

Royalty Modification



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Director

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Royalty Modification

AS 38.05.180(j)

- Allows commissioner to modify royalty to allow for production from a field or pool that is:
 - Not yet in production
 - Field or pool must be sufficiently delineated to the satisfaction of the commissioner to conduct the analysis
 - Field that would not otherwise be economically feasible
 - Royalty shall never be lower than 5%
 - Producing (to prolong the economic life)
 - Royalty shall never be lower than 3%
 - Shut-in (to re-establish production)
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- Commissioner may not approve unless he determines that lessee makes a clear and convincing showing that relief is in the best interest of the state
 - But for royalty modification, development would not proceed
 - Royalty modification is applied only to the point where investor is inclined to develop, nothing more
- DNR may hire an independent contractor at the applicants expense, for up to \$150,000 per application
 - Selected by lessee from contractor list provided by DNR
- Relief mechanism must adjust percentage based on price and may also adjust based on production rate, ultimate recovery, CapEx, OpEx.
- Between issuing the preliminary and the final findings, DNR must offer to appear before LB&A to explain the preliminary finding.

Royalty Modification Applications

- February 1995 BP application for Milne Point
 - Application explicitly made only to comply with BP's contract with OXY
 - BP called the application “a formality, we do not intend to push it, nor should you take this seriously”
- 1997 Unocal application for 10 platforms in Cook Inlet
 - Unocal did not continue to pursue application
- 1999 Phillips application for Tyonek Deep in Cook Inlet
 - Phillips withdrew the application

Royalty Modification Applications

- 2005 Pioneer Natural Resources application for leases in and near the Ooguruk Unit
 - Approval effective February 2, 2006, with conditions
- 2006 Kerr-McGee application for leases in the Nikaitchuq and Tuvaaq units
 - Denied October 31, 2006
- 2007 ENI application for leases in the Nikaitchuq Unit
 - Approval effective January 30, 2008, with conditions
- 2007 Chevron application for leases in the Ivan River and Stump Lake units
 - Chevron withdrew the application

Appendix

Oooguruk Unit

- Pioneer Natural Resources application for the existing Oooguruk Unit and adjacent leases, on behalf of itself and Eni (70/30% WIOs)
- Applied May 20, 2005, amended application filed November 1, 2005
- Approval effective February 2, 2006
 - Royalty modification mechanism is based on payout on one net profit share lease centrally located over two reservoirs delineated in the application
 - Additional terms also apply

Nikaitchuq (Kerr-McGee)

- Kerr-McGee applied for RM at Nikaitchuq and Tuvaq Units and adjacent leases, on behalf of itself and Eni (70%/30% WIOs)
- Applied January 11, 2006
- Anadarko acquires Kerr-McGee
- Economic analysis of Kerr-McGee
 - New tax regime materially improved economics for Applicant
 - Relief not needed
- Denied effective October 31, 2006

Nikaitchuq (Eni)

- Eni (now 100% owner) application for several Nikaitchuq Unit leases
- Applied October 16, 2007
- Approved effective January 30, 2008
 - New cost projections changed economics of the project
 - Low price trigger: for 25 years after first commercial production, if ANS WC inflation adjusted price falls below \$42.64, royalty is modified to 5% on production from all subject leases from the reservoirs delineated in the application
 - Low production trigger: between 18 months and 120 months after first commercial production, if production from all subject leases averages below 4,000 BOPD, royalty is modified to 5% no matter what oil prices are
 - Additional terms also apply

Ivan River/Stump Lake

- Union Oil Company of California applied for royalty modification on three leases at Ivan River and Stump Lake units (not all leases in these units)
- Applied on September 14, 2007
- The three leases were held by units
- The three leases had high royalty rates, 62% - 64%
- Application made no attempt at reservoir delineation
- Unocal withdrew their application on February 18, 2008, after conversations with DNR