

SB

209

<TARGET><BILL>SB 209</BILL><SUBJECT>SB
209</SUBJECT><COMM>SRES27</COMM></TARGET>

ALASKA STATE LEGISLATURE

Session

State Capitol, Rm. 101
Juneau, AK 99801
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Interim

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Chair

State Affairs Committee

Co-chair

Joint Armed Services Committee

Vice Chair

Resources Committee
Judiciary Committee

Member

Administrative Regulation Review

SENATOR BILL WIELECHOWSKI

To: Senators Tom Wagoner and Joe Paskvan
Co-Chairs, Senate Resources Committee

From: Senator Bill Wielechowski

Date: March 6, 2011

Subject: Hearing request for SB 209

I am writing to request a hearing on SB 209, which would encourage greater and timelier development of the state's oil and gas resources, consistent with Alaska's constitutional mandate to develop the state's natural resources for the maximum benefits of its people.

This bill was developed in response to concerns that some oil companies are winning exclusive leases of state lands with high oil and gas potential, then delaying development of those leases, effectively warehousing Alaska's resources.

To address this concern, SB 209 requires:

- 1) companies interested in acquiring an exclusive lease of state petroleum lands to submit a plan of exploration or development for those lands;
- 2) the Department of Natural Resources (DNR) to review each plan and determine if it will develop the state's resources in the best interest of the state before "qualifying" the company to bid on a lease;
- 3) DNR to include work plans submitted by winning bidders within the terms of their leases; and
- 4) DNR to annually review leases to ensure that lease holders are developing state lands consistent with their plans of exploration or development.

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SENATOR BILL WIELECHOWSKI

Sponsor Statement

SB 209: Spurring Greater Oil and Gas Production Through Improved Leasing Procedures

The purpose of SB 209 is to encourage greater and timelier development of the state's oil and gas resources, consistent with our constitutional mandate to develop the state's natural resources for the maximum benefits of Alaskans.

It was developed in response to concerns that some oil companies are winning exclusive leases of oil-rich state lands, then sitting on those leases and warehousing Alaska's resources, while investing elsewhere. For example, some state lands with vast quantities of oil and gas were leased more than three decades ago and have yet to be developed.

To address this concern, SB 209 requires:

- 1) companies interested in acquiring an exclusive lease of state petroleum lands to submit a plan of exploration or development for those lands;
- 2) the Department of Natural Resources (DNR) to review each plan and determine if it will develop the state's resources in the best interest of the state before "qualifying" the company to bid on a lease;
- 3) DNR to include work plans submitted by winning bidders within the terms of their leases; and
- 4) DNR to annually review leases to ensure that lease holders are developing state lands consistent with their plans of exploration or development.

SB 209 also provides a process for the Commissioner of DNR to waive a work commitment if conditions outside the lessee's control prevent the work from being carried out.

Please join me in supporting SB 209.

SB 209: Oil and Gas Leasing

Fact Sheet

- One way to address declining oil production is to ensure that oil and gas leases go to companies that will develop leases expeditiously and efficiently.
- Last year the Department of Natural Resources reported that of 1,320 leases, 578 were part of production units or were producing oil or gas, 404 had been sold in the preceding three years (so might still be in the planning stages), and 338 could be “idle,” as lessees had not applied for any permits to explore or develop them.
- This means more than 25% of existing leases could be sitting idle, effectively warehousing Alaska’s resources.
- Under existing statutes, the DNR commissioner has the option of including a minimum work commitment in a lease, along with a penalty provision in the event the lessee does not fulfill the work commitment.
- This bill requires that work commitments be part of a lease, consistent with the Alaska Constitution’s mandate to develop our natural resources for the maximum benefit of the people.
- The bill has the following provisions:
 - requires bidders for an oil and gas lease to submit a plan of development for exploring, developing, and/or producing from the lease;
 - requires the commissioner to review each bidder’s plan of development and determine if the plan is “reasonably expected to develop the lease in the best interest of the state”;
 - a bidder may not be a “qualified bidder” if the commissioner finds the bidder has not submitted a plan that is in the state’s best interest or the bidder is not “reasonably capable” of implementing the plan;
 - requires that these plans be included in leases and that DNR review leases annually to ensure that plans are being implemented;
 - allows the commissioner to waive a work commitment if conditions preventing drilling or exploration were beyond the lessee’s reasonable ability to foresee or control or the lessee demonstrates through good faith efforts an intent to drill or develop the lease in the following two years;

- requires DNR to analyze the economics of each Participating Area (a unitized reservoir where sustained production is occurring) every five years to determine whether the Area is capable of increased production; and
- requires DNR to annually submit a report to the legislature that lists each lease found to be out of compliance and the action taken by the commissioner to bring the lessee back into compliance.

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES

Division of Lands

LEASE NO. ADL -63059

Competitive Oil and Gas Lease

THIS LEASE is made by and between the State of Alaska, acting by and through the Director of the Division of Lands, Department of Natural Resources or his authorized agent, hereinafter called 'Lessor', and

Union Oil Company of California

909 W. 9th Avenue, Anchorage, Alaska 99501

hereinafter called 'Lessee', whether one or more.

1. GRANT. For and in consideration of a cash bonus and the first year's rental, the receipt of which is hereby acknowledged, and of the rentals, royalties, covenants, and conditions herein contained on the part of the Lessee to be paid, kept and performed, and subject to the conditions and reservations herein contained, Lessor does hereby grant and lease unto Lessee, exclusively, without warranty, for the sole and only purposes of exploration, development, production, processing and marketing of oil, gas, and associated substances produced therewith, and of installing pipe lines and structures thereon to find, produce, save, store, treat, process, transport, take care of and market all such substances, and for housing and boarding employees in its operation thereon, the following described tract of land in Alaska:

T2N, R12W, S.M.

Section 4: Protracted remainder only

Section 5: All

containing 756.38 acres, more or less, hereinafter called 'said land'.

For the purposes of this lease, said land contains the legal subdivisions, as shown on the plat of said land attached hereto, marked Exhibit A and by this reference made a part of this lease.

If said land is described above by protracted legal subdivision and Lessor hereafter causes said land to be surveyed under the public land rectangular system, the boundaries of said land shall be those established by such survey, when approved, subject, however, to the provisions of the regulations relating to such surveys.

2. 'OIL AND GAS'. 'Oil' means crude petroleum oil and other hydrocarbons regardless of gravity which are produced and saved in liquid form at the well by ordinary production methods. 'Gas' means all natural gas and all hydrocarbons produced at the well not defined herein as oil. 'Associated substances' mean all substances produced in association with oil or gas and not defined herein as oil or gas.

3. TERM. This lease is issued for an initial primary term of 10 years from date hereof, subject to extension as provided in Paragraph 4 hereof, and shall continue so long thereafter as oil and gas or either or any of them are produced in paying quantities from said land; provided, that this lease may be extended beyond its primary term as provided in Paragraph 5 hereof and shall not expire under the conditions set forth in Paragraphs 6, 7, and 8 hereof.

4. EXTENSION BY SUSPENSION OF OPERATIONS. If, prior to the expiration of the primary term, Lessor, in the interest of conservation, directs or assents to the suspension of all operations and production, if any, hereunder, the primary term will be extended by adding the period of suspension thereto.

5. EXTENSION BY UNIT PRODUCTION. (a) This lease shall without application be extended beyond its primary term if upon or prior to the expiration date of such term the lease is committed to a unit agreement approved or prescribed by Lessor as provided in the regulations, production of oil or gas is had in paying quantities under the agreement, and a portion of such production is allocated to said land under the agreement. In such event this lease shall continue in effect so long as it remains subject to such agreement and actual production under said agreement is allocated to said land; (b) The commissioner may, in his discretion provide for the extension of the term of this lease, if such lease is on the expiration date thereof included in an approved unit plan or if it is included in a program of secondary recovery operation designed to bring about or restore production, provided, however, that if any lease or portion thereof is eliminated from such unit plan or recovery program, or if such unit plan or recovery program is terminated, then any such lease or portion thereof shall continue in full force and effect for ninety (90) days from the date of such elimination or termination and so long thereafter as drilling or re-drilling operations are being conducted thereon and so long thereafter as oil or gas is produced in paying quantities.

6. EXTENSION BY DRILLING. (a) If production shall have been obtained in paying quantities during the primary term, and if, at the end of the primary term, or at any time prior to the expiration of the primary term, such production shall have ceased from any cause, or in the event production shall at any time or times after the expiration of the primary term cease from any cause, then this lease shall not terminate if the Lessee commences drilling or reworking operations (either in a well from which such production has ceased or in a new well) within sixty days after the cessation of production, and the lease shall remain in full force and effect so long as such operations are prosecuted with reasonable diligence or are suspended under Paragraph 25 hereof; and, if such drilling or reworking operations result in the production of oil or gas, the lease shall remain in full force and effect so long as oil or gas is produced therefrom in paying quantities; (b) if actual drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, such operations to include re-drilling, sidetracking or other means necessary to reach the originally proposed bottom hole location, the lease shall continue in full force and effect until ninety (90) days after such drilling had ceased and for so long thereafter as oil or gas is produced in paying quantities.

7. EXTENSION BY SHUT-IN PRODUCTION. If, upon the expiration of the primary term or at any time or times thereafter, there is on said land a well capable of producing oil or gas in paying quantities, this lease shall not expire because Lessee fails to produce the same unless Lessor gives notice to Lessee allowing a reasonable time, which shall not be less than sixty days, after such notice to place the well on a producing status, and Lessee fails to do so; provided, that after such status is established such production shall continue on the said land unless and until suspension of production is allowed by Lessor.

8. EXTENSION BY SUSPENSION OF PRODUCTION. This lease shall not expire because of any suspension of operations in or upon or production from said land if such suspension is made under any order or with the consent of Lessor.

9. RENTAL. This lease shall terminate on any anniversary date hereof prior to the completion on said land of a well capable of producing oil or gas in paying quantities, unless on or before said anniversary date Lessee shall pay or tender to Lessor as annual rental a sum equal to \$1.00 per acre, or fraction thereof, then included in this lease, or unless such annual rental has been waived or suspended as provided in Paragraph 12 of this lease. If Lessor's office is not open for business on the anniversary date, the time for payment is extended to include the next day on which said office is open for business.

10. MINIMUM ROYALTY. Commencing with the lease year beginning on or after completion on said land of a well capable of producing oil or gas in paying quantities, Lessee shall pay Lessor, at the expiration of each lease year, in lieu of rental a minimum royalty equal to \$1.00 per acre, or fraction hereof, then included in this lease, or the difference between the actual royalty paid on production during the year if less than \$1.00 per acre and the rescribed minimum royalty.

11. ROYALTY ON PRODUCTION. Except for oil and gas used on said land for development and production or unavoidably lost, Lessee shall pay Lessor as royalty the following:

- (a) On oil 10-2/3 per cent in amount or value of the oil produced and saved and removed or sold from said land.
- (b) On gas 10-2/3 per cent in amount or value of the gas produced and saved and sold or used off said land or used for the extraction of natural gasoline or other products therefrom.
- (c) On associated substances 10-2/3 per cent in amount or value of such substances produced and saved and removed or sold from said lands.

12. REDUCTION OF RENTAL AND ROYALTY. Rental or minimum royalty may be waived, suspended, or reduced, or royalty may be reduced on all of said land or any tract or portion thereof segregated for royalty purposes if Lessor finds that such relief is necessary for the purpose of encouraging the greatest ultimate recovery of oil or gas and is in the interest of conservation of natural resources and either that such relief is necessary in order to promote

13. **ROYALTY IN KIND.** Whenever, at the option of Lessor, which may be exercised from time to time upon not less than six months notice to Lessee, Lessor elects to take its royalty in kind, Lessee shall deliver free of charge (on said land or at such place as Lessor and Lessee mutually agree upon) to Lessor or to such individual, firm, or corporation as Lessor may designate all royalty oil and/or gas produced and saved from said land. Such oil and/or gas shall be in good and merchantable condition. Lessee shall, if necessary, furnish storage for royalty oil free of charge for thirty days after the end of the calendar month in which the oil is produced from said land; provided, that Lessee shall not be held liable for loss or destruction of royalty oil and/or gas from causes beyond Lessee's reasonable control. Should Lessee dehydrate or clean the oil or gas produced from said land, Lessee shall be entitled to an allowance of the actual cost of dehydrating or cleaning said royalty oil or gas.

14. **ROYALTY IN VALUE.** At the option of Lessor, which may be exercised from time to time upon not less than six months notice to Lessee, and in lieu of royalty in kind, Lessee shall pay to Lessor the field market price or value at the well of all royalty oil and/or gas. All royalty that may become payable in money to Lessor shall be paid on or before the last day of the calendar month following the month in which the oil or gas is produced. The payments shall be accompanied by copies of run tickets or other satisfactory evidence of sales, shipments, and amounts of gross production.

15. **PRICE.** The field market price or value of royalty oil or gas shall not be less than the highest of: (1) The price actually paid or agreed to be paid to Lessee at the well by the purchaser thereof, if any; or (2) The posted price of Lessee in the field for such oil or gas at the well, if any, or, (3) The prevailing price received by other producers in the field at the well for oil of like grade and gravity or gas of like kind and quality at the time such oil or gas is removed from said land or run into storage, or such gas is delivered to an extraction plant.

16. **PAYMENTS.** All payments to Lessor under this lease shall be made payable to the Department of Revenue of the State of Alaska and shall be tendered to Lessor at the place designated under Paragraph 44 for giving notices to Lessor.

17. **OFFSET WELLS.** Lessee shall drill such wells as a reasonably prudent operator would drill to protect Lessor adequately from loss by reason of drainage resulting from production on other land. Without limiting the generality of the foregoing sentence, if oil or gas should be produced in a well on other land not owned by Lessor or on which Lessor receives a lower rate of royalty than the royalty under this lease, which well is within 500 feet in the case of an oil well or 1,500 feet in the case of a gas well of lands then subject to this lease, and such well shall produce oil or gas in paying quantities for a period of thirty consecutive days, and if, after notice to Lessee and an opportunity to be heard, Lessor finds that production from such well is draining lands then subject to this lease, Lessee shall within 120 days after written demand by Lessor begin in good faith and prosecute diligently drilling operations for an offset well on said land in lieu of drilling any well required by this paragraph, Lessee may with Lessor's consent compensate Lessor in full each month for the estimated loss of royalty through drainage in the amount determined by Lessor.

18. **OTHER WELLS.** This lease contemplates the reasonable development of said land for oil and gas as the facts may justify. Upon discovery of oil or gas in paying quantities on said land, Lessee shall drill such wells as a reasonably prudent operator would drill having due regard for the interests of Lessor as well as the interests of Lessee.

19. **DILIGENCE; PREVENTION OF WASTE.** Lessee shall exercise reasonable diligence in drilling, producing, and operating wells on said land unless consent to suspend operations temporarily is granted by Lessor; shall carry on all operations hereunder in a good and workmanlike manner in accordance with approved methods and practices, having due regard for the prevention of waste of oil and gas and the entrance of water to the oil and gas bearing sands or strata to the destruction or injury of such deposits and the preservation and conservation of the property for the future productive operations; shall use reasonable care and all proper safeguards to prevent the pollution of water; shall plug securely in an approved manner any well before abandoning it; shall allow Lessor to inspect all operations at any time; shall carry out at Lessee's expense all reasonable orders and requirements of Lessor relative to the prevention of waste and the preservation of said land, and on failure of Lessee so to do, Lessor shall have the right together with any other recourse available to it to enter on said land to repair damage or prevent waste at Lessee's expense; and shall, abide by and conform to valid applicable rules and regulations of the Alaska Oil and Gas Conservation Committee and the regulations of Lessor relating to the matters covered by this paragraph in effect on the effective date hereof or hereafter in effect if not inconsistent with any specific provisions of this lease.

20. **APPROVAL OF PLANS.** Lessee shall not place into actual operation any plan or method for the purpose of stimulating or increasing production on said land other than plans and methods in common use without first having obtained the written approval of Lessor.

21. **LOGS AND RECORDS.** An electric log or radioactive log, if taken, and a descriptive geologic sample log, if taken, and a record of all tests run for each well drilled on said land, together with a plat showing the exact location of each such well, shall be filed with Lessor within thirty (30) days after such well has been completed, suspended, or abandoned. Any and all information filed by Lessee with Lessor in connection with this lease shall be available at all times for the confidential use of Lessor for the purpose of enforcing compliance with the terms, covenants, and conditions of this lease and the regulations of the Lessor but shall not be open for inspection by any person other than officers, or employees of Lessor and persons performing any function or work assigned to them by Lessor for a period of twenty-four (24) months after the thirty (30) day filing period, except upon written consent of Lessee. Notwithstanding any other provision hereof, said information may be disclosed to any person where such disclosure is reasonably necessary for the administration of the functions, responsibilities, and duties vested by law in the Commissioner of the Department of Natural Resources or in the Division of Lands or the Director thereof, including but not limited to functions, responsibilities, and duties arising in connection with any litigation or administrative adjudication relating to this lease or to the rights, duties, and obligations arising hereunder.

22. **RECORDS.** Lessee shall keep and have in its possession books and records showing the production and disposition of all oil and gas produced from said land and shall permit Lessor or its agents at all reasonable hours to examine the same. Such records and reports of production shall be based upon such methods and techniques as shall insure the most accurate figures reasonably available without requiring the Lessee to provide separate tankage for each well.

23. **DAMAGES.** AS 38.05.130 provides in part that no rights under reservations contained in certain leases or grants of Alaska land shall be exercised by Lessor or its Lessee until provision has been made to pay the owner of the land upon which the reserved rights are sought to be exercised full payment for all damages sustained by said owner by reason of entering on said land; provided, that if said owner for any cause whatever refuses or neglects to settle said damages, Lessor or its Lessee shall have the right to institute such legal proceeding in a court of competent jurisdiction wherein the land is situated as may be necessary to determine the damage which the owner of such land may suffer. Lessee hereby agrees to pay any damage that may become payable under said statutory provisions and to indemnify Lessor and hold it harmless from and against any claims, demands, liabilities, and expenses arising from or in connection with such damage. The furnishing of a bond in compliance with this Lease will be regarded by Lessor as a sufficient provision for the payment of all damage that may become payable under said statutory provisions.

24. **BONDS.**
(a) If required by Lessor, Lessee shall furnish a bond prior to the issuance of this lease in an amount equal to at least \$2.00 per acre or fraction thereof contained in said land but not less than \$1,000.00 and shall maintain said bond as long as required by Lessor.

(b) Before beginning drilling operations on said land Lessee must have furnished and shall maintain a bond in an amount of at least \$5,000.00.

(c) Lessee may, in lieu of the foregoing, furnish and maintain a statewide bond in the amount of \$100,000.00.

(d) Lessor may, after notice to Lessee and an opportunity to be heard, require a bond in a reasonable amount greater than the amount specified above in this paragraph where such greater amount is justified by the nature of the surface and its uses and improvements in the vicinity of said land and the degree of the risks involved in the types of operations being or to be carried out under this lease. A statewide bond will not satisfy any requirement of a bond imposed under this subparagraph but will be considered by Lessor in determining the need for and the amount of any additional bond under this subparagraph.

(e) If said land is committed in whole or in part to a cooperative or unit agreement approved or prescribed by Lessor pursuant to law and the regulations and a unit bond is furnished in accordance with the regulations, Lessee need not thereafter maintain any bond with respect to the portion of said land so committed to such agreement.

25. **ACTS OF GOD.** Should Lessee be prevented from complying with any expressed or implied covenant of this lease, from conducting drilling operations thereon, or from producing or marketing oil or gas from said land after efforts made in good faith, by reason of war, riots, acts of God, severe weather in the area of said land, acts of governmental authorities, failure or lack of adequate transportation facilities, or any other cause beyond Lessee's reasonable control whether similar to those enumerated or not, then while so prevented and for a reasonable time thereafter within which to resume operations, Lessee's obligation to comply with such covenant shall be suspended and Lessee shall not be liable for damages for failure to comply therewith. If drilling or reworking operations are suspended by virtue of this paragraph and the prosecution of such operations would have had the effect of preventing the expiration or termination of this lease, then this lease shall not terminate during the period which the obligation to perform such operations is suspended under this paragraph; provided, however, that nothing in this paragraph shall be construed to suspend the payment of rentals or of minimum royalties.

26. **SUSPENSION.** Lessor may from time to time direct or assent to the suspension of production or other operations or both under this lease if such action is necessary or justified in the interest of conservation.

27. **RESERVATIONS.** Lessor reserves the right to dispose of the surface of said land to others subject to this lease, and the right to authorize others by grant, lease, or permit subject to this lease and under such conditions as will prevent unnecessary or unreasonable interference with the rights of Lessee and operations under this lease, to enter upon and use said land:

(a) To explore for oil or gas by geological or geophysical means including the drilling of shallow core holes or stratigraphic tests to a depth of not more than 1,000 feet.

(b) To explore for, develop and remove natural resources other than oil, gas, and associated substances on or from said land.

AMENDMENT TO LEASE FORM # 2

(1) REGULATIONS: (a) This lease is subject to all applicable and valid regulations of the Department of Natural Resources in effect on the effective date hereof or hereafter in effect if not inconsistent with any express and specific provision of the lease. (b) The term "regulations" as used herein, unless otherwise specified, means applicable and valid regulations of the Department of Natural Resources, now or hereafter adopted, when not inconsistent with any express and specific provision herein.

(2) LOCAL HIRE UNDER STATE LEASES: Lessee shall comply with all valid and applicable laws and regulations with regard to hire of Alaska residents. Qualified Alaska residents shall be hired as required in AS 38.40; lessee shall not discriminate against Alaska residents, as prohibited by AS 38.40 and other applicable laws and regulations of the State of Alaska.

(c) For nonexclusive easements and rights of way for any lawful purpose including shafts and tunnels necessary or appropriate for the working of said land or other lands for natural resources other than oil, gas or associated substances.

(d) For well sites and well bores of wells drilled from or through said land to explore for or produce oil, gas, and associated substances in and from other lands.

(e) For any other purpose now or hereafter authorized by law and not inconsistent with the rights of Lessee under this lease.

28. UNDERGROUND STORAGE. This lease does not authorize the subsurface storage of oil or gas except as a necessary incident to recycling pressure maintenance, repressuring, or other similar operation designed to increase the ultimate recovery of oil or gas or prevent the waste of oil or gas produced from said land or from any unit area of which the said land is a part. Lessor reserves the right to authorize the subsurface storage of oil or gas in said land by Lessee or by others in order to avoid waste or to promote conservation of natural resources and upon such conditions as will prevent unnecessary or unreasonable interference with the rights and operations of Lessee under this lease, including conditions prohibiting the storage of oil or gas without the consent of Lessee in any reservoir covered by this lease capable of producing oil or gas in paying quantities.

29. ASSIGNMENTS. This lease or any undivided interest herein may with the approval of Lessor be assigned or subleased as to said land or any one or more legal subdivisions included therein, or any separate and distinct zone or geological horizon underlying said land or such one or more legal subdivisions, to any person or persons qualified to hold a lease. No transfer of any interest in this lease including assignments of working or royalty interests and operating agreements and subleases shall be binding upon Lessor unless approved by Lessor. Lessee shall remain liable for all obligations under this lease accruing prior to the approval of such transfer. Approval of transfer of this lease or an interest therein will not be denied except (1) for failure to comply with the regulations, (2) in the discretion of Lessor, where the transfer covers any distinct zone or geological horizon, or (3) where Lessor determines that the best interests of Lessor justify such action. Applications for approval of transfer under this paragraph must comply with the regulations and must be filed within ninety days after the date of final execution of the instrument of transfer. Where a transfer is made of all or a part of Lessee's interest in and to a portion of the acreage in said land the assigned acreage shall, at the option of Lessor, or may upon request of the transferee and with the approval of Lessor be segregated into a separate and distinct lease having the same effective date as this lease.

30. UNITIZATION. Whenever determined and certified by Lessor to be necessary or advisable in the public interest for the purpose of properly conserving the natural resources of any oil or gas pool, field or like area or any part thereof, which includes or underlies said land or any part thereof, Lessee may unite with other Lessees of Lessor or with others owning or operating lands not belonging to Lessor including lands belonging to the United States and with others, jointly or separately, in collectively adopting and operating under a cooperative or unit agreement for the development or operation of the pool or field or like area or part thereof. Lessee shall within thirty days after demand by Lessor subscribe to such a cooperative or unit agreement, which agreement shall be reasonable and shall adequately protect all parties in interest including Lessor. Lessor may with the consent of Lessee establish, alter, change, or revoke drilling, producing, rental, minimum royalty, and royalty requirements of this lease if committed to any such cooperative or unit agreement and may make such regulations with reference to this lease with the like consent of Lessee in connection with the institution and operation of any such cooperative or unit agreement as Lessor may determine to be necessary or proper to secure the proper protection of the public interest. If a portion of said land is committed to an approved or prescribed unit agreement, the committed acreage shall at the option of Lessor and may upon the request of Lessee and with the approval of Lessor be segregated into a separate and distinct lease having the same effective date as this lease.

31. SURRENDER. Lessee may at any time make and file with Lessor a written surrender of all rights under this lease or any portion thereof comprising one or more legal subdivisions or, with the consent of Lessor, of any separate and distinct zone or geological horizon underlying said lands or such one or more legal subdivisions thereof. Such a surrender shall be effective as of the date of filing subject to the continued obligations of Lessee and his surety to make payment of all royalties theretofore accrued and to place all wells on the surrendered land or in the surrendered zones or horizons in condition satisfactory to Lessor for suspension or abandonment; thereupon, Lessee shall be released from all other obligations accrued or to accrue under this lease with respect to the surrendered lands, zones, or horizons.

32. DEFAULT; TERMINATION. Whenever Lessee fails to comply with any of the provisions of this lease other than the payment of rental and Lessee fails within sixty days after written notice of such default to commence to remedy and thereafter prosecute diligently operations to remedy such default, Lessor may cancel this lease if at that time there is no well on said land capable of producing oil or gas in paying quantities. If at such time there is on said land a well capable of producing oil or gas in paying quantities, this lease may be cancelled only by judicial proceedings. In the event of any cancellation under this paragraph, Lessee shall have the right to retain under this lease any and all drilling or producing wells as to which no default exists together with a parcel of land surrounding each such well or wells and such rights of way through said land as may be reasonably necessary to enable Lessee to drill and operate such retained well or wells.

33. EXCESS AREA. If for any reason said land includes more acreage than the maximum permitted under applicable laws and/or regulations, this lease shall not be void but the acreage included in said land shall be reduced to the permitted maximum. Whenever Lessor determines that this lease so exceeds the permitted acreage and notifies Lessee stating the amount of acreage that must be eliminated, Lessee may within sixty days after such notice surrender one or more legal subdivisions included in said lands comprising at least the amount of acreage that must be eliminated. If such a surrender is not filed within such sixty days Lessor may terminate this lease as to the acreage that must be eliminated by mailing notice of such termination to Lessee describing the parcel or parcels eliminated. Such a notice shall have the effect of terminating this lease as to the parcel or parcels described in such notice.

34. RIGHTS ON TERMINATION. Upon the expiration or earlier termination of this lease as to all or any portion of said lands, Lessee shall have the privilege at any time within a period of six months thereafter, or such extension thereof as may be granted Lessor, of removing from said land or portion thereof all machinery, equipment, tools, and materials other than improvements needed for producing wells. Any materials, tools, appliances, machinery, structures, and equipment subject to removal as above provided which are allowed to remain on said land or portion thereof shall become the property of Lessor upon expiration of such period; provided, that Lessee shall remove any and all of such properties when so directed by Lessor. Subject to the foregoing, Lessee shall deliver up said lands or such portion or portions thereof in good order and condition.

35. INTEREST IN LAND. It is the intention of the parties that the rights vested in Lessee by this lease shall constitute an interest in real property in said land.

36. LESSOR INTEREST. If Lessor owns a lesser interest in the oil and gas deposits in said land than the entire and undivided fee simple estate, then the royalties and rentals herein provided shall be paid Lessor only in the proportion which its interest bears to the whole and undivided fee.

37. CONDITIONAL LEASE. If all or a part of said land is land that has been selected by the Lessor under laws of the United States granting lands to Lessor, but such land has not been patented to Lessor by the United States, then this lease is a conditional lease as provided by law until such patent becomes effective. If for any reason such a selection is not finally approved or such a patent does not become effective, any rental, royalty or minimum royalty payments made to Lessor under this lease will not be refunded.

38. DRILLING OPERATIONS. As used in this lease 'drilling operations' mean any work or actual operations undertaken or commenced in good faith for the purpose of carrying out any of the rights, privileges or duties of Lessee under this lease, followed diligently and in due course by the construction of a road or derrick and/or other necessary structures for the drilling of an oil or gas well, and by the actual operation of drilling in the ground. Any such work or operations preliminary to drilling in the ground may be undertaken either on said land or in the vicinity of said land in any order Lessee shall see fit.

39. ACTUAL DRILLING. As used in this lease, 'actual drilling' means any and all operations necessary or convenient to the drilling of a well in the ground after the first drilling or spudding with equipment of sufficient size and capacity to drill to the total depth proposed for the well.

40. DIRECTIONAL DRILLING. This lease may be maintained in force by directional wells drilled under the leased area from surface locations on adjacent or adjoining lands or on other premises not covered by this lease. In such circumstances, drilling shall be considered to have commenced on the leased area when actual drilling is commenced on the adjacent or adjoining lands or on lands other than the leased premises for the purpose of directionally drilling under the leased area, and production of oil or gas from the leased area through any directional well surfaced on adjacent or adjoining lands or lands other than the leased premises, or drilling or re-working of such directional well shall be considered production or drilling or re-working operations (as the case may be) on the leased area for all purposes of this lease. Nothing contained in this paragraph is intended or shall be construed as granting to the lessee any leasehold interest, licenses, easements, or other rights in or with respect to such adjacent or adjoining land in addition to any such leasehold interest, licenses, easements, or other rights which the lessee may have lawfully acquired from the lessor or from others. However, the Director, Alaska Division of Lands, may in his discretion and upon proper application by the lessee, grant a surface permit for the location of a directional well site upon and through adjoining, adjacent, or other state lands other than the leasehold premises.

42. INTERPRETATION. As used in this lease words which are defined in the regulations have the meaning assigned by such definition except where the context clearly requires a different meaning. The paragraph headings are not a part of this lease and are inserted only for convenience.

43. EMPLOYMENT. Lessee shall be required to furnish the Department of Labor a quarterly report regarding the employment on the leased property of state residents in compliance with regulations adopted by the Commissioner of Labor under AS 38.05.180(t).

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES

Competitive Oil and Gas Lease

ADL No.

THIS LEASE is entered into _____, between the State of Alaska, "the state," and

"the lessee," whether one or more, whose sole address for purposes of notification is under Paragraph 25.

In consideration of the cash payment made by the lessee to the state, which payment includes the first year's rental and any required cash bonus, and subject to the provisions of this lease, including applicable stipulation(s) and mitigating measures attached to this lease and by this reference incorporated in this lease, the state and the lessee agree as follows:

1. GRANT. (a) Subject to the provisions in this lease, the state grants and leases to the lessee, without warranty, the exclusive right to drill for, extract, remove, clean, process, and dispose of oil, gas, and associated substances in or under the following described tract of land:

containing approximately _____ acres, more or less (referred to in this lease as the "leased area"); the nonexclusive right to conduct within the leased area geological and geophysical exploration for oil, gas, and associated substances; and the nonexclusive right to install pipelines and build structures on the leased area to find, produce, save, store, treat, process, transport, take care of, and market all oil, gas, and associated substances and to house and board employees in its operations on the leased area. The rights granted by this lease are to be exercised in a manner which will not unreasonably interfere with the rights of any permittee, lessee or grantee of the state consistent with the principle of reasonable concurrent uses as set out in Article VIII, Section 8 of the Alaska Constitution.

(b) For the purposes of this lease, the leased area contains the legal subdivisions as shown on the attached plat marked Exhibit A.

(c) If the leased area is described by protracted legal subdivisions and, after the effective date of this lease, the leased area is surveyed under the public land rectangular system, the boundaries of the leased area are those established by that survey, when approved, subject, however, to the provisions of applicable regulations relating to those surveys. If for any reason the leased area includes more acreage than the maximum permitted under applicable law (including the "rule of approximation" authorized in AS 38.05.145 and defined in AS 38.05.965 (18)), this lease is not void and the acreage included in the leased area must be reduced to the permitted maximum. If the state determines that the leased area exceeds the permitted acreage and notifies the lessee in writing of the amount of acreage that must be eliminated, the lessee has 60 days after that notice to surrender one or more legal subdivisions included in the leased area comprising at least the amount of acreage that must be eliminated. Any subdivision surrendered must be located on the perimeter of the leased area as originally described. If a surrender is not filed within 60 days, the state may terminate this lease as to the acreage that must be eliminated by mailing notice of the termination to the lessee describing the subdivision eliminated.

(d) If the State of Alaska's ownership interest in the oil, gas, and associated substances in the leased area is less than an entire and undivided interest, the grant under this lease is effective only as to the state's interest in that oil, gas, and associated substances, and the royalties and rentals provided in this lease must be paid to the state in the proportion that the state's interest bears to the entire undivided fee.

(e) The state makes no representations or warranties, express or implied, as to title, or access to, or quiet enjoyment of, the leased area. The state is not liable to the lessee for any deficiency in title to the leased area, nor is the lessee or any successor in interest to the lessee entitled to any refund due to deficiency in title for any rentals, bonuses, or royalties paid under this lease.

2. RESERVED RIGHTS. (a) The state, for itself and others, reserves all rights not expressly granted to the lessee by this lease. These reserved rights include, but are not limited to:

(1) the right to explore for oil, gas, and associated substances by geological and geophysical means;

(2) the right to explore for, develop, and remove natural resources other than oil, gas, and associated substances on or from the leased area;

(3) the right to establish or grant easements and rights-of-way for any lawful purpose, including without limitation for shafts and tunnels necessary or appropriate for the working of the leased area or other lands for natural resources other than oil, gas, and associated substances;

(4) the right to dispose of land within the leased area for well sites and well bores of wells drilled from or through the leased area to explore for or produce oil, gas, and associated substances in and from lands not within the leased area; and

(5) the right otherwise to manage and dispose of the surface of the leased area or interests in that land by grant, lease, permit, or otherwise to third parties.

(b) The rights reserved may be exercised by the state, or by any other person or entity acting under authority of the state, in any manner that does not unreasonably interfere with or endanger the lessee's operations under this lease.

3. TERM. This lease is issued for an initial primary term of 7 years from the effective date of this lease. The term may be extended as provided in Paragraph 4 below.

4. EXTENSION. (a) This lease will be extended automatically if and for so long as oil or gas is produced in paying quantities from the leased area.

(b) This lease will be extended automatically if it is committed to a unit agreement approved or prescribed by the state, and will remain in effect for so long as it remains committed to that unit agreement.

(c) (1) If the drilling of a well whose bottom hole location is in the leased area has commenced as of the date on which the lease otherwise would expire and is continued with reasonable diligence, this lease will continue in effect until 90 days after cessation of that drilling and for so long as oil or gas is produced in paying quantities from the leased area.

(2) If oil or gas in paying quantities is produced from the leased area, and if that production ceases at any time, this lease will not terminate if drilling or reworking operations are commenced on the leased area within six months after cessation of production and are prosecuted with reasonable diligence; if those drilling or reworking operations result in the production of oil or gas, this lease will remain in effect for so long as oil or gas is produced in paying quantities from the leased area.

(d) If there is a well capable of producing oil or gas in paying quantities on the leased area, this lease will not expire because the lessee fails to produce that oil or gas unless the state gives notice to the lessee, allowing a reasonable time, which will not be less than six months after notice, to place the well into production, and the lessee fails

to do so. If production is established within the time allowed, this lease is extended only for so long as oil or gas is produced in paying quantities from the leased area.

(e) If the state directs or approves in writing a suspension of all operations on or production from the leased area (except for a suspension necessitated by the lessee's negligence), or if a suspension of all operations on or production from the leased area has been ordered under federal, state, or local law, the lessee's obligation to comply with any express or implied provision of this lease requiring operations or production will be suspended, but not voided, and the lessee shall not be liable for damages for failure to comply with that provision. If the suspension occurs before the expiration of the primary term, the primary term will be extended at the end of the period of the suspension by adding the period of time lost under the primary term because of the suspension. If the suspension occurs during an extension of the primary term under this paragraph, upon removal of that suspension, the lessee will have a reasonable time, which will not be less than six months after notice that the suspension has been removed, to resume operations or production. For the purposes of this subparagraph, any suspension of operations or production specifically required or imposed as a term of sale or by any stipulation made a part of this lease will not be considered a suspension ordered by law.

(f) If the state determines that the lessee has been prevented by force majeure, after efforts made in good faith, from performing any act that would extend the lease beyond the primary term, this lease will not expire during the period of force majeure. If the force majeure occurs before the expiration of the primary term, the primary term will be extended at the end of the period of force majeure by adding the period of time lost under the primary term because of the force majeure. If the force majeure occurs during an extension of the primary term under this paragraph, this lease will not expire during the period of force majeure plus a reasonable time after that period, which will not be less than 60 days, for the lessee to resume operations or production.

(g) Nothing in subparagraphs (e) or (f) suspends the obligation to pay royalties or other production or profit-based payments to the state from operations on the leased area that are not affected by any suspension or force majeure, or suspends the obligation to pay rentals.

5. RENTALS. (a) The lessee shall pay annual rental to the state in accordance with the following rental schedule:

- (1) For the first year, \$1.00 per acre or fraction of an acre;
- (2) For the second year, \$1.50 per acre or fraction of an acre;
- (3) For the third year, \$2.00 per acre or fraction of an acre;
- (4) For the fourth year, \$2.50 per acre or fraction of an acre;
- (5) For the fifth year and following years, \$3.00 per acre or fraction of an acre; provided that

the state may increase the annual rental rate as provided by law upon extension of this lease beyond the primary term.

(b) Annual rental paid in advance is a credit on the royalty or net profit share due under this lease for that year.

(c) The lessee shall pay the annual rental to the State of Alaska (or any depository designated by the state with at least 60 days notice to the lessee) in advance, on or before the annual anniversary date of this lease. The state is not required to give notice that rentals are due by billing the lessee. If the state's (or depository's) office is not open for business on the annual anniversary date of this lease, the time for payment is extended to include the next day on which that office is open for business. If the annual rental is not paid timely, this lease automatically terminates as to both parties at 11:59 p.m., Alaska Standard Time, on the date by which the rental payment was to have been made.

6. RECORDS. The lessee shall keep and have in its possession books and records showing the development and production (including records of development and production expenses) and disposition (including records of sale prices, volumes, and purchasers) of all oil, gas, and associated substances produced from the leased area. The lessee shall permit the State of Alaska or its agents to examine these books and records at all reasonable times. Upon request by the state, the lessee's books and records shall be made available to the state at the state office designated by the state. These books and records of development, production, and disposition must employ methods and techniques that will ensure the most accurate figures reasonably available without requiring the lessee to provide separate tankage or meters for each well. The lessee shall use generally accepted accounting procedures consistently applied.

7. APPORTIONMENT OF ROYALTY FROM APPROVED UNIT. The landowners' royalty share of the unit production allocated to each separately owned tract shall be regarded as royalty to be distributed to and among, or the proceeds of it paid to, the landowners, free and clear of all unit expense and free of any lien for it. Under this provision, the state's royalty share of any unit production allocated to the leased area will be regarded as royalty to be distributed to, or the proceeds of it paid to, the state, free and clear of all unit expenses (and any portion of those expenses incurred away from the unit area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering,

saltwater disposal, and preparing oil, gas, or associated substances for transportation off the unit area, and free of any lien for them.

8. PAYMENTS. All payments to the State of Alaska under this lease must be made payable to the state in the manner directed by the state, and unless otherwise specified, must be tendered to the state at:

DEPARTMENT OF NATURAL RESOURCES
550 WEST 7TH AVENUE, SUITE 1410
ANCHORAGE, ALASKA 99501-3561
ATTENTION: FINANCIAL SERVICES SECTION

or in person at either of the Department's Public Information Centers located at

550 W. 7th Ave., Suite 1260
Anchorage, Alaska

3700 Airport Way
Fairbanks, Alaska

or to any depository designated by the state with at least 60 days notice to the lessee.

9. PLAN OF OPERATIONS. (a) Except as provided in (b) of this section, a plan of operations for all or part of the leased area must be approved by the commissioner before any operations may be undertaken on or in the leased area.

(b) A plan of operations is not required for:

- (1) activities that would not require a land use permit; or
- (2) operations undertaken under an approved unit plan of operations.

(c) Before undertaking operations on or in the leased area, the lessee shall provide for full payment of all damages sustained by the owner of the surface estate as well as by the surface owner's lessees and permittees, by reason of entering the land.

(d) An application for approval of a plan of operations must contain sufficient information, based on data reasonably available at the time the plan is submitted for approval, for the commissioner to determine the surface use requirements and impacts directly associated with the proposed operations. An application must include statements and maps or drawings setting out the following:

(1) the sequence and schedule of the operations to be conducted on or in the leased area, including the date operations are proposed to begin and their proposed duration;

(2) projected use requirements directly associated with the proposed operations, including the location and design of well sites, material sites, water supplies, solid waste sites, buildings, roads, utilities, airstrips, and all other facilities and equipment necessary to conduct the proposed operations;

(3) plans for rehabilitation of the affected leased area after completion of operations or phases of those operations; and

(4) a description of operating procedures designed to prevent or minimize adverse effects on other natural resources and other uses of the leased area and adjacent areas, including fish and wildlife habitats, historic and archeological sites, and public use areas.

(e) In approving a lease plan of operations or an amendment of a plan, the commissioner will require amendments that the commissioner determines necessary to protect the state's interest. The commissioner will not require an amendment that would be inconsistent with the terms of sale under which the lease was obtained, or with the terms of the lease itself, or which would deprive the lessee of reasonable use of the leasehold interest.

(f) The lessee may, with the approval of the commissioner, amend an approved plan of operations.

(g) Upon completion of operations, the lessee shall inspect the area of operations and submit a report indicating the completion date of operations and stating any noncompliance of which the lessee knows, or should reasonably know, with requirements imposed as a condition of approval of the plan.

(h) In submitting a proposed plan of operations for approval, the lessee shall provide ten copies of the plan if activities proposed are within the coastal zone, and five copies if activities proposed are not within the coastal zone.

10. PLAN OF DEVELOPMENT. (a) Except as provided in subparagraph (d) below, within 12 months after certification of a well capable of producing oil, gas, or associated substances in paying quantities, the lessee shall file two copies of an application for approval by the state of an initial plan of development that must describe the lessee's plans

for developing the leased area. No development of the leased area may occur until a plan of development has been approved by the state.

(b) The plan of development must be revised, updated, and submitted to the state for approval annually before or on the anniversary date of the previously approved plan. If no changes from an approved plan are contemplated for the following year, a statement to that effect must be filed for approval in lieu of the required revision and update.

(c) The lessee may, with the approval of the state, subsequently modify an approved plan of development.

(d) If the leased area is included in an approved unit, the lessee will not be required to submit a separate lease plan of development for unit activities.

11. INFORMATION ACQUIRED FROM OPERATIONS. (a) The lessee shall submit to the state all geological, geophysical and engineering data and analyses obtained from the lease within 30 days following the completion of a well. The lessee shall submit to the state data and analyses acquired subsequent to well completion within 30 days following acquisition of that data. The state may waive receipt of operational data from some development, service or injection wells. The state will inform the operator of the waiver prior to well completion. The lessee shall submit the data and analyses to the Division of Oil and Gas, Department of Natural Resources, at the location specified in paragraph 25 of this lease. The data and analyses shall include the following:

(1) a copy of the completion report (AOGCC form 10-407) with an attached well summary, including daily drilling reports, formation tops encountered, a full synopsis of drillstem and formation testing data, an identification of zones of abnormal pressure, oil and gas shows and cored intervals;

(2) latitudinal and longitudinal coordinates for the completed surface and bottom hole locations;

(3) a copy of the permit to drill (AOGCC form 10-401 only, additional documentation not required) and the survey plat of the well location;

(4) a paper copy (no sepia copies) of all final 2-inch open hole and cased hole logs, including measured depth and true-vertical depth versions, specialty logs (such as Schlumberger's cyberlook, formation microscanners and dipmeter logs), composite mud or lithology log and report, measured-while-drilling (MWD) and logged-while-drilling (LWD) logs, velocity and directional surveys;

(5) a digital version of well logs in LAS, LIS or ASCII format on IBM format floppy disks, a digital version of velocity surveys in SEG Y format, a digital version of directional surveys in ASCII format (other formats may be acceptable upon agreement with the Division of Oil and Gas); and

(6) a paper copy of all available well analyses, including geochemical analyses, core analyses (porosity, permeability, capillary pressure, photos, and descriptions), paleontologic and palynologic analyses, thermal maturation analyses, pressure build up analyses, and fluid PVT analyses (an ASCII format digital version of the above information shall also be submitted, if available). The state may require the lessee to submit additional information in accordance with the applicable statutes and regulations in effect at the time of the completion date of the well.

(b) Any information submitted to the state by the lessee in connection with this lease will be available at all times for use by the state and its agents. The state will keep information confidential as provided in AS 38.05.035(a)(9) and its applicable regulations. In accordance with AS 38.05.035(a)(9)(C), in order for geological, geophysical and engineering information submitted under paragraph 11(a) of this lease to be held confidential, the lessee must request confidentiality at the time the information is submitted. The information must be marked **CONFIDENTIAL**.

12. DIRECTIONAL DRILLING. This lease may be maintained in effect by directional wells whose bottom hole location is on the leased area but that are drilled from locations on other lands not covered by this lease. In those circumstances, drilling will be considered to have commenced on the leased area when actual drilling is commenced on those other lands for the purpose of directionally drilling into the leased area. Production of oil or gas from the leased area through any directional well surfaced on those other lands, or drilling or reworking of that directional well, will be considered production or drilling or reworking operations on the leased area for all purposes of this lease. Nothing contained in this paragraph is intended or will be construed as granting to the lessee any interest, license, easement, or other right in or with respect to those lands in addition to any interest, license, easement, or other right that the lessee may have lawfully acquired from the state or from others.

13. DILIGENCE AND PREVENTION OF WASTE. (a) The lessee shall exercise reasonable diligence in drilling, producing, and operating wells on the leased area unless consent to suspend operations temporarily is granted by the state.

(b) Upon discovery of oil or gas on the leased area in quantities that would appear to a reasonable and prudent operator to be sufficient to recover ordinary costs of drilling, completing, and producing an additional well in

the same geologic structure at another location with a reasonable profit to the operator, the lessee must drill those wells as a reasonable and prudent operator would drill, having due regard for the interest of the state as well as the interest of the lessee.

(c) The lessee shall perform all operations under this lease in a good and workmanlike manner in accordance with the methods and practices set out in the approved plan of operations and plan of development, with due regard for the prevention of waste of oil, gas, and associated substances and the entrance of water to the oil and gas-bearing sands or strata to the destruction or injury of those sands or strata, and to the preservation and conservation of the property for future productive operations. The lessee shall carry out at the lessee's expense all orders and requirements of the State of Alaska relative to the prevention of waste and to the preservation of the leased area. If the lessee fails to carry out these orders, the state will have the right, together with any other available legal recourse, to enter the leased area to repair damage or prevent waste at the lessee's expense.

(d) The lessee shall securely plug in an approved manner any well before abandoning it.

14. **OFFSET WELLS.** The lessee shall drill such wells as a reasonable and prudent operator would drill to protect the state from loss by reason of drainage resulting from production on other land. Without limiting the generality of the foregoing sentence, if oil or gas is produced in a well on other land not owned by the State of Alaska or on which the State of Alaska receives a lower rate of royalty than under this lease, and that well is within 500 feet in the case of an oil well or 1,500 feet in the case of a gas well of lands then subject to this lease, and that well produces oil or gas for a period of 30 consecutive days in quantities that would appear to a reasonable and prudent operator to be sufficient to recover ordinary costs of drilling, completing, and producing an additional well in the same geological structure at an offset location with a reasonable profit to the operator, and if, after notice to the lessee and an opportunity to be heard, the state finds that production from that well is draining lands then subject to this lease, the lessee shall within 30 days after written demand by the state begin in good faith and diligently prosecute drilling operations for an offset well on the leased area. In lieu of drilling any well required by this paragraph, the lessee may, with the state's consent, compensate the state in full each month for the estimated loss of royalty through drainage in the amount determined by the state.

15. **UNITIZATION.** (a) The lessee may unite with others, jointly or separately, in collectively adopting and operating under a cooperative or unit agreement for the exploration, development, or operation of the pool, field, or like area or part of the pool, field, or like area that includes or underlies the leased area or any part of the leased area whenever the state determines and certifies that the cooperative or unit agreement is in the public interest.

(b) The lessee agrees, within six months after demand by the state, to subscribe to a reasonable cooperative or unit agreement that will adequately protect all parties in interest, including the state. The state reserves the right to prescribe such an agreement.

(c) With the consent of the lessee, and if the leased area is committed to a unit agreement approved by the state, the state may establish, alter, change, or revoke drilling, producing, and royalty requirements of this lease as the state determines necessary or proper to secure the proper protection of the public interest.

(d) Except as otherwise provided in this subparagraph, where only a portion of the leased area is committed to a unit agreement approved or prescribed by the state, that commitment constitutes a severance of this lease as to the unitized and nonunitized portions of the leased area. The portion of the leased area not committed to the unit will be treated as a separate and distinct lease having the same effective date and term as this lease and may be maintained only in accordance with the terms and conditions of this lease, statutes, and regulations. Any portion of the leased area not committed to the unit agreement will not be affected by the unitization or pooling of any other portion of the leased area, by operations in the unit, or by suspension approved or ordered for the unit. If the leased area has a well certified as capable of production in paying quantities on it before commitment to a unit agreement, this lease will not be severed. If any portion of this lease is included in a participating area formed under a unit agreement, the entire leased area will remain committed to the unit and this lease will not be severed.

16. **INSPECTION.** The lessee shall keep open at all reasonable times, for inspection by any duly authorized representative of the State of Alaska, the leased area, all wells, improvements, machinery, and fixtures on the leased area, and all reports and records relative to operations and surveys or investigations on or with regard to the leased area or under this lease. Upon request, the lessee shall furnish the State of Alaska with copies of and extracts from any such reports and records.

17. **SUSPENSION.** The state may from time to time direct or approve in writing suspension of production or other operations under this lease.

18. ASSIGNMENT, PARTITION, AND CONVERSION. This lease, or an interest in this lease, may, with the approval of the state, be assigned, subleased, or otherwise transferred to any person or persons qualified to hold a lease. No assignment, sublease, or other transfer of an interest in this lease, including assignments of working or royalty interests and operating agreements and subleases, will be binding upon the state unless approved by the state. The lessee shall remain liable for all obligations under this lease accruing prior to the approval by the state of any assignment, sublease, or other transfer of an interest in this lease. All provisions of this lease will extend to and be binding upon the heirs, administrators, successors, and assigns of the state and the lessee. Applications for approval of an assignment, sublease, or other transfer must comply with all applicable regulations and must be filed within 90 days after the date of final execution of the instrument of transfer. The state will approve a transfer of an undivided interest in this lease unless the transfer would adversely affect the interests of Alaska or the application does not comply with applicable regulations. The state will disapprove a transfer of a divided interest in this lease if the transfer covers only a portion of the lease or a separate and distinct zone or geological horizon unless the lessee demonstrates that the proposed transfer of a divided interest is reasonably necessary to accomplish exploration or development of the lease, the lease is committed to an approved unit agreement, the lease is allocated production within an approved participating area, or the lease has a well certified as capable of production in paying quantities. The state will make a written finding stating the reasons for disapproval of a transfer of a divided interest. Where an assignment, sublease, or other transfer is made of all or a part of the lessee's interest in a portion of the leased area, this lease may, at the option of the state or upon request of the transferee and with the approval of the state, be severed, and a separate and distinct lease will be issued to the transferee having the same effective date and terms as this lease.

19. SURRENDER. The lessee at any time may file with the state a written surrender of all rights under this lease or any portion of the leased area comprising one or more legal subdivisions or, with the consent of the state, any separate and distinct zone or geological horizon underlying the leased area or one or more legal subdivisions of the leased area. That surrender will be effective as of the date of filing, subject to the continued obligations of the lessee and its surety to make payment of all accrued royalties and to place all wells and surface facilities on the surrendered land or in the surrendered zones or horizons in condition satisfactory to the state for suspension or abandonment. After that, the lessee will be released from all obligations under this lease with respect to the surrendered lands, zones, or horizons.

20. DEFAULT AND TERMINATION; CANCELLATION. (a) The failure of the lessee to perform timely its obligations under this lease, or the failure of the lessee otherwise to abide by all express and implied provisions of this lease, is a default of the lessee's obligations under this lease. Whenever the lessee fails to comply with any of the provisions of this lease (other than a provision which, by its terms, provides for automatic termination), and fails within 60 days after written notice of that default to begin and diligently prosecute operations to remedy that default, the state may terminate this lease if at the time of termination there is no well on the leased area capable of producing oil or gas in paying quantities. If there is a well on the leased area capable of producing oil or gas in paying quantities, this lease may be terminated by an appropriate judicial proceeding. In the event of any termination under this subparagraph, the lessee shall have the right to retain under this lease any and all drilling or producing wells for which no default exists, together with a parcel of land surrounding each well or wells and rights-of-way through the leased area that are reasonably necessary to enable the lessee to drill, operate, and transport oil or gas from the retained well or wells.

(b) The state may cancel this lease at any time if the state determines, after the lessee has been given notice and a reasonable opportunity to be heard, that:

(1) continued operations pursuant to this lease probably will cause serious harm or damage to biological resources, to property, to mineral resources, or to the environment (including the human environment);

(2) the threat of harm or damage will not disappear or decrease to an acceptable extent within a reasonable period of time; and

(3) the advantages of cancellation outweigh the advantages of continuing this lease in effect. Any cancellation under this subparagraph will not occur unless and until operations under this lease have been under suspension or temporary prohibition by the state, with due extension of the term of this lease, continuously for a period of five years or for a lesser period upon request of the lessee.

(c) Any cancellation under subparagraph (b) will entitle the lessee to receive compensation as the lessee demonstrates to the state is equal to the lesser of:

(1) the value of the cancelled rights as of the date of cancellation, with due consideration being given to both anticipated revenues from this lease and anticipated costs, including costs of compliance with all applicable regulations and stipulations, liability for clean-up costs or damages, or both, in the case of an oil spill, and all other costs reasonably anticipated under this lease; or

(2) the excess, if any, over the lessee's revenues from this lease (plus interest on the excess from the date of receipt to date of reimbursement) of all consideration paid for this lease and all direct expenditures made by the lessee after the effective date of this lease and in connection with exploration or development, or both, under this lease, plus interest on that consideration and those expenditures from the date of payment to the date of reimbursement.

21. RIGHTS UPON TERMINATION. Upon the expiration or earlier termination of this lease as to all or any portion of the leased area, the lessee will be directed in writing by the state and will have the right at any time within a period of one year after the termination, or any extension of that period as may be granted by the state, to remove from the leased area or portion of the leased area all machinery, equipment, tools, and materials. Upon the expiration of that period or extension of that period and at the option of the state, any machinery, equipment, tools, and materials that the lessee has not removed from the leased area or portion of the leased area become the property of the state or may be removed by the state at the lessee's expense. At the option of the state, all improvements such as roads, pads, and wells must either be abandoned and the sites rehabilitated by the lessee to the satisfaction of the state, or be left intact and the lessee absolved of all further responsibility as to their maintenance, repair, and eventual abandonment and rehabilitation. Subject to the above conditions, the lessee shall deliver up the leased area or those portions of the leased area in good condition.

22. DAMAGES AND INDEMNIFICATION. (a) No rights under the AS 38.05.125 reservation may be exercised by the lessee until the lessee has provided to pay the owner of the land, his lessees and permittees, upon which the AS 38.05.125 reserved rights are sought to be exercised, full payment for all damage sustained by the owner by reason of entering the land. If the owner for any reason does not settle the damages, the lessee may enter the land after posting a surety bond determined by the state, after notice and an opportunity to be heard, to be sufficient as to form, amount, and security to secure to the owner, his lessees and permittees, payment for damages, and may institute legal proceedings in a court of competent jurisdiction where the land is located to determine the damages which the owner of the land may suffer. The lessee agrees to pay for any damages that may become payable under AS 38.05.130 and to indemnify the state and hold it harmless from and against any claims, demands, liabilities, and expenses arising from or in connection with such damages. The furnishing of a bond in compliance with this paragraph will be regarded by the state as sufficient provision for the payment of all damages that may become payable under AS 38.05.130 by virtue of this lease.

(b) The lessee shall indemnify the state for, and hold it harmless from, any claim, including claims for loss or damage to property or injury to any person caused by or resulting from any act or omission committed under this lease by or on behalf of the lessee. The lessee is not responsible to the state under this subparagraph for any loss, damage, or injury caused by or resulting from the sole negligence of the state.

(c) The lessee expressly waives any defense to an action for breach of a provision of this lease or for damages resulting from an oil spill or other harm to the environment that is based on an act or omission committed by an independent contractor in the lessee's employ. The lessee expressly agrees to assume responsibility for all actions of its independent contractors.

23. BONDS. (a) If required by the state, the lessee shall furnish a bond prior to the issuance of this lease in an amount equal to at least \$5 per acre or fraction of an acre contained in the leased area, but no less than \$10,000, and must maintain that bond as long as required by the state.

(b) The lessee may, in lieu of the bond required under (a) above, furnish and maintain a statewide bond in accordance with applicable regulations.

(c) The state may, after notice to the lessee and a reasonable opportunity to be heard, require a bond in a reasonable amount greater than the amount specified in (a) above where a greater amount is justified by the nature of the surface and its uses and the degree of risk involved in the types of operations being or to be carried out under this lease. A statewide bond will not satisfy any requirement of a bond imposed under this subparagraph, but will be considered by the state in determining the need for and the amount of any additional bond under this subparagraph.

(d) If the leased area is committed in whole or in part to a cooperative or unit agreement approved or prescribed by the state, and the unit operator furnishes a statewide bond, the lessee need not maintain any bond with respect to the portion of the leased area committed to the cooperative or unit agreement.

24. AUTHORIZED REPRESENTATIVES. The Director of the Division of Oil and Gas, Department of Natural Resources, State of Alaska, and the person executing this lease on behalf of the lessee shall be authorized representatives for their respective principals for the purposes of administering this lease. The state or the lessee may change the designation of its authorized representative or the address to which notices to that representative are to be sent by a notice given in accordance with Paragraph 25 below. Where activities pursuant to a plan of operations are

underway, the lessee shall also designate, pursuant to a notice under Paragraph 25 below, by name, job title, and address, an agent who will be present in the state during all lease activities.

25. NOTICES; PROTEST. (a) Any notices required or permitted under this lease must be by electronic media producing a permanent record or in writing and must be given personally or by registered or certified mail, return receipt requested, addressed as follows:

TO THE STATE:

DIRECTOR, DIVISION OF OIL AND GAS
DEPARTMENT OF NATURAL RESOURCES
550 WEST 7TH AVENUE, SUITE 800
ANCHORAGE, ALASKA 99501-3560

TO THE LESSEE:

(b) Any notice given under this paragraph will be effective when delivered to the above authorized representative.

(c) A lessee who wishes to protest the amount of money due the state under the lease or any action of the state regarding a provision of this lease must file a written protest with the Division of Oil and Gas within 30 days after the mailing date of the state's notice or bill. A lessee who fails to file a protest within the required time waives any further right to protest. The state will establish the administrative appeal procedure to be followed and will inform the lessee of the procedure no later than 30 days after the filing of the written protest.

26. STATUTES AND REGULATIONS. This lease is subject to all applicable state and federal statutes and regulations in effect on the effective date of this lease, and insofar as is constitutionally permissible, to all statutes and regulations placed in effect after the effective date of this lease. A reference to a statute or regulation in this lease includes any change in that statute or regulation whether by amendment, repeal and replacement, or other means. This lease does not limit the power of the State of Alaska or the United States of America to enact and enforce legislation or to promulgate and enforce regulations affecting, directly or indirectly, the activities of the lessee or its agents in connection with this lease or the value of the interest held under this lease. In case of conflicting provisions, statutes and regulations take precedence over this lease.

27. INTERPRETATION. This lease is to be interpreted in accordance with the rules applicable to the interpretation of contracts made in the State of Alaska. The paragraph headings are not part of this lease and are inserted only for convenience. The state and the lessee expressly agree that the law of the State of Alaska will apply in any judicial proceeding affecting this lease.

28. INTEREST IN REAL PROPERTY. It is the intention of the parties that the rights granted to the lessee by this lease constitute an interest in real property in the leased area.

29. WAIVER OF CONDITIONS. The state reserves the right to waive any breach of a provision of this lease, but any such waiver extends only to the particular breach so waived and does not limit the rights of the state with respect to any future breach; nor will the waiver of a particular breach prevent cancellation of this lease for any other cause or for the same cause occurring at another time. Notwithstanding the foregoing, the state will not be deemed to have waived a provision of this lease unless it does so in writing.

30. SEVERABILITY. If it is finally determined in any judicial proceeding that any provision of this lease is invalid, the state and the lessee may jointly agree by a written amendment to this lease that, in consideration of the provisions in that written amendment, the invalid portion will be treated as severed from this lease and that the remainder of this lease, as amended, will remain in effect.

31. LOCAL HIRE. The lessee is encouraged to hire and employ local and Alaska residents and companies, to the extent they are available and qualified, for work performed on the leased area. Lessees shall submit, with the plans

of operations, a proposal detailing the means by which the lessee will comply with this measure. The lessee is encouraged, in formulating this proposal, to coordinate with employment services offered by the State of Alaska and local communities and to recruit employees from local communities.

32. **CONDITIONAL LEASE.** If all or a part of the leased area is land that has been selected by the state under laws of the United States granting lands to the state, but the land has not been patented to the state by the United States, then this lease is a conditional lease as provided by law until the patent becomes effective. If for any reason the selection is not finally approved, or the patent does not become effective, any rental, royalty, or other production or profit-based payments made to the state under this lease will not be refunded.

33. **NONDISCRIMINATION.** The lessee and the lessee's contractors and subcontractors may not discriminate against any employee or applicant because of race, religion, marital status, change in marital status, pregnancy, parenthood, physical handicap, color, sex, age, or national origin as set out in AS 18.80.220. The lessee and its contractors and subcontractors must, on beginning any operations under this lease, post in a conspicuous place notices setting out this nondiscrimination provision.

34. **DEFINITIONS.** All words and phrases used in this lease are to be interpreted where possible in the manner required in respect to the interpretation of statutes by AS 01.10.040. However, the following words have the following meanings unless the context unavoidably requires otherwise:

(1) "oil" means crude petroleum oil and other hydrocarbons, regardless of gravity, that are produced in liquid form by ordinary production methods, including liquid hydrocarbons known as distillate or condensate recovered by separation from gas other than at a gas processing plant;

(2) "gas" means all natural gas (except helium gas) and all other hydrocarbons produced that are not defined in this lease as oil;

(3) "associated substances" means all substances except helium produced as an incident of production of oil or gas by ordinary production methods and not defined in this lease as oil or gas;

(4) "drilling" means the act of boring a hole to reach a proposed bottom hole location through which oil or gas may be produced if encountered in paying quantities, and includes redrilling, sidetracking, deepening, or other means necessary to reach the proposed bottom hole location, testing, logging, plugging, and other operations necessary and incidental to the actual boring of the hole;

(5) "reworking operations" means all operations designed to secure, restore, or improve production through some use of a hole previously drilled, including, but not limited to, mechanical or chemical treatment of any horizon, plugging back to test higher strata, etc.;

(6) "paying quantities" means quantities sufficient to yield a return in excess of operating costs, even if drilling and equipment costs may never be repaid and the undertaking considered as a whole may ultimately result in a loss; quantities are insufficient to yield a return in excess of operating costs unless those quantities, not considering the costs of transportation and marketing, will produce sufficient revenue to induce a prudent operator to produce those quantities; and

(7) "force majeure" means war, riots, acts of God, unusually severe weather, or any other cause beyond the lessee's reasonable ability to foresee or control and includes operational failure of existing transportation facilities and delays caused by judicial decisions or lack of them.

35. **ROYALTY ON PRODUCTION.** Except for oil, gas, and associated substances used on the leased area for development and production or unavoidably lost, the lessee shall pay to the state as a royalty 12.50 percent in amount or value of the oil, gas, and associated substances saved, removed, or sold from the leased area and of the gas from the leased area used on the leased area for extraction of natural gasoline or other products.

36. **VALUE.** (a) For the purposes of computing royalties due under this lease, the value of royalty oil, gas, or associated substances shall not be less than the highest of:

(1) the field price received by the lessee for the oil, gas, or associated substances;

(2) the volume-weighted average of the three highest field prices received by other producers in the same field or area for oil of like grade and gravity, gas of like kind and quality, or associated substances of like kind and quality at the time the oil, gas, or associated substances are sold or removed from the leased or unit area or the gas is delivered to an extraction plant if that plant is located on the leased or unit area; if there are less than three prices reported by other producers, the volume-weighted average will be calculated using the lesser number of prices received by other producers in the field or area;

(3) the lessee's posted price in the field or area for the oil, gas, or associated substances; or
(4) the volume-weighted average of the three highest posted prices in the same field or area of the other producers in the same field or area for oil of like grade and gravity, gas of like kind and quality, or associated substances of like kind and quality at the time the oil, gas, or associated substances are sold or removed from the leased or unit area or the gas is delivered to an extraction plant if that plant is located on the leased or unit area; if there are less than three prices posted by other producers, the volume-weighted average will be calculated using the lesser number of prices posted by other producers in the field or area.

(b) If oil, gas, or associated substances are sold away from the leased or unit area, the term "field price" in subparagraph (a) above will be the cash value of all consideration received by the lessee or other producer from the purchaser of the oil, gas, or associated substances, less the lessee's actual and reasonable costs of transportation away from the leased or unit area to the point of sale. The "actual and reasonable costs of transportation" for marine transportation are as defined in 11 AAC 83.229(a), (b)(2), and (c) - l.

(c) In the event the lessee does not sell in an arm's-length transaction the oil, gas, or associated substances, the term "field price" in subparagraphs (a) and (b) above will mean the price the lessee would expect to receive for the oil, gas, or associated substances if the lessee did sell the oil, gas, or associated substances in an arm's-length transaction, minus reasonable costs of transportation away from the leased or unit area to the point of sale or other disposition. The lessee must determine this price in a consistent and logical manner using information available to the lessee and report that price to the state.

(d) The state may establish minimum values for the purposes of computing royalties on oil, gas, or associated substances obtained from this lease, with consideration being given to the price actually received by the lessee, to the price or prices paid in the same field or area for production of like quality, to posted prices, to prices received by the lessee and/or other producers from sales occurring away from the leased area, and/or to other relevant matters. In establishing minimum values, the state may use, but is not limited to, the methodology for determining "prevailing value" as defined in 11 AAC 83.227. Each minimum value determination will be made only after the lessee has been given notice and a reasonable opportunity to be heard. Under this provision, it is expressly agreed that the minimum value of royalty oil, gas, or associated substances under this lease may not necessarily equal, and may exceed, the price of the oil, gas, or associated substances.

37. **ROYALTY IN VALUE.** Except to the extent that the state elects to receive all or a portion of its royalty in kind as provided in Paragraph 38 below, the lessee shall pay to the state that value of all royalty oil, gas, and associated substances as determined under Paragraph 36 above. Royalty paid in value will be free and clear of all lease expenses (and any portion of those expenses that is incurred away from the leased area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering, saltwater disposal, and preparing the oil, gas, or associated substances for transportation off the leased area. All royalty that may become payable in money to the State of Alaska must be paid on or before the last federal banking day of the calendar month following the month in which the oil, gas, or associated substances are produced. The amount of all royalty in value payments which are not paid when due under this lease or the amount which is subsequently determined to be due to the state or the lessee as the result of a redetermination will bear interest from the last federal banking day of the calendar month following the month in which the oil, gas, or associated substances were produced, until the obligation is paid in full. Interest shall accrue at the rate provided in AS 38.05.135(d) or as may later be amended. Royalty payments must be accompanied by such information relating to valuation of royalty as the state may require which may include, but is not limited to, run tickets, evidence of sales, shipments, and amounts of gross oil, gas, and associated substances produced.

38. **ROYALTY IN KIND.** (a) At the state's option, which may be exercised from time to time upon not less than 90 days' notice to the lessee, the lessee shall deliver all or a portion of the state's royalty oil, gas, or associated substances produced from the leased area in kind. Delivery will be on the leased area, unit area, or at a place mutually agreed to by the state and the lessee, and must be delivered to the State of Alaska or to any individual, firm, or corporation designated by the state.

(b) Royalty oil, gas, or associated substances delivered in kind must be delivered in good and merchantable condition, of pipeline quality, and free and clear of all lease expenses (and any portion of those expenses incurred away from the leased area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering, saltwater disposal, and preparing the oil, gas, or associated substances for transportation off the leased area.

(c) After having given notice of its intention to take, or after having taken its royalty oil, gas, or associated substances in kind, the state, at its option and upon 90 days' notice to the lessee, may elect to receive a different portion or none of its royalty in kind. If, under federal regulations, the taking of royalty oil, gas, or associated substances in value by the state creates a supplier-purchaser relationship, the lessee hereby waives its right to continue

to receive royalty oil, gas, or associated substances under that relationship, and further agrees that it will require any purchasers of the royalty oil, gas, or associated substances likewise to waive any supplier-purchaser rights.

(d) The lessee shall furnish storage for royalty oil, gas, and associated substances produced from the leased or unit area to the same extent that the lessee provides storage for the lessee's share of oil, gas, and associated substances. The lessee shall not be liable for the loss or destruction of stored royalty oil, gas and associated substances from causes beyond the lessee's ability to control.

(e) If a state royalty purchaser refuses or for any reason fails to take delivery of oil, gas, or associated substances, or in an emergency, and with as much notice to the lessee as is practical or reasonable under the circumstances, the state may elect without penalty to underlift for up to six months all or a portion of the state's royalty on oil, gas, or associated substances produced from the leased or unit area and taken in kind. The state's right to underlift is limited to the portion of royalty oil, gas, or associated substances that the royalty purchaser refused or failed to take delivery of, or the portion necessary to meet the emergency condition. Underlifted oil, gas, or associated substances may be recovered by the state at a daily rate not to exceed 10 percent of its royalty interest share of daily production at the time of the underlift recovery.

39. REDUCTION OF ROYALTY. Lessee may request a reduction of royalty in accordance with the applicable statutes and regulations in effect on the date of application for the reduction.

40. EFFECTIVE DATE. This lease takes effect on

BY SIGNING THIS LEASE, the state as lessor and the lessee agree to be bound by its provisions.

STATE OF ALASKA

By: _____
Mark D. Myers
Director, Division of Oil and Gas

STATE OF ALASKA)
) ss.
Third Judicial District)

On _____, before me appeared Mark D. Myers of the Division of Oil and Gas of the State of Alaska, Department of Natural Resources, and who executed this lease and acknowledged voluntarily signing it on behalf of the State of Alaska as lessor.

Notary public in and for the State of Alaska
My commission expires September 28, 2007

LESSEE: _____

Signature: _____

Printed Name/Title: _____

INSERT NOTARY ACKNOWLEDGMENT OF LESSEE'S SIGNATURE HERE.

LESSEE: _____

Signature: _____

Printed Name/Title: _____

INSERT NOTARY ACKNOWLEDGMENT OF LESSEE'S SIGNATURE HERE.

LESSEE: _____

Signature: _____

Printed Name/Title: _____

INSERT NOTARY ACKNOWLEDGMENT OF LESSEE'S SIGNATURE HERE.

Sec. 38.05.180. Oil and gas and gas only leasing.

(a) The legislature finds that

(1) the people of Alaska have an interest in the development of the state's oil and gas resources to

(A) maximize the economic and physical recovery of the resources;

(B) maximize competition among parties seeking to explore and develop the resources;

(C) maximize use of Alaska's human resources in the development of the resources;

(2) it is in the best interests of the state

(A) to encourage an assessment of its oil and gas resources and to allow the maximum flexibility in the methods of issuing leases to

(i) recognize the many varied geographical regions of the state and the different costs of exploring for oil and gas in these regions;

(ii) minimize the adverse impact of exploration, development, production, and transportation activity; and

(B) to offer acreage for oil and gas leases or for gas only leases, specifically including

(i) state acreage that has been the subject of a best interest finding at annual areawide lease sales; and

(ii) land in areas that, under (d) of this section, may be leased without having been included in the leasing program prepared and submitted under (b) of this section.

(b) The commissioner shall annually prepare and, before February 1 of each calendar year notify the legislature of a five-year program of proposed oil and gas lease sales and proposed gas only lease sales, specifying as precisely as practicable the location of tracts to be offered for leasing during the calendar year of the notification and the following four calendar years. The commissioner may, at any time, notify the legislature of revisions, including additions, to the program. Notification to each legislator, by electronic message or other written means, constitutes notification to the legislature under this subsection.

(c) Except as provided in (d) and (w) of this section, an oil and gas lease sale or gas only lease sale may not be held unless it was included in the proposed leasing programs submitted to the legislature during the two calendar years preceding the year in which the sale is held. A lease sale, whether for oil and gas or for gas only, may not be held before the date it is scheduled in the proposed oil and gas leasing program.

(d) The commissioner

(1) may annually offer leases for oil and gas or leases for gas only of the acreage described in AS 38.05.035(e)(6)(F);

(2) may issue leases in an area that has not been included in a leasing program prepared, in accordance with (b) of this section, if the land to be leased

(A) was previously subject to a valid state oil and gas lease, a valid state gas lease, or a valid federal oil and gas lease;

(B) is contiguous to land already under state, federal, or private lease and the commissioner makes a written finding, after hearing, that leasing of the land would result in a substantial probability of early evaluation and development of the land to be leased;

(C) is adjacent to land owned or controlled by another party on which a discovery of commercial quantities of oil or gas has been made, and the commissioner finds, after hearing, that there is a reasonable probability that the land to be leased contains oil or gas in communication with the oil or gas discovered on the land of the other party;

(D) is adjacent to land included in the federal five-year Outer Continental Shelf leasing program under 43 U.S.C. 1344, and the commissioner makes a written finding, after hearing, that coordinated or simultaneous leasing with the federal government is in the public interest; or

(E) is the subject of an exploration license issued under AS 38.05.131 - 38.05.134; however, if the license issued was for exploration for and recovery of gas only, then the lease issued under this subsection shall be limited to exploration for and recovery of gas only.

(e) The commissioner shall annually prepare and notify the legislature of the availability of a report containing the following:

(1) the schedule of all lease sales held during the preceding calendar year, the bidding method or methods utilized, and an analysis of the results of the bidding;

(2) if determined, a description of the bidding methods to be used for all lease sales to be held during the current and next two succeeding calendar years;

(3) the reasons a particular bidding method has been selected.

(f) Except as provided by AS 38.05.131 - 38.05.134, the commissioner may issue oil and gas leases or leases for gas only on state land to the highest responsible qualified bidder as follows:

(1) the commissioner shall issue an oil and gas lease or a gas only lease, as appropriate, to the successful bidder determined by competitive bidding under regulations adopted by the commissioner; bidding may be by sealed bid or according to any other bidding procedure the commissioner determines is in the best interests of the state;

(2) whenever, under any of the leasing methods listed in this subsection, a royalty share is reserved to the state, it shall be delivered in pipeline quality and free of all lease or unit expenses, including but not limited to separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation off the lease or unit area;

(3) following a pre-sale analysis, the commissioner may choose at least one of the following leasing methods:

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

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

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

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

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

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

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

(4) notwithstanding a requirement in the leasing method chosen of a minimum fixed royalty share, on and after March 3, 1997, the lessee under a lease issued in the Cook Inlet sedimentary basin who is the first to file with the commissioner a nonconfidential sworn statement claiming to be the first to have drilled a well discovering oil or gas in a previously undiscovered oil or gas pool and who is certified by the commissioner within one year of completion of that discovery well to have drilled a well in that pool that is capable of producing in paying quantities shall pay a royalty of five percent on all production of oil or gas from that pool attributable to that lease for a period of 10 years following the date of discovery of that pool, and thereafter the royalty payable on all production of oil or gas from the

pool attributable to that lease shall be determined and payable as specified in the lease; for purposes of this paragraph, the reduced royalty authorized by this paragraph is subject to the following:

(A) only one reduction of royalty authorized by this paragraph may be allowed on each lease that qualifies for reduction of royalty under this paragraph;

(B) if, under this paragraph, application is made for a royalty reduction for a lease that was entered into before March 3, 1997, the commissioner may approve the application only if, on that date, the lease was a nonproducing lease that was not committed to a unit approved by the commissioner under (m) of this section, that is not part of a unit under (p) or (q) of this section, and that has not been made part of a unit under AS 31.05;

(C) if application for a royalty reduction is made under this paragraph for a lease on which a discovery royalty was claimed or may be claimed under the discovery royalty provisions of former AS 38.05.180(a) in effect before May 6, 1969, the commissioner shall disallow the application under this paragraph unless the applicant waives the right to claim the right to a reduced royalty under the discovery royalty provisions of former AS 38.05.180(a) in effect before May 6, 1969; and

(D) the commissioner shall adopt regulations setting out the standards, criteria, and definitions of terms that apply to implement the filing of applications for, and the review and certification of, discovery certifications under this paragraph;

(5) notwithstanding and in lieu of a requirement in the leasing method chosen of a minimum fixed royalty share, or the royalty provision of a lease, for leases unitized as described in (p) of this section, leases subject to an agreement described in (s) or (t) of this section, or interests unitized under AS 31.05, the lessee of all or part of an oil or gas field identified in this section that has been granted approval of a written plan submitted to the Alaska Oil and Gas Conservation Commission under AS 31.05.030(i) shall, subject to (dd) of this section, pay a royalty of five percent on the first 25,000,000 barrels of oil and the first 35,000,000,000 cubic feet of gas produced for sale from that field that occurs in the 10 years following the date on which the production for sale commences; the fields eligible for royalty reduction under this paragraph, all of which are located within the Cook Inlet sedimentary basin, were discovered before January 1, 1988, and have been undeveloped or shut in from at least January 1, 1988, through December 31, 1997, are

- (A) Falls Creek;
- (B) Nicolai Creek;
- (C) North Fork;
- (D) Point Starichkof;
- (E) Redoubt Shoal; and
- (F) West Foreland;

(6) notwithstanding and in lieu of a requirement in the leasing method chosen of a minimum fixed royalty share, or the royalty provision of a lease, for leases unitized as described in (p) of this section, leases subject to an agreement described in (s) or (t) of this section, or interests unitized under AS 31.05, the lessee of all or part of an oil field located offshore in Cook Inlet on which an oil production platform specified in (A), (C), or (E) of this paragraph operates, or the lessee of all or part of the field located offshore in Cook Inlet and described in (G) of this paragraph,

(A) shall pay a royalty of five percent on oil produced from the platform if oil production that equaled or exceeded a volume of 1,200 barrels a day declines to less than that amount for a period of at least one calendar quarter, as certified by the Alaska Oil and Gas Conservation Commission, for as long as the volume of oil produced from the platform remains less than 1,200 barrels a day; the provisions of this subparagraph apply to

- (i) Dolly;
- (ii) Grayling;
- (iii) King Salmon;

(iv) Steelhead; and

(v) Monopod;

(B) shall pay a royalty calculated under this subparagraph if the volume of oil produced from the platform that was certified by the Alaska Oil and Gas Conservation Commission under (A) of this paragraph later increases to 1,200 or more barrels a day and remains at 1,200 or more barrels a day for a period of at least one calendar quarter; until the royalty rate determined under this subparagraph applies, the royalty continues to be calculated under (A) of this paragraph; on and after the first day of the month following the month the increased production exceeds the period specified in this subparagraph, the royalty payable under this subparagraph is

(i) for production of at least 1,200 barrels a day but not more than 1,300 barrels a day - seven percent;

(ii) for production of more than 1,300 barrels a day but not more than 1,400 barrels a day - 8.5 percent;

(iii) for production of more than 1,400 barrels a day but not more than 1,500 barrels a day - 10 percent; and

(iv) for production of more than 1,500 barrels a day - 12.5 percent;

(C) shall pay a royalty of five percent on oil produced from the platform if oil production that equaled or exceeded a volume of 975 barrels a day declines to less than that amount for a period of at least one calendar quarter, as certified by the Alaska Oil and Gas Conservation Commission, for as long as the volume of oil produced from the platform remains less than 975 barrels a day; the provisions of this subparagraph apply to

(i) Baker;

(ii) Dillon;

(iii) XTO.A; and

(iv) XTO.C;

(D) shall pay a royalty calculated under this subparagraph if the volume of oil produced from the platform that was certified by the Alaska Oil and Gas Conservation Commission under (C) of this paragraph later increases to 975 or more barrels a day and remains at 975 or more barrels a day for a period of at least one calendar quarter; until the royalty rate determined under this subparagraph applies, the royalty continues to be calculated under (C) of this paragraph; on and after the first day of the month following the month the increased production exceeds the period specified in this subparagraph, the royalty payable under this subparagraph is

(i) for production of at least 975 barrels a day but not more than 1,100 barrels a day - seven percent;

(ii) for production of more than 1,100 barrels a day but not more than 1,200 barrels a day - 8.5 percent;

(iii) for production of more than 1,200 barrels a day but not more than 1,350 barrels a day - 10 percent; and

(iv) for production of more than 1,350 barrels a day - 12.5 percent;

(E) shall pay a royalty of five percent on oil produced from the platform if oil production that equaled or exceeded a volume of 750 barrels a day declines to less than that amount for a period of at least one calendar quarter, as certified by the Alaska Oil and Gas Conservation Commission, for as long as the volume of oil produced from the platform remains less than 750 barrels a day; the provisions of this subparagraph apply to

(i) Granite Point;

(ii) Anna; and

(iii) Bruce;

(F) shall pay a royalty calculated under this subparagraph if the volume of oil produced from the platform that was certified by the Alaska Oil and Gas Conservation Commission under (E) of this paragraph later increases to 750 or more barrels a day and remains at 750 or more barrels a day for a period of at least one calendar quarter; until the royalty rate determined under this subparagraph applies, the royalty continues to be calculated under (E) of this paragraph; on and after the first day of the month following the month the increased production exceeds the period specified in this subparagraph, the royalty payable under this subparagraph is

(i) for production of at least 750 barrels a day but not more than 850 barrels a day - seven percent;

(ii) for production of more than 850 barrels a day but not more than 1,000 barrels a day - 8.5 percent;

(iii) for production of more than 1,000 barrels a day but not more than 1,200 barrels a day - 10 percent; and

(iv) for production of more than 1,200 barrels a day - 12.5 percent;

(G) shall pay a royalty of five percent on oil produced from the field if oil production that equaled or exceeded a volume of 750 barrels a day declines to less than that amount for a period of at least one calendar quarter, as certified by the Alaska Oil and Gas Conservation Commission, for as long as the volume of oil produced from the field remains less than 750 barrels a day; the provisions of this subparagraph apply to the West McArthur River field;

(H) shall pay a royalty calculated under this subparagraph if the volume of oil produced from the field that was certified by the Alaska Oil and Gas Conservation Commission under (G) of this paragraph later increases to 750 or more barrels a day and remains at 750 or more barrels a day for a period of at least one calendar quarter; until the royalty rate determined under this subparagraph applies, the royalty continues to be calculated under (G) of this paragraph; on and after the first day of the month following the month the increased production exceeds the period specified in this subparagraph, the royalty payable under this subparagraph is

(i) for production of at least 750 barrels a day but not more than 850 barrels a day - seven percent;

(ii) for production of more than 850 barrels a day but not more than 1,000 barrels a day - 8.5 percent;

(iii) for production of more than 1,000 barrels a day but not more than 1,200 barrels a day - 10 percent; and

(iv) for production of more than 1,200 barrels a day - 12.5 percent; and

(I) may obtain the benefits of the royalty adjustments set out in (A) - (H) of this paragraph only if the commissioner determines that the reduction in production from the platform or the field is

(i) based on the average daily production during the calendar quarter based on reservoir conditions; and

(ii) not the result of short-term production declines due to mechanical or other choke-back factors, temporary shutdowns or decreased production due to environmental or facility constraints, or market conditions.

(g) The share of the net profit derived from a lease reserved to the state under (f) of this section is royalty sale proceeds for the purposes of the Alaska permanent fund under AS 37.13.010.

(h) The commissioner may include terms in any lease imposing a minimum work commitment on the lessee. These terms shall be made public before the sale, and may include appropriate penalty provisions to take effect in the event the lessee does not fulfill the minimum work commitment. If it is demonstrated that a lease has been proven unproductive by actions of adjacent lease holders, the commissioner may set aside a work commitment. The commissioner may waive for a period not to exceed one two-year period any term of a minimum work commitment if the commissioner makes a

written finding either that conditions preventing drilling or exploration were beyond the lessee's reasonable ability to foresee or control or that the lessee has demonstrated through good faith efforts an intent and ability to drill or develop the lease during the term of the waiver.

(i) The commissioner may provide for the establishment of an exploration incentive credit system under which a lessee of state land drilling an exploratory well on that land may earn credits based upon the footage drilled and the region in which the well is situated. The commissioner may also provide for credits to be earned by persons performing geophysical work on state land, if that work is performed during the two seasons immediately preceding an announced lease sale and on land included within the sale area and the geophysical information is made public following the sale. Credits may not exceed 50 percent of the cost of the drilling or geophysical work. Credits may be used during a limited period established by the commissioner and may be assigned during that period. Credits may be applied against (1) royalty and rental payments for oil and gas or for gas only payable to the state or (2) taxes payable under AS 43.55. A credit may not exceed 50 percent of the payment toward which it is being applied. Amounts due the Alaska permanent fund (AS 37.13.010) shall be calculated before the application of credits under this subsection.

(j) The commissioner

(1) may provide for modification of royalty on individual leases, leases unitized as described in (p) of this section, leases subject to an agreement described in (s) or (t) of this section, or interests unitized under AS 31.05

(A) to allow for production from an oil or gas field or pool if

(i) the oil or gas field or pool has been sufficiently delineated to the satisfaction of the commissioner;

(ii) the field or pool has not previously produced oil or gas for sale; and

(iii) oil or gas production from the field or pool would not otherwise be economically feasible;

(B) to prolong the economic life of an oil or gas field or pool as per barrel or barrel equivalent costs increase or as the price of oil or gas decreases, and the increase or decrease is sufficient to make future production no longer economically feasible; or

(C) to reestablish production of shut-in oil or gas that would not otherwise be economically feasible;

(2) may not grant a royalty modification unless the lessee or lessees requesting the change make a clear and convincing showing that a modification of royalty meets the requirements of this subsection and is in the best interests of the state;

(3) shall provide for an increase or decrease or other modification of the state's royalty share by a sliding scale royalty or other mechanism that shall be based on a change in the price of oil or gas and may also be based on other relevant factors such as a change in production rate, projected ultimate recovery, development costs, and operating costs;

(4) may not grant a royalty reduction for a field or pool

(A) under (1)(A) of this subsection if the royalty modification for the field or pool would establish a royalty rate of less than five percent in amount or value of the production removed or sold from a lease or leases covering the field or pool;

(B) under (1)(B) or (1)(C) of this subsection if the royalty modification for the field or pool would establish a royalty rate of less than three percent in amount or value of the production removed or sold from a lease or leases covering the field or pool;

(5) may not grant a royalty reduction under this subsection without including an explicit condition that the royalty reduction is not assignable without the prior written approval, which may not be unreasonably withheld, by the commissioner; the commissioner shall, in the preliminary and final findings and determinations, set out the conditions under which the royalty reduction may be assigned;

(6) shall require the lessee or lessees to submit, with the application for the royalty reduction, financial and technical data that demonstrate that the requirements of this subsection are met; the commissioner

(A) may require disclosure of only the financial and technical data related to development, production, and transportation of oil and gas or gas only from the field or pool that are reasonably available to the applicant; and

(B) shall keep the data confidential under AS 38.05.035(a)(8) at the request of the lessee or lessees making application for the royalty reduction; the confidential data may be disclosed by the commissioner to legislators and to the legislative auditor and as directed by the chair or vice-chair of the Legislative Budget and Audit Committee to the director of the division of legislative finance, the permanent employees of their respective divisions who are responsible for evaluating a royalty reduction, and to agents or contractors of the legislative auditor or the legislative finance director who are engaged under contract to evaluate the royalty reduction, if they sign an appropriate confidentiality agreement;

(7) may

(A) require the lessee or lessees making application for the royalty reduction under (1)(A) of this subsection to pay for the services of an independent contractor, selected by the lessee or lessees from a list of qualified consultants compiled by the commissioner, to evaluate hydrocarbon development, production, transportation, and economics and to assist the commissioner in evaluating the application and financial and technical data; if, under this subparagraph, the commissioner requires payment for the services of an independent contractor, the total cost of the services to be paid for by the lessee or lessees may not exceed \$150,000 for each application, and the commissioner shall determine the relevant scope of the work to be performed by the contractor; selection of an independent contractor under this subparagraph is not subject to AS 36.30;

(B) with the mutual consent of the lessee or lessees making application for the royalty reduction under (1)(B) or (1)(C) of this subsection, request payment for the services of an independent contractor, selected from a list of qualified consultants to evaluate hydrocarbon development, production, transportation, and economics by the commissioner to assist the commissioner in evaluating the application and financial and technical data; if, under this subparagraph, the commissioner requires payment for the services of an independent contractor, the total cost of the services that may be paid for by the lessee or lessees may not exceed \$150,000 for each application, and the commissioner shall determine the relevant scope of the work to be performed by the contractor; selection of an independent contractor under this subparagraph is not subject to AS 36.30;

(8) shall make and publish a preliminary findings and determination on the royalty reduction application, give reasonable public notice of the preliminary findings and determination, and invite public comment on the preliminary findings and determination during a 30-day period for receipt of public comment;

(9) shall offer to appear before the Legislative Budget and Audit Committee, on a day that is not earlier than 10 days and not later than 20 days after giving public notice under (8) of this subsection, to provide the committee a review of the commissioner's preliminary findings and determination on the royalty reduction application and administrative process; if the Legislative Budget and Audit Committee accepts the commissioner's offer, the committee shall give notice of the committee's meeting to all members of the legislature;

(10) shall make copies of the preliminary findings and determination available to

(A) the presiding officer of each house of the legislature;

(B) the chairs of the legislature's standing committees on resources; and

(C) the chairs of the legislature's special committees on oil and gas, if any;

(11) shall, within 30 days after the close of the public comment period under (8) of this subsection,

(A) prepare a summary of the public response to the commissioner's preliminary findings and determination;

(B) make a final findings and determination; the commissioner's final findings and determination prepared under this subparagraph regarding a royalty reduction is final and not appealable to the court;

(C) transmit a copy of the final findings and determination to the lessee;

(D) with the applicant's consent, amend the applicant's lease or unitization agreement consistent with the commissioner's final decision; and

(E) make copies of the final findings and determination available to each person who submitted comment under (8) of this subsection and who has filed a request for the copies;

(12) is not limited by the provisions of AS 38.05.134(3) or (f) of this section in the commissioner's determination under this subsection.

(k) The commissioner shall define all terms and adopt all regulations necessary for a reasonable understanding and evaluation of a particular bidding method before the public announcement of the terms of proposed sale employing that method.

(l) Subject to the provisions of AS 31.05, the commissioner has discretion to enter into an agreement whereby, with the consent of the lessee, the state's royalty share of production of oil and gas or gas only may be stored or retained in storage by the lessee, or the commissioner may enter into an agreement with one or more of the affected field lease holders to trade current royalty production from a field for a like amount, kind, and quality of future production, on the condition that the state receives back its stored or traded royalty share during the first half of the estimated field life or no later than 15 years after start of production, whichever is sooner.

(m) An oil and gas lease or a gas only lease must cover a reasonably compact area not exceeding 5,760 acres, and may be for a maximum period of 10 years, except that the commissioner may issue a lease for a period not less than five years upon a finding that it is in the best interests of the state. An oil and gas lease shall be automatically extended if and for so long thereafter as oil or gas is produced in paying quantities from the lease or if the lease is committed to a unit approved by the commissioner, and a gas only lease shall be automatically extended if and for so long thereafter as gas is produced in paying quantities from the lease or if the lease is committed to a unit approved by the commissioner. A lease issued under this section covering land on which there is a well capable of producing oil or gas in paying quantities does not expire because the lessee fails to produce oil or gas unless the lessee is allowed reasonable time to place the well on a producing status. Upon extension, the commissioner may increase lease rentals so long as the increased rental rate does not exceed 150 percent of the rate for the preceding year. If drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, including such operations as redrilling, sidetracking, or other means necessary to reach the originally proposed bottom hole location, the lease continues in effect until 90 days after drilling has ceased and for so long thereafter as oil or gas is produced in paying quantities. An oil and gas lease or a gas only lease issued under this section which is subject to termination by reason of cessation of production does not terminate if, within 60 days after production ceases, reworking or drilling operations are commenced on the land under lease and are thereafter conducted with reasonable diligence during the period of nonproduction.

(n) The commissioner may establish by regulation that after a well has been plugged and abandoned, the rental rate which was in effect during the year of abandonment is maintained for the remainder of the term. Rental is payable in advance and continues until income to the state from royalty or net profit share exceeds rental income to the state for that year. Under this subsection,

(1) leases for oil and gas or for gas only shall provide for payment to the state of rental on the following basis:

- (A) for the first year, \$1.00 per acre;
- (B) for the second year, \$1.50 per acre;
- (C) for the third year, \$2.00 per acre;
- (D) for the fourth year, \$2.50 per acre;
- (E) for the fifth and following years, \$3.00 per acre;

(2) if the lessee under a gas only lease demonstrates to the commissioner that the potential resources underlying the lease are reasonably estimated to be only nonconventional gas,

(A) the rental payment is \$1.00 per acre until the lease expires or paying quantities of conventional oil or gas are discovered underlying the lease; and

(B) if the nonconventional gas produced will not be in direct competition with gas on which a royalty at a rate of at least 12.5 percent is payable, then the royalty share payable to the state on all production of gas from the pool attributable to that lease shall be 6.25 percent based upon production delivered in pipeline quality and free of all lease expenses, including separation, cleaning, dehydration, gathering, salt water disposal, and preparation for transportation off the lease.

(o) Upon timely application as provided by regulation, the state may issue to the holder of a federal or private lease, a state shoreland lease covering land within the exterior boundaries of the federal or private lease which has been excluded on the basis of navigability or which is later administratively or judicially determined to be shoreland. The term of such a state shoreland lease shall be the same as the term of the federal or private lease.

(p) To conserve the natural resources of all or a part of an oil or gas pool, field, or like area, the lessees and their representatives may unite with each other, or jointly or separately with others, in collectively adopting or operating under a cooperative or a unit plan of development or operation of the pool, field, or like area, or a part of it, when determined and certified by the commissioner to be necessary or advisable in the public interest. The commissioner may, with the consent of the holders of leases involved, establish, change, or revoke drilling, producing, and royalty requirements of the leases and adopt regulations with reference to the leases, with like consent on the part of the lessees, in connection with the institution and operation of a cooperative or unit plan as the commissioner determines necessary or proper to secure the proper protection of the public interest. The commissioner may not reduce royalty on leases in connection with a cooperative or unit plan except as provided in (j) of this section. The commissioner may require a lease issued under this section to contain a provision requiring the lessee to operate under a reasonable cooperative or unit plan, and may prescribe a plan under which the lessee must operate. The plan must adequately protect all parties in interest, including the state.

(q) A plan authorized by (p) of this section, which includes land owned by the state, may contain a provision vesting the commissioner, or a person, committee, or state agency, with authority to modify from time to time the rate of prospecting and development and the quantity and rate of production under the plan. All leases operated under a plan approved or prescribed by the commissioner are excepted in determining holdings or control under AS 38.05.140. The provisions of this section concerning cooperative or unit plans are in addition to and do not affect AS 31.05.

(r) Producing acreage on a known geologic structure of a producing oil or gas field is excluded from chargeability as against the acreage limitation provisions of AS 38.05.140.

(s) When separate tracts cannot be individually developed and operated in conformity with an established well-spacing or development program, a lease, or a portion of a lease, may be pooled with other land, whether or not owned by the state, under a communitization or drilling agreement providing for an apportionment of production or royalties among the separate tracts of land comprising the drilling or spacing unit when determined by the commissioner to be in the public interest. Operations or production under the agreement are considered as operations or production as to each lease

committed to the agreement. The commissioner may not reduce royalty on leases in connection with a communitization or drilling agreement except as provided in (j) of this section.

(t) The commissioner may prescribe conditions and approve, on conditions, drilling, or development contracts made by one or more lessees of oil or gas leases, with one or more persons, when, in the discretion of the commissioner, the conservation of natural resources or the public convenience or necessity requires it or the interests of the state are best served. All leases operated under approved drilling or development contracts and interests under them, are excepted in determining holding or control under AS 38.05.140. The commissioner may not reduce royalty on a lease or leases that are subject to a drilling or development contract except as provided in (j) of this section.

(u) To avoid waste or to promote conservation of natural resources, the commissioner may authorize the subsurface storage of oil or gas, whether or not produced from state land, in land leased or subject to lease under this section. This authorization may provide for the payment of a storage fee or rental on the stored oil or gas, or, instead of the fee or rental, for a royalty other than that prescribed in the lease when the stored oil or gas is produced in conjunction with oil or gas not previously produced. A lease on which storage is so authorized shall be extended at least for the period of storage and so long thereafter as oil or gas not previously produced is produced in paying quantities. Notwithstanding the authorization for payments under this subsection, when requested by a lessee, the commissioner shall exempt a gas storage facility that qualifies for a tax credit under AS 43.20.046 from any payment described in this subsection for the periods described in this subsection. The exemption is available for the calendar year in which the facility commences commercial operation and for each of the nine calendar years immediately following the first year of commercial operation; however, an exemption is not applicable for the calendar year after the facility ceases commercial operation or for any subsequent calendar year. The lessee shall provide the commissioner with any information the commissioner requests to determine if the exemption applies. The information related to state land leased for a gas storage facility under this subsection is public information and may be furnished to the Regulatory Commission of Alaska. On request, the commissioner shall provide the name of each person using state land leased for a gas storage facility under this chapter, the years for which an exemption was granted, and the amount of the exemption. Gas withdrawn from a gas storage facility regulated under AS 42.05 is considered to be non-native gas and is not considered to be produced and subject to royalty until all non-native gas injected into the gas storage facility has been withdrawn from the gas storage facility. A person receiving an exemption for a payment under this section that contracts to store gas for a utility regulated under AS 42.05 shall reduce the storage price to reflect the value of the exemption. In this subsection, "ceases commercial operation," "commences commercial operation," "gas storage facility," and "non-native gas" have the meanings given in AS 31.05.032.

(v) [Repealed, Sec. 36 ch 94 SLA 1980].

(w) Notwithstanding any other provisions of this section, land that was subject to a best interest finding issued within the previous 10 years may be, at the discretion of the commissioner, immediately offered for lease, under regulations adopted by the commissioner, upon terms appearing most advantageous to the state; however, noncompetitive leasing is prohibited. The commissioner shall establish a royalty determined to be in the public interest but not less than 12 1/2 percent. A lease must provide for payment to the state of rental but need not adhere to the rental schedule in (n) of this section nor to the 5,760-acres-per-lease limitation in (m) of this section. The lease term may not exceed 10 years, except as provided in (o) of this section.

(x) A lessee conducting or permitting any exploration for, or development or production of, oil or gas on state land shall provide the commissioner access to all noninterpretive data obtained from that lease and shall provide copies of that data, as the commissioner may request. The confidentiality provisions of AS 38.05.035 apply to the information obtained under this subsection.

(y) A noncompetitive lease existing at October 10, 1978, shall be extended for a period of two years and so long thereafter as oil and gas is produced in paying quantities. A noncompetitive lease extended under this subsection is subject to the regulations in force at the expiration of the initial five-year term of the lease. No extension may be granted, however, unless within a period of 90 days before the expiration date an application for extension is filed by the record title holder or an assignee whose assignment has been filed for approval, or an operator whose operating agreement has been filed for approval.

(z) No leases may be issued under this section without the inclusion of the following language: "The landowners' royalty share of the unit production allocated to each separately owned tract shall be regarded as royalty to be distributed to and among, or the proceeds of it paid to, the landowners, free and clear of all unit expense and free of any lien for it." Leases issued in violation of this subsection shall, for all purposes, be construed as containing the language required by this subsection.

(aa) Within 90 days after the written request of a lessee of a lease issued under this section or of a lessee of federal land from which the state is entitled under applicable federal law to receive a share of the royalty on gas production, the commissioner shall enter into an agreement with the lessee to use or accept, as the value of the state's royalty share of gas production, the price for the gas established in the contract between the lessee and a gas or electric utility sold by the lessee under the contract or the transfer price between the lessee and a gas or electric utility for a transfer by the lessee under an order establishing the transfer price

(1) but only if the primary function of the utility with which the lessee has entered into the contract or transfer is to provide, either directly or by selling at wholesale to another utility, gas or electricity to the general public, including residential consumers, within the utilities' service areas, and the utility with which the lessee has entered into

(A) the contract is not an affiliated interest, as that term is defined in AS 42.05.990, with the lessee or with a subsequent purchaser of more than 10 percent of the utility's gas or electricity; or

(B) the transfer is an affiliated interest, as that term is defined in AS 42.05.990, and the transfer price between the lessee and the utility is established by an order of the Regulatory Commission of Alaska; and

(2) unless the commissioner makes a written finding, based on clear and convincing evidence, that

(A) the contract price or transfer price is unreasonably low;

(B) the prospective reduction in royalty receipts would not be balanced by increased benefits to in-state gas and electric consumers;

(C) the lessee and the utility are related in management, ownership, or other aspect and, in the case of a transfer price, that relationship is not regulated under AS 42.05; and

(D) the contract price or transfer price is not in the best interest of the state.

(bb) In (aa) and (ee) of this section,

(1) "gas or electric utility" includes an electric cooperative organized under AS 10.25, a municipal utility, and a gas or electric utility regulated under AS 42.05; provided that, if the contract gas is transmitted to consumers through a pipeline and the gas utility either owns the pipeline or is related in ownership to the owner of the pipeline, then the gas utility qualifies as a "gas or electric utility" within the meaning of this paragraph only if it is bound or agrees to be bound by the covenants set out in AS 38.35.120;

(2) "manufacturer of agricultural chemicals" means a person that is a business entity primarily engaging in the manufacturing of nitrogenous and phosphatic based fertilizers, mixed fertilizers, pesticides, and similar chemicals for agricultural purposes;

(3) "price for the gas established in the contract" includes tax reimbursement amounts, deliverability and other charges, and other forms of consideration paid by the gas or electric utility or by the manufacturer of agricultural chemicals, as appropriate, under the contract;

(4) "state's royalty share of gas production"

(A) includes payments on federal leases made to the state under 30 U.S.C. 191;

(B) does not include the state's royalty share of gas production from land patented to the state under

(i) P.L. 84-830, 70 Stat. 709 (Alaska Mental Health Enabling Act);

(ii) 38 Stat. 1214 (Act of March 4, 1915); or

(iii) 43 U.S.C. 1635 in settlement of the claims of the state under 38 Stat. 1214.

(cc) The provisions of (aa) and (ee) of this section do not prohibit the commissioner from accepting any payment on a federal lease tendered by the federal agency responsible for determination and transmittal of the payment to the state under 30 U.S.C. 191 or otherwise due the state as the state's royalty share of gas production irrespective of the state's acceptance of an amount that is different than the amount due under the lease for purposes of determining royalty share on gas production under that subsection.

(dd) A lessee is eligible for the royalty in (f)(5) of this section only if production of oil or gas for sale begins from the eligible field before January 1, 2004. However, if the state or an agency of the state is a party to a suit, other than a suit brought by the lessee or agent of the lessee, and if the suit challenges (f)(5) of this section or AS 31.05.030(i) or an act under (f)(5) of this section or AS 31.05.030(i), the January 1, 2004, deadline is extended by the number of days the state or agency of the state is a party to the suit, including any appeals.

(ee) For a contract that is entered into on or after September 9, 2003, within 90 days after the written request of a lessee of a lease issued under this section or of a lessee of federal land from which the state is entitled under applicable federal law to receive a share of the royalty on gas production, in order to establish the value of the state's royalty share of gas production sold by the lessee under the contract, the commissioner may enter into an agreement with the lessee to use or accept as a price for the gas an amount that is not less than the price established in the contract between the lessee and a manufacturer of agricultural chemicals, not to exceed the amount that would otherwise be due under the lease. The commissioner may enter into the agreement if it is in the best interest of the state

(1) only if the primary function of the manufacturer is to engage in the production of a value-added product, and the manufacturer with which the lessee has entered into the contract is not affiliated with the lessee or with a subsequent purchaser of more than 10 percent of the manufacturer's value-added product; for purposes of this paragraph, the parties to a contract or purchase are affiliated if, in the judgment of the commissioner, one of the parties to the contract or purchase exercises substantial influence over the policies and actions of the other as evidenced by relationship based on common ownership or family interest or by action taken in concert without regard to whether that influence is based upon stockholdings, stockholders, officers, or directors;

(2) unless the commissioner makes a written finding, based on clear and convincing evidence, that

(A) the contract price is unreasonably low; or

(B) the prospective reduction in royalty receipts would not be balanced by employment opportunities or other tangible benefits to the state.

(ff) The provisions of this section that authorize oil and gas leases also apply to authorize the commissioner to issue leases for the production of gas only, subject to the following:

(1) in authorizing and managing leases under this subsection, the terms "oil and gas" or "oil or gas" as they are used in this chapter may be read and applied as appropriate as referring to gas only;

(2) when a lease is authorized as a gas only lease, the lease does not give the lessee the right to produce oil; if a well drilling for gas under a gas only lease authorized by this subsection penetrates a formation capable of producing oil, the owner or operator

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

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

(3) the provisions of this subsection do not apply to authorize a lease for the recovery of nonconventional gas on land that is held under an existing coal lease entered into under AS 38.05.150 that has an active permit for exploration or mining unless the lessee under this subsection is also the lessee under AS 38.05.150 of that land.


(gg) For an activity or operation related to the extraction of coal bed methane,

(1) for which the department by regulation requires submission and approval of a plan of operations before activities or operations may be undertaken, the director shall, as a condition for determining a bond requested under AS 38.05.130, after notice and an opportunity to be heard, review the plan of operations to determine if use of the owner's land is reasonably necessary to extract the coal bed methane; a bond determined under AS 38.05.130 and this paragraph may, at the discretion of the director, be imposed against a statewide bond that has been posted by the person initiating the request for determination of the bond if the statewide bond remains in effect, and an additional bond is not required;

(2) before approving operations for the development of coal bed methane under AS 38.05.134, 38.05.177, or this section, the director shall ensure that the approval is conditioned upon reasonable and appropriate


(A) setbacks governing the placement by the operator of compressor stations; setbacks approved under this subparagraph must be determined with reference to the population density and general character of the parcels surrounding the proposed compressor station site; and

(B) measures to mitigate the noise of compressors, engines, and other noise generating equipment operated by the operator on the lease or license; measures approved under this subparagraph must be determined with reference to the population density and general character of the parcels surrounding the proposed compressor, engine, or other noise-generating equipment.



**SB 209:
Strengthening Alaska's
Oil and Gas
Leasing Laws**

**Senate Resources Committee
March 23, 2012**




The purpose of SB 209 is to encourage greater development of the state's oil and gas resources, consistent with Article VIII of the Alaska Constitution.




Section 8.1 of the Alaska
Constitution states:

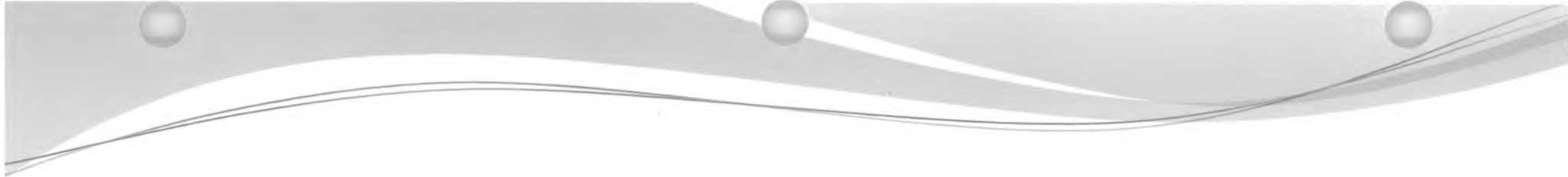
“It is the policy of the State to encourage the settlement of its land and **the development of its resources** by making them available for **maximum use** consistent with the public interest.”




SB 209 was developed in response to concerns that some oil companies are winning exclusive leases of petroleum-rich state lands, then sitting on those leases and warehousing Alaska's resources, while investing elsewhere.



Committee members are all aware of the Pt. Thomson case, in which state lands with vast quantities of oil and gas were leased more than three decades ago and have yet to be developed.



The sponsor's intent with SB 209 is to ensure that we don't have more Pt. Thomsons – to reform Alaska's leasing laws now to avoid spending millions of dollars 20 or 30 years from now to regain control over valuable state lands and resources.



Of course, these are not any resources. They are the state's most valuable resources.

They are commonly referred to as our “lifeblood.”




They provide:

- jobs for tens of thousands of Alaskans,*
- roughly 90% of our unrestricted state revenue, which pays for essential state services and infrastructure
- support for economic development in all other sectors of our economy from seafood to timber.

* Nearly 42,000 direct, indirect and induced jobs (or roughly 1/3 of the jobs within our economy), according to Dr. Scott Goldsmith at the Institute for Social and Economic Research.



They are critical to our economy,
wellbeing and future.



This importance clearly raises the stakes. It means we must exercise the greatest diligence when it comes to the management of our oil and gas resources.




So, just how bad is the problem
SB 209 seeks to address?

It could be significant, according
to the Department of Natural
Resources. More than 25% of
Alaska's existing oil and gas
leases could be sitting idle.




Last year DNR examined 1,320 leases.

- 578 were part of production units or were producing oil or gas,
- 404 had been sold in the preceding three years, so might still be in the planning stages, and
- 338 could be “idle,” as lessees had not applied for a single permit to explore or develop them.




What is the resource potential of these lands? Could they support production at some point? Could they help to fill the pipeline and provide jobs for Alaskans?




The answer is we don't know. Some company gave the state a bonus bid some years back and continues to pay rent (usually \$1/acre per month), indicating the land might have potential.


But that potential has never been explored or realized.



Alaskans have gained little from having taken these lands off the public rolls, putting them out of reach of other companies who may actually want to explore or develop them.




This is no way to ensure
“maximum use” of our resources,
especially as production in
Alaska’s largest fields declines,
pipeline volumes decrease, and
concerns over the state’s future
fiscal health intensify.




Regular litigation to take back idle leases is not the answer. It should be Alaska's last resort.

Carefully crafted laws that result in clear expectations about each party's responsibilities and intentions is the better way to go.




Alaskans deserve to know precisely what they are getting when they give exclusive 10-year leases, as was done recently on the North Slope, to resource-rich lands.




They deserve commitments they can count on, so 10 or 20 years down the road they don't feel misled or betrayed, ready to do battle against some of the world's most powerful corporations.




How does SB 209 accomplish
this?




1) It requires bidders for an oil and gas lease to submit a plan of exploration or, if appropriate, a plan of development for areas it seeks to lease, prior to submitting a formal bid.




The plan could outline seismic work that will be performed or exploration wells that will be drilled.




Actual production commitments would not, of course, be required if the tracts have yet to be adequately explored.



2) It requires the commissioner to review each bidder's plan to determine if it is "reasonably expected to develop the lease in the best interest of the state."




A company may not be qualified to bidder if the commissioner finds it has submitted a plan that is not in the state's best interest or the bidder is not “reasonably capable” of implementing the plan.




While this “best interest” finding sounds vague and subjective, this terminology is used frequently in Alaska law and governs many state procedures.


It appears 131 times in our statute books. It is used to determine to what actions the state should take as well as to select among bidders and competing proposals.




3) SB 209 also requires that these plans be included in leases and requires DNR to review leases annually to ensure that plans are being implemented.




It allows the commissioner to waive a work commitment if conditions preventing drilling or exploration were beyond the lessee's reasonable ability to foresee or control.




It also allows for a waiver if the lessee demonstrates through good faith efforts an intent to drill or develop the lease in the following two years.




Under existing statutes, DNR has the option of including a minimum work commitment in a lease, along with penalties if the lessee does not fulfill the commitment.




This bill simply requires that work commitments, developed by bidders and approved by the state, be part of all future leases.



4) SB 209 also requires DNR to analyze the economics of each “participating area” (a unitized reservoir where sustained production is occurring) every five years to determine whether the area is capable of increased production.



There are 42 “participating areas” in Alaska. They are within the Badami, Colville River, Duck Island, Kuparuk, Milne Point, Nikaitchuq, Northstar, Oooguruk, and Prudhoe Bay units.




Knowing whether a prospect is reasonably economic matters, and the state currently lacks this knowledge.




It determines what lessees obligations are under contracts they have willingly signed.

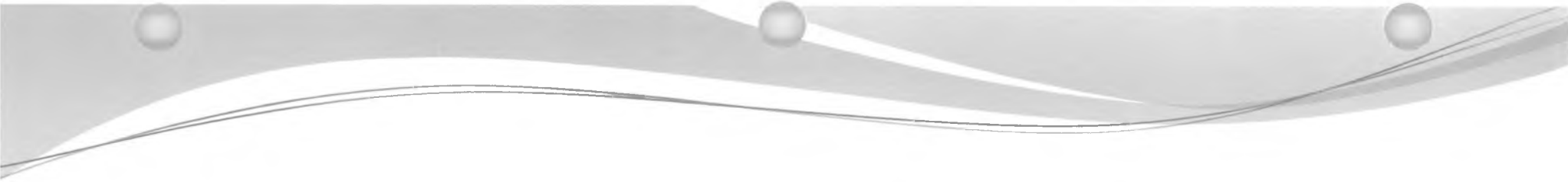
The following slide contains language from new oil and gas leases which speaks to lessees' obligations to develop. (Form DOG 200204)



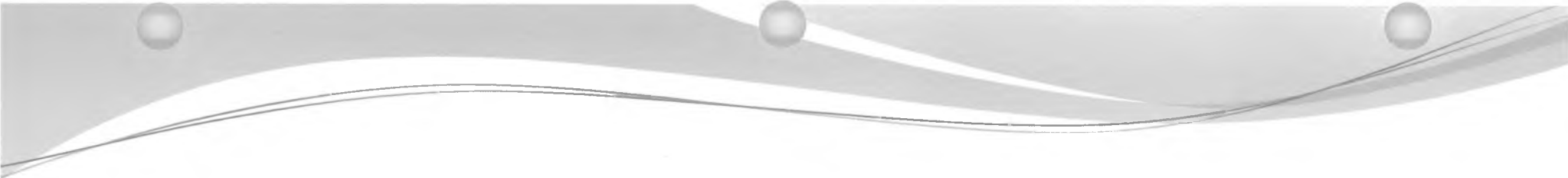
13 (b): Upon discovery of oil or gas on the leased area in quantities that would appear to a **reasonable and prudent operator to be sufficient to recover ordinary costs of drilling**, completing, and producing an additional well in the same geologic structure at another location with a reasonable profit to the operator, **the lessee must drill those wells** as a reasonable and prudent operator would drill, **having due regard for the interest of the state as well as the interest of the lessee.**




Language in old leases (referred to as DL-1 leases) addresses the same obligations.




18. OTHER WELLS. Upon discovery of oil and gas in paying quantities on said land, Lessee shall drill such wells as a reasonably prudent operator would drill having due regard for the interests of Lessor as well as the interests of Lessee.



As this contractual language makes explicitly clear, knowing whether a particular prospect is economic is key to enforcing the binding terms of leases Alaska has signed with our partners in the oil and gas industry.



The economic data we have today is limited, but indicates that Alaska remains a highly profitable place to do business.



We know that net income per BOE is nearly double in Alaska what it is elsewhere, at least for ConocoPhillips.


The information on the following slide is drawn from their SEC filings.

Table 2: ConocoPhillips: Net Income per Barrel of Oil Equivalent (BOE)

Jurisdiction	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Average
Alaska	\$8.97	\$6.01	\$6.19	\$10.43	\$14.36	\$20.38	\$21.08	\$20.66	\$22.84	\$15.73	\$19.47	\$15.10
Lower 48	\$9.13	\$8.02	\$3.77	\$8.42	\$10.56	\$15.96	\$10.63	\$9.80	\$14.39	(\$0.20)	\$6.26	\$8.79
International	\$5.35	\$3.61	\$3.33	\$5.69	\$9.27	\$12.33	\$13.17	\$1.06	\$18.96	\$3.89	\$17.62	\$8.57
Global	\$7.54	\$5.62	\$4.43	\$7.32	\$10.75	\$14.79	\$13.73	\$7.02	\$18.26	\$4.39	\$14.86	\$9.88
Proportion of BOE Production												Average
Alaska	35.9%	47.6%	35.6%	23.6%	24.1%	22.0%	15.5%	16.6%	15.5%	11.9%	14.4%	23.9%
Lower 48	23.8%	19.6%	19.2%	18.8%	19.8%	19.1%	26.2%	30.9%	28.3%	22.2%	26.7%	23.1%
International	40.4%	32.7%	45.1%	57.6%	56.1%	59.0%	58.2%	52.5%	56.2%	65.9%	58.9%	53.0%

Notes: "Barrel of oil equivalent" expresses the amount of a given fuel required to equal the amount of energy contained in one standard U.S. barrel of crude oil (42 gallons). For instance, a generally accepted BOE approximation for natural gas is 5,800 cubic feet (5.8 Mcf). Please note, however, that the amount of energy provided by crude oil (or any fuel) varies by production location or, more precisely, the grade of oil produced. Therefore, BOE figures should be viewed as estimates. The figures in this table are the results of dividing net income by the aggregate BOE production of oil, natural gas, and natural gas liquids.

Source: Legislative Research calculations based on annual filings of form 10-K with the U.S. Securities and Exchange Commission posted to the EDGAR online database, <http://www.sec.gov/edgar/searchedgar/webusers.htm> .



We know that 2 of Alaska's three largest producers have made extraordinary profits in Alaska since ACES passed.

BP Alaska Net Income

(in billions)

2007: \$2.5

2008: \$2.0

2009: \$1.9

2010: \$2.3*

*minus \$1.5 billion in 2010 deducted for non-Alaska costs,
such as the Gulf spill

\$8.7 billion in profits under ACES



ConocoPhillips

Alaska Net Income

(in billions)


2007: \$2.3

2008: \$2.3

2009: \$1.5

2010: \$1.7

\$7.8 billion in profits under ACES



And we know what consultants retained by the Administration and Legislature have told us about the estimated rates of return an oil company would receive when further investing in Prudhoe Bay. The following slide estimates returns at 123% when oil sells at \$80 a barrel.



Senate CS – Forecast Mode, \$80 oil

- IRR = 123%, NPV10 = \$5.375 billion

Modeling the Prudhoe Success contained in AOGA/BP Testimony

Drilling Program Year

2002

2003

2004

2005

2006

Capex M of Bbls 300%

Opex M of Bbls 100%

Production M of Bbls 100%

Discount Rate 10%

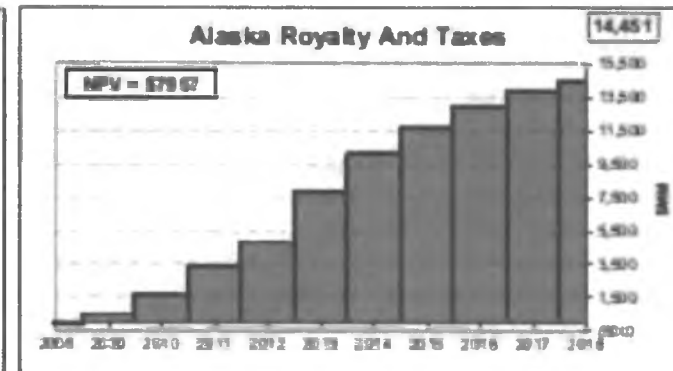
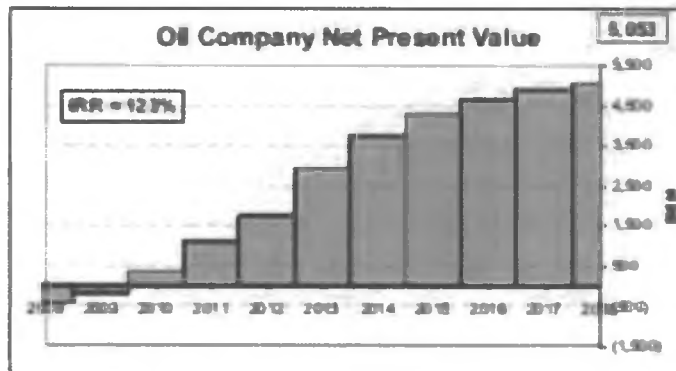
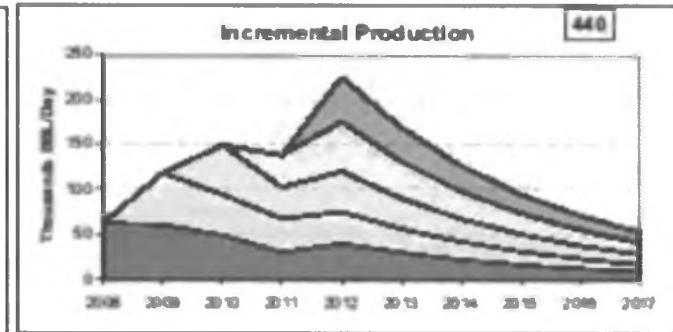
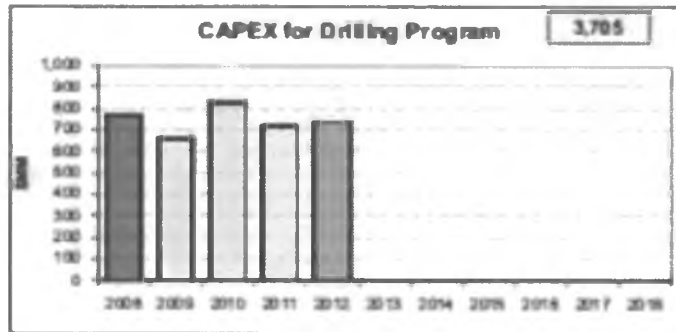
Royalty 12.5%

Net Tax Rate 25.0%

Progressivity 0.40%

Progressivity Start 30

Price 80



Tax Credits from actual


Forecast Only Mode



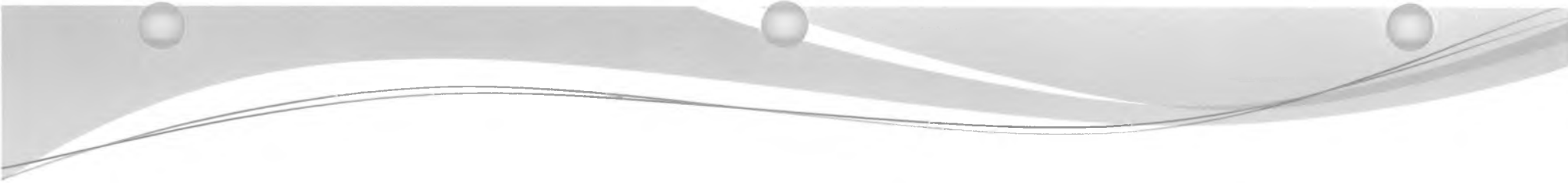
There is one final provision in SB 209 the sponsor asked me to highlight. It requires DNR to annually submit a report to the legislature that lists each lease found to be out of compliance and the action taken by the commissioner to bring the lessee back into compliance.



DNR has expressed its view on timely lease development in a variety of public statements.




The following statements were made in the context of Point Thomson, but could apply to any lease on which no exploration or development has taken place over an extended period of time.



“The State and the public are primarily interested in timely oil and gas production from State leases. Every year that production is delayed costs the State millions of dollars in unrealized interest on production revenue...”

(Denial of the proposed plans for the development of the Point Thomson Unit, page 18)



“It is not in the public interest to grant a state lessee an indefinite extension on development merely because development in their view is not currently profitable enough or is too risky.”

(Denial of the proposed plans for the development of the Point Thomson Unit. Page 20)


“It is not in the public interest to change leasehold intent by allowing a lessee’s parochial interests to supersede the State interest for orderly and reasonably prompt development.”

(Denial of the proposed plans for the development of the Point Thomson Unit, page 20)



“ ... delaying timely production
also constitutes waste.”

(Denial of proposed plans for the development of the Point Thomson
Unit, page 21)




“One of the state’s most significant interests in oil and gas leasing is production. The interest is realized by **compliance with the terms of the oil and gas leases....**”


(DNR Commissioner decision on appeal from DNR oil and gas Director’s October 27, 2005 decision on the 22nd PTU POD, page 15)

“The unitization scheme is intended to cause state leases to be developed efficiently. It is not intended to allow lessees to simply hold oil and gas leases indefinitely until such time as the probable profit from a project meets their subjective and internal expectations or the state agrees to modify its royalty or other contract rights or the state’s right to collect taxes.”

(DNR Commissioner decision on appeal from DNR oil and gas Director’s October 27, 2005 decision on the 22nd PTU POD, page 17)




This last slide is of particular interest in light of statements made by ConocoPhillips' Exploration Manager Michael Faust following Conoco's successful acquisition of 35 North Slope tracts this past December.



Faust said that exploration funding would depend in part on whether changes are made to the state's ACES production tax.

“One of that things that certainly weighs into that decision is the fiscal regime in Alaska.”

Michael Faust, Petroleum News, December 8, 2011



The sponsor believes this is an inappropriate approach to the development of leased state lands, which violates the terms of leases ConocoPhillips has signed.

“The state oil and gas leasing system is not intended to require DNR to engage in a murky subjective contest about a Lessees’ internal economics, development risk, or view of the difficult of developing the unit. One of the state’s primary interests is production. If production is not the plan, the state’s remedy is to terminate the unit and find another means to develop the unit.”

(DNR Commissioner decision on appeal from DNR oil and gas Director’s October 27, 2005 decision on the 22nd PTU POD, pg 17)

“Continuing this 30-year record of non-development and delay of an oil and gas lessee’s obligations to develop and produce its oil and gas leases makes a mockery of the statutory, regulatory and contractual protections for the State as owner of the oil and gas estate.”

(Denial of proposed plans for the development of the Point Thomson Unit, page 21)




As the legislature considers strategies to increase oil and gas production, the sponsor believes it's important to review and strengthen the state's leasing laws and commitment to lease enforcement.




Changing fiscal terms is not the only way to increase production.

As John Minge, the president of BP Exploration Alaska, recently said, “It’s not always only about taxes.”



During Alaska's constitutional convention, Bob Bartlett warned fellow delegates that outside interests might “attempt to acquire great areas of Alaska's public lands in order not to develop them until such time as ... they see fit.” He saw this as a danger to our development as a state.



Senate Bill 209 attempts to pre-empt that danger by requiring the state to include meaningful work commitments in all state oil and gas leases and to enforce those leases to ensure our resources are developed for the maximum benefit of all Alaskans.

Craig Richards

Presentation Outline Senate Resources on SB 209

855-463-5009

Have Alaska resources been warehoused?

Examples of warehousing

Northstar

Point Thomson

Prudhoe Bay

Gas

Other oil opportunities (e.g., heavy oil)

Big picture question asked by SB209: Should the State modify the terms of its leases to prevent acreage from being held with no present intent to develop?

Explain Primary Term v. Secondary Term

Habendum clause – actual production in paying quantities ; can substitute capability of production (i.e., shut in well)

Primary Term

Speculation: I'll define as holding a WI w/o present intent to develop

- Good and bad.
- Traditionally has had a role in marketplace - liquidity
- Have not studied speculation in Alaska
- More justifiable in role of speculator might lead to development
 - Cook Inlet v. North Slope
- Alaska has long primary terms
 - Common less than 5 years lower-48; 1 or 2 not uncommon
 - Less justifiable in longer primary terms
 - Challenged in Alaska
 - **10 years:** spot checked a half dozen leases and all 10 years;
 - **7 years:** in the 1990's 7 common including 2003 and 2009 model forms on website
 - although Model 2011 form for Beaufort had term blank.
- **Work commitments**
 - Could be from small to large (e.g, seismic to wells)
 - More demanding the more you'll diminish speculation
 - Intuition is speculation plays an important role in the market place
 - In Cook Inlet but not necessarily the ANS
 - For first few years but not after
 - I'd suggest a study as to the role of speculation in market place

- Might find mandatory work commitments on ANS leases make sense, or for any lease with a primary term over say five years.
 - Could have two parts to primary term, where first five years no work commitment but to hold for the next two to five you have to have approved plans of exploration

Secondary Term

- More observable problems are in secondary term
 - Unitization used as tool to maintain leases not in production
 - Point Thomson
 - Leases getting attached to existing units
 - Cook Inlet
 - Point Thomson
 - Production maintaining acreage, but not being fully developed
 - Classic example – drill one well and won't drill anymore
 - I'd be concerned about Cook Inlet
 - One but not all pools developed
 - Gas
 - Prudhoe Bay

Duty to Develop

- When no development, you fight over the term or duration of the lease or unit
- But once production commences term indefinite
- Duty to develop becomes the mechanism
- Express or implied
- 100% accepted by all o&g states by Statehood; applies to all of our leases. In fact most if not all of lease forms refer to the implied covenants
- Relevant implied covenants (Williams & Myers § 804)
 - *Duty to reasonably develop* – have to drill known, producing formations
 - *Duty to explore further* – must drill test wells in non-producing but potentially productive formations
 - *Duty to market* –
 - *Duty to conduct with reasonable care and due diligence all operations on the leasehold that affect lessor's royalty interest.*
 - *Catchall*
 - Must develop reasonably and not damage reservoir
 - No premature abandonment
 - Must use advanced production techniques
 - Must seek regulatory approvals
- Prudent operator standard
- Reasonable expectation of profit
- Example – Duty to Market suit on Prudhoe Bay Gas

- Prima facie case
 1. Discovery of oil and gas
 2. Failure to sell the product
 3. *Ability of a prudent operator to sell the product through exercise of reasonable diligence*
 4. Damage to the lessor as a result of failing to obtain a market.
- **Remedies**
 - Damages
 - Conditional decree of forfeiture
 - Forfeiture
 - Art. 8, § 8
- Can State recontract part of a unit or PA where there is production?
 - If voluntary or court orders forfeiture
 - Happens all the time that first lessee keeps existing wells and then second lessee comes in with right to further develop
 - In large producing fields remedy would complex and court mandated

Conclusion

State using tax policy as a substitute for enforcing its contract rights

The harm is declining oil production

- Discussion has been, cause is too high taxes
- But there are other, likely more relevant causes, that the State can address without giving away tax dollars
 - **Access to information**
 - Failure of this legislature to demand, or the Alaska ANS producers, to bring forward information makes optimizing ACES guess work.
 - **Competitive entry**
 - Barriers to entry in terms of access to facilities and reasonable transportation charges
 - Only one entity other than an Owners of TAPS that ships down TAPS
 - **Refusal to develop existing leases**
 - Steps to take:
 1. Non-producing leases/units: Diligence in not allowing non-producing leases, via unitization, to be held into secondary term
 2. Producing leases/units: Concern is Oil but not gas, or one oil play but not another
 - a. Mandatory reporting for marketing

b. Mandatory 5-year economic look

Jeff Stepp

From: Michelle Sydeman
Sent: Friday, March 23, 2012 9:42 AM
To: craig-wwa@ak.net
Cc: Sen. Bill Wielechowski; Jeff Stepp
Subject: Senate Bill 209: Stenghtening O&G leasing and enforcement procedures

Hi Craig,

Here are some of the issues Law was going to address that you should feel free to cover.

- What is the “duty to develop”?
- Does it apply to old leases (e.g., for the Prudhoe Bay unit) as well as new leases?
- Does it require production wherever oil can be recovered in paying quantities or simply that production occurs somewhere within a unit or participating area?
- What does “paying quantities” mean?
- Can units or participating areas be contracted if production is not occurring (and hasn’t over many years) in a particular part of a unit or PA where development would be reasonable profitable?
- Should our laws be amended to allow this?
- What does the “prudent operator” standard mean in practical terms?
- To what extent must state interests be considered when lessees are making investment decisions?

We thank you again for the insights and information you are providing to the legislature. Your service is much appreciated.

Michelle
465-6881

Senate Resources Committee
Joe Paskvan, Co-Chair / March 23, 2012

Let's call the meeting to order.

Let the record reflect that it is _____ p.m. on Friday, March 23.

Let the record reflect that there is a quorum. Present are

- Co-Chair Wagoner -- excused
- Senator Stedman
- Senator Stevens
- Senator Wielechowski
- Senator French
- Senator McGuire -- excused
- And myself, Senator Paskvan

During this hearing, we have two items on the agenda:

- First, the Committee will hear the merits of Senate Bill 209 relating to Development Plans for Oil and Gas Leases. This is the first hearing for Senate Bill 209 and the Committee looks forward to Senator Wielechowski's presentation of the bill and invited testimony;
- Second, the Committee will hear additional testimony regarding Senate Bill 215, relating to the Gasline Development Corporation and an In-State Gas Pipeline. Joining us today will be Joe Dubler, Vice President and Chief Financial Officer for the Alaska Gasline Development Corporation, to share his thoughts on the bill.

We will dedicate the first hour of the hearing to Senate Bill 209 and the final 30 minutes to Senate Bill 215. Both bills have been scheduled for additional hearings next week.

Senator Wielechowski ...

Calculation of State Subsidy for South to North Line

	<u>Tariff</u>	<u>Tariff+Gas</u>
ASAP Estimated Cost	6.45	8.45
Current Cook Inlet Cost of Gas		<u>6.85</u>
Allowable Tariff to beat ASAP	<u>6.45</u>	<u>1.60</u>
Average MCF/Day	60,000.00	60,000.00
# Days/Year	365.25	365.25
Allowable cost recovery/year	141,351,750	35,064,000
# of years of cost recovery in Tariff	<u>20</u>	<u>20</u>
Total cost able to be recovered	<u>2,827,035,000</u>	<u>701,280,000</u>
Pipeline cost, Big Lake to Dunbar	1,565,000,000 *	1,565,000,000
Lateral Line Dunbar to Fairbanks	60,000,000	60,000,000
Cost of Compressor Station in Cook Inlet	80,000,000	80,000,000
Cost of Chilling Unit at Cantwell	20,000,000	20,000,000
Annual Operating Costs @2% CapEx*20 years	690,000,000	690,000,000
Total cost of South to North	<u>2,415,000,000</u>	<u>2,415,000,000</u>
State Subsidy to run South to North	<u>(412,035,000)</u>	<u>1,713,720,000</u>

Note: Does not include cost of fuel gas, local distribution system for Fairbanks and vicinity, cost of re-engineering project, or inflation.

***cost of pipeline from dunbar to big lake less CI NGL Extraction and Compressor Station. Costs shown on 3-4 and 5-35 of July 1 report.**

Presented to the Senate Resources Committee by Joe Dubler, AGDC (3/23/2012)