviews, assist in determining land ownership boundaries, determine tract acreage.

One Natural Resource Officer II to administer leases and licenses including the awarding and issuing of leases and licenses, adjudicating assignment of ownership, and the enforcement of lease and license terms.

Travel costs include costs for staff to attend public hearings, and public meetings concerning the issuing of leases and licenses.

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

Supplies costs include costs for paper, pens, computer disks and other misc. supplies.

Equipment costs include phones, desks, computers, and other misc. equipment.

\*\* There are uncertainties in the bill which may change the fiscal impact, once clarified with the sponsor.

# FISCAL NOTE

P.O. 1  
 Bill Version: CSHB 394(06G)  
 (H) Publish Date: 2/28/96

## STATE OF ALASKA 1996 LEGISLATIVE SESSION

Revision Date: \_\_\_\_\_  
 Title: An Act authorizing a program of natural gas and coal bed methane development...  
 Sponsor: Reps. Ogan and Rokeberg  
 Requester: \_\_\_\_\_

Department Affected: Environmental Conservation  
 BRU: Environmental Health  
 Component: Solid Waste

COMPONENT SERIAL NO. 2067

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
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>CAPITAL EXPENDITURES</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>CHANGE IN REVENUES</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

FUND SOURCE	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
100 Federal Receipts	0.0	0.0	0.0	0.0	0.0	0.0
100 CF Match	0.0	0.0	0.0	0.0	0.0	0.0
100 CF	0.0	0.0	0.0	0.0	0.0	0.0
100 CF Program Receipts	0.0	0.0	0.0	0.0	0.0	0.0
100 CF MISC	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
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of net current cost (FY98 cost) 0.0

POSITIONS	FY 97	FY 98	FY 99	FY 00	FY 01	FY 02
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.)

The proposed change to AS 46.03 (06G) will not require a change in solid waste program activities. All permits are not required for an air discharge or disposal of waste material from activities associated with coal bed methane exploration drilling.

Prepared by: Larry Jones  
 Director, Division of Administrative Services

Phone: 465-1010  
 Date: 1/18/96

Approved by Commissioner: [Signature]  
 Agency: Department of Environmental Conservation

Date: 1/18/96

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# SENATE COMMITTEE REPORT

## First Committee of Referral

DATE: 4/18/96

FURTHER: Finance

DATE TURNED INTO OFFICE: 4.27.96

The Resources Committee considered CS FOR HOUSE BILL NO. 394(FIN) am  
 Authorizing shallow natural gas leasing

and recommends:

- be replaced with SCR CS HB 394 (DEC)
- adopt previous      CS      (    )
- attached amendment(s)
- adopt Letter of Intent by      Committee
- further referral to the      Committee

- Senate Bill:
- same title
  - new title
- House Bill:
- same title
  - technical title
  - new: SCR#

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	NR	DNP	AM
<i>[Signature]</i>		<i>[Signature]</i>	✓		
<i>[Signature]</i>		<i>[Signature]</i>	✓		
CHAIR: <i>[Signature]</i>		CHAIR:			

**NEW FISCAL NOTE(S):**

Department	Date	Zero	Fiscal

**PREVIOUS FISCAL NOTE(S):\***

Department	Date	Zero	Fiscal
<del>DEC 394</del>	<del>7/95</del>		<del>3860</del>
DEC 394	7/95	✓	

*23,300  
has  
in CS 394*

APPROPRIATION - no fiscal note

\*include fiscal notes accompanying Governor's bill



# Alaska State Legislature


## Senate Resources Committee

State Capitol  
Juneau AK 99801

Official Business

### MEMO

TO: Jack Chenoweth  
Legal Services  
via fax: X2029 this page only

FROM: Annette Kreitzer, Aide to   
Senate Resources Committee

DATE: April 23, 1996

RE: CS HB 394: SHALLOW NATURAL GAS LEASING

-----  
Please draft a FINAL Resources committee substitute for HB 394 using 9-LS1463VZ with the following amendments:

Page 6, Line 2:

Insert following "payment to the state of"  
annual

Page 7, Line 10:

Insert before "production":  
exploration and

Page 7, Line 25:

exchange lease for lessee and lessee for lease

Sentence should read:

may not be mined or extracted by the coal lessee from the coal lease without prior

Page 7, Lines 21-23:

DELETE:

[CONSISTENT WITH THE PRINCIPLE OF REASONABLE  
CONCURRENT USES AS SET OUT IN ART. VIII, SEC. 8,  
CONSTITUTION OF THE STATE OF ALASKA, THE STATE MAY ALSO  
LEASE THE LAND UNDER AS 38.05.150.]

The Committee passed this bill out today with the amendments. Please deliver to Room 115 of the Capitol. There were no other changes.

AMENDMENT #1

OFFERED IN SENATE RESOURCES  
TO: SCS CS HB 394 (RES)

Page 6, Line 2:

Insert following "payment to the state of"

annual

Page 7, Line 10:

Insert before "production":

exploration and

Page 7, Line 25:

exchange lease for lessee and lessee for lease

Sentence should read:

may not be mined or extracted by the coal lessee from the coal lease without prior

Force  
of legislation

6.11.02

9-LS1463Z  
Chenoweth  
4/24/96

**SENATE CS FOR CS FOR HOUSE BILL NO. 394(RES)  
IN THE LEGISLATURE OF THE STATE OF ALASKA  
NINETEENTH LEGISLATURE - SECOND SESSION**

**BY THE SENATE RESOURCES COMMITTEE**

Offered:  
Referred:

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

**A BILL**

**FOR AN ACT ENTITLED**

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

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

- 9     • Section 1. LEGISLATIVE FINDINGS AND PURPOSE. (a) The legislature finds that
- 10         (1) there exist throughout the state sizeable deposits of coal and small but
- 11 commercially significant amounts of natural gas located close to the earth's surface that are
- 12 usually, though not always, associated with and emitted from coal deposits;
- 13         (2) the methane derived from this coal and other sources and that is found in

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

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

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

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

15 \* Sec. 2. AS 38.05.035(e)(6) is amended to read:

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

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

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

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

30 (D) a mineral claim located under AS 38.05.195;

31 (E) a mineral lease issued under AS 38.05.205;

32 (F) a production license issued under AS 38.05.207;

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

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

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

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

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

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

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

27 \* Sec. 5. AS 38.05 is amended by adding a new section to read:

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

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

- 1 (2) do not apply to authorize lease of  
2 (A) land  
3 (i) that is subject to an oil and gas exploration license or  
4 lease issued under AS 38.05.131 - 38.05.134; or  
5 (ii) that is leased under AS 38.05.180;  
6 (B) the land (i) that is proposed to be subject to an oil and gas  
7 exploration license or lease issued under AS 38.05.131 - 38.05.134; or (ii) that  
8 is described in and part of a proposed oil and gas leasing program prepared under  
9 AS 38.05.180(b); however, the commissioner may waive the limitations of this  
10 subparagraph;  
11 (C) the land that is held under a coal lease entered into under  
12 AS 38.05.150, unless the applicant for a shallow natural gas lease is also the  
13 lessee under AS 38.05.150 of that land; or  
14 (D) the valid existing selections of the Alaska Mental Health  
15 Trust Authority made for the purpose of reconstituting the mental health trust  
16 established under the Alaska Mental Health Enabling Act, P.L. 84-830, 70 Stat.  
17 709 (1956), that become subject to management under AS 38.05.801, or of land  
18 that has been designated by law for or is subject to designation for conveyance  
19 to the Alaska Mental Health Trust Authority; however, after consultation with  
20 the Alaska Mental Health Trust Authority, the commissioner may waive the  
21 limitations of this subparagraph.  
22 (b) For the purpose of exploring for and developing shallow natural gas  
23 reservoirs, upon application, the director may lease to a person land for which the state  
24 owns the subsurface rights. A person applying for a lease under this subsection:  
25 (1) shall specify the area to be leased; the area to be leased may not  
26 exceed 5,760 acres; a lessee may not hold more than 46,080 acres of land under leases  
27 entered into under this section;  
28 (2) may be required to pay a reasonable application fee of up to \$500.  
29 (c) Within 20 days of receipt of a lease application, the director shall give  
30 notice under AS 38.05.945 of receipt of the lease application and call for comments  
31 from the public. The director's call for public comments must provide opportunity for  
32 public comment for a period of 60 days. If, after review of information received

1 during the public comment period, the director determines that the discovery of a local  
2 source of natural gas would benefit the residents of an area, the director shall execute  
3 a lease for the area described in (b) of this section. The director shall execute the  
4 lease within 90 days after the close of the public comment period or, if review is  
5 required under AS 46.40, within 30 days after the final consistency determination is  
6 made under AS 46.40, whichever is later. A lease entered into under this subsection  
7 gives the lessee the exclusive right to explore for, develop, and produce, for a term of  
8 three years, natural gas on the state land described in the lease; the right to explore for,  
9 develop, and produce is limited to gas derived from natural gas within 3,000 feet of  
10 the surface.

11 (d) A lease shall be automatically extended if and for so long thereafter as gas  
12 is produced in paying quantities from the lease and the lessee continues to meet all  
13 requirements of the lease. A lease issued under this section covering land on which  
14 there is a well capable of producing gas in paying quantities does not expire because  
15 the lessee fails to produce gas unless the lessee is allowed reasonable time to place the  
16 well on a producing status. If drilling has commenced on the expiration date of the  
17 primary term of the lease and is continued with reasonable diligence, including such  
18 operations as redrilling, sidetracking, or other means necessary to reach the originally  
19 proposed bottom hole location, the lease is extended for one year and for so long  
20 thereafter as gas is produced in paying quantities. A gas lease issued under this  
21 section that is subject to termination by reason of cessation of production does not  
22 terminate if, within 90 days after production ceases or a longer period determined at  
23 the discretion of the director, reworking or drilling operations are commenced on the  
24 land under lease and are thereafter conducted with reasonable diligence during the  
25 period of nonproduction. In addition, upon application by the lessee, the director may  
26 once extend a lease issued under (c) of this section for a period of not more than three  
27 years.

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

1 (b)(1) of this section.

2 (f) A shallow gas lease must provide for payment to the state of rent in the  
3 amount of 50 cents per acre. The rent is due and payable on the dates determined in  
4 the lease. The director shall mail the lessee one written notice, certified return receipt  
5 requested, three weeks before the due date of the rent. If the lessee fails to pay rent,  
6 the director shall terminate the lease.

7 (g) The royalty payable on natural gas produced from a lease

8 (1) is

9 (A) 12.5 percent of the value of production removed or sold  
10 from the lease for gas exported from the state or gas that is produced in direct  
11 competition with gas on which a royalty at a rate of at least 12.5 percent is  
12 payable; and

13 (B) except as provided in (A) of this paragraph, 6.25 percent of  
14 the value of the production removed or sold from the lease; and

15 (2) shall be based upon production delivered in pipeline quality and  
16 free of all lease expenses, including but not limited to separation, cleaning,  
17 dehydration, gathering, salt water disposal, and preparation for transportation off the  
18 lease.

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

22 (1) the lessee may surrender the lease or relinquish part of the lease at  
23 any time;

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

32 (i) The applicant for a lease is responsible for conducting a title search for the

1 area described in the lease application.

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

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

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

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

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

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

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

30 • Sec. 6. AS 38.05.180(f) is amended to read:

31 (f) Except as provided by AS 38.05.131 - 38.05.134 and 38.05.177, the  
32 commissioner may issue oil and gas leases on state land to the highest responsible

1 qualified bidder determined by competitive bidding under regulations adopted by the  
2 commissioner. Bidding may be by sealed bid or according to any other bidding  
3 procedure the commissioner determines is in the best interests of the state. Whenever,  
4 under any of the leasing methods listed in this subsection, a royalty share is reserved  
5 to the state, it shall be delivered in pipeline quality and free of all lease or unit  
6 expenses, including but not limited to separation, cleaning, dehydration, gathering, salt  
7 water disposal, and preparation for transportation off the lease or unit area. Following  
8 a pre-sale analysis, the commissioner may choose at least one of the following leasing  
9 methods:

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

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

17 (3) a fixed cash bonus with a royalty share reserved to the state as the  
18 bid variable but no less than 12.5 percent in amount or value of the production  
19 removed or sold from the lease;

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

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

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

30 (7) a fixed cash bonus with a royalty share reserved to the state based  
31 on a sliding scale according to the volume of production or other factor as the bid

1 variable but not less than 12.5 percent in amount or value of the production removed  
2 or sold from the lease.

3 \* Sec. 7. AS 46.03.100(f) is amended to read:

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

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

10 (2) landscaping;

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

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

18 (A) the drilling, ditching, trenching, or similar activity will  
19 involve the removal of the groundwater, stormwater, or wastewater runoff that  
20 has accumulated and is present at an excavation site for facility, road, or other  
21 transportation construction or maintenance; and

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

23 \* Sec. 8. AS 46.04.030(b) is amended to read:

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

30 \* Sec. 9. AS 46.04.040(b) is amended to read:

31 (b) A person may not cause or permit the operation of a pipeline or an

1 exploration or production facility in the state unless the person has furnished to the  
2 department, and the department has approved, proof of financial ability to respond in  
3 damages. Proof of financial responsibility required for

4 (1) a pipeline or an offshore exploration or production facility is  
5 \$50,000,000 per incident;

6 (2) an onshore production facility is

7 (A) \$20,000,000 per incident if the facility produces over  
8 10,000 barrels per day of oil;

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

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

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

15 (3) an onshore exploration facility is

16 (A) \$25,000 per incident for a facility used solely to explore  
17 for shallow natural gas by means of drilling a well to explore for gas,  
18 whether methane associated with and derived from coal deposits or  
19 otherwise, from a source that is within 3,000 feet of the surface; and

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

# FISCAL NOTE

STATE OF ALASKA  
1996 LEGISLATIVE SESSION

BILL NO. SCSCSHB394(RES)

Revision Date:	<u>Original</u>	Dept Affected:	<u>Natural Resources</u>
Title:	<u>An Act authorizing shallow natural gas</u>	BRU:	<u>Resource Development</u>
	<u>leasing from sources within 3,000 feet of the surface ..</u>	Component:	<u>Oil &amp; Gas Development</u>
Sponsor:	<u>Rep(s) Ogan, Rokeberg, James, Kahng</u>		
Requestor:	<u>Senate Finance</u>	Component Serial No.:	<u>439</u>

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						
<b>TOTAL OPERATING</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>
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						
<b>TOTAL</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>	<b>15.0</b>

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

POSITIONS	FY97	FY98	FY99	FY00	FY01	FY02
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: <u>Ken Boyd, Director</u>	Phone: <u>259 8600</u>
Division: <u>Oil &amp; Gas</u>	Date: <u>29-Apr-96</u>
Approved by: <u>Commissioner</u>	Date: <u>29-Apr-96</u>
Agency: <u>Natural Resources</u>	

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# Alaska State Legislature

## Senate Resources Committee

Official Business

State Capitol  
Juneau AK 99801

MEMO

TO: Jack Chenoweth  
Legal Services  
via fax: X2029 4 pages

FROM: Annette Kreitzer, Aide to  
Senate Resources Committee

DATE: April 23, 1996

RE: CS HB 394: SHALLOW NATURAL GAS LEASING

Please draft a Resources committee substitute for HB 394 using 9-LS146.NJ (HB0394c) with the following amendments:

1) Page 3, Line 31:

Create the onshore exception by inserting it in (1) (onshore and within 3,000 feet of the surface) Delete "onshore" from wherever else it appears in the bill to describe the shallow gas wells.

2) Page 4, lines 2-6:

**DELETE ALL MATERIAL**

Insert:

(A) land

(i) that is subject to an oil and gas exploration license or lease issued under AS 38.05.131-38.05.134; or

(ii) that is leased under AS 38.05.180;

(B) the land (i) that is proposed to be subject to an oil and gas exploration license or lease issued under AS 38.05.131-38.05.134; or (ii) that is described in and part 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

Reletter the following subparagraphs accordingly.

3) Page 4, Line 15:

Following "conveyance to the Alaska Mental Health Trust Authority"

Insert:

however, after consultation with the Alaska Mental Health Trust Authority, the commissioner may waive the limitations of this subparagraph.

4) Page 4, Line 20:

**DELETE:**

(23,040)

Insert:

46,080

- 5) Page 4, Line 23:  
Add notice of lease application for shallow natural gas leases to AS 38.05.945. (It is not defined here. Change is made where it is appropriate to insert 38.05.945)
- 6) Page 4, Line 26:  
DELETE:  
[AVAILABLE INFORMATION]  
Insert:  
information received during the public comment period  
Page 4, Line 26-27:  
DELETE:  
[IT IS IN THE STATE'S INTEREST TO ENTER INTO]  
Insert following "the director determines":  
that the discovery of a local source of natural gas would benefit the residents of an area, the director shall execute a lease for the area.
- 7) Page 4, Line 30:  
Insert following "AS 46-80"  
whichever is later.
- 8) Page 5, Line 4:  
Insert following "from the lease":  
and the lessee continues to meet all lease requirements.
- 9) Page 5, Lines 23-31:  
DELETE ALL MATERIAL AND REPLACE WITH THE FOLLOWING:  
(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. The director shall mail the lessee, per written notice, certified return receipt requested, three weeks prior to the due date of the rent. If the lessee fails to pay rent, the director shall terminate the lease.
- 10) Page 6, Lines 11:  
DELETE:  
[COMMERCIAL PRODUCTION]  
Insert:  
paying quantities
- 11) Page 6, Line 18:  
DELETE:  
[SHALL CONDUCT]  
Insert:  
is responsible for conducting
- 12) Page 6, Line 23:  
Insert following "surface":  
or penetrates a formation capable of producing oil

- 13) Page 7, Line 7:  
 DELETE:  
 (THE COAL DEPOSIT)  
 Insert:  
 other mineral deposits
- 14) Page 9, Lines 17-26:  
 DELETE ALL MATERIAL and renumber following sections
- 15) Page 10, Lines 14-15:  
 DELETE:  
 (AND DEVELOP)
- 16) Page 10, Lines 20-29:  
 DELETE ALL MATERIAL.
- 17) Attached is your amendment US which the sponsor wants, but I can't find where it fits. The Page/Line numbers don't match my version. Please insert it into the CS, also.

*Handwritten notes:*

Work  
 The Bill is in the State. Holders.  
 has not to 5-31-77  
 1/12/77  
 24977  
 C. Hig. 1000/1000

AMENDMENT

OFFERED IN THE HOUSE  
TO CSIB 394(FN)

*in line 28*  
*of 394(FN)*

1 Page 5, line 28:

2 Delete "is"

3 Insert

4 (A) is

5 (i) 12.5 percent of the value of production removed  
6 from the lease for gas exported from the state or gas that is produced  
7 in direct competition with gas on which a royalty at a rate of at least  
8 12.5 percent is payable; and

9 (ii) except as provided in (i) of this subparagraph."

10 Page 5, line 29:

11 Delete ", the production to be"

12 Insert ", and

13 (B) shall be based upon production'

# LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES  
LEGISLATIVE AFFAIRS AGENCY  
STATE OF ALASKA

(907) 465-2887 or 465-2450  
FAX (907) 465-2029  
Mail Stop 3101

130 Seward Street, Suite 409  
Juneau, Alaska 99801-2105

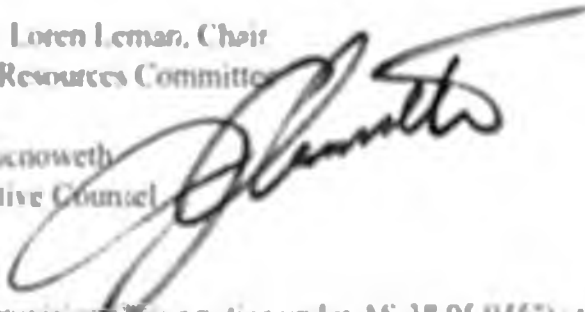
## MEMORANDUM

April 24, 1996

**SUBJECT:** Draft SCS CSIB 394 (Resources)  
(Work Order No. 9-LS1463/2)

**TO:** Senator Loren Lemar, Chair  
Senate Resources Committee

**FROM:** Jack Cichnoweth  
Legislative Counsel



With the insertion of the new provision ("give notice under AS 38.05.945") at the beginning of AS 38.05.177(c), it seems to me that we've moved the notice provisions into a limbo. Is all of AS 38.05.945 to apply or do the "special" provisions of this subsection override when they are not consistent with AS 38.05.945's provisions? This hybrid provision is confusing on the point of notice to be given, and, it seems to me, either sec. 945 notice provisions should cleanly apply or the provision should remain as written.

JBC:kib  
96-306:kib

AMENDMENT

OFFERED IN THE HOUSE

TO: CSHB 394(FIN)

1 Page 4, lines 2 - 6:

2 Delete all material and insert:

3 (A) land

4 (i) that is subject to an oil and gas exploration license or  
5 lease issued under AS 38.05.131 - 38.05.134; or

6 (ii) that is leased under AS 38.05.180;

7 (B) the land (i) that is proposed to be subject to an oil and gas  
8 exploration license or lease issued under AS 38.05.131 - 38.05.134; or (ii) that is  
9 ~~described in and part of a~~ included in the final findings of a proposed oil and gas leasing program prepared  
10 under AS 38.05.180(b); however, the commissioner may waive the limitations of this  
11 subparagraph; or

12 Reletter the following subparagraph accordingly.

AMENDMENT

OFFERED IN THE HOUSE

TO: CSHB 394(FIN) am

1 Amendment No. 1 to CSHB 394(FIN), as set out at p.3747 of the House Journal (April 15,  
2 1996), and adopted, is amended to read:

3 At the conclusion of subparagraph (C) added by Amendment No. 1,

4 Following "conveyance to the Alaska Mental Trust Health Authority":

5 Insert "; however, after consultation with the Alaska Mental Health Trust Authority,  
6 the commissioner may waive the limitations of this subparagraph"

**LAPP Resources Inc.**

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Anchorage, Alaska U.S.A.  
99502-4169

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Facsimile +1 (907) 248-7278

**FAX TRANSMISSION SHEET**

DATE 4/19/96 TOTAL # OF PAGES 1  
TO Rep. Ogan  
ATTENTION Hans  
FACSIMILE NUMBER 1 907 465-3265  
FROM D. Lappi  
REGARDING Possible Wording Discussed 4/18/96

PLEASE CALL OR FAX IF YOU HAVE QUESTIONS ON THIS FAX.

No person may own shallow gas leases whose total aggregate size is more than 23,040 acres.

If an entity holding a lease is owned by more than one person, the acreage is attributed to that person in proportion to their interest in the entity.

*D. Lappi*

## DEPARTMENT OF NATURAL RESOURCES

## DIVISION OF OIL AND GAS

3601 C STREET, SUITE 1380  
 ANCHORAGE, ALASKA 99503-5948  
 PHONE: (907) 762-2549

April 19, 1996

The Honorable Scott Ogan  
 Alaska State Representative  
 Capitol Building, Room 409  
 Juneau, Alaska 99801-1182

Dear Representative Ogan:

I have asked Mary Lundquist at Department of Law to review the latest version of HB 394 (9-LS1463/U), to see if there are any legal problems with its content. Her observation that concerns me the most deals with Sec. 5(c) on page 4, which might result in the Court requiring a best interest finding. Following is a line-by-line analysis with her comments (and some of mine):

p3. line 21: (Note: This is actually a comment on existing law) Set aside for how long? Withdrawn for how long? Until the end of the lease? This would prohibit oil and gas leasing, should anything be found that extends below 3000 ft. (Note: I question as to whether we would ever want to issue such a lease if the land is already under a shallow gas lease, but according to this, there is no way we could)

p4. line 4: Change to "...is currently leased" *(Handwritten: (10) and (11) (12))*

p4. line 17: "...to a person..." is probably not needed. Replace "...land for which the state owns the subsurface rights." with "state land". See AS 38.05.965 (20)

p4. line 23: "Notice" is not defined. See AS 38.05.945

p4. line 26: "...after review of available information..." -- this is more than just the public comment, it will require staff to research information; "...the director determines" will require a written finding or record showing the basis for the determination. Moore v State; "state's interest" sounds too much like best interests, which could also lead to doing a finding.

p4. line 30: Add "whichever is later" after AS 46.40.

p5. Sec (f): Needs clarity. The director shall notify lessee at least 30 days before the lease is to be terminated. Define date of termination. Is it the 90th day after the due date of the rental? Should termination be automatic? If notice is going to be tied to termination, it should be. (Note: We don't want to leave wiggle room for just cause for non-payment)

p6. line 11: "Commercial production" is not defined. Should be changed to paying quantities. see 11 AAC 83.105 & 11 AAC 83.395

p6. line 18: When will the title search be done? Before leasing? After?

p6. line 23: Saying that if the formation is capable of producing gas below 3000 ft could be pretty limiting. It wouldn't matter if the gas being produced is only from above 3000 ft. If the formation were capable of also producing from below 3000 ft, all operations would have to cease. (Note: If one hits a gas zone that is located between 2800 and 2900 ft, for example, without drilling other wells to map the zone or running a dipmeter log (an expensive operation) one cannot know if the zone is dipping to below 3000 ft.)

p6. line 27: "...until the facility complies with all applicable laws and regulations relating to oil and gas production" could mean requiring a best interest finding. Should be reworded so that it is specific to AOGCC statute and regs.

p7. line 1: "...reasonable and that are necessary" is already required by law; extraneous language.

p7. Sec (I): This assumes that the only other use will be coal, and Sec. 8 of the constitution says reasonably concurrent use -- no limitation. If one did discover hydrocarbons from below 3000 ft, we would not be able to include that land in an oil and gas lease sale as long as the shallow gas lease was active. (I realize I have always been leery of double leasing a tract (shallow v deep rights), but is it unconstitutional to include only coal leasing and exclude oil and gas leasing? )

p7. line 11 What does "...without prior agreement" mean? Agreement as to what?

p9. sec (9)(s): Why is the oil provision placed in 46.04.030, oil spill contingency plan statute, while the gas provision is under 38.05.177(j)? 177(j) makes more sense. Sec. 9(s)(2) suggests that once the lessee complies with laws and regs, that the lessee will be able to produce, yet this is not true according to 177 (a)(1).

p10. sec 11. This should be in 177. Also, the last sentence of this section is a repeat of Sec 9(s)(2).

p10. sec 12: AS 46.04.030(s) should be in 177.

If you have any questions, either call me or contact Mary directly at 269-5266.

Sincerely,

  
James J. Hansen  
Chief Petroleum Geophysicist

# STATE OF ALASKA

TONY KNOWLES, GOVERNOR

## DEPARTMENT OF NATURAL RESOURCES

### DIVISION OF OIL AND GAS

3601 C STREET, SUITE 1380  
ANCHORAGE, ALASKA 99503-6948  
PHONE: (907) 762-2549

March 7, 1996

The Honorable Scott Ogan  
Alaska State Representative  
State Capitol, Room 409  
Juneau, Alaska 99801-1182

Dear Representative Ogan:

It's the department's position that since the intent of HB 394 is to provide for the development of coalbed methane from within the coals, we prefer that this proposed leasing activity be under the department's coal leasing program. However, if your desire is to keep this activity within the confines of oil and gas law via HB 394, the department has identified problems and concerns with this legislation.

In addition to the four general concerns discussed below, I have completed a line-by-line analysis of the legislation and suggested changes.

#### General Concerns:

**1. There are no provisions for a public process prior to issuing a lease.**

It's generally agreed that we don't want to reinvent the best interest finding process, but there needs to be some community involvement prior to issuing a noncompetitive lease. This could be requiring the division to give public notice of the request to lease, followed by a public comment period. The division would need some input in order to develop any mitigation measures that would be a condition of the lease. Also, in many instances, we would have to go through the ACMP process, which can take up to 180 days by existing regulation.

**2. The department is prohibited from developing any regulations specific to this program, but rather must recommend new legislation to correct any deficiencies.**

It should be left to the commissioner to decide whether any regulations need to be adopted. Having to go back to the legislature every time there is a problem to fix would be an unnecessary burden on the department, and would cause even more delay in this program than that caused by the writing of regulations.

**3. There are too many changes to existing oil and gas statute and regulations.**

The fewer changes, the easier the program will be to implement. Also, by adhering to current statute and regulations as much as possible, there should be no need to develop new regs.

4. It's not clear what conflicts may eventually exist if exploration licensing occurs in the area of existing shallow gas leases.

We're just not sure that possible problems have been fully thought out. For example, could an exploration license actually include an existing shallow gas lease? If so, what conflicts might arise? What if the licensee wants to produce gas from a coal or other formation, where the reservoir is in communication with the one being produced from the shallow gas lease?

I remain available to work with you on this legislation, as is necessary.

Sincerely,



James J. Hansen  
Chief Petroleum Geophysicist

Attachment: Line-by-line Analysis

Line-by-Line Comments and Suggested Changes:

Delete the word "bed" throughout. This is not "shallow bed natural gas", it's simply "shallow natural gas". Also, change "shallow bed gas development lease" to "shallow gas lease".

p.2, line 4: Change to read "the methane derived from these coals or other sources and which is found in reservoirs at depths less than 3000 feet could be tapped to serve..."

p.2, line 7: Change to read "the methane derived from these coals and other shallow gas reservoirs could be developed..."

p.2, line 12: Delete "commercial quality", then at end of line 13 add ", especially when this natural gas can be delivered to consumers at less cost than alternative energy sources"

p.2, line 20: After "...Act promptly", delete rest of sentence in (1). See general comment #3 above.

p.2, line 23: Delete all of (2). Anyone can recommend legislation, we don't need it in here as something binding to the commissioner.

p.3, line 2: What if the source, located above the 3,000 ft. level, also extends below 3,000 ft. Is this a legal problem? What about a dipping bed, in which the gas may be located above 3,000 ft. at the drill site, but as one moves laterally away, is found deeper than 3,000 ft? Does the wording need to be more explicit so there is no question about what reserves can or cannot be accessed?

p.3, line 10: This would exclude from this program portions of the Susitna Basin, which are included in areas proposed for oil and gas leasing. However, some of this area is open to exploration licensing, and should also be available to this leasing program. It would seem easiest to adopt the exclusion areas that are stated in AS 38.05.131.

p.3, line 14: Add "reservoirs" after "natural gas".

p.3, line 15: Substitute "for which the state owns the subsurface rights" in place of "of the state".

p.3, line 18: The maximum size of an oil and gas lease is 5760 acres. Why not keep that as a standard. One can simply apply for more than one lease in an area, in order to get to the 23,040 figure. It should be made clear that 23,040 is the total number of acres of state-owned land that any one lessee can have throughout the state that are subject to shallow gas leases. (this assumes the lessee can have additional privately-owned acreage under lease). Also, why specify a minimum size?

p.3, line 19: Substitute "shall" for "may".

p.3, line 24: Here is where we need to introduce the public process. Upon receipt of a lease application, the division should give notice and establish a public comment period. Once the comment period has ended the division should have up to 90 days in which to issue the lease(s) (following the public comment period we will need time to address the comments and develop

whatever mitigation measures are necessary). Also, if the ACMP process is involved, the timeline needs to be stretched in accordance with existing regulations.

p. 3, line 25: Delete "initial".

p. 3, line 28: Replace "two years" with "five years" (this is the minimum term of a lease, AS38.05.180(m)). This lease would be for the purpose of exploring for commercial quantities of gas. By the end of the initial term, if commerciality has been determined (and how this will be done needs to be fully described in this legislation), the permittee then would apply to the director for an extension of his lease. Or, if the lessee can argue for extending the lease based on the results of exploratory work that has been done and future exploratory plans, an extension could be granted. This is all covered under existing laws and regulations. There would be no need for subsection (c)(2).

p. 3, line 29: In regards to "at the drill site" (see above comment, p.3 line 2).

p. 4, line 2: Delete entire subsection (d). By adhering to existing law (see above comment, p.3, line 28), none of this is needed.

p.4, line 14: Need to describe what is meant by "a single unit". Need to specify under what standards or procedures is a unit formed (using existing law).

p.4, subsection (e): Reference should be made to existing law that governs plans of operation and annual review of those plans by the director. There is no need to establish a new procedure for one that works.

p.4, line 31: "initial commercial production" has not been defined, need a reference to its definition.

p.4, line 32: 25 cents seems low. One could either have no rental payments during the initial term of the lease (as is the case for exploration licensing--no rental until the license is converted into a lease), or stick to the existing rental schedule for oil and gas leases.

p.5, line 2: 50 cents? See above.

p.5, line 4: Suggest leaving royalties at 12.5 percent in accordance with existing statute. Under current royalty reduction laws operator can have royalties reduced to below 6.25%, if necessary.

p. 5, line 10: Subsection (2) is badly written. Can a lessee be a number of individuals? Does this prohibit someone from getting funding from a number of individuals (who are now leaseholders and not necessarily a third party) who will essentially pay that person to drill wells? If there is no production who actually pays the exploration expenses? Does this subsection, as written, really get rid of the problem of speculators who end up getting something for nothing?

p. 5, line 11: Have not defined "initial commercial production".

p. 5, line 23: When would a title search not be required? (i) should read "The applicant for a shallow gas lease shall be responsible for conducting the title search".

p. 5, line 29: Delete "at the drilling site".

p. 5, subsection (1): Delete section. Commissioner should not be prohibited from adopting regulations if any are deemed necessary.

p. 8, line 10: Delete this amendment. Placing more special conditions on these leases, as opposed to conventional oil and gas leases, will only invite criticism of the program.

p. 9, subsection 5: Line 25 on the previous page refers to discharge from a point source, as that term is defined in regulations adopted under this chapter. Do those regulations include coal bed as a point source? One should be aware that formation water from coals can contain salt and be acidic. Improper handling of this water would adversely impact nearby streams and the subsurface aquifer.

Coalbed wells typically must be dewatered prior to producing significant quantities of methane. This creates large quantities of saline and acidic water at the surface which needs to be properly disposed of, either through surface evaporation, reinjection or a surface discharge (i.e. into the ocean). Additionally, proper downhole completion and casing of the well is necessary to prevent downhole contamination of the shallow fresh water zones. Is it necessary to make it clear that the AOGCC will oversee the drilling of these shallow gas wells?

p. 9, subsection (s): This doesn't really answer the question, what does one do if the operator strikes oil? What happens to the lease? Is it terminated? What about adjacent leases, if any? Is DNR allowed to include these lands in an oil and gas lease sale? Even if the shallow gas lease still exists?

p. 10, subsection (3): Is this bonding sufficient to cover the cost of cleaning up an aquifer? Who pays if there is irreparable damage to subsistence harvest in nearby streams?

p. 11, section: Delete section. As previously stated, this is a bad idea.

# 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,

A handwritten signature in cursive script, appearing to read 'Judith M. Brady', is written over a printed name and title.

JUDITH M. BRADY  
Executive Director

# MEMO

**To:** Annette Kreitzer, Senate Resources  
**From:** L. A. (Ardie) Gray  
**Subject:** HB 388 (Areawide Leasing) & HB 394 (Shallow Bed Gas Leasing)  
**Date:** March 12, 1996

Annette:

As we discussed by phone, attached are AOGA comments on CSHB 388 (version F), Areawide Oil & Gas Leasing. Attached also FYI is version F. We understand that a new Oil & Gas Committee Substitute is expected this afternoon.

Attached, also, is AOGA's letter to Rep. Ogan on CSHB 394.

F A X

polarconsult alaska, Inc.

1503 West 33rd Avenue, Suite 310

Anchorage, Alaska 99503-3881

Phone: (907) 258-2420

FAX: (907) 258-2410



From: Earle Ausman

Date: 04/25/96

To: Senate Resources Committee

FAX Number: (907) 465-3810

Attn: Senator Loren Leman

No. of pages including this page:

Subject: CS FOR HOUSE BILL NO 394(RES)

Dear Chairman: *Loren*

During the hearings last evening you asked for our faxed comments. I would like to make the following comments:

Page 6, Lines 5 & 6

There should be some grace period in these leases so if they are not exactly on time the lease is not lost. There could be a penalty to discourage lateness. Quite a few of the lease holders will be villages, native corporations and individuals. Their bookkeeping will not meet the same standards as the majors.

Testimony:

The testimony by Jim Hansen appeared to be aimed at derailing this bill. If DNR could do all of these things as stated, why has it not been done. I do not know his motivation, but with consideration of the rewards versus the risk to Alaska, I do not believe delaying this bill for what *might be* is sound public policy. I hope that you will agree.

Doc-ga/gov/1960425

CHANGES TO CS HB 394(FIN)AM: SHALLOW NATURAL  
GAS LEASING

1) Page 3, Line 31:

Create the onshore exception by inserting it in (1) (~~onshore and within 3,000 feet of the surface~~) Delete "onshore" from wherever else it appears in the bill to describe the shallow gas wells.

- This change states the intent of the bill from the outset.

2) Page 4, lines 2-6:

**DELETE ALL MATERIAL**

Insert:

(A) land

(i) that is subject to an oil and gas exploration license or lease issued under AS 38.05.131-38.05.134; or

(ii) that is leased under AS 38.05.180;

(B) the land (i) that is proposed to be subject to an oil and gas exploration license or lease issued under AS 38.05.131-38.05.134; or (ii) that is described in and part of a proposed oil and gas leasing program prepared under AS 38.05.110(b); however, the commissioner may waive the limitations of this subparagraph; or

Reletter the following subparagraphs accordingly.

- This language simply clarifies the existing language.

3) Page 4, Line 15:

Following "conveyance to the Alaska Mental Health Trust Authority"

Insert:

however, after consultation with the Alaska Mental Health Trust Authority, the commissioner may waive the limitations of this subparagraph.

- This addition would allow Mental Health lands to be developed after consultation with the Trust Authority if the commissioner waives the limitations.

4) Page 4, Line 20:

**DELETE:**

(23,040)

Insert:

46,080

- This changes the total acreage limitations to keep consistent with current coal lease acreage limitations.

5) Page 4, Line 23:

Add notice of lease application for shallow natural gas leases to AS 38.05.945. (It is not defined here. Change is made where it is appropriate to insert 38.05.945)

- The word "notice" is defined by referring back to AS 38.05.945

6) Page 4, Line 26:

DELETE:

[AVAILABLE INFORMATION]

Insert:

information received during the public comment period

Page 4, Line 26-27:

DELETE:

[IT IS IN THE STATE'S INTEREST TO ENTER INTO]

Insert following "the director determines":

that the discovery of a local source of natural gas would benefit the residents of an area, the director shall execute a lease for the area.

- This language was suggested after DNR pointed out that the current language would lead toward a best interest findings.

7) Page 4, Line 30:

Insert following "AS 46.40"

whichever is later.

- A suggestion by DNR.

8) Page 5, Line 4:

Insert following "from the lease":

and the lessee continues to meet all lease requirements.

9) Page 5, Lines 23-31.

DELETE ALL MATERIAL AND REPLACE WITH THE FOLLOWING:

(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. The director shall mail the lessee one written notice, certified return receipt requested, three weeks prior to the due date of the rent. If the lessee fails to pay rent, the director shall terminate the lease.

10) Page 6, Lines 11:

DELETE:

[COMMERCIAL PRODUCTION]

Insert:

paying quantities

- This change will keep the bill consistent. "Paying quantities" is the language used throughout the bill.

11) Page 6, Line 18:

~~DELETE:~~

~~[SHALL CONDUCT]~~

Insert:

is responsible for conducting

- This language gives the responsibility of doing the title search to the lessee.

12) Page 6, Line 23:

Insert following "surface,":

or penetrates a formation capable of producing oil

- This language is included to add clarity. The lessee is also required to cease operations if they penetrate a formation capable of producing oil.

13) Page 7, Line 7:

~~DELETE:~~

~~[THE COAL DEPOSIT]~~

Insert:

other mineral deposits

- The current language would only allow for the eventual development of coal, however it is the sponsor's intent to encourage all future development of other mineral deposits.

14) Page 9, Lines 17-26:

~~DELETE ALL MATERIAL.~~ and renumber following sections.

- This is extraneous language as it is already stated in AS 38.05.177 (pp. line 20 of this bill).

15) Page 10, Lines 14-15:

~~DELETE:~~

~~[AND DEVELOP]~~

- This language is removed since bonding isn't required for the development of natural gas.

16) Page 10, Lines 20-29:

~~DELETE ALL MATERIAL.~~

- These sections are removed because they are extraneous. The references to these sections aren't necessary.

17) Pages 5&6, Lines 32-4:

Delete:

[ALL MATERIAL]

Insert:

(g) The royalty payable on natural gas produced from a lease

(1) is

(A) 12.5 percent of the value of production removed from the lease for gas exported from the state or gas that is produced in direct competition with gas to which a royalty at a rate of at least 12.5 percent is payable; and

(B) except as provided in (A) of this paragraph, 6.25 percent of the value of the production removed or sold from the lease; and

(2) shall be based upon production 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.

- This amendment is made in order to make sure that any gas produced that may be in competition with gas companies that pay a royalty of 12.5 percent has to pay the same royalty.



# ALASKA MINERS ASSOCIATION, INC.

501 W. Northern Lights Blvd., Suite 200, Anchorage, Alaska 99503 FAX (907) 275-7997 Telephone (907) 278-0347

April 24, 1996

Honorable Loren Loman  
Chairman, Resources Committee  
Alaska State Senate  
Capitol Building  
Juneau, AK 99801

APR 24 1996

RE: CSHB-394(FIN)am, Shallow Gas Leasing

Dear Senator Loman,

The Alaska Miners Association wishes to go on record in support of CSHB-394(FIN)am. This bill involving leasing of shallow gas, which is typically methane gas from coal seams, has the opportunity of providing an energy source to many areas of the state while not affecting the future mining of the coal.

Coal bed methane is a source of energy that has a very good opportunity for supplying gas for home and industrial use, thereby decreasing the cost of heating in many parts of the State. In addition to this obvious benefit, there are potential benefits regarding transportation, handling and storage from an environmental standpoint.

Our primary focus on this bill has been to insure that leasing of coal bed methane does not adversely affect the future mining of the coal. These concerns have been addressed and this bill is actually complementary to mining the coal.

Thank you for this opportunity to comment. If there is any way we can help move this bill to passage and signing into law please contact me.

Sincerely,

Steven C. Borrell, P.E.  
Executive Director

cc: Representative Scott Ogan

**HB 394 - SHALLOW GAS DEVELOPMENT**  
**Distributed by Representative Scott Ogan**

Saturday 13, 1996

COMMENTS BY Michelle Brown

during her confirmation hearing as Commissioner of DEC  
State Affairs Committee Meeting

"Here's another area that is really of interest to you as well - the coal bed methane issue. If that really can take off, it's a wonderful energy source and can get us out of a lot of the problems we have with the bulk fuel tanks. So what I did when I first met with some of your (Representative Ogan's) constituents, actually and that was one instance with your constituents where the Mat-Su office probably imposed a requirement that really wasn't needed & we're reversing that."

"What I asked our staff to do was, this is a really innovative idea and has a lot of potential, I asked each of our divisions to give me a report on whether we have sufficient regulatory authority to get these on line. Whether we need any changes, whether we're holding them to standards that don't apply to them, for instance, they're shallow wells and they're not likely to encounter oil. There's no need for them to file for a million dollar financial responsibility because there's very little risk. So we had each of the divisions do that kind of analysis. We're now almost finished with that analysis. In the next 2 weeks we'll sit down with the industry, and say here's, how we're viewing it. Do you agree, what do you need, so that as soon as DNR and everyone is finished with what they need to do on this - we're ready to go on line. We're not going to be a permanent hold-up. We want to take sort of a sector by sector approach and be ready to jump into gear."



# NAKNEK ELECTRIC ASSOCIATION, INC.

POST OFFICE BOX 118 • NAKNEK, ALASKA 99633 • PHONE (907) 246-4261 • FAX (907) 246-0242

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.

Testimony on HB394  
April 3, 1996  
Page 2

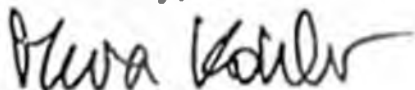
The area surrounding Naknek is mostly state owned. We need the support of the state in our efforts to switch to a local energy source. When I have approached the Department of Natural Resources in the past, the first response I have gotten is "Well, there's no identified gas source in your area." That 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  
General Manager



# 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  
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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 Initiative* 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 oversight, 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.

# 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  
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Representative Scott Ogan  
House District 27

## SECTIONAL ANALYSIS

### HB 394

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 clarifies the relationship between shallow natural gas and coal.

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 natural gas, from coal deposits or any other source, located within 3,000 feet of the surface, 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. However, the commissioner may waive these exceptions to the reach of AS 38.05.177 so that the provisions of this section would authorize the leasing of these lands, except for lands that are already part of a lease. The program is unavailable to land under a coal lease unless the shallow 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 must pay an application fee of up to \$500.

- Following a public comment period for a lease application, the director is authorized to provide the lease applicant an initial shallow gas development lease giving the exclusive right, for a period of three years, to explore for, develop, and produce shallow natural gas.
- The initial shallow natural 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 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.
- An applicant must conduct a title search
- 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 the commissioner to adopt regulations is spelled out.
- Overlapping development of shallow natural gas and coal resources is possible, and stipulations are expounded upon.

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

Bill section 7 (AS 46.03.100(F)) adds shallow 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)) 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. This section establishes an exception from that requirement for an onshore exploration facility used solely to explore for shallow natural gas by drilling a well on an authorized lease.

vi.

Bill section 9 (AS 46.04.030(s)) sets out the steps that a shallow 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 natural gas at \$25,000 per incident.

Bill section 11 (AS 46.04.040(n)) requires the operator of a shallow 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 natural gas exploration facilities except as may be required when that well penetrates a formation capable of producing oil.

JAN 30 1996

# **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.

*Breaking developments in the search of affordable fuel alternatives for Alaskans.*



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**W**ELCOME to the second edition of the Rural Alaska Gas News newsletter. This publication has been written to keep you informed on the current status of coal bed gas development taking place in our state.

**House Bill 394:** Representatives Scott Ogan and Norman Rokeberg sponsored this bill to make state land available for natural gas production and to reduce the cost of drilling shallow gas wells (less than 3,000 feet). The bill has passed from the House Resources Committee to the House Finance Committee, where it has been for several weeks. When the bill clears the Finance Committee it is scheduled for the Senate Resources and Finance Committees before going to the Governor. *Support and testimony before these committees is solicited.*

**Bill Highlights:** House Bill 394 applies only to natural gas within 3,000 feet of the surface. The bill allows a simplified three year lease of State land with reduced leasing fees and a 6.25% royalty. By reducing regulatory costs, shallow gas wells in rural Alaska can be a low cost, environmentally friendly source of fuel for heat and electricity.

**Coal Bed Gas Production:** Natural gas is frequently found adsorbed in coal. Many underground mines remove the gas before mining operations begin to prevent explosions. The Federal Environmental Protection Agency (EPA) is encouraging the removal of methane from coal prior to mining to reduce methane emissions into the atmosphere. Methane is a "greenhouse" gas, thought to contribute to global warming. To extract gas from coal, a small diameter well is placed in the coalbed. The equipment used to drill the well is similar to that used to construct a water well. As water is usually found in the coal, it must be removed by pumping to allow the gas to flow to the surface. Most gas found in coal is not produced at high pressure. At the surface a separator is used to remove the water from the gas. The gas is further dehydrated, which is important as the

pipeline can be blocked by ice if water vapor is left in the gas. The gas is then compressed and sent to the consumer. If the gas well is close to the village where it is used, the pressure can be as low as 30 psi. If the well is many miles from its point of use, the gas will be compressed to several hundred psi. The gas is odorized before it is distributed in buried underground distribution lines to provide easy detection and early warning of a leak. At each building there is a shutoff valve, pressure reducer, and gas meter.

**Village Conversion:** Most villages use oil or wood for heat. Where there is a gun type oil burner, conversion to gas is simple and inexpensive as only the burner is replaced. Pot burners, and wood heaters can be replaced by inexpensive gas appliances. Propane stoves will have their orifices replaced or bored out. In Anchorage the gas company financed conversions and this financing was added to the fuel bill, spreading the cost of conversion over a greater period of time. Because natural gas was so inexpensive compared to burning oil, the total monthly fuel bill was reduced. Electric power generators may also be converted. Some engines can be fitted with new parts to allow them to burn natural gas, in other cases natural gas engines will be purchased. Since the cost of fuel is much greater for electric generation than equipment costs, low cost gas will overcome conversion or new equipment expenses and yield a net savings.

**Further Information:** To acquire additional information on coalbed gas development, contact the following sources at their world wide web sites:

**Lapp Resources, Inc.:**  
<http://www.alaska.net/~lapres/lapres.htm>  
**Environmental Protection Agency (EPA):**  
<http://www.epa.gov/GCDOAR/coalhome.html>  
**Gas Research Institute:**  
<http://www.gri.org/home.html>

# 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.

## 2. BULK FUEL STORAGE FACILITIES

### 2.1 Reliance on Petroleum Fuels in Rural Alaska

The remote villages of rural Alaska are heavily dependent on fuel oil for heat and power generation as well as transportation.

Although wood is available in Alaska's forested interior region as an alternative heating fuel, most of the remote villages are located on the treeless wetlands of western Alaska where alternative heating fuels are scarce. Overall, about 75% of households in Alaska's remote villages depend on fuel oil for heat, which represents their largest category of energy use. Public facilities in these villages, including schools, are nearly all dependent on fuel oil as their only source of heat.

Reliance on diesel fuel for power generation is nearly universal in these same communities due again to the scarcity and relative cost of viable alternatives. The State of Alaska continues to fund evaluation and development of renewables including small hydro and wind generation, and of non-renewable alternatives on a village scale including coal and natural gas. However, these alternatives are not expected to challenge the dominance of diesel generation in Alaska's remote communities for the foreseeable future.

Village residents are also dependent on gasoline for aircraft, boats, all-terrain vehicles, and snowmobiles used for subsistence hunting and fishing, transportation between villages, and search and rescue operations.

The lack of water access in winter to most of the remote villages means that sufficient fuel must be stored in each village to last most of the year. The adequacy and integrity of fuel storage facilities is therefore essential to life in these communities.

Fuel storage facilities have been constructed or funded in the past by Federal, State, and local governments, schools, electric utilities, fuel distributors, ANCSA Native Corporations and other private interests. Unfortunately, adequate controls were not in place to ensure that these facilities were properly engineered or constructed to code.

Over the last several years, an increasing number of villages have faced the possibility that fuel will not be delivered due to the unacceptable condition of their storage tanks. 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 piping systems between the delivery barge and the storage tank, has sent letters to the owners of nearly 80 fuel storage facilities stating that fuel delivery will be denied unless deficiencies are corrected. These orders were deferred until March 1995 to allow time for emergency repairs (see Attachment 2). Although no village has yet been denied its fuel delivery, stepped-up enforcement of regulations by the Coast Guard has contributed to the urgency and visibility of the problem of deteriorating fuel storage tanks in remote communities.

### 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.

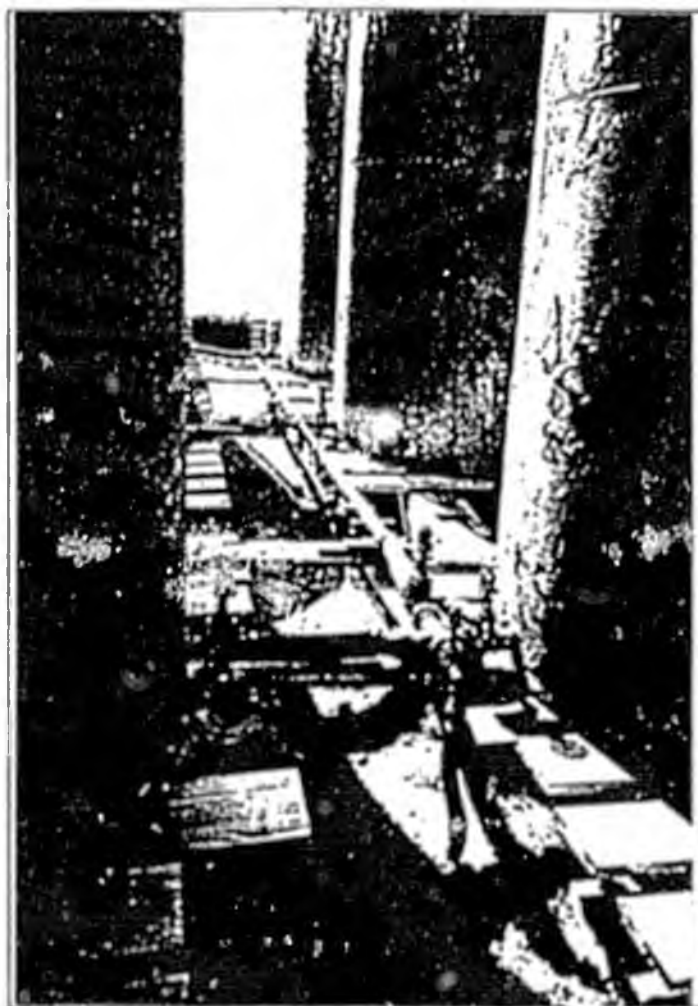
### **3.3 Estimated Cost to Upgrade Rural Utility Systems to Industry Standards**

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.

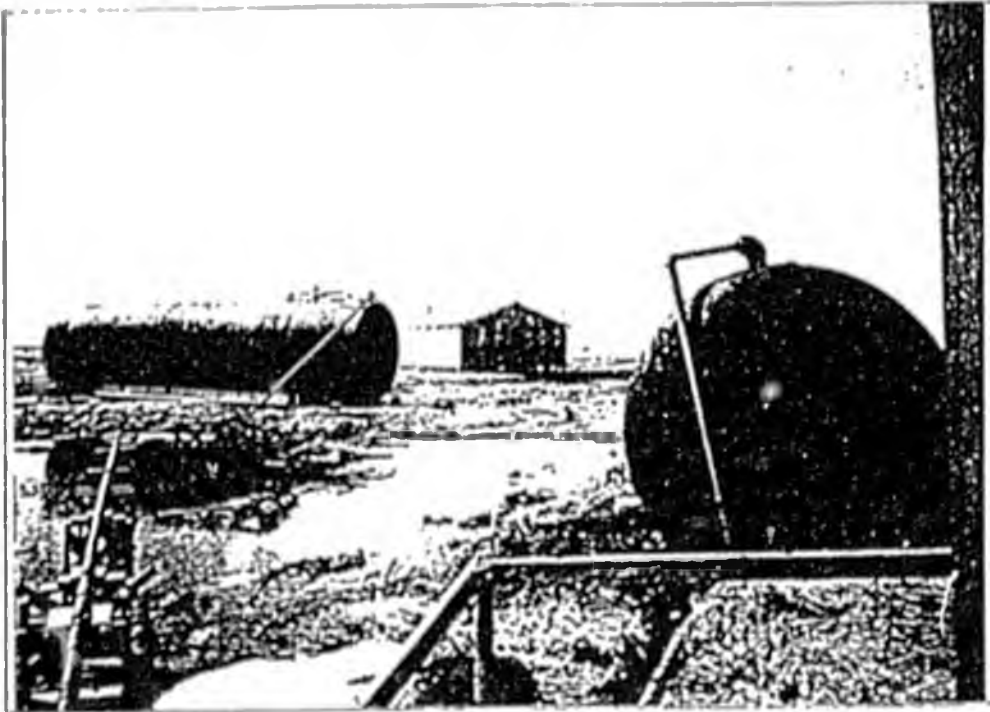
The estimates presented for the 52 single-village utilities in Appendix B provide only for code compliance of diesel dependent remote utilities, and do not include any additional amount for funding alternatives to local diesel generation such as small hydro or wind generation where appropriate resources 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.



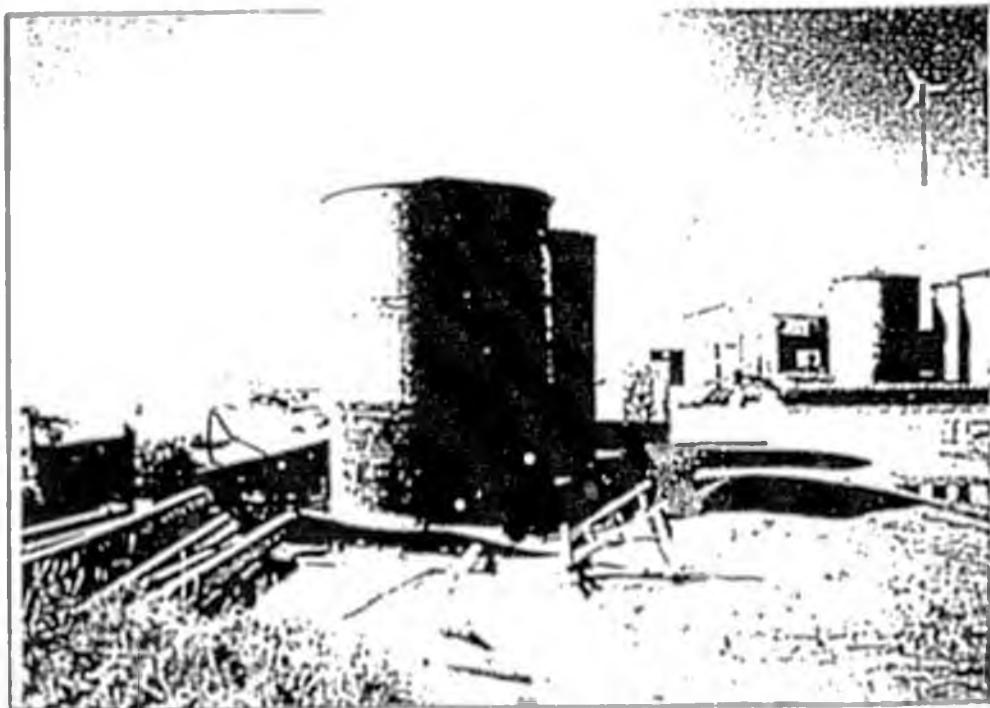
**Photograph A.1**  
Severely corroded tanks connected by rubber hose. Evidence of fuel spillage throughout area.



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



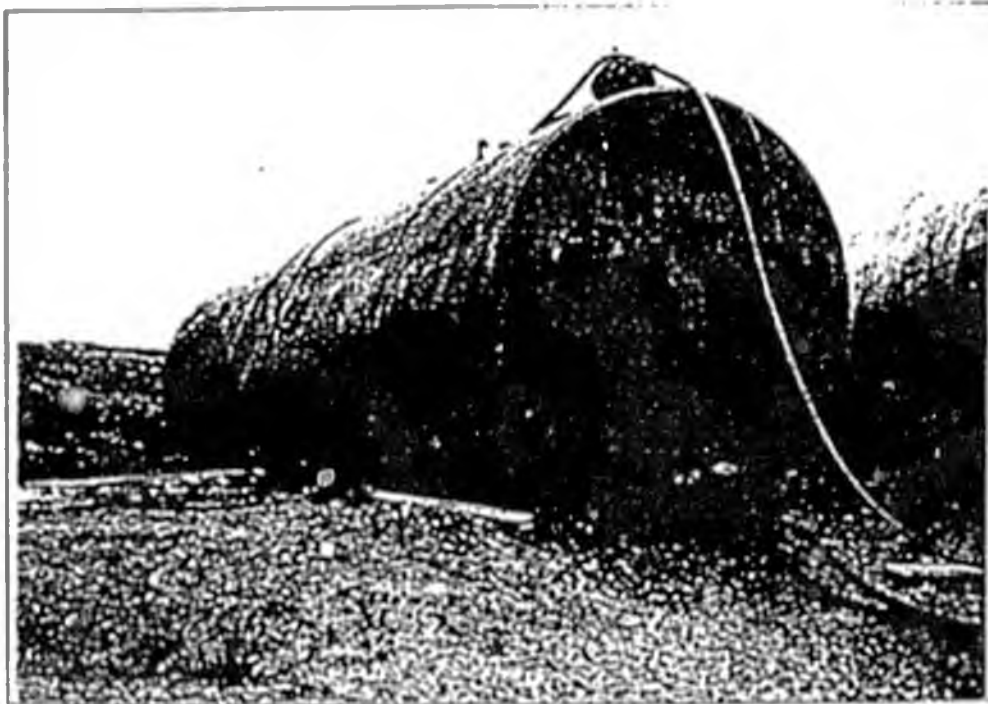
**Photograph A.3**  
Tanks on improper foundations with no means of secondary containment. Facility located in close proximity to a river.



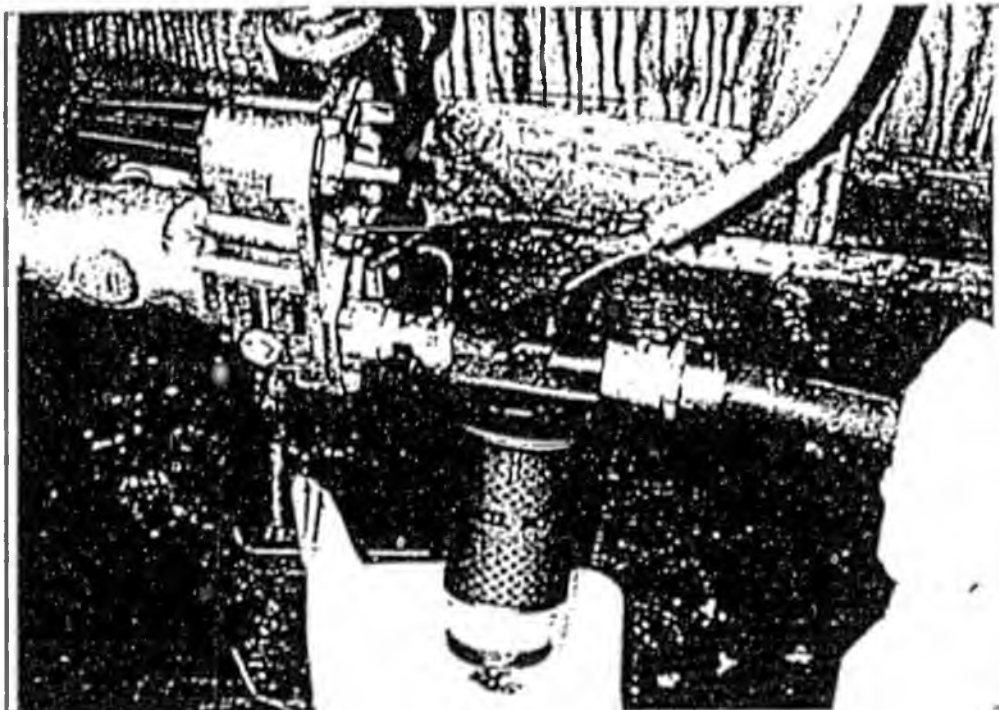
**Photograph A.4**  
Corroded tanks located immediately adjacent to ocean. Steel dike completely rusted out and unusable as secondary containment.



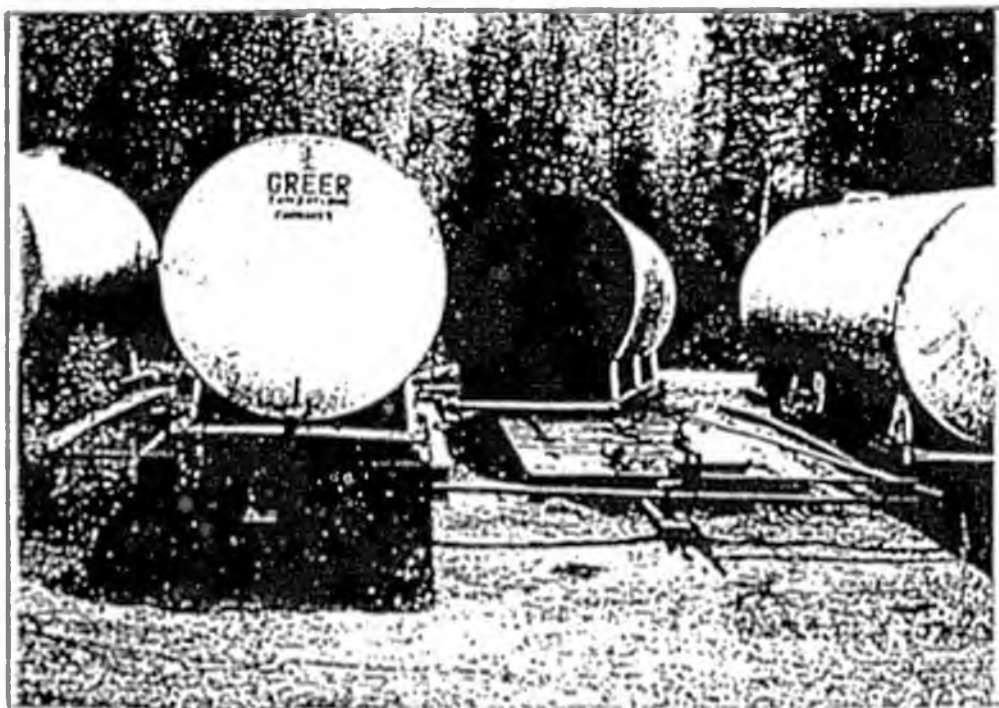
**Photograph A.5**  
Tanks scattered along  
river bank with no dikes,  
no security, and improper  
foundations.



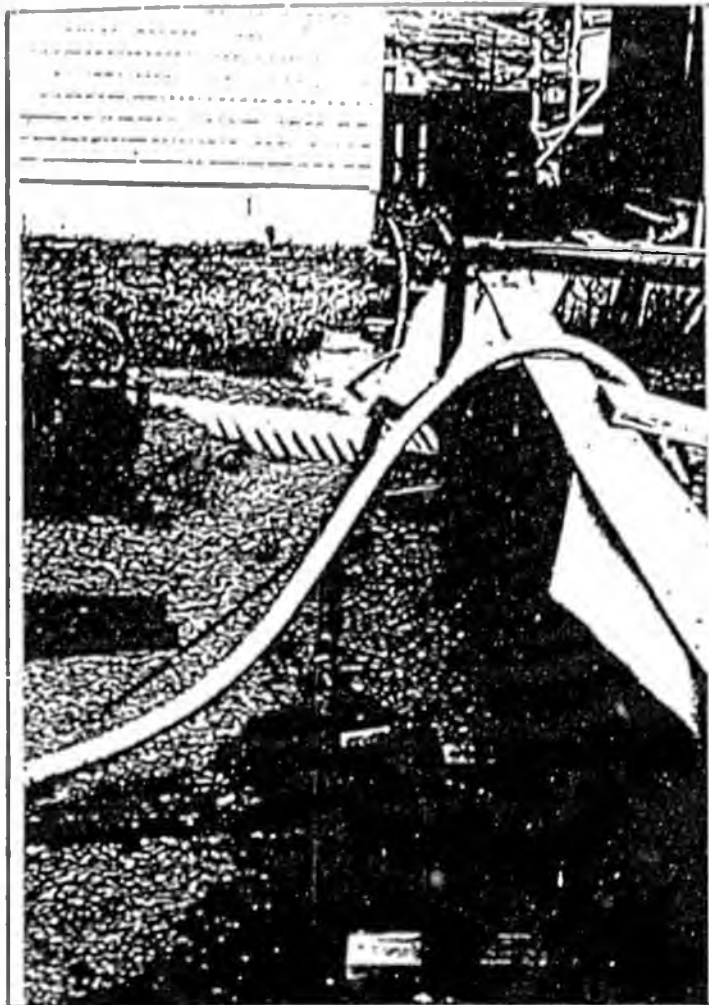
**Photograph A.6**  
Severely dented tank with  
no foundation. Placed at  
edge of beach with no  
dike. Gravity dispensing  
of fuel. No security.



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



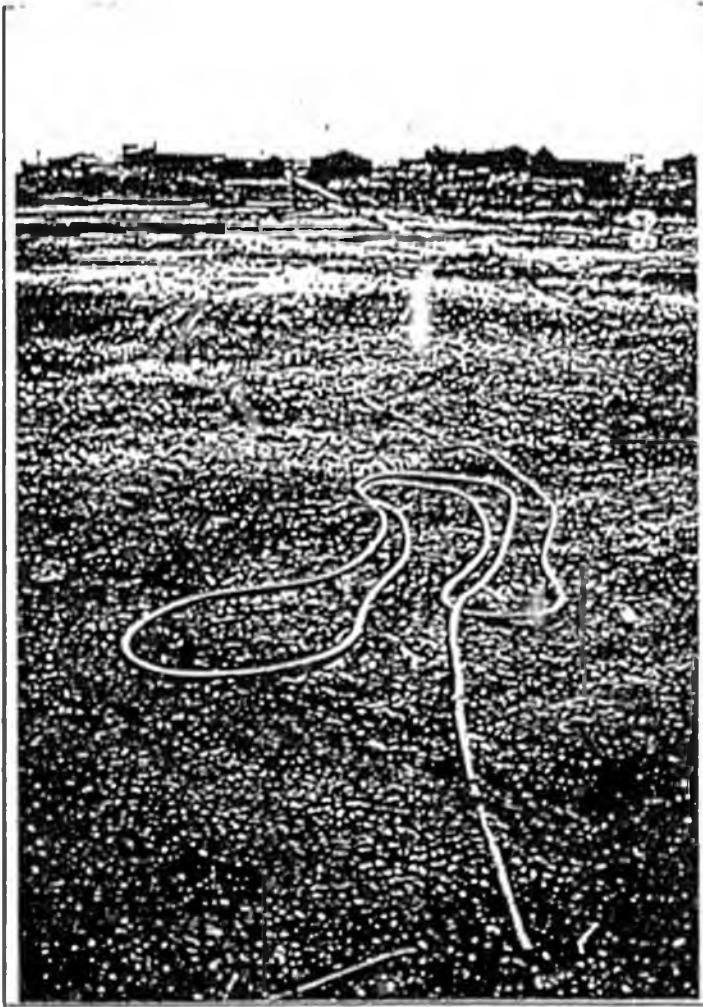
**Photograph A.8**  
Improper piping system  
and poor operational  
procedures resulted in  
explosion of tank.



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

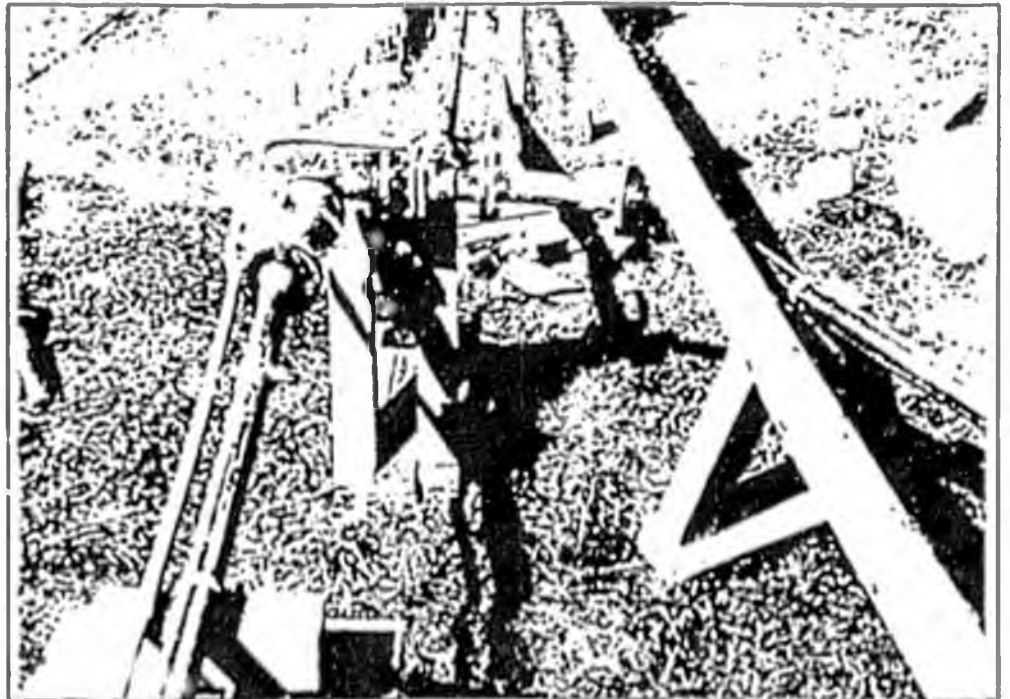
**Photograph A.10**  
Faulty piping system reportedly broke during winter, spilling an estimated 50 gallons of fuel.





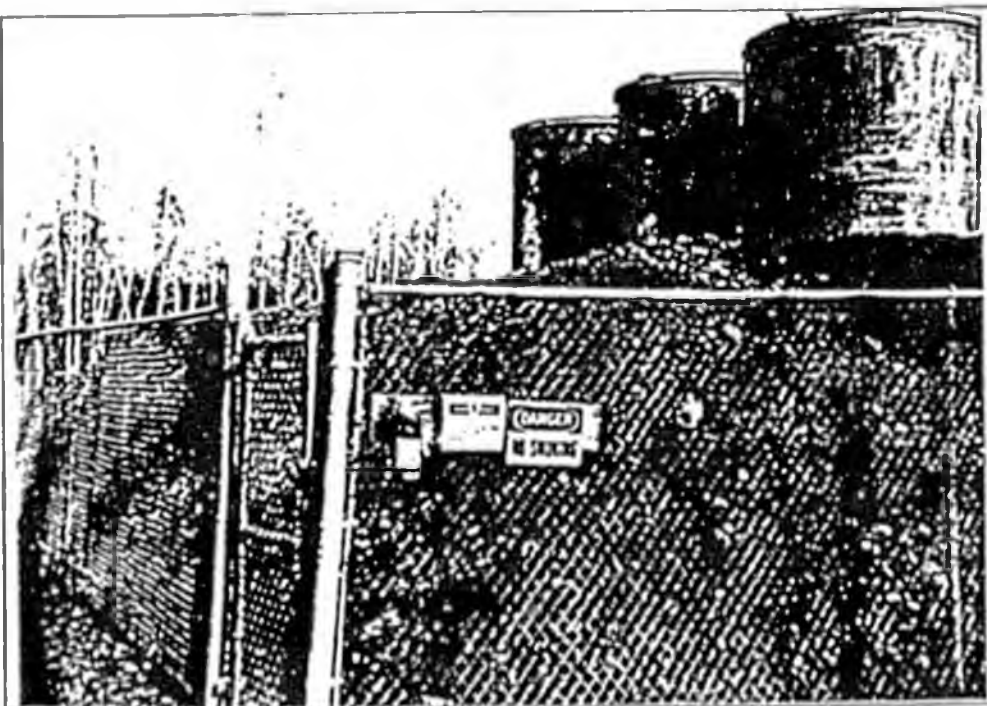
**Photograph A.11**  
1200' long hose used to transfer diesel fuel from storage tanks to power plant on a weekly basis.

**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.

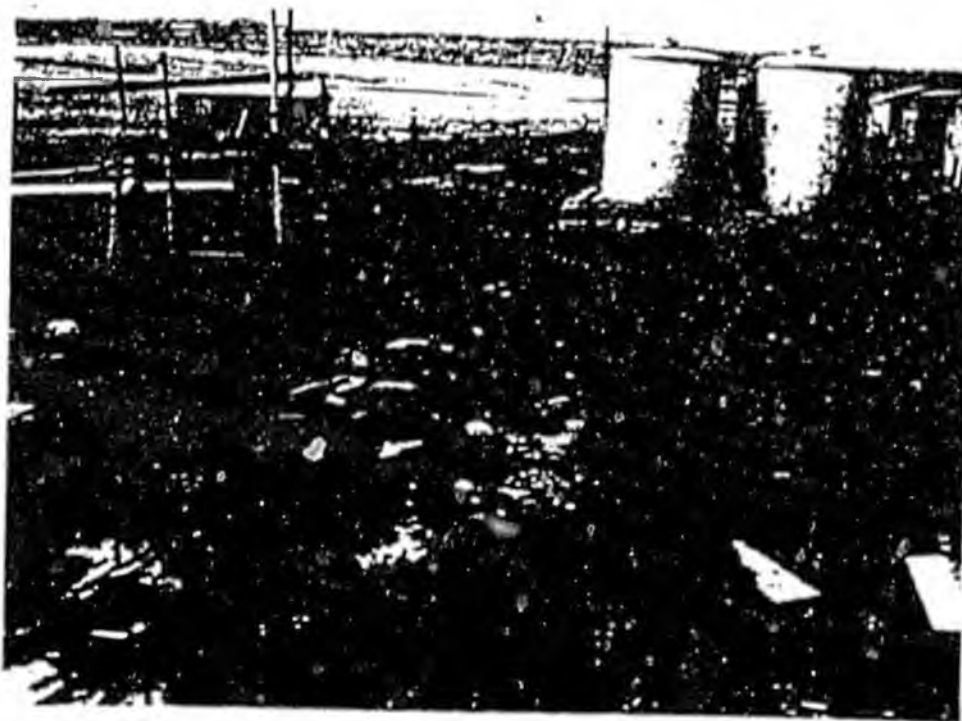


**Photograph A.14**  
Tanks placed in new lined  
dike on gravel pad above  
flood stage. Facility  
repaired to meet  
applicable code and  
regulation requirements.  
Construction administered  
by AEA, supported by  
State and Federal disaster  
relief funds.

JAN 30 1996

# **RURÁL 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.

We ~~might~~<sup>do</sup>  
Have on  
Line

Jim Hanson, BOG  
Jim Haynes  
For HR 394

04/24/96

LEGISLATIVE TELECONFERENCE NETWORK SYSTEM

LTN1150

17:11:13

PARTICIPANT LIST (ALL PARTICIPANTS)

BY:ANC

TCN:60787

SCHEDULED FOR:04/24/96 15:30 TO 17:00

FOR:ANC

PUBLIC HEARING

SENATE RESOURCES

LOCATION: ANCHORAGE

~~HEARINGS~~  
EARLE

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TESTIFY

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