STATE OF ALASKA

SEAN PARNELL, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

P.O. BOX 111000
JUNEAU, ALASKA 99811-1000
PHONE: (907) 465-2400
FAX: (907) 465-3886

550 WEST 7TH AVENUE, SUITE 1400
ANCHORAGE, ALASKA 99501-3650
PHONE: (907) 269-8431
FAX: (907) 269-8918

February 22, 2011

Senator Thomas H. Wagoner
Senate District Q
Co-Chair: Senate Resources Committee
Alaska State Legislature
State Capitol, #427
Juneau, AK 99801

Dear Senator Wagoner:

Thank you for your letter of February 4, 2011. I appreciate your interest in leasing practices designed to incentivize meaningful exploration and development of state lands and resources.

The Division of Oil and Gas is currently exploring several potential methods for creating just such incentives. Potential changes to our leasing structure must be carefully evaluated for the proper balance of "carrots" and "sticks" to ensure that, while we eliminate non-productive lessees to the greatest degree possible, we do not inadvertently discourage good operators who simply require time to acquire additional resources or information to make exploration and production activities economic.

Options currently available to us under our leasing statute and regulations include the following:

- Various combinations of cash bonus bid, royalty share and net profit share as the bid variables;
- Imposition of a minimum work commitment, made public before the lease sale and which may include penalty provisions if not fulfilled;
- Exploration incentive credits for exploratory wells;
- Exploration incentive credits for geophysical work performed within two years of a lease sale which may be assigned against royalty, rentals or taxes during a limited time period;
- Royalty modification upon application and a definitive finding;
- Lease terms of five to ten years in length;
- Producing leases excepted from statewide acreage limitations;
- Offering tracts in excess of 5,760 acres;
- Immediate, competitive offering of lands returned to the state;
- Rental reductions on returned lands to encourage re-leasing.

Several of these options have been exercised in the past, with varying but less than optimal results. For example, in 1980 the State issued 10-year leases with a work commitment requirement to begin drilling by the end of year five. The leases were terminated, and the State found itself in litigation over requests for extension of the leases. In a current example, 5-year leases were issued, resulting in a premature application for unitization to avoid relinquishment of the leases, on which production may be possible but has not been proven.

Nevertheless, the Division of Oil and Gas is evaluating all available options, as well as possible solutions for which we do not currently have adequate authority, such as changes to our lease qualification requirements. It is our goal to implement the changes we feel will be most effective overall at the earliest opportunity.

The next oil and gas lease sale, on May 24th, will offer the Cook Inlet and Alaska Peninsula lands. While the available timeframe will not allow for radical changes to our leasing structure at this sale, know that all leases that have been relinquished or otherwise returned to the State, including the recently relinquished Cosmopolitan Unit leases, will be offered.

The North Slope, North Slope Foothills and Beaufort Sea lands will be offered in late October, 2011. We believe that the changing industry view of this acreage provides a great opportunity for implementation of changes in our leasing approach based on existing authorities.

I'm happy to discuss this further with you, as is Kevin Banks, Director of the Division of Oil and Gas.

Sincerely,

Daniel S. Sullivan
Commissioner