

HB

531

HFIN

FILE

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: CSHB 531(O&G)
(H) Publish Date: 4/5/04

Revision Date/Time (Note if correction): _____ Dept. Affected: Natural Resources
Title: Conventional & Non-conventional Gas Leasing RDU: Resource Development
Component: Oil and Gas Development
Sponsor: House Resources
Requester: House Oil and Gas Component No. 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

CAPITAL EXPENDITURES						
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CHANGE IN REVENUES (1004 GF) +)	**Indeterminate Positive Amount**					
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FUND SOURCE	(Thousands of Dollars)					
1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2004) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2005 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)
This bill would eliminate the current over-the-counter shallow natural gas program. HB 531 would create a new gas only option under the competitive leasing and exploration licensing programs.

**Indeterminate positive fiscal note: Moving from an over-the-counter program to a competitive program will result in increased revenue to the state. The commissioner will be able to set minimum rentals and bonus bid amounts based on technical analysis of the potential resources and economics of the lease or license area. While a best interest finding process will cost more up front, that cost will be more than offset by the gains in going to a competitive process. Also, having a best interest finding process at the leasing stage will facilitate a more efficient progression to exploration and development and provide the state with royalties and other revenues from development sooner.

Prepared by: Mark D. Myers Phone 269-8800
Division: Oil and Gas Date/Time 3/11/04
Approved by: Thomas Irwin, Commissioner Date 3/12/04
Agency: Natural Resources

ALASKA STATE HOUSE OF REPRESENTATIVES

Co-Chair
Representative Beverly L. Masek
State Capital, Rm. #403
Juneau, AK. 99801-1182
(907) 465-2679



Co-Chair
Representative Nancy A. Dahlstrom
State Capital, Rm. #126
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HOUSE COMMITTEE ON RESOURCES

SPONSOR STATEMENT

HB 531 – Conventional / Non-Conventional Gas Leases

The intent of original shallow gas leasing legislation in 1995, HB 394, was to expand development of our state's marketable natural gas resources, as well as to promote private-sector employment, generate less expensive energy alternatives for rural Alaskan consumers, and enhance local tax bases for municipalities. Shallow gas legislation was inspired by the need to tailor the particular economies of this resource opportunity to available market opportunities. This type of gas extraction does not conform to the same economies of scale as conventional deep-hole oil and gas drilling.

Original legislation provided for leasing on a first-come, first-served basis so that development of the resource in areas away from the energy grid could take place. With a well-known shortage of natural gas development opportunities in South Central Alaska, prospects of leasing on-shore fields in the Cook Inlet Basin became very attractive. Two unintended consequences of this sudden interest materialized. One, it sparked leasing of the state-owned subsurface mineral estate in uneconomic areas, and two, it encouraged leasing in areas where divergent interests between gas development and established local residential and business activities came into conflict.

Without HB 531, a subsequent gas development entity could immediately lease land relinquished by the original lessee. In addition, land not currently leased remains subject to current over-the-counter standards. This bill initiates a permanent solution to these problems. It has been brought forward in response to strong citizen interest in the Mat-Su Valley and on the Kenai Peninsula, with input from several public meetings held at one time or another by the Alaska Department of Natural Resources (DNR), and the Senate Resources Committee.

Legislation Highlights

Eliminates over-the-counter, first-come, first-served shallow gas leases and replaces it with area-wide leasing or exploration licensing.

Requires a best-interest finding before any oil and gas leasing or exploration licensing. This will give DNR control of what land is leased, avoiding unnecessary surface-owner conflicts. Best-interest finds are a time-tested public process.

Creates a gas-only section of area-wide leasing and exploration licensing identified in a best-interest finding by DNR.

- 2 Differentiates conventional and non-conventional gas resources for the purposes of lease rentals.
- 2 Defines conventional and non-conventional gas development, and treats each distinctly. Recognizes that lease rights should not be determined by a depth criteria only. Enhances production opportunities.
- 2 Encourages exploration licenses with a best-interest finding as the method for non-conventional gas exploration outside of the area-wide leasing in rural Alaska.
- 2 Makes leasing and regulatory criteria fit the appropriate activity.
- 2 Ensures competitive processes, thereby maximizing the state's interests.

HB 531 / House Resources Committee / Rp. Beverly Masek / staff: Eleanor Wolfe / 465-6585

withdrawn 4/27/04

AMENDMENT 1

OFFERED IN THE HOUSE
TO: CSHB 531(RES)

BY REPRESENTATIVE ~~XXXXXXXXXX~~ FATE

1 Page 20, lines 9 - 10:

2 Delete "[EXCEPT AS PROVIDED BY AS 38.05.177(a)(2)(C),]"

3 Insert "except as provided by AS 38.05.180(ff)(4) [AS 38.05.177(a)(2)(C)],"

4

5 Page 20, line 23:

6 Delete "A [NOTWITHSTANDING AS 38.05.177, A]"

7 Insert "Notwithstanding AS 38.05.180(ff) [AS 38.05.177], a"

8

9 Page 40, line 11, following "property":

10 Insert ";

11 (4) the provisions of this subsection do not apply to authorize a lease
12 for the recovery of nonconventional gas on land that is held under a coal lease entered
13 into under AS 38.05.150 unless the lessee under this subsection is also the lessee
14 under AS 38.05.150 of that land"

4/27/04
AMENDMENT

2 failed

OFFERED IN THE HOUSE
FINANCE COMMITTEE
TO: CSHB 531(RES), Draft Version "V"

BY REPRESENTATIVE CROFT 4-4

1 Page 39, Line 31-Page 40, Line 11;

2 Delete all material and insert:

3 "(3) for a nonconventional gas lease, rights under the reservation as set out
4 in AS 38.05.125 may not be exercised under the lease unless

5 (A) the owner and the state and its lessees, successors, or
6 assigns reach a prior written agreement under which the state and its
7 lessees, successors, or assigns may enter upon the land in the exercise of
8 the reserved right; only one written agreement authorizing entry onto the
9 land may be required under this subparagraph to authorize activity by the
10 state and its lessees, successors, or assigns, or by their agents, attorneys,
11 and servants as allowed under this subsection; an agreement entered into
12 under this subparagraph is

13 (i) for the duration of the period of production or recovery
14 operations unless the parties agree to a different duration; and

15 (ii) a covenant running with the land;

16 (B) the director, after notice and an opportunity to be heard,
17 determines that, to exercise rights under the reservation and the lease, the
18 lessee has no other reasonable means of entry than access and entry upon
19 the land of the owner; the lessee has the burden of demonstrating
20 compliance with this subparagraph; and

21 (C) the state, its lessees, successors, or assigns make provisions to
22 pay the owner of the land full payment for all damages sustained by the
23 owner by reason of entering upon the land for the purpose of exercising
24 rights under the lease, by posting a surety bond determined by the owner
25 and by the state, its lessees, successors, or assigns to be sufficient as to
26 form, amount and security to secure to the owner payment for all damages,
27 subject to the following:

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(i) if a provision of this subparagraph conflicts with a requirement of AS 38.05.130, the provision of this subparagraph prevails; and

(ii) in addition to the coverage for actual damages required by AS 38.05.130 or this subparagraph, as appropriate, the parties shall make provision for payment of reasonable compensation to the owner for any loss by the owner of the owner's use and enjoyment of the property."

4/27/04

Adopted

AMENDMENT

3 n/obj

OFFERED IN THE HOUSE

TO: CSIB 531 (RES)

- 1 Page 40, line 2:
- 2 Delete "(A)"
- 3
- 4 Page 40, line 8:
- 5 Delete "subparagraph; and"
- 6 Insert "paragraph."
- 7
- 8 Page 40, lines 9 - 11:
- 9 Delete all material.

4/27/04

AMENDMENT

4

Adopted
no obj

OFFERED IN THE HOUSE
TO: CSHB 531(RES)

1 Page 48, following line 12:

2 Insert a new bill section to read:

3 **** Sec. 60.** The uncodified law of the State of Alaska is amended by adding a new section
4 to read:

5 **CONVERSION OF EXISTING SHALLOW NATURAL GAS LEASE**
6 **APPLICATIONS.** (a) The applicant for a shallow natural gas lease under AS 38.05.177
7 whose application was received by the Department of Natural Resources before the effective
8 date of this section may, not later than August 31, 2004, or 60 days after the effective date of
9 this Act, whichever is later, convert the application to an exploration license and lease
10 application under AS 38.05.131(a), as amended by sec. 14 of this Act. An applicant
11 converting an application under this subsection

12 (1) may apply for as few as 3,000 acres, notwithstanding the minimum
13 limitation of acreage set out in AS 38.05.132(c)(2);

14 (2) shall pay the fee required by AS 38.05.132(c)(6);

15 (3) is subject to a three-year work commitment in lieu of a work commitment
16 of any other duration required by AS 38.05.132 and, notwithstanding AS 38.05.132(c)(3), is
17 under an obligation to perform a specified work commitment of \$1 per acre per year; and

18 (4) may, subject to (b) of this section, convert an exploration license to a lease
19 under AS 38.05.134, as amended by sec. 22 of this Act.

20 (b) The provisions of AS 38.05.035(e) apply to an application made under (a) of this
21 section.

22 (c) For an application made under (a) of this section, the director of the division of
23 lands shall remit to the applicant the application fee paid by the applicant under

- 1 AS 38.05.177(b)(2)."
- 2
- 3 Renumber the following bill section accordingly.

THE
FOLLOWING
DOCUMENT(S)
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Alaska Oil and Gas Association



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Judith Brady, Executive Director

April 22, 2004

Via Facsimile: (907)465-3793

The Honorable Bill Williams
Alaska State House of Representatives
State Capitol, Room 515
Juneau, AK 99801-1182

AOGA Concerns on Shallow Gas Legislation
(CSHB 531 and CSHB 395)

Dear Representative Williams:

The Alaska Oil & Gas Association (AOGA) shares your interest in Alaska's shallow gas leasing/coalbed methane program and your concern for its future. We have been following the proposed legislation pertaining to the shallow gas program and the public meetings undertaken by the Department of Natural Resources (DNR). We note that the Department has just released the public draft review of the Coalbed Methane Development Standards.

AOGA supports repealing the present, separate shallow gas leasing/coalbed methane program and incorporating it into Alaska's competitive oil and gas system with its required Best Interest Finding as proposed in CSHB 531. Simply stated, we believe many of the issues raised in this proposed legislation could, and should, be addressed by a Best Interest Finding. AOGA also recommends that CSHB 531 and CSHB 395 be revised to incorporate the same surface protection rights, including payment of damages and bonding requirements for nonconventional gas and coalbed methane, as the state demands for its conventional oil and gas leasing program. Alaska's current bonding requirements are based on legal precedent, are legally defensible, protect the state's dominant subsurface interest in the oil and gas that belongs to all Alaskans while assuring the surface owner of the right to negotiate a fair agreement for surface damages, should there be any. Finally, we have made recommendations on other provisions of CSHB 531 and CSHB 395.

AOGA is a private, nonprofit trade association whose 19 member companies represent the majority of oil and gas operations in the state. Our interest, as an association, is the same as the State of Alaska's: oil and gas leasing programs that have clear standards that are legally defensible and environmentally and technically sound, and that respect the rights of the public, the lessees and individual property owners.

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We appreciate the willingness of policy makers to understand the complex legal and political challenges inherent in Alaska's "split estate" heritage. While Alaska's ownership of the subsurface mineral estate on state-selected oil and gas lands is the basis for the state's wealth and its Permanent Fund, this same ownership sometimes causes concerns with private surface owners and managers. Both CSHB 531 and CSHB 395 address unconventional gas leasing in those instances where the state owns the subsurface and a private individual owns the surface.

The historical record of split estate transactions, both in other states and in Alaska, shows that most transactions between companies and individual landowners involve mutual respect, accommodation and agreement. For those transactions for which no agreement can be reached, there is a history of court decisions, including those in Alaska, which lay the foundation for resolving any such disputes today.

In 1996 the shallow gas leasing/coalbed methane program was viewed as a positive opportunity for the people of the state. In a bi-partisan vote the Legislature established the shallow gas leasing program with a vote of 57 yeas and 3 nays. Governor Knowles signed it into law.

The support for the program was based on its potential to bring new sources of clean, efficient energy to the state as well as providing jobs and taxes for local economies, and that in light of the tightening gas market in the Cook Inlet area, this new source could provide much needed gas reserves. It was believed the state had regulations in place to assure it could be done in an environmentally safe manner while protecting the rights of surface owners.

AOGA believes that shallow gas leasing and coalbed methane development is still a positive opportunity. The state does have regulations in place to assure environmentally safe development of coalbed methane and the state has the legal means of protecting both the surface and subsurface owners.

However, it has become clear that there is a lack of understanding of Alaska's split estate heritage as well as a variety of homeowner concerns that must be addressed if the future of the program is to be assured.

Most, if not all, of the present concerns being expressed by homeowners would have been aired, discussed and addressed had the program included a Best Interest Finding in the beginning.

AOGA agrees with concerned legislators and the administration that it will be in the best interest of all parties for the state to have the same leasing, public notice requirements, environmental protections, Best Interest Finding requirements, and bonding and surface use protections for nonconventional gas as it does for conventional oil and gas.

Alaska's conventional oil and gas leasing program is comprehensive, timely and legally defensible. It meets the public criteria for fair notice, local involvement, environmental protection, bonding and damage requirements. A Best Interest Finding:

- provides extensive public notice;
- provides for public hearings;

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- provides written responses to all concerns raised;
- provides the opportunity for experts from all agencies, the Departments of Environmental Conservation, Fish & Game and Natural Resources, as well as local governments, private organizations and individuals to provide input;
- provides a method for responding to special circumstances with special mitigation measures; and
- provides a legally defensible, comprehensive finding on which all parties can rely.

Recommendations for CSHB 531

1. AOGA supports repealing the present, separate shallow gas leasing/coalbed methane program and incorporating it into Alaska's competitive oil and gas system with its required Best Interest Finding as proposed in CSHB 531.

We believe that such an action will restore the faith of the public in these programs.

2. We support that provision of CSHB 531 that clearly identifies the role of the Alaska Oil & Gas Conservation Commission (AOGCC) in protecting water rights for nonconventional gas. (AS 31.05.030(j)).

This is the same role the Commission plays in conventional oil and gas leasing and therefore meets our recommendation that nonconventional oil and gas must be subject to the same environmental criteria as conventional oil and gas.

3. AOGA recommends that CSHB 531 be revised to incorporate the same surface protection rights, including payment of damages and bonding requirements for nonconventional gas and coalbed methane, as the state demands for its conventional oil and gas leasing program.

Alaska has strict surface damage requirements to protect the rights of surface owners.

Since Statehood there have been many cases of split estate negotiations in the Matanuska and the Kenai Boroughs. Only two cases have gone to DNR for resolution.

A straightforward approach would be to include a provision making it clear that existing state law governing damages and bonds also applies to gas only leases. Recommended language for CSHB 531(RES), Version V, is suggested below, along with language that clarifies the process. This language replaces the language included in Section 41, AS 38.05.180(ff)(3)(A) and (B):

(3) the provisions of AS 38.05.130 apply to gas only leases and shall be implemented as follows:

(A) **Damages and posting of bond.** A developer may not exercise a right of entry until the developer makes provision to pay the surface owner full payment for all damages sustained by the surface owner by reason of entering upon the land. If the surface owner, for any cause, refuses or

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neglects to settle the damages, the developer may enter upon the land after posting a surety bond determined by the Department of Natural Resources using a procedure similar to the procedure used to administer AS 38 05.130, including notice and an opportunity to be heard. The bond must be sufficient as to form, amount, and security to secure the surface owner payment for damages. The surface owner may institute legal proceedings in a court where the land is located as may be necessary to determine the damages that the surface owner may suffer.

(B) Before the amount of the surety bond to be posted is determined by the director, the director, after notice and an opportunity to be heard, shall review the lessee's proposed Plan of Operations to determine if use of the surface is reasonably necessary to remove the minerals.

(C) If the lessee holds a statewide bond, the amount determined by the director may be imposed against such bond and no separate additional bond will be required.

4. AOGA is strongly advising that there be no added requirement, special to shallow gas leasing or coalbed methane, concerning bonding/damages. Both CSHB 531 and CSHB 395 propose that, if the land owner and the lessee do not come to an agreement on use of the land, the director, in determining the amount of surety bond, shall make a finding that the lessee "has no other reasonable means of entry than access and entry on the land of the owner". Further, that in addition to the coverage of actual damages a surface owner be paid "reasonable compensation ... for any loss by the owner of the owner's use and enjoyment of the property." (Proposed language in CSHB 531 AS 38.05.180 (f)(3); CSHB 395 AS 38.05.177(k)(3)).

As to the requirement that there be a finding that the lessee has no other reasonable means of entry, the legislature's attorney, Jack Chenoweth, pointed out his concern in a March 30 memo that, insofar as the new bonding provisions in CSHB 531 and CSHB 395 limit access to the subsurface estate, they would therefore "call into question compliance with the statutory reservation" of the state's subsurface reservation of mineral rights.

The new bonding and damages proposals in CSHB 531 and in CSHB 395 raise serious legal and practical issues for all of Alaska's oil and gas leasing programs by making the dominant mineral estate into the subservient estate. Case law on surface estate is very clear that the mineral estate is the dominant estate, carrying with it the right to make such use of the surface as is reasonably necessary to remove the minerals.

Alaska's current bonding requirements are based on legal precedent, are legally defensible, protect the state's dominant subsurface interest in the oil and gas that belongs to all Alaskans while assuring the surface owner of the right to negotiate a fair agreement for surface damages, should there be any.

Alaska is not unique in having different owners of the surface and subsurface or mineral estate. Alaska is unique in that the state's mineral estate was deemed so important to the state's future that the Alaska Statehood Act imposed restrictions on the state's ability to alienate its mineral estate.

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Under 6(i) of the Statehood Act, the state must reserve to itself the mineral rights of all lands granted to it and must continue to do so even when the state sells, grants, deeds or patents these lands to third parties. If the state does not do so, the state lands "shall be forfeited to the United States...".

This restriction has implications for what rights the state can and cannot grant to surface owners when the state owns the subsurface. Quite simply, the state cannot transfer to a private surface owner a right that is inherent in the mineral state.

The combination of long-standing legal precedent in the resolutions of rights between surface and subsurface owners along with the restrictions in 6(i) of the Statehood Act means that care must be taken in responding to the challenge of protecting rights.

With the changes proposed above, nonconventional gas (shallow gas and coalbed methane) would be subject to the same process, notice, environmental and surface protection requirements as the conventional oil and gas leasing program in Alaska.

Recommendations on CSHB 395

1. AOGA supports the direction to the AOGCC on the protection of water in the proposed amendment of AS 31.05.030(j). AOGCC's role should be the same for conventional and unconventional oil and gas leasing.
2. We question the purpose and workability of the proposed AOGCC public forum process for shallow gas proposed in the section on AS 31.05.098. If the shallow gas program is incorporated into a Best Interest Finding, which we believe is the most comprehensive answer to concerns being expressed, this section will not be necessary.

If, this section is retained in lieu of a Best Interest Finding, the following should be considered:

- Tighten up the language to reflect that only matters within AOGCC's jurisdiction will be addressed in the hearings. (See especially lines 28-30 on page 3.)
 - Determine who can complain and in what time period. As written, anyone, anywhere, at any time can file a complaint and expect a public process 60 days later. Due process to the lessee is lost.
 - This section also seems to be making the AOGCC the gatekeeper for all complaints to the Department of Environmental Conservation, the Department of Public Safety, the Department of Natural Resources. Is the intent to add a new layer of hearings on these departments based on complaints?
3. It is noted that in the proposed amendment for private, non-state lands, the state's "damages and posting of bond" is almost identical to that provided for conventional oil and gas leasing (Chapter 90 Mineral Interests; Sec. 34.90.020) and yet for nonconventional leasing, additional requirements are proposed. (AS 38.05.177 (k)(3). (See also Section 12.)

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The first issue is whether the legislature wants to impose those requirements on private lands.


The second issue has to do with imposing additional bonding and damage requirements for nonconventional leases. We have expressed our concern with this approach in our comments on CSHB 531 (See comments 3 and 4.) AOGA believes that conventional and nonconventional oil and gas leasing programs should be bound by the same historic case law pertaining to damages and surface use. We believe these laws provide the protection that Alaskans expect. We recommend that the same language we've proposed in Section 41 of HB 531 be substituted in this legislation for the same reasons.

We emphasize that the proposed additional requirements for damages have serious implications both for the legal precedents that have governed split estate matters for years and for the implications to Alaska's conventional oil and gas leasing program. They are the single largest impediment in both CSHB 395 and CSHB 531.

4. Additional water testing, this time a requirement that each private water well within a quarter mile circle be tested by the lessee, is included in a new subsection, AS 38.05.177(f). It may be desirable to baseline test, but the size of area required to be tested is going to present some problems, aside from the obvious cost. It is our understanding that many Alaskans do not register their wells nor are all wells that are not registered logged. Further, some owners may not want them tested. There should be consideration given as to how a lessee could comply with this requirement.
5. The sections pertaining to appropriate setbacks and reasonable and appropriate noise mitigation would be more appropriately addressed in a Best Interest Finding, as would the lease abandonment requirement. All of these issues are commonly addressed in Best Interest Findings.

This concludes AOGA's comments. We hope they are helpful. We would be glad to work with you to ensure that the unconventional gas leasing program offers the same level of protection and assurance to the lessees, the public and the State as does Alaska's conventional oil and gas program.

Sincerely,


JUDITH BRADY
Executive Director

FISCAL NOTE

STATE OF ALASKA
2004 LEGISLATIVE SESSION

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(H) Publish Date: 4/5/04

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Prepared by: Mark D Myers Phone: 269-8800
Division: Oil and Gas Date/Time: 3/11/04
Approved by: Thomas Irwin, Commissioner Date: 3/12/04
Agency: Natural Resources