ALASKA LEGISLATURE COMMITTEE FILES 1995-1996 8672
8965 SENATE RESOURCES

In May of 1963 the SRS group spudded a well in the Middle Ground Shoal area immediately to the south of the lease on which Pan Am had drilled the gas blowout the previous year and for which Pan Am and its partners had been awarded a discovery royalty in January. The first day the new regulations on discovery royalties were in effect, SRS filed an affidavit of first discovery based on encountering oil sands in various intervals in the area. Their application was denied by the department in December of 1963.

SRS requested reconsideration by the department and concurrently filed a document claiming that Pan Am's discovery award was not valid because the well was a blowout and, therefore, ought to be revoked. Several documents were filed on both sides.

The department issued a decision in May of 1965 upholding the original discovery royalty award to Pan Am and denying Shell's petition. This matter was then appealed to the courts. In 1969 the Alaska supreme court upheld the department's decision. Pan American Petroleum Corp. v. Shell Oil Co., 455 P.2d 12 (Alaska 1969).

E. Discovery Royalty Awards for North Cook Inlet, Beluga River, and Falls Creek.

1. North Cook Inlet award.

On November 12, 1962, the date Pan American had applied for discovery award for the Middle Ground Shoal No. 1, Pan Am also applied for a discovery award on ADL 17589 on the basis of the Cook Inlet No. 1 blowout. The department decided not to act on this application until after the discovery royalty regulations went into effect.

In August of 1963 (after the new regulations became effective), Pan Am was informed that a potential test to verify the existence of commercial quantities would be required. No testing was possible until the summer of 1964.

In the interim Shell protested any award of discovery benefits to Pan Am for the Cook Inlet No. 1 well and spudded a well on the lease immediately to the north of the lease where Pan Am had drilled the Cook Inlet No. 1 and No. 1-A wells.

In June and July of 1964, the Cook Inlet No. 1-A well was tested by Pan Am. In December of 1964, Pan Am was granted a discovery royalty for lease ADL 17589 based on the discovery made in the Cook Inlet No. 1 well and the potential test of the Cook Inlet No. 1-A well.

2. Beluga River and Falls Creek awards.

The SRS group had requested a discovery royalty in December of 1962 in conjunction with its Beluga discovery. Action on this request was initially delayed because the commissioner of natural resources believed that the Beluga discovery might be on the same structure as Pan Am's North Cook Inlet blowout. The SRS group contended, however, that it had an automatic right to an award because the state had recognized the Beluga discovery for the purpose of reclassifying adjoining state upland acreage from noncompetitive to competitive. There was an exchange of information between the department and the SRS group over this application at the same time as the deliberations on the adoption of the discovery royalty regulations were occurring.

In May of 1963 the SRS group applied for a discovery royalty for lease ADL 00590 on the basis of the gas discovery made in the Falls Creek Unit Number 1 well in April of 1961. When the department decided to defer action on both the Falls Creek and Beluga River applications until after the discovery royalty regulations were adopted, The SRS group objected that it was being treated unfairly.

In September and October of 1963, the SRS group reapplied for Beluga discovery certification. It was awarded on the same day that the SRS application for the Middle Ground Shoal oil discovery was denied.

In December of 1963 an application was submitted for the Falls Creek lease. It was processed under the new regulations, and a discovery royalty award was made on February 18, 1964.

F. Application for and Award of Discovery Royalty Certifications in the Trading Bay, McArthur River, and Nicolai Creek Areas.*/

1. Introduction.

In 1965, for the first time, offshore wildcat wells were drilled along the west shore of Cook Inlet on leases issued during the seventh and ninth competitive lease sales. Mobil and Union drilled the Granite Point No. 1 well on lease ADL 18761 from April 5, 1965, to August 5, 1965. The well resulted in discovery of the Granite Point oil field. The companies applied for a discovery royalty for the lease, which was awarded on September 14, 1965.

---

*/ A map depicting the top of the Hemlock gelogic formation and illustrating applications for discovery royalty awards in the Trading Bay and McArthur River areas is attached to this opinion as Appendix 3. Appendix 2 should be referenced to locate the Nicolai Creek area for which a discovery royalty award was also sought.

During this same drilling season Union (on behalf of itself and its co-lessee, Marathon) drilled four wells in the Trading Bay-McArthur River area. These wells and others which followed encountered oil in almost every instance in reservoirs contained in the Hemlock formation, which also contained the major oil reservoirs in the Middle Ground Shoal and Swanson River fields.

A number of exploratory wells were drilled in the Trading Bay-McArthur River area during the 1966 drilling season. Filings for five of these wells were made with the state, which initiated the discovery royalty certification process.

2. Application for and award of a discovery royalty certification for the Union Trading Bay No. 1-A well.

On May 9, 1965, Union, on behalf of itself and Marathon, spudded the first well on lease ADL 18731. The well (Trading Bay No. 1) was drilled to a depth of 747 feet. The casing parted at a depth of 126 feet while it was being set in the well, and the well was plugged and abandoned. On May 23, 1965, Union spudded another well from the same location, Trading Bay No. 1-A. In drilling this well Union discovered oil in the Trading Bay field. The well was completed at a depth of 6,832 feet on June 25, 1965.

Union and Marathon applied for a discovery royalty for lease ADL 18731 based on this discovery. The department found that Union and Marathon had adequately established a discovery date of May 23, 1965, and that the potential test conducted on June 17, 1965, had established that the Trading Bay No. 1-A well was capable of producing commercial quantities. The department also found that the Trading Bay feature was a separate structure. The application for this discovery award was processed and certified on August 27, 1965.

3. Application for a discovery royalty certification of the Grayling No. 1-A well.

Union and Marathon drilled two more wells from locations on lease ADL 18731 after the Trading Bay No. 1-A discovery. In the late summer of 1965 the drilling barge which had been used to drill these wells was moved to lease ADL 17594 immediately to the south, also a Union-Marathon lease. Union commenced the Grayling No. 1 well here on September 2, 1965. As a result of mechanical problems encountered in the early stages of drilling, the well had to be plugged and abandoned at a depth of 817 feet.

Grayling No. 1-A was commenced immediately and tested for commercial quantities from November 6 to November 8, 1965. An application for discovery royalty certification was submitted on November 15 and amended on November 19. Oil and gas sands

were encountered intermittently in this well from depths of 3,305 feet to 9,770 feet, including a 400-foot pay interval from 9,370 to 9,770 feet in the Hemlock zone.

The department found that the date of discovery for the Grayling No. 1-A well was October 24, 1965, and that commercial quantities had been encountered within the Hemlock zone. However, for the first time since the discovery royalty program was commenced, there was a serious question as to whether the discovery had been made on a new geologic structure. The decision issued on January 26, 1966, concluded:

> Insufficient subsurface information exists to determine that the McArthur River feature on which the Grayling No. 1-A well is located is not overlapped by the previously certified Trading Bay geologic feature. Thus, the well does not satisfy the requirement for being a discovery well on a geologic structure previously uncertified, and the application on the Grayling No. 1-A well is hereby denied.

On February 10, 1966, a meeting took place in Anchorage between Union-Marathon officials and department officials to discuss the decision denying Union-Marathon's request for discovery certification. In one meeting Tom Marshall of the division of mines and minerals told Union-Marathon officials that he was concerned about the possibility that shallow productive sands continuously overlaid both the Trading Bay structure and the Grayling structure. Marshall also told one of the oil

company representatives that his view of the McArthur River application relied heavily on the "dominant structure concept" referred to in USGS Circular 419. Another meeting was held with Erle Mathis, chief of the minerals section of the division of lands, who encouraged Union and Marathon to request time to submit additional evidence.

On February 14, 1966, Union filed a document with the division of lands entitled, "Petition for Reconsideration and Interpretation of Decision of the Director of the Division of Lands Dated January 26, 1966, in the Matter of Discovery Well Certification Grayling No. 1-A well -- ADL 17594." In this petition Union requested that applicable regulations be interpreted to permit Union to submit additional and supporting information at a later time or to allow reconsideration by the director of his decision on the basis of additional supporting information then available, including evidence satisfying the criteria used for the determination of geologic structures by the USGS in administering the Mineral Leasing Act of February 25, 1920.

Erle Mathis prepared a proposed decision responding to Union's petition. He conferred with Tom Marshall about it before sending it to the commissioner. The proposed decision denied Union's request for reconsideration on the ground that the state's oil and gas leasing regulations would not permit it. However, the proposed decision permitted Union to submit any

additional supporting information and authorized an award of discovery royalty if that information established that Grayling No. 1-A was on a separate geologic structure. This proposed decision was never issued.

Beginning on February 16, 1966, Tom Marshall provided Jim Williams, director of the division of mines and minerals and chairman of the Oil and Gas Conservation Committee, with a series of reports regarding his February 11 meeting with Union-Marathon. In these reports Marshall stated that the discussion was limited to the state's interpretation of the definition of geologic structure and that USGS Circular 419 was the principal basis used for determining geologic structure. He outlined a number of problems regarding the definition of geologic structure, including the complicating effects of stratigraphically controlled production, dominant structure, trends of folding, the interpretation and accuracy of seismic records, and the absence of subsurface data.

In his reports Marshall reiterated that the main problem with the Grayling application was the occurrence of undefined stratigraphic traps in the shallow horizons. He felt that it would be a mistake to award a discovery royalty for the Grayling well before the extent and continuity of those traps were known. He mentioned the other problem of determining how much vertical displacement along faults is required to separate geologic structures, and wondered what development of the field

would provide sufficient subsurface information to resolve this problem.

Marshall also said that the procedures used by the USGS in determining KGSs were discussed and that the point was made that the state regulations did not allow the state to make a tentative determination regarding geologic structure, unlike federal regulations which allowed federal officials to delineate an undefined KGS. He noted that state officials were without the benefit of surface geology available to persons working in uncovered upland areas. He explained that the USGS makes its final KGS determination after an evaluation of all controlling factors, but that like information was not available to the state with respect to the Trading Bay and McArthur River areas at this time.

On March 2, 1966, the commissioner of natural resources responded to Earl Mathis' suggested reply to Union-Marathon's petition for reconsideration. In his response the commissioner concluded that there were two separate geologic structures present, but expressed concern about the problem of one lease covering a portion of two separate structures -- an entirely different issue than that being dealt with by Marshall, Williams, and Mathis. He felt that the time limit imposed by the regulations could be circumvented if the petition were accepted by the commissioner rather than the division of lands, thus enabling

a study of the problem to be made. He also indicated that the attorney general had been requested to review the question of whether a five percent royalty would apply to the entire lease if a discovery well were drilled in a new structure where the area of the lease also covered a second structure that had been previously certified as a discovery on a different lease. It is apparent from this opinion request that the commissioner was concerned with lease boundaries (the legal interpretation of the words "all production from the lease") rather than a question involving the boundaries of a geologic structure.

On August 26, 1966, an opinion was issued by the attorney general's office which resolved the question of lease boundaries. The conclusion was that all production from the lease should enjoy the benefits of discovery royalty even though it were derived from a structure which was previously the subject of a discovery royalty on another lease. However, the principal questions of whether or not Trading Bay and McArthur River were separate structures was not addressed by this opinion.

There was no further active consideration of the Union-Marathon application until 1968.

4. Discovery royalty certification of the Nicolai Creek State No. 1 well.

Because the term of the leases issued in the seventh and ninth competitive sales was five years, there were a large number of wells drilled and several discovery well certification applications filed in the 1966 drilling season.

The first discovery royalty request in the 1966 drilling season came for a well drilled by Texaco -- Nicolai Creek State No. 1. Texaco had spudded this well in the fall of 1965. On May 23, 1966, Texaco submitted evidence in support of an April 28, 1966, priority date. In early May the well was tested and found to be capable of producing commercial quantities of gas. Texaco applied for discovery well certification on June 13, 1966, which was approved on August 19, 1966.

5. Discovery affidavit for the SAS Foreland Channel State No. 1 well.

On June 10, 1966, Shell (on behalf of itself, Standard Oil of California, and Atlantic Richfield) filed an affidavit of first discovery for the SAS Foreland Channel State No. 1 well. No potential tests were conducted on this well, and no discovery certification application was filed.

6. Discovery affidavit for the Pan Am North Redoubt Well No. 1.

Pan Am drilled the North Redoubt Well No. 1 for the Pan Am group in the spring and summer of 1966. According to the affidavit filed on June 23, 1966, the depth in that well corresponded very closely to the Hemlock discovery in Union's Grayling No. 1-A well. Although geologic structure boundary information and evidence of commercial quantities were submitted in early September, Pan Am did not actually apply for discovery royalty certification.

7. Application for discovery royalty certification of the Kustatan No. 1-A well.

Meanwhile, Union had been drilling the Kustatan No. 1 well on Union-Marathon's lease ADL 18729, immediately to the south of their Grayling lease. This well was drilled to 11,600 feet during April, May, and June 1966. Union filed affidavits to establish priority of time and date of discovery for this well. During the period August 5 to 7, 1966, a commercial quantities test was witnessed by the state. On September 6, 1966, Union formally applied for discovery certification. One week later Union withdrew the application pending submission of additional information, which was submitted on October 7, 1966. Union withdrew this application in December 1966 before any action on it had been taken by the department.

8. Application for discovery royalty certification of the West Foreland Unit No. 3 well.

Atlantic Richfield drilled the West Foreland Unit No. 3 well on lease ADL 18777 into the upper left arm of the McArthur River Hemlock reservoir. On August 3, 1966, an affidavit of first discovery was filed in support of a July 25, 1966, discovery date with the Oil and Gas Conservation Committee. A commercial quantities test was conducted on August 16, 1966.

On September 28, 1966, Atlantic Richfield submitted its geologic structure boundary evidence to the Conservation Committee. In an explanatory letter which accompanied this evidence, Atlantic Richfield explained why it believed the Hemlock reservoir, in what it labeled the "Foreland Field," was separate from the Hemlock reservoir encountered by Union in Grayling No. 1-A. The explanation claimed that a barren syncline separated the Hemlock field encountered by the Grayling 1-A well from that encountered by the West Foreland Unit No. 3 well and that the hydrocarbon accumulation in the McArthur River structure was not in communication with that of West Foreland No. 3.

On September 30, 1966, Atlantic Richfield formally applied to the division of lands for certification of discovery royalty of the West Foreland Unit No. 3 well. On the basis of this submission, there was further discussion within the

department on the definition of geologic structure and whether the concept of dominant structure, originally advanced by Tom Marshall from USGS Circular 419, was the best interpretive approach to solving this issue.

On December 9, 1966, a decision was issued by the director of the division of lands denying Atlantic Richfield's request for discovery royalty certification on the ground that the well was on the Greater Trading Bay structure for which a discovery royalty had been previously awarded. He made this decision notwithstanding the fact that the earlier denial of Union-Marathon's application was on the basis that there was insufficient evidence to determine whether the Trading Bay and McArthur River features were separate structures. On December 30 Atlantic Richfield filed a petition for reconsideration of the director's decision. There was discussion within the department on whether and when to consider the petition for reconsideration (Atlantic Richfield was in favor or delay until further information from drill reports from subsequent operations became available). Like the Union-Marathon request for reconsideration, there is no indication in the record that any thought was given to the matter until a year later.

9. Application for discovery royalty certification of Texaco's Trading Bay State No. 1 well.

In the late summer of 1966 Texaco, on behalf of itself and Superior Oil Company, commenced the Trading Bay State No. 1 well on lease ADL 17597. On September 27, 1966, the well was tested for commercial quantities. This test also served as the basis for an affidavit of first discovery. The well was drilled through the oil bearing zones in both the Kenai and Hemlock formations.

On March 7, 1967, denial of Texaco's application was issued by the director of the division of lands on the grounds that the well was not capable of producing oil in commercial quantities and that it was located on the Greater Trading Bay structure on which discovery certification was previously granted.

10. Application for discovery royalty certification of Atlantic Richfield's Trading Bay State No. 1 well.

Another discovery was claimed in the McArthur River-Trading Bay area in the summer of 1967. This claim was made by Atlantic Richfield for the Trading Bay State No. 1 well on lease ADL 34531. According to the affidavit of first discovery, evidence of first discovery was encountered in the well on June 7, 1967. The well was drilled into the Hemlock accumulation north of the McArthur River Hemlock reservoir on the downthrown side of the Trading Bay fault. Atlantic Richfield named this

accumulation the Ivan Bering Field. A commercial quantities test was conducted on June 25, 1967. Application for discovery royalty certification was filed on September 27, 1967. The application was then considered by state officials.

The decision of the Oil and Gas Conservation Committee issued to the division of lands recommended that certification be denied on the ground that drilling the Trading Bay State No. 1 well had not resulted in the first discovery on a new geologic structure. The relevant portion of the committee's decision stated:

> Section 505.744 - Establishment of Geologic Structure: It is the opinion of the Oil and Gas Conservation Committee that the Ivan Bering Field discovered by the Trading Bay State #1 well is controlled by a fault or faults associated with the Greater Trading Bay Structure. Inasmuch as a discovery royalty was previously awarded to the Trading Bay Structure, the Committee does not consider that the Trading Bay State #1 well is the first discovery on the dominant geological structure.

On December 7, 1967, the decision denying Atlantic Richfield's application for discovery royalty certification of the Ivan Bering field was issued. By letter dated December 21, 1967, Atlantic Richfield requested reconsideration of the decision rejecting their application and permission to submit additional data. This petition was supplemented on December 28, 1967.

11. Application for discovery royalty certification for Redoubt Shoal No. 2.

There was one more discovery well certification application considered by the state for a well drilled in the Trading Bay vicinity. In the summer of 1968, Pan American drilled Redoubt Shoal Unit No. 2 well on lease ADL 29690. This well was drilled into a Hemlock accumulation 4 1/2 miles south of the McArthur River Hemlock reservoir. An affidavit to establish priority of discovery was filed in early October 1968. The formal application for discovery certification was filed on November 12. The committee concluded that commercial quantities had been encountered but that the Redoubt Shoal feature was a downfaulted nose subsidiary to the Trading Bay dominant geologic structure which had been previously awarded a discovery royalty. Pan American filed a notice of appeal to the superior court on February 19, 1969, but the appeal never proceeded to a disposition on the merits.

12. Reconsideration of the Grayling No. 1-A, West Foreland Unit No. 3, and Atlantic Richfield Trading Bay State No. 1 applications for discovery royalty certification.

Atlantic Richfield's application for reconsideration of the denial of discovery royalty certification for the discovery

in the Ivan Bering field prompted Pedro Denton, chief of the minerals section of the division of lands, to change his mind about how much time should be given to discovery certification applicants to prove the boundaries of geologic structures. On January 29, 1968, he wrote to then Commissioner Thomas E. Kelly that the cutoff period established by the regulations provided a reasonable time period, that holding discovery royalty applications in abeyance would cause serious financial administrative problems, and that no evidence gathered after the time limit should be accepted. He was concerned that if the period were unlimited, some companies would continue to demand refunds or credit many years after the ten year term from first encounter had expired, with severe adverse effects on state fiscal planning.

On October 31, 1968, the commissioner sent out three decisions with respect to these three long-standing discovery royalty applications, Union-Marathon's Grayling 1-A (ADL 17594), ARCO's West Foreland No. 3 (ADL 18777) and ARCO's Trading Bay State No. 1 (ADL 35431). Each of these decisions provided as follows:

1. On the basis of the information available at this time, the Director's decision was proper.

2. Adequate time has been allowed the applicant to submit supporting information as requested in their petition for reconsideration.

3. That applicant's request for an opportunity to submit supporting information is reasonable.

> Therefore, the applicant is granted 60 days from receipt of this decision in which to supply supporting information or to schedule a hearing at a time mutually agreeable to the state and the applicant. If no supporting information or hearing is scheduled within the time allowed, the Director's decision will be affirmed.

Atlantic Richfield filed a letter, three exhibits, two enclosures, and a copy of the notice describing the well tests ending July 1, 1967, with Commissioner Kelly in response to these decisions on December 26, 1968. The letter suggested a meeting with state officials to discuss and develop technical data supporting the application. The technical data submitted with this letter included Exhibit 1, an evaluation of mechanical logs; Exhibit 2, a structure contour map; Exhibit 3, a structural cross section A-A[1]; Enclosure 1, well completion information drafted on an electric log; and Enclosure 2, a core analysis -- cores 1-10. They all pertained to lease ADL 34531 and the Ivan Bering field and purported to show that the field was on a separate structure from both the Trading Bay and McArthur River fields. Atlantic Richfield filed nothing with respect to lease ADL 18777 and the West Foreland Unit No. 3 well. These letters were followed up on January 26, 1968, with a legal brief from Theodore F. Stevens and Russell H. Holland, representing Atlantic Richfield. The brief was almost word-for-word the same as the one filed a year earlier in support of Atlantic Richfield's discovery royalty application for the West Foreland Unit No. 3 well.

On December 30, 1968, Union supplemented their application for certification of the Grayling No. 1-A well by filing a blue box which was labeled, "Appendix Geologic Reports and Exhibits." In the box were maps and exhibits and a narrative interpretation explaining the maps and exhibits. Union requested that the matter be set for a hearing at the earliest possible time.

On January 9, 1969, Pedro Denton forwarded to the commissioner his arguments on why the 90-day time limit on geologic structure information ought to be strictly enforced.

On February 7, 1969, Atlantic Richfield was notified that the decision of December 9, 1966, denying discovery certification of the Foreland field was affirmed because no additional information had been submitted.

On June 5, 1969, the Oil and Gas Conservation Committee informed the director of lands that they had reviewed the documents and exhibits submitted to the division of lands on December 30, 1968, and found that this additional information did not warrant a change in the committee's original decision dated January 1, 1966. This letter was signed by Tom Marshall and O. K. Gilbreth, Jr. The results of the review were never forwarded to Union-Marathon.

No further action was taken on either Union's or ARCO's application until February 26, 1970. At that time the commissioner sent out decisions to both Atlantic Richfield and Union-Marathon establishing hearing dates of April 16, 1970, and April 17, 1970, for the pending certification applications. In this notice Commissioner Kelly notified both sets of applicants that his review would be limited to information which was filed within the original 90-day period.

The Atlantic Richfield hearing was conducted on April 16, 1970. At the hearing additional information was presented to show that the Ivan Bering field was one of several entrapping mechanisms on separate structures, each of which should be entitled to discovery royalty certification.

The Union-Marathon hearing was conducted on the next day. At this hearing Union and Marathon introduced a light blue folder full of new exhibits corresponding with Volumes 1 and 2 of the exhibits later submitted on September 28, 1969.

On June 8, 1970, Union-Marathon sent Commissioner Kelly a letter stating the legal reasons why he should look at the after-acquired evidence. Pedro Denton then sent the commissioner a copy of his January 7, 1969, notes which argued that after-acquired evidence should be disregarded.

In August of 1970 the Conservation Committee sent Commissioner Kelly a memorandum which concluded that the original Union-Marathon decision was correct. Pedro Denton then drafted a decision to send to Union-Marathon which contained a lengthy justification for disregarding the after-acquired evidence. The commissioner did not sign Pedro Denton's proposed decision. Rather, he signed a final decision prepared by the Attorney General's office. This decision, again denying Union-Marathon's application for discovery certification, was sent on October 7, 1970.

On November 5, 1970, the chief of minerals forwarded to the commissioner for signature a proposed decision denying Atlantic Richfield's discovery royalty application for ADL 35431. The commissioner signed the decision on December 3, 1970, and the decision was sent to Atlantic Richfield.

13. Judicial review of the decisions denying discovery royalty for Union's Grayling No. 1-A well and Atlantic Richfield's Trading Bay State No. 1 well.

Both Union-Marathon and Atlantic Richfield appealed to the courts. Union and Marathon sought review of the commissioner's October 7, 1970, decision in the superior court, which remanded the matter to the commissioner for a new decision including a statement of the basis for the decision. The

commissioner issued a decision on February 17, 1972, denying discovery well certification on the grounds that insufficient information had been submitted within the 90-day period prescribed by the regulations to determine whether the Grayling well was on a separate geologic structure and that evidence submitted after the 90-day period could not be considered. The companies again sought review in the superior court which dismissed the appeal on the ground that the court lacked jurisdiction. Union-Marathon then lodged their first appeal with the supreme court, which reversed and remanded the matter for further consideration. Union Oil Co. of Cal. v. State Dept. of Nat. Resources, 526 P.2d 1357 (Alaska 1974).

On remand, the superior court affirmed the administrative decision and concluded that the commissioner could not legally consider the after-acquired evidence offered by the applicants, that the commissioner had not granted them the right to submit after-acquired data, and that the director's decision denying discovery royalty certification was clearly sustained by the evidence. Union-Marathon appealed to the supreme court for the second time. The court concluded that the commissioner could legally consider after-acquired evidence and remanded the matter to the commissioner for a determination of the reasonableness of the 90-day limit and to receive additional data and rule upon the basis of all data submitted if, under the circumstances, the limit were found to be unreasonable.. Union Oil Co. of

Cal. v. State Dept. of Nat. Resources, 574 P.2d 1266 (Alaska 1978).

The Atlantic Richfield case was stayed in the superior court by stipulation pending resolution of the Union-Marathon application. Atlantic Richfield Co. v. State Dept. of Nat Resources, No. 3AN-70-3789 Civ.

VI. THE 90-DAY LIMITATION.

In its 1978 decision the supreme court addressed the question of whether the commissioner has the power to consider new evidence of geologic structure which is supplied after the 90-day deadline established by 11 AAC 505.744 (recodified as 11 AAC 83.210(c) (repealed November 9, 1979). The court concluded that the unreasonableness of the 90-day limitation could not be answered on the basis of the record before it. Therefore, it ordered that Union-Marathon be given the opportunity on remand to demonstrate that the 90-day limitation, as applied to them in this case, was unreasonable.

In its decision the supreme court discussed some of the factors which are pertinent to a determination of whether the 90-day requirement should be waived in this case. 574 P.2d at 1272-74. These factors included the advantages of finality, the

desire for stability, the importance of administrative freedom to reformulate policy, the extent of party reliance upon the first decision, the degree of care or haste in making the first decision, and the general equities of each problem, among others.

I determined this issue without affording Union-Marathon the opportunity to demonstrate that the 90-day limitation, as applied to them was unreasonable. My consideration of the factors raised by the supreme court led to my conclusion that I should waive the 90 day limitation and consider data submitted after that period where that data contains evidence of facts in existence at the time the original decision was made. I reached that conclusion for the following reasons.

1. Promot adjudication of discovery royalty applications was of some importance given the incentive nature of the discovery royalty program. Early decisions on awards would tend to maximize the incentive from the standpoint of applicants and other lessees. Delays in processing applications would have diluted the incentive were they to become a consistent pattern. However, most of the applications were relatively routine. Therefore, permitting occasional delays for the submission of additional evidence on unusually difficult applications would not have significantly dampened the incentive. Moreover, the state experienced no trend in false submissions requiring expeditious denial as an enforcement mechanism.

2. Agencies often request additional specified information if the information in the original submittal is not sufficient to provide grounds for a firm decision. In this case, the applicable regulations plainly did not guarantee conclusive determinations in every instance because the evidence in support of a geologic structure determination was largely left to the discretion of the applicant. For example, 11 AAC 83.210(c) (repealed November 9, 1979)*/ states that this evidence may include the "operator's interpretation" of geophysical and other specified data in addition to the data itself. Other than a definition of the term "geologic structure," there are no set criteria establishing the guidelines for the state's decision. 11 AAC 83.200 - 11 AAC 83.230 (repealed November 9, 1979).**/ The exercise of some latitude in the handling of each application is therefore implicit in the content of these regulations. Under the circumstances, an extension of time to submit additional evidence would not be considered unusual as a matter of agency practice. Moreover, the supreme court strongly suggested that there would be no prejudice to the public interest in considering data obtained after the 90-day period where the data (in this case subsurface geology) would not change over time. See 574 P.2d at 1273.

---

*/ Formerly 11 AAC 505.744.

**/ Formerly 11 AAC 505.74 -- 11 AAC 505.741.

3. During the early years of the discovery royalty program in Cook Inlet, the government had little or no information other than the data submitted by the applicant. In the case of the Grayling No. 1-A application, Union-Marathon submitted during the 90-day peiod unusually complete information which included a cross-sectional interpretation of the data. It was this cross section which led Tom Marshall to postulate a possible overlap in the shallow Middle Kenai sands extending into the Trading Bay feature. See Section V.F.3 above. This was only an hypothesis; later-acquired evidence proved it to be incorrect. Nevertheless, Marshall's hypothesis led the department to deny the discovery royalty application on the ground that insufficient subsurface information existed to determine that the McArthur River feature was not overlapped by the previously certified Trading Bay geologic structure.

It is only logical to permit the submission of additional evidence when (1) the applicant submitted unusually detailed information originally, (2) the information generated possible doubt about the validity of the application but could not be proved, (3) the government could only deny the application based on insufficient (rather than contrary) evidence with the 90-day period, and (4) the regulatory requirements governing submission of evidence were vague and judgmental. In order to establish procedural finality, the government could have set a cutoff date for any further evidence. However, while

Union-Marathon appealed the initial denial of January 26, 1966, on February 4, 1966, the Department took no action at all for 2½ years, at which time it granted Union 60 days to submit more information. On December 30, 1968, Union submitted additional information and requested a hearing.

The department did not hold a hearing until April 17, 1970, almost five years after the 90-day period had elapsed. Half a year after the hearing, on October 7, 1970, the commissioner summarily affirmed the original decision. His decision was appealed to the superior court, which remanded the matter to the commissioner for a new decision, including the basis for the decision. On February 17, 1972, the commissioner denied certification on exactly the same grounds as the original 1966 decision, namely that insufficient information was submitted during the 90-day period to determine whether Grayling No. 1-A was on a separate structure.

In summary, although the state's decision not to consider evidence beyond the 90-day period may initially have been reasonable, by virtue of its subsequent behavior it has waived any opportunity to confine additional evidence to a limited period. Further, the discovery royalty program was repealed in 1969, so there is a limited potentially adverse precedent to consider.

Therefore, it is appropriate to consider all geologic evidence submitted by Union-Marathon in conjunction with this case to determine whether they are entitled to a discovery royalty on the grounds that the McArthur River feature is a separate geologic structure from the previously certified Trading Bay geologic structure.

VII. GEOLOGIC STRUCTURE.

A. Applicable Law.

At the time that Union-Marathon applied for discovery well certification of their Grayling No. 1-A well, the holder of a state oil and gas lease that drilled and made the first discovery of oil or gas in commercial quantities in a geologic structure could be rewarded by paying a discovery royalty of only five percent for the first ten years, after which the normal rate (12 1/2 percent of the value of the oil and gas produced) was applicable. AS 38.05.180(a). The pertinent portion of AS 38.05.180(a) provided:

> . . . the holder of a lease who drills and makes the first discovery of oil or gas in commercial quantities in a geologic structure shall pay a royalty on all production under the lease of five per cent for 10 years following the date of discovery and thereafter the royalty rate shall be not less than 12 1/2 per cent.

(Emphasis supplied.)

The regulations contained at 11 AAC 83.230 (repealed November 9, 1979) (formerly 11 AAC 505.74--11 AAC 505.748) specified the procedures for proving the three elements required by AS 38.05.130(a) for discovery well certification: date of discovery, commercial quantities, and geologic structure. 11 AAC 83.210(c) (repealed November 9, 1979) (formerly 11 AAC 505.744) specified the procedure for establishing geologic structure, the only criterion at issue here. The relevant portion provided:

> To establish the geologic structure from which the oil or gas can be produced, the operator must furnish pertinent data to the committee which will enable it to determine the geologic structure from which the oil or gas is being produced. This may include, but is not limited to, geophysical data, total depth, casing records, perforation data, electric logs, drilling and mud logs, core analyses, sample cuttings and sample logs and the operator's interpretation thereof, together with any other records and interpretations the operator deems pertinent. This data must be supplied within 90 days after the date of the potential test as required in (b) of this section.

Additional guidance was provided by 11 AAC 83.205(2) (repealed November 9, 1979) (formerly 11 AAC 505.741(b)), which defined the term "geologic structure" as:

> any structural and/or stratigraphic entrapping mechanism containing one or more intervals, zones, strata, formations, or fault blocks which has the necessary physical characteristics to accumulate and prevent the escape of oil and/or gas. It is intended that the meaning shall be similar to that

used by the United States Geological Survey in the administration of the Federal Mineral Leasing Act of February 25, 1920 (41 Stat. 437) as amended.

The discovery royalty system was curtailed and finally abolished by legislative amendments in 1967 and 1969. 1967 Alaska Sess. L., ch. 97, §2; 1969 Alaska Sess. L., ch. 65, §1.

B. Historic Background.

In 1959 Alaska was a cash-poor state. At this time, exploitation of the state's oil and gas resources was thought to be the best avenue for remedying this situation. The cash would come from bonuses from lease sales and from royalties from leases producing hydrocarbons in commercial quantities. An active leasing program and aggressive exploration activities by lessees were therefore desired goals. Against this background the state's discovery royalty program (which made its first appearance as section 3(7), article VIII, chapter 169, SLA 1959) was adopted to provide a substantial incentive to oil companies to come to Alaska (which was, at the time of statehood, a frontier area from the standpoint of its oil and gas potential) and conduct exploratory drilling operations for and produce oil and gas on state leased land.

The discovery royalty program was plainly successful. It is obvious from the attention devoted to including the dis-

covery royalty program in the 1959 Alaska Land Act, the active participation of oil companies in the drafting of the discovery royalty regulations, and the disputes among the companies over controversial awards that discovery royalty provided an incentive for oil companies to come to Alaska. It is also evident that the discovery royalty program generated drilling races between competing companies on neighboring leases. Undoubtedly, Cook Inlet would have been explored and developed by the oil companies even without the discovery royalty program. However, the state's discovery royalty program definitely accelerated exploration and development activities on state oil and gas leases, thus helping to satisfy the state's objective of obtaining cash as quickly as possible after statehood to fund the state government and finance the provision of essential public services.

C. Decision Criteria.

In considering the issue of geologic structure, there were several approaches suggested in the course of the hearings which I did not consider a valid basis for determining the issue.

First, I did not use the predeposition approach advanced by Mr. William Van Alen. Under this approach Mr. Van Alen constructed a paleostructure map depicting the greater Trading Bay feature at the time hydrocarbons were deposited in the reservoir rock. This paleostructure map was constructed

using all available well data by (1) restoring all fault blocks to the positions they occupied before faulting took place, (2) undoing the effects of compression acting on the structure, and (3) restoring the location of sediments to their original position. The result was that Mr. Van Alen demonstrated the existence of an ancestral Trading Bay anticline dating back approximately 60 million years. The Trading Bay and McArthur River features which exist today evolved from a once undistorted anticline similar in general appearance to that at Middle Ground Shoal. Were I to adopt Mr. Van Alen's approach, I would deny the Union-Marathon application on the ground that both the Trading Bay No. 1-A and Grayling No. 1-A wells penetrated features the origin of which was a single anticline.

I have accepted the accuracy of Mr. Van Alen's paleostructure map as well as his outstanding analysis of the general development of Cook Inlet geology notwithstanding some contrary interpretations submitted by Union-Marathon. However, I do not believe that the existence of an ancestral Trading Bay anticline is pertinent to this decision. Given the incentive nature of the discovery royalty program, it is my belief that the determination should be made on the basis of the geology as it existed at the time of the alleged discovery, regardless of whether that geology was substantially different at an earlier period in time. Otherwise, the program might not have accomplished its purpose of encouraging the discovery of new geologic structures.

Second, I did not employ the K6S concept used by the USGS in the administration of the Federal Mineral Leasing Act of February 25, 1920, 41 Stat. 437, as amended, as described further in USGS Circular 419. That the KGS concept is not dispositive of the issue is demonstrated by the conflicting testimony of Emmett Finley and Joseph David "Red" Cerkel, both formerly serving as chief of the Minerals Classification Branch of the USGS, the agency responsible for making KGS determinations.

Based upon well completion reports from the original Trading Bay No. 1-A well, Mr. Finley drew the KGS boundary around the 7000 foot contour (essentially describing the Trading Bay feature). When shown the well completion reports from the other Trading Bay wells and the Grayling No. 1-A well, Mr. Finley stated that USGS practice would have been to extend the KGS boundary to encompass both areas. Thus, his opinion was that only one KGS would have been drawn around the Trading Bay and McArthur River features by the USGS. Mr. Finley adhered to this conclusion even after reviewing Union's after-acquired evidence graphically displaying the best current geologic understanding of the Trading Bay and McArthur River fields.

However, based on the information available at the time of Union-Marathon's discovery royalty application for the Grayling No. 1-A well, Mr. Cerkle testified that he would have placed an undefined KGS around each feature. When presented with

the updated information, he testified that it was sufficient to completely define the areas and warranted their formal promulgation as two separate defined KGSs.

Further, Mr. Ed Hall, a witness appearing on behalf of Union-Marathon, systematically reviewed USGS KGS determinations in various oil and gas provinces around the United States and demonstrated conclusively that USGS practice varied substantially from area to area. He proved that either Mr. Finley's or Mr. Cerkle's approach might have been used in this case. Moreover, the KGS concept was used by the USGS to make determinations as to whether lands would be leased competitively or noncompetitively, not for discovery royalty awards. The competitive determination is considerably less crucial than a decision as to whether a lessee is to receive a discovery royalty award, and substantial flexibility in applying the KGS for its original intended purpose is acceptable, since the principal effect is on prospective rather than existing lessees. This may explain why the UGS did not feel compelled to issue Circular 419 until 1959 despite the use of the KGS concept in thousands of competitive/noncompetitive determinations since 1920, and the observation in Circular 419 that no phrase in the 1920 Mineral Leasing Act "has resulted in more speculation as to its precise meaning than the phrase 'known geologic structure of a producing oil and gas field.'" In essence, the KGS concept was far less precise than the task it was expected to accomplish in circumstances such as presented by

this case. It worked adequately in obvious cases and not well at all in closer ones. Therefore, while the authors of Alaska's discovery royalty statute and regulations may have intended to follow federal practice, the KGS concept did not provide sufficiently specific criteria to properly found a decision.*/

A third approach which did not present a sufficient basis for determination of this case was the "dominant structure" concept used by the department during the early 1960s on a number of discovery royalty applications. This concept, developed by Thomas Marshall, was used as the basis for rejecting discovery royalty applications filed by Atlantic Richfield for certification of its West Foreland Unit No. 3 and Trading Bay State No. 1 wells, by Texaco for its Trading Bay State No. 1 well, by Amoco for the Redoubt Shoals well, and by Union-Marathon for the Grayling No. 1-A well. All of these applications except the Grayling application were rejected on the basis that the geologic structure on which each well was located was part of the previously certified Greater Trading Bay geologic structure. The Grayling application was rejected on the basis that insufficient

---

*/ In addition, none of the regulations implementing the Alaska Oil Proviso, the federal counterpart to Alaska's discovery royalty program, ever used the term "known geologic structure of a producing oil and gas field." Rather, like Alaska's discovery royalty provision, the term "geologic structure" was used. There is, therefore, no express application of the Circular 419 KGS methodology contained in either federal or state law governing discovery royalties.

subsurface information existed to determine whether or not the McArthur River feature was overlapped by the Greater Trading Bay structure.

Mr. Marshall testified that this approach was designed to treat essentially intact anticlinal areas as dominant structures for purposes of aggregating discovery royalty applications. It was devised in response to the inherent ambiguity of the discovery royalty statute. The statute provided for the award of a discovery royalty to the first well drilled on a new "geologic structure" which, from the standpoint of geology, could be as large as Cook Inlet or as small as a microfold. Two competing objectives needed to be reconciled in the context of the inherent ambiguity of the statute: (1) the provision of a sufficiently strong incentive to encourage the oil industry to venture expeditiously into a frontier oil and gas province, and (2) the need to avoid a discovery royalty approach which would result in the award of a discovery royalty for every new accumulation of oil that was found.

Generally, the department did an excellent job in the award of discovery royalties; a review of all discovery royalty awards for Cook Inlet shows that only one was made for each major anticline in the Cook Inlet area. Any other approach would have resulted in too few or too many awards to have successfully meshed the competing objectives mentioned above. However, all of

the other anticlines in Cook Inlet are relatively intact and undisturbed: the Trading Bay/McArthur River features constitute a geologic exception to the pattern of reservoirs discovered in Cook Inlet. The "dominant structure" concept is simply overly general to provide a conclusive answer to a situation where a once single anticline was subsequently severely compressed, distorted, and offset into two distinct features. As a result, the "dominant structure" concept does not provide a sufficient basis to deny a discovery royalty award solely on a finding that a well is located on the same essentially intact anticlinal area as a previously certified discovery well.

Consequently, in order to determine whether the Grayling No. 1-A well was drilled on the same "geologic structure" as the Trading Bay No. 1-A well, there must be an inquiry based on a common sense analysis of the purposes of the discovery royalty program. I have determined that this inquiry must have two parts:

Predrilling Expectation: Did the lessee's opportunity to drill the Grayling No. 1-A well on the McArthur River prospect, based on the information available at the time the decision was made, constitute a proposition of sufficient risk with respect to the possible discovery of a new reservoir such that the state would wish to encourage it by providing a discovery royalty incentive?

Post-drilling Verification: Did the geologic evidence generated after the Grayling No. 1-A well was drilled tend to confirm the lessee's initial belief that the McArthur River feature was relatively distinct from the Trading Bay feature, and that a decision to drill constituted a risk which should be rewarded by granting the discovery royalty incentive?

The Predrilling Expectation inquiry is necessary because the discovery royalty incentive operates at the time a lessee is faced with a decision to commence a well on a new prospect. If the geologic information then available indicated a magnitude of difference in the characteristics of the Trading Bay and McArthur River features, the potential award of a discovery royalty could substantially influence the outcome of the decision on whether and when to drill the well, which was the purpose of the discovery royalty program.

The Post-drilling Verification inquiry is required to demonstrate that the Predrilling Expectation, as contained in the lessee's geologic interpretation of the area, was not seriously in error as a result of substandard evaluation efforts and that a distinct structure has been discovered.

The Predrilling Expectation factor is important; reliance solely on geologic information acquired long after a well has been drilled to adjudicate an application would render

the discovery royalty concept a mere sporting proposition. The Post-drilling Verification factor is equally necessary; inadequate geophysical evaluation at the time of a decision to drill a well could make a gamble out of what would be a virtual certainty for a prudent lessee, and the incentive would be promoting inefficiency. Therefore, both inquiries must be satisfied to justify the discovery royalty award.

D. Analysis

1. Predrilling Expectation. The decision by Union-Marathon to drill the Grayling No. 1-A well was accompanied by sufficient risk with respect to discovery of a new major reservoir, given the information available at the time, as to justify the provision of an incentive by the state, for the following reasons:

a. Union-Marathon's recognition of the existence of two separate features in the Trading Bay area resulted from data provided by their 1959 offshore seismic survey of Cook Inlet. The results of offshore gas exploder seismic surveys conducted in 1960-1961 in preparation for a 1961 state lease sale further defined these two structures. At this time, the companies assigned separate code names to both prospects. Although evidence indicated that Union-Marathon was aware of the discovery royalty implications inherent in the designation of two struc-

tures rather than one collective Trading Bay structure, it is apparent that the companies considered these separate features with differing characteristics. Mr. Richard Lyon testified that the seismic data on the Trading Bay feature consistently showed a sharply defined and attractive potential entrapping mechanism. The data for McArthur River, however, was less consistent. While indicating the presence of an anticline which might be a considerable reservoir, the anticline was shallow and less well defined with a substantial possibility that insufficient closure existed to contain any hydrocarbons which might have been produced. As a result, Union-Marathon bid ten times the bonus money to acquire the tract overlying the Trading Bay feature as it did for the tract covering the McArthur River feature.

b. Seismic work done in 1963 and 1964 further defined these two prospects and was used to locate sites for test wells. Predrilling interpretations of this seismic data showed the existence of two features separated by faulting and a syncline at both the shallow and deep horizons. In 1964 separate AFEs (authorizations for expenditure) were prepared for management approval or the test wells to be drilled on each geologic prospect. Mr. Lyon testified that the presence of a discovery royalty provided him with additional support within his company in the competition to obtain AFEs for both wells.

c. In 1965 three wells (including the Trading Bay No. 1-A discovery well) were drilled to locate the accumulation limits of the Trading Bay structure and to define the boundaries of the Trading Bay structural trap. While the Trading Bay discovery did confirm that the Hemlock was a producing zone within at least part of the collective Trading Bay area as it was elsewhere in Cook Inlet, the evidence of substantial faulting between Trading Bay and McArthur River (and therefore the likelihood of noncommunication between any productive zones) was, if anything, reinforced. Moreover, doubts regarding closure of the McArthur River anticline were in no way diminished.

d. While it may have been logistically convenient for Union-Marathon to move its drilling barge south from Trading Bay to drill the Grayling No. 1-A well, Tom Marshall testified that this action definitely represented a stepping out by Union-Marathon into an area of very considerable uncertainty. It must be remembered that the seismic data and even well data at this point were very scarce and relatively unreliable. Moreover, all of the wells in this area were offshore, and there was no surface geology which could be used to assist in confirming seismic data interpretations. Most important, although it is difficult to appreciate now that platforms are a routine part of the landscape, Cook Inlet was a frontier area during the years shortly after statehood. With the presence of ice, severe tides, and highly adverse weather conditions, there was no assurance

that the area would be successfully developed even if hydrocarbons were present. It was viewed, therefore, much as the Beaufort Sea or the Chukchi Sea are looked at now as potential oil and gas provinces.

e. While the Hemlock zone which produced oil at Trading Bay was considered prospective, Union-Marathon were more attracted by structures at shallower horizons. Thus, the prime target with respect to potential reservoir rock was different at McArthur River than at Trading Bay, increasing the risk factor.

f. In summary, the McArthur River prospect was very much the type that the state would have wanted to have explored. The area was definitely doubtful despite a discovery at Trading Bay, but the potential returns were large given the size of the prospect. Seismic data existing at the time before the drilling of the area indicated two separate prospects of considerably different characteristics and risk, and would have been so viewed by any competent lessee. Under these circumstances, the application of an incentive to obtain early and expeditious drilling of the McArthur River prospect was plainly in the state's interest.*/

---

*/ Whether the discovery royalty program actually caused or influenced Union-Marathon's decision to drill the Grayling 1-A well is irrelevant. To deny an award based on the fact that the particular lessee would have drilled the well anyway for its own reasons would be unjustly punitive. The question is whether there was sufficient risk or doubt regarding success that the state would have wanted to encourage an affirmative decision to drill.

2. Post-Drilling Verification. The after-acquired evidence submitted by Union-Marathon demonstrates that the situation occurring at the Pre-Drilling Expectation stage was as perceived, and that the risk involved at the time justified the application of the discovery royalty incentive. In fact, the after-acquired evidence substantiates that the separateness and differing characteristics of the respective reservoirs was somewhat greater than believed in 1965. This conclusion is warranted by the following factors:

a. Evidence presented by the applicant demonstrates that there is no overlap in any gas or oil formation between the Trading Bay and McArthur River features.

b. The extensive number of wells drilled in the intervening area between the Trading Bay and McArthur River features establishes that there is no communication between hydrocarbon accumulations in either of the features.

c. Although both the Trading Bay and McArthur River features possess oil bearing sands in the Hemlock formation, there are both gas (above D zone) and oil (West Foreland) producing horizons in the McArthur River feature which are not present in the Trading Bay feature.

d. The geochemistry for McArthur River hydrocarbons differs significantly for parafins, aromatics, and napthenes from that discovered at Trading Bay.*/

e. The area between the Trading Bay and McArthur River features is transected by a massive strike slip fault. The area within the Trading Bay feature which at the time of the ancestral anticline was opposite the McArthur river featureis now 3 1/2 miles to the east. Moreover, there is a very large displacement of the Hemlock zone to the extent that it is 3,500 feet deeper in McArthur River than in the Trading Bay feature.

It is the last factor which is most persuasive. When looking at the oil and gas fields discovered in Cook Inlet, they are nearly all readily discernable and intact anticlines with primarily a single defined reservoir within each. One discovery royalty was awarded for each of these anticlines. While nearly all of these anticlines contain some local faulting, no discovery royalty was awarded before or after the Grayling 1-A well on the

---

*/ While the applicant claimed that this resulted from different geologic origins of Trading Bay and McArthur River, it is my opinion that the McGoon and Claypool report (referenced in Exhibit 1 to Mr. Van Alen's testimony) is more likely correct. It is their belief that variations in geochemistry resulted from differing bacterial deterioration rates of accumulated hydrocarbons during the post-deposition stage rather than from a totally different geologic origin in the context of source rock. However, this does not affect my conclusion that the once existing Trading Bay ancestral anticline developed into two very distinct structures.

basis that local faulting created separate structures (in fact, most applications initially filed on this basis were later withdrawn). The greater Trading Bay/McArthur River area, however, is the one heavily distorted and displaced anticline in Cook Inlet, the only one in which major oil accumulations are divided by a large regional fault (in fact, the only regional fault present in Cook Inlet), and substantially offset in vertical distance as well.

In the context of Cook Inlet geology, the pattern of discovery royalty awards, the purpose of the discovery royalty system, and the potential risk of drilling on the McArthur River feature (which appeared very different from the Trading Bay feature before drilling and was confirmed to be very different after drilling) justifies the conclusion that (1) both the Predrilling Expectation and Post-drilling Verification analyses confirm the propriety of applying a discovery royalty from the standpoint of the purpose of the program, (2) McArthur River is, therefore, a separate geologic structure from the structure at Trading Bay within the meaning of the discovery royalty statutes and regulations, and (3) Union-Marathon is, therefore, entitled to a discovery royalty award for all production from lease ADL 17594.

Dated August 18th, 1982, in Juneau, Alaska.

Geoffrey Haynes
Deputy Commissioner
Department of Natural Resources

APPENDIX 1

CORRECTION

THE FOLLOWING DOCUMENT(S)
HAVE BEEN REFILMED TO
ASSURE LEGIBILITY OR PAGINATION

APPENDIX 1

Final sponsor: The Rules Committee
By request of the Governor

Offered: 3/10/69

IN THE SENATE BY THE COMMERCE COMMITTEE

CS FOR SENATE BILL NO. 81

IN THE LEGISLATURE OF THE STATE OF ALASKA

SIXTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to oil and gas leases; and providing for an effective date."

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

* Section 1. AS 38.05.180(a) is amended to read:

(a) All tide and submerged lands, mental health lands, school lands, and university lands shall be leased by competitive bidding, and whenever oil or gas is discovered in commercial quantities, the commissioner shall determine the extent of the area of lands in addition to tide, submerged, mental health lands, school, or university lands in the same general area of the discovery well which, by reason of the discovery, the commissioner reasonably believes to be capable of producing oil or gas, and the additional lands shall be leased to the highest responsible qualified bidder by competitive bidding under general regulations, in units of not exceeding 2,560 acres (except that tide and submerged lands shall be leased in units of not exceeding 5,760 acres), which shall be as nearly compact in form as possible, upon the payment by the lessee of such bonus as may be accepted by the commissioner and of such royalty as may be fixed in the lease which shall not be less than 12 1/2 per cent in amount or value of the production removed or sold from the lease. [HOWEVER, THE HOLDER OF A LEASE WHO DRILLS AND MAKES THE FIRST DISCOVERY OF OIL OR GAS IN COMMERCIAL QUANTITIES IN A GEOLOGIC STRUCTURE SHALL PAY A ROYALTY ON ALL PRODUCTION UNDER THE LEASE OF FIVE PER CENT FOR 10 YEARS FOLLOWING THE DATE OF DISCOVERY AND THEREAFTER THE ROYALTY RATE SHALL BE NOT

LESS THAN 12 1/2 PER CENT, PROVIDED, HOWEVER, THAT THE ROYALTY RATE FOR THE FIRST DISCOVERY IN ANY UNPROVEN AREA OF THE COOK INLET SEDIMENTARY BASIN SHALL NOT BE LESS THAN 12 1/2 PER CENT UNLESS THE COMMISSIONER SPECIFICALLY PROVIDES THAT SUCH ROYALTY SHALL BE LESS AT THE TIME SUCH LANDS ARE OFFERED FOR LEASE AND IN NO EVENT SHALL SUCH ROYALTY BE LESS THAN FIVE PER CENT.] All lands other than those above provided to be leased by competitive bidding may be leased competitively or noncompetitively as determined by the commissioner to be in the best interests of the state. Noncompetitive leases shall be issued in units of not exceeding 2,560 acres in any one lease. Noncompetitive leases shall be conditioned upon the payment by the lessee of a royalty of 12 1/2 per cent in amount or value of the production removed or sold from the lease. [HOWEVER, THE HOLDER OF A LEASE WHO DRILLS AND MAKES THE FIRST DISCOVERY OF OIL OR GAS IN COMMERCIAL QUANTITIES IN A GEOLOGIC STRUCTURE SHALL PAY A ROYALTY ON ALL PRODUCTION UNDER THE LEASE OF FIVE PER CENT FOR 10 YEARS FOLLOWING THE DATE OF DISCOVERY AND THEREAFTER THE ROYALTY RATE IS 12 1/2 PER CENT.] Competitive leases issued under this subsection shall be for 10 years <u>except that in the Cook Inlet sedimentary basin, leases shall be for a primary term of not more than 10 years and not less than five years at the discretion of the commissioner,</u> and shall continue so long thereafter as oil or gas is produced in paying quantities. Noncompetitive leases issued under this subsection shall be for a primary term of five years and shall continue so long thereafter as oil or gas is produced in paying quantities. If drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, such operations to include redrilling, sidetracking or other means necessary to reach the originally proposed bottom hole location, the lease shall continue in effect until 90 days after drilling has ceased and for so long

thereafter as oil or gas is produced in paying quantities. If all or part of the lands covered by the lease are lands that have been selected by the state under laws of the United States granting lands to the state and a patent has not been issued thereon, a conditional lease may be issued. However, no term extension may be granted for the period during which the lease was conditional.[CONDITIONAL LEASE WAS ISSUED THEREON, THE TERM OF THE LEASE SHALL BE EXTENDED FOR A PERIOD EQUAL TO THE PERIOD DURING WHICH THE LEASE WAS CONDITIONAL]

* Sec. 2. This Act takes effect on the day after its passage and approval or on the day it becomes law without approval.

LAWS OF ALASKA

1969

Source: CSSB 81 am H

Chapter No. 65

AN ACT

Relating to oil and gas leases; and providing for an effective date.

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

* Section 1. AS 38.05.180(a) is amended to read:

(a) All tide and submerged lands, mental health lands, school lands, and university lands shall be leased by competitive bidding, and whenever oil or gas is discovered in commercial quantities, the commissioner shall determine the extent of the area of lands in addition to tide, submerged, mental health lands, school, or university lands in the same general area of the discovery well which, by reason of the discovery, the commissioner reasonably believes to be capable of producing oil or gas, and the additional lands shall be leased to the highest responsible qualified bidder by competitive bidding under general regulations, in units of not exceeding 2,560 acres (except that tide and submerged lands shall be leased in units of not exceeding 5,760 acres), which shall be as nearly compact in form as possible, upon the payment by the lessee of such bonus as may be accepted by the commissioner and of such royalty as may be fixed in the lease which shall not be less than 12 1/2 per cent in amount or value of the production removed or sold from the lease. All lands other than those above provided to be leased by competitive bidding may be leased competitively or noncompetitively as determined by the commissioner to be in the best interests of the state. Noncompetitive leases shall be issued in units of not exceeding 2,560 acres in any one lease. Noncompetitive leases shall be conditioned upon the payment by the lessee of a royalty of 12 1/2 per cent in amount or value of the production removed or sold from the lease. Competitive leases issued under this subsection shall be for 10 years except that in the Cook Inlet sedimentary

basin, leases shall be for a primary term of not more than 10 years and not less than five years at the discretion of the commissioner, and shall continue so long thereafter as oil or gas is produced in paying quantities. Noncompetitive leases issued under this subsection shall be for a primary term of five years and shall continue so long thereafter as oil or gas is produced in paying quantities. If drilling has commenced on the expiration date of the primary term of the lease and is continued with reasonable diligence, such operations to include redrilling, sidetracking or other means necessary to reach the originally proposed bottom hole location, the lease shall continue in effect until 90 days after drilling has ceased and for so long thereafter as oil or gas is produced in paying quantities. If all or part of the lands covered by the lease are lands that have been selected by the state under laws of the United States granting lands to the state and a patent has not been issued thereon, a conditional lease may be issued. However, no term extension may be granted for the period during which the lease was conditional.

• Sec. 2. This Act takes effect on the day after its passage and approval or on the day it becomes law without approval.

Approved by governor: May 5, 1969

LAWS OF ALASKA

1969

Source: HB 233

Chapter No.: 66

AN ACT

Relating to sale of timber and materials.

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

• Section 1. AS 38.05.115 is amended to read:

Sec. 38.05.115. LIMITATIONS AND CONDITIONS OF SALE. (a) The commissioner, upon recommendation of the director, shall determine the timber and other materials to be sold, and the limitations, conditions and terms of sale. The limitations, conditions and terms shall include the utilization, development and maintenance of the sustained yield principle, subject to preference among other beneficial uses. The director may negotiate sales of timber or materials without advertisement and on the limitations, conditions, and terms which he considers are in the best interests of the state, subject to the approval of the commissioner. However, not more than 500 M.B.M. of timber or more than $2,500 of materials may be sold by nonadvertised, negotiated sale to the same purchaser within a one-year period.

(b) Negotiated sales for timber or materials not exceeding a value of $250 are exempt from the provisions of AS 34.15.150.

Approved by governor: May 5, 1969
Actual effective date: August 3, 1969

INDEX

No.	Author and Title	First reading	Committee reports	Second reading	Third reading	Reconsideration: Sent to [illegible]	Other action	Action by governor	First reading	Committee reports	Second reading	Third reading	Reconsideration: Returned to [illegible]	Other action	Ch. No.	Chapter No.
73.	Engstrom: Relating to national forest income.	25	104 303	319	320	329	598 625	720	345	582	614	614	614 695			32
74.	Engstrom: Relating to foreign fish processing vessels.	25	484	532												
74.	Substitute: Resources Committee: Same title.			532	532 542 562											
75.	Begich: Relating to relocation assistance and authorizing payments to persons displaced by certain highway activities; effective date.	25	426 441													
76.	Thomas: Relating to judgments and orders of juvenile courts.	25	176 688	724	724	742			841	876 908						
77.	B. Phillips, Ziegler: Establishing the voting age at 18 years; effective date.	26	644	679 681	681	689	341		790							
78.	Josephson, Rader: Relating to state legal holidays.	26														
79.	Josephson: Relating to oil and gas lease provisions requiring reports of labor conditions.	26	687 785													

No.	Author and Title	First reading	Committee reports	Second reading	Third reading	Reconsideration: Sent to [illegible]	Other action	Action by governor	First reading	Committee reports	Second reading	Third reading	Reconsideration: Returned to [illegible]	Other action	Ch. No.	Chapter No.
80.	B. Phillips: Relating to the state museum.	29	207	219	219	230	353	442	253	323	339	340 348	349	364		10
81.	Rules Committee by Request of the Governor: Relating to oil and gas leases; effective date.	29	139 304	320												
A1.	Substitute: Commerce Committee: Same title.			320	321	329	764 782 851	943	346	573 717 794	820	821	837	778 899		65
82.	Rules Committee by Request of the Governor: Providing for a gubernatorial successor in the event that both the Governor and Secretary of State are temporarily absent from the office.	30	458 688	724	725	742			841	909 942						
83.	Blodgett: Relating to department of fish and game employees as guides.	30														
84.	Blodgett: Requiring nonresident big game hunters to be accompanied by a guide.	31														
85.	Meyers: Relating to the compilation of jury lists.	31	616	631												
85.	Substitute: Judiciary Committee: Same title.			631	631	632	798 816		715	809	872	872	877	885 899		
85.	Substitute: Free Conference Committee: Same title.						830 913	943					955	920		67
86.	Begich: Relating to the rights of initiative, referendum and recall reserved to the people of the organized boroughs.	32	160 254	291	291	306	720 759	943	313	686 746	795	796	796 800 836			70
87.	Begich: Amending the Teachers' Retirement System; effective date.	32	358													

The House was called to order at 11:25 a.m.

CSHB 332 am — Mr. Fink withdrew his objection. There being no further objection, amendment No. 3 was adopted.

amendment No. 4 by Beirne:

Page 2, line 5: Strike "period" and add "provided the applicant shall have complied with AS 08.80.110(5)"

Mrs. Beirne moved and asked unanimous consent that amendment No. 4 be adopted. Mr. Guess objected. Mr. Guess withdrew his objection. Mr. Sweet objected. Mr. Sweet withdrew his objection. There being no further objection, amendment No. 4 was adopted.

Mrs. Beirne moved and asked unanimous consent that COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 332 amended be considered engrossed, advanced to third reading and placed on final passage. There being no objection, it was so ordered.

COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 332 amended was read the third time.

The question being: "Shall COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 332 amended pass the House?" The roll was called with the following result:

Yeas: 37 - Anderson, Banfield, Beirne, Boardman, Borer, Bradner, Bronson, Cornelius, Croft, Deveau, Ellason, Guess, Harris, Haugen, Hensley, Hillstrand, Hohman, Holm, Jackson, Kay, McGill, McVeigh, Miller, Orbeck, Paukan, Reeves, Rettig, Sackett, Schwarm, Sweet, Tillion, Young.

Nays: 5 - Fink, Kerttula, Metcalf, Ray, Sassara.

Excused: 3 - Chance, Moses, Peratrovich.

And so, COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 332 amended passed the House and was referred to the Chief Clerk for engrossment.

Mr. Guess moved and asked unanimous consent that the House revert to Reports of Standing Committees. There being no objection, the House reverted to

REPORTS OF STANDING COMMITTEES

CSSB 81 — The Finance Committee has had COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 (relating to oil and gas leases) under consideration and a majority of the members of the committee recommends it do pass with the following amendment:

amendment No. 1 by the Finance Committee:

Page 3, lines 1 through 4: Restore deleted material on lines 1 through 4 ending with the word AND.

Page 3, line 4: Insert following material after AND: "patent has not been issued thereon, a conditional lease may be issued.

However, no term extension may be granted for the period during which the lease was conditional." CSSB 81

The report was signed by Mr. Ray, Chairman, and concurred in by Ray, Croft, Bradner, Sackett, Haugen and Borer.

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 was referred to the Rules Committee for placement on the calendar.

CONSIDERATION OF DAILY CALENDAR (continued)

SECOND READING OF SENATE BILLS

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 191 (relating to property exempt from execution) was read the second time with the Judiciary Committee report (pages 718 - 719 of the journal). CSSB 191

amendment No. 1 by the Judiciary Committee:

Page 1, lines 14, 17 and 18: Delete "a single person" and insert in its place "he is not the head of a family."

Mr. Cornelius moved and asked unanimous consent that amendment No. 1 be adopted. There being no objection, amendment No. 1 was adopted. CSSB 191 am

Mr. Cornelius moved and asked unanimous consent that COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 191 amended by the House be considered engrossed, advanced to third reading and placed on final passage. There being no objection, it was so ordered.

COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 191 amended by the House was read the third time.

The question being: "Shall COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 191 amended by the House pass the House?" The roll was called with the following result:

Yeas: 29 - Anderson, Banfield, Beirne, Boardman, Bronson, Cornelius, Croft, Deveau, Fink, Guess, Haugen, Hensley, Hohman, Holm, Jackson, Kay, Kerttula, Metcalf, Miller, Moses, Orbeck, Paukan, Reeves, Rettig, Sackett, Sassara, Schwarm, Sweet, Young.

Nays: 6 - Borer, Bradner, Ellason, Harris, Hillstrand, Tillion.

Excused: 5 - Chance, McGill, McVeigh, Peratrovich, Ray.

Mr. Ellason changed his vote from yea to nay.

And so, COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 191 amended by the House passed the House and was referred to the Chief Clerk for engrossment.

SENATE BILL NO. 86 (relating to the rights of initiative, referendum and recall reserved to the people of the SB 86

HB 341 And so, HOUSE BILL NO. 341 passed the House.

Mr. Ray moved and asked unanimous consent that the roll call on the passage of HOUSE BILL NO. 341 be considered the roll call on the effective date clause. There being no objection, it was so ordered.

HOUSE BILL NO. 341 was referred to the Chief Clerk for engrossment.

HB 273 HOUSE BILL NO. 273 (relating to the examination for communicable diseases of persons in custody) was read the second time with the Health, Welfare and Education Committee report (page 333 of the journal) and the Judiciary Committee report (pages 745 - 746 of the journal).

CSHB 273 Mr. Cornelius moved and asked unanimous consent that COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 273 be adopted in lieu of HOUSE BILL NO. 273. Mr. Guess objected. Mr. Guess withdrew his objection. There being no further objection, COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 273 was adopted.

Mr. Cornelius moved and asked unanimous consent that COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 273 be considered engrossed, advanced to third reading and placed on final passage. There being no objection, it was so ordered.

COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 273 was read the third time.

The question being: "Shall COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 273 pass the House?" The roll was called with the following result:

Yeas: 29 - Anderson, Banfield, Beirne, Boardman, Bronson, Cornelius, Deveau, Fink, Guess, Harris, Haugen, Hillstrand, Hohmann, Holm, Kay, Kerttula, McGill, Metcalf, Miller, Mosea, Orbeck, Peratrovich, Ray, Rettig, Sackett, Schwamm, Sweet, Tillion, Young.

Nays: 5 - Borer, Bradner, Croft, Ellason, Reeves.

Excused: 6 - Chance, Hensley, Jackson, McVeigh, Paukan, Sansara.

And so, COMMITTEE SUBSTITUTE FOR HOUSE BILL NO. 273 passed the House and was referred to the Chief Clerk for engrossment.

SECOND READING OF SENATE BILLS

CSSB 81 COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 (relating to oil and gas leases; and providing for an effective date) was read the second time with the Resources Committee report (page 573 of the journal) and the Finance Committee report (pages 794 - 795 of the journal).

amendment No. 1 by the Finance Committee:

Page 1, lines 1 through 4: Restore deleted material on lines 1 through 3 ending with the word AND.

Page 3, line 8: Insert the following material after AND: "patent has not been issued thereon, a conditional lease may be issued. However, no term extension may be granted for the period during which the lease was conditional." CSSB 81

Mr. Croft moved and asked unanimous consent that amendment No. 1 be adopted. Mr. Kay objected. Mr. Kay withdrew his objection. There being no further objection, amendment No. 1 was adopted. CSSB 81 am H

Mr. Croft moved and asked unanimous consent that COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 amended by the House be considered engrossed, advanced to third reading and placed on final passage. Mr. Fink objected. Mr. Fink withdrew his objection. Mr. McGill objected. Mr. McGill withdrew his objection. There being no further objection, it was so ordered.

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 amended by the House was read the third time.

The question being: "Shall COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 amended by the House pass the House?" The roll was called with the following result:

Yeas: 32 - Anderson, Banfield, Beirne, Boardman, Borer, Bradner, Bronson, Cornelius, Croft, Deveau, Ellason, Fink, Guess, Harris, Haugen, Hillstrand, Holm, Kay, Kerttula, McGill, Metcalf, Mosea, Orbeck, Peratrovich, Ray, Reeves, Rettig, Sackett, Schwamm, Sweet, Tillion, Young.

Nays: 1 - Miller.

Excused: 7 - Chance, Hensley, Hohman, Jackson, McVeigh, Paukan, Sansara.

And so, COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 amended by the House passed the House.

Mr. Guess moved and asked unanimous consent that the roll call on the passage of COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 amended by the House be considered the roll call on the effective date clause. There being no objection, it was so ordered.

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 amended by the House was referred to the Chief Clerk for engrossment.

Mr. McGill gave notice of reconsideration of his vote on COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 amended by the House.

Mr. Cornelius gave notice of reconsideration of his vote on COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 amended by the House.

SENATE BILL NO. 142 amended (relating to physical therapists; and providing for an effective date) was read the second time with the Health, Welfare and Education Committee report (page 681 of the journal) and the Commerce Committee report SB 142 am

January 30.

Also, if it is agreeable with the members of the House and Senate, I would suggest 3 p.m., this same date, as the time for presentation of the budget message and 1969-1970 budget appropriation bill to a joint session of the Legislature.

I join with all Alaskans in wishing the members of the First Session of the Sixth State Legislature a productive and rewarding session.

Best personal regards.

Sincerely yours,

s/ Keith H. Miller
Keith H. Miller
Governor"

MESSAGES FROM THE HOUSE

A message dated January 30, 1969, was read requesting the Senate meet in joint session January 30, 1969, at 11:00 a.m. to hear the Governor's State of Affairs message, and at 3:00 p.m. to receive the Governor's budget message.

Senator Hammond moved and asked unanimous consent that a message be transmitted to the House accepting their invitation. There being no objection, it was so ordered.

Senator Hammond moved and asked unanimous consent that a message be sent to the House asking it to join with the Senate in inviting Congressman Howard W. Pollock to address a joint session of the Legislature February 10, 1969. There being no objection, it was so ordered.

• • •

Senator Pledgett requested permission to be excused from a call of the Senate from today until Monday, February 4. There being no objection, it was so ordered.

ENGROSSMENT

SCR 2 The Secretary reported that SENATE CONCURRENT RESOLUTION NO. 2 (honoring the late E. L. "Bob" Bartlett) had been correctly engrossed, signed by the President and Secretary and transmitted to the House for their consideration.

INTRODUCTION AND REFERENCE OF SENATE RESOLUTIONS

SCR 1 SENATE CONCURRENT RESOLUTION NO. 1 by Senator Peetch,

expressing concern of the Legislature for sound oil and gas conservation practices in Alaska and directing that a study be made, was read the first time and referred to the Resources Committee. SCR 1

INTRODUCTION AND REFERENCE OF SENATE BILLS

SENATE BILL NO. 80 by Senator B. Phillips, entitled: SB 80

"An Act relating to the state museum."

was read the first time and referred to the State Affairs Committee.

SENATE BILL NO. 81 by the Rules Committee by request of the Governor, entitled: SB 81

"An Act relating to oil and gas leases; and providing for an effective date."

was read the first time and referred to the Resources Committee.

The Governor's transmittal letter covering SENATE BILL NO. 81 is as follows:

"January 29, 1969

The Honorable Jay S. Hammond
Chairman, Senate Rules Committee
Alaska State Legislature
Juneau, Alaska 99801

Dear Mr. Chairman:

Pursuant to State Law and the Uniform Rules of the Legislature, I am transmitting herewith a bill entitled 'An Act relating to oil and gas leases; and providing for an effective date.'

This amendment eliminates the extension of term on the lease for lands on which the State has only tentative approval at the time of leasing. A conditional lease has often been considered by most companies as drillable title and the fact of conditionality is no detriment to development of the leases. Some leases have extended to 15 years. I feel that the State did not contemplate nor intend for a lessee to be entitled to hold a lease beyond a ten year primary term. This bill also reverts to a minimum five year term oil and gas lease, at the discretion of the Department. The shorter term will hasten development and drilling activities in many areas and will open up more opportunities for smaller companies and independents not presently active in Alaska, by causing the land to be released at an earlier date.

Sincerely yours

SCR 6 SCR 6 The above two resolutions were referred to the Rules Committee for placement on the calendar.

SCR 7 The State Affairs Committee has had SENATE CONCURRENT RESOLUTION NO. 7 (study of Alaskan natives' employment) under consideration and the committee recommends it do pass. The report was signed by Senator Engstrom, Chairman, and concurred in by Senators Kosiosky, Merdes, Butrovich and Blodgett.

SENATE CONCURRENT RESOLUTION NO. 7 was referred to the Rules Committee for placement on the calendar.

Senator Blodgett moved and asked unanimous consent that his name be added as a sponsor on SENATE CONCURRENT RESOLUTION NO. 7. There being no objection, it was so ordered.

SB 104 The State Affairs Committee has had SENATE BILL NO. 104 (statue of E.L. Bartlett) under consideration and the committee recommends it do pass. The report was signed by Senator Engstrom, Chairman, and concurred in by Senators Merdes, Butrovich, Kosiosky and Blodgett.

SENATE BILL NO. 104 was referred to the Rules Committee for placement on the calendar.

SB 131 The State Affairs Committee has had SENATE BILL NO. 131 (Human Rights Commission) under consideration and the committee recommends it do pass. The report was signed by Senator Engstrom, Chairman, and concurred in by Senators Butrovich, Merdes and Blodgett. Not concurring was Senator Kosiosky who recommends: "Do not pass."

SENATE BILL NO. 131 was referred to the Rules Committee for placement on the calendar.

SJR 1 The State Affairs Committee has had COMMITTEE SUBSTITUTE FOR HOUSE JOINT RESOLUTION NO. 1, am (National Cemetery [illegible]) under consideration and the committee recommends it do pass. The report was signed by Senator Engstrom, Chairman, and concurred in by Senators Butrovich, Merdes, Blodgett and Kosiosky.

COMMITTEE SUBSTITUTE FOR HOUSE JOINT RESOLUTION NO. 1, am, was referred to the Rules Committee for placement on the calendar.

HJR 14 The State Affairs Committee has had HOUSE JOINT RESOLUTION NO. 14 (Commemorative Stamp, the late Sen. E. L. "Bob" Bartlett) under consideration and the committee recommends it do pass. The report was signed by Senator Engstrom, Chairman, and concurred in by Senators Merdes, Butrovich, Kosiosky and Blodgett.

HJR 14 HOUSE JOINT RESOLUTION NO. 14 was referred to the Rules Committee for placement on the calendar.

HCR 6 The State Affairs Committee has had HOUSE CONCURRENT RESOLUTION NO. 6 (commending Senator Gruening) under consideration and the committee recommends it do pass. The report was signed by Senator Engstrom, Chairman, and concurred in by Senators Kosiosky, Merden and Butrovich. Not concurring was Senator Blodgett, who had no recommendation.

HOUSE CONCURRENT RESOLUTION NO. 6 was referred to the Rules Committee for placement on the calendar.

SB 70 The Finance Committee has had SENATE BILL NO. 70 (appropriating for Legislative Affairs Agency) under consideration and the committee recommends it be replaced with COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 70, with the same title, and that the Committee Substitute do pass. The report was signed by Senator V. Phillips, Chairman, and concurred in by Senators Lewis, Bradshaw and Haggland. Not concurring was Senator Miller who had no recommendation.

SENATE BILL NO. 70 was referred to the Rules Committee for placement on the calendar.

SB 81 The Resources Committee has had SENATE BILL NO. 81 (oil and gas leases) under consideration and the committee recommends it do pass with the following amendment:

Page 2, line 4: "and the area north of the crest of the Brooks Range between the Arctic Ocean and the Alaska-Canada border, and all state-owned lands seaward of this area."

Page 2, line 5: Place period after "12 1/2 per cent," and delete remainder of sentence which ends on line 8 with the words, "less than five per cent."

Page 2, line 11: after word "leases," insert "in the Cook Inlet Basin"

The report was signed by Senator Palmer, Chairman, and concurred in by Senators Thomas, Butrovich, Kosiosky, Hammond and Poland. Not concurring was Senator Christiansen, who had no recommendation.

SENATE BILL NO. 81 was referred to the Commerce Committee.

Senator Engstrom moved and asked unanimous consent that the Judiciary Committee report be adopted. There being no objection, the report was adopted thus adopting the amendment offered by the Judiciary Committee (page 303 of the Journal).

There being no further amendments, Senator Hammond moved and asked unanimous consent that SENATE BILL NO. 73, am, be considered engrossed, advanced to third reading and placed on final passage. There being no objection, it was so ordered.

SENATE BILL NO. 73, am, was read the third time.

The question being: "Shall SENATE BILL NO. 73, am, (national forest income) pass the Senate?" The roll was taken with the following result:

Yeas:	18	Begich, Blodgett, Butrovich, Christiansen, Engstrom, Haggland, Hammond, Josephson, Kosiosky, Merdes, Miller, Palmer, V. Phillips, Poland, Rader, Thomas, Ziegler and B. Phillips.
Nays:	1	Bradshaw.
Absent:	1	Lewis.

And so, SENATE BILL NO. 73, am, passed the Senate.

SENATE BILL NO. 73, am, was referred to the Secretary for engrossment.

SB 81 SENATE BILL NO. 81 (oil and gas leases) was read the second time.

Senator Haggland moved and asked unanimous consent that the Commerce Committee report be adopted, thus adopting COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81. Senator Miller objected. Senator Miller withdrew his objection. There being no further objection, the CS Commerce Committee report was adopted, thus adopting SB COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81. 81

There being no amendments, Senator Hammond moved and asked unanimous consent that COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 be considered engrossed, advanced to third reading and placed on final passage. Without objection, it was so ordered.

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 was read the third time.

The question being: "Shall COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 (oil and gas leases) pass the Senate?" The roll was taken with the following result:

Yeas:	18	Begich, Blodgett, Bradshaw, Butrovich, Christiansen, Engstrom, Haggland, Hammond, Josephson, Kosiosky, Merdes, Miller, Palmer, V. Phillips, Poland, Rader, Thomas, Ziegler and B. Phillips.

Nays:	0	CS SB 81
Absent:	1	Lewis.

And so, COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 passed the Senate.

Senator Hammond moved and asked unanimous consent that the roll call on the passage of COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 be considered the roll call on the effective date clause. Without objection, it was so ordered.

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 was referred to the Secretary for engrossment.

SENATE BILL NO. 208 (search warrants) was read the second time. SB 208

There being no amendments, Senator Hammond moved and asked unanimous consent that SENATE BILL NO. 208 be considered engrossed, advanced to third reading and placed on final passage. Without objection, it was so ordered.

SENATE BILL NO. 208 was read the third time.

The question being: "Shall SENATE BILL NO. 208 (search warrants) pass the Senate?" The roll was taken with the following result:

Yeas:	19	Begich, Blodgett, Bradshaw, Butrovich, Christiansen, Engstrom, Haggland, Hammond, Josephson, Kosiosky, Merdes, Miller, Palmer, V. Phillips, Poland, Rader, Thomas, Ziegler and B. Phillips.
Nays:	0	
Absent:	1	Lewis.

And so, SENATE BILL NO. 208 passed the Senate.

SENATE BILL NO. 208 was referred to the Secretary for engrossment.

SENATE BILL NO. 218 (single judicial ballot in each judicial district) was read the second time. SB 218

There being no amendments, Senator Hammond moved and asked unanimous consent that SENATE BILL NO. 218 be considered engrossed, advanced to third reading and placed on final passage. Without objection, it was so ordered.

SENATE BILL NO. 218 was read the third time.

The question being: "Shall SENATE BILL NO. 218 (single judicial ballot in each judicial district) pass the Senate?" The roll was taken with the following result:

SB 275 SJR 36 SCR 83 — A message dated April 19, 1969, was read, stating the House has passed SENATE BILL NO. 275, SENATE JOINT RESOLUTION NO. 36 and SENATE CONCURRENT RESOLUTION NO. 38 and returning same.

SENATE BILL NO. 275, SENATE JOINT RESOLUTION NO. 36 and SENATE CONCURRENT RESOLUTION NO. 38 were referred to the Secretary for enrollment.

CSSB 81 — A message dated April 19, 1969, was read, stating the House has passed COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 (relating to oil and gas leases) with the following amendment and returning same.

Page 3, lines 1 through 4: Restore deleted material on lines 1 through 4 ending with AND.

Page 3, line 4: Insert the following material after AND: "patent has not been issued thereon, a conditional lease may be issued. However, no term extension may be granted for the period during which the lease was conditional."

Senator Palmer moved that the Senate concur in the House amendment to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81. Senator Engstrom objected.

Senator Butrovich moved and asked unanimous consent that the House message relating to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 be held one legislative day for action by the Senate. There being no objection, it was so ordered and the Secretary was instructed to reproduce the amendments for distribution to all Senators.

• • •

CSSB 136 (Rules) — A message dated April 19, 1969, stating the House had passed COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 136 (Rules) (interest allowed on judgments) with the following amendment and returning same, was read:

HOUSE COMMITTEE SUBSTITUTE FOR COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 136.

Senator Hammond moved and asked unanimous consent that the Senate concur in the House amendment to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 136 (Rules). Senator V. Phillips objected, and then withdrew his objection. Senator Engstrom objected.

The question being: "Shall the Senate concur in the House amendment to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 136 (Rules)?" On voice vote, the Senate concurred, and the Secretary was instructed to so inform the House.

HCS CSSB 136 — HOUSE COMMITTEE SUBSTITUTE FOR COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 136 was referred to the Secretary for enrollment.

• • •

CSSB 14 — A message dated April 19, 1969, was read, stating the House has passed COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 14, amended, (electrical safety) withthe following amendment and returning same:

HOUSE COMMITTEE SUBSTITUTE FOR COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 14

Senator Thomas moved that the Senate concur in the House amendment.

The question being: "Shall the Senate concur in the House amendment to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 14, am?" On voice vote, the Senate failed to concur in the House amendments.

The Secretary was instructed to so inform the House and request that the House recede from its amendment.

• • •

CSSB 174 — A message dated April 19, 1969, was read, stating the House has passed COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 174 (state manpower training program) with the following amendment, and returning same:

Page 2, line 9: Change one to three

Page 2, line 10: Change one to three

Page 2, line 11: Add s to member (twice in line)

Page 2, line 12: Change one to three

Senator Hammond moved that the Senate concur in the House amendments to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 174.

The question being: "Shall the Senate concur in the House amendments to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 174?" On voice vote, the Senate concurred, and the Secretary was instructed to so notify the House.

CSSB 174 am H — COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 174, am H, was referred to the Secretary for enrollment.

• • •

A message dated April 19, 1969, was read, stating the House has passed the following resolutions, and they are herewith transmitted for consideration:

HOUSE CONCURRENT RESOLUTION NO. 52

HOUSE JOINT RESOLUTION NO. 53

HOUSE CONCURRENT RESOLUTION NO. 56 amended

FIRST READING AND REFERENCE OF HOUSE RESOLUTIONS

HCR 52 — HOUSE CONCURRENT RESOLUTION NO. 52 by Messrs. Kerttula and Faukan, directing the Legislative Council to conduct a study on the reindeer industry, was read the first time and referred to the Resources Committee.

SENATE JOURNAL

ALASKA STATE LEGISLATURE

SIXTH LEGISLATURE - FIRST SESSION

Juneau, Alaska April 22, 1969

Eighty-Sixth Day

Pursuant to adjournment the Senate was called to order by President Phillips at 2:15 p.m.

Roll call showed all members present.

The prayer, offered by the Chaplain, the Reverend Ralph Wegener, follows:

> "Our heavenly Father, the Author of all freedom, we in this hour do thank Thee for the Great Land in which we live and for all its basic freedoms. May this freedom mean for us that we are a responsible people, each having special interests, and yet living in the hope that a better tomorrow is actually possible. May it mean that varying opinions may grow and live side by side and also flow freely.
>
> We ask Thy divine blessings on this Senate. Cause the members of this body to deliberate, to debate, and to decide as individualistic, self-reliant, property-owning citizens . . . who are enlightened and aroused as they live in this atmosphere of freedom to seek to solve our common problems and to provide for our common good.
>
> We ask this, humbly grateful for Thy many blessings we do even now enjoy, in the blessed Savior's precious name. Amen."

The Secretary certified as to the correctness of the journal for the eighty-fifth legislative day in accordance with the rules. Senator Hammond moved and asked unanimous consent that the journal be approved as submitted. Without objection, it was so ordered.

MESSAGES FROM THE HOUSE

The message dated April 19, 1969 relating to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81 (page 764 of the journal) was read again with the House amendments. This message had been held one legislative day for study. CSSB 81

Senator Palmer moved and asked unanimous consent that the Senate concur in the House amendments to COMMITTEE

CSSB 81 am H — SUBSTITUTE FOR SENATE BILL NO. 81 (relating to oil and gas leases). There being no objection, it was so ordered; and the Secretary was instructed to so inform the House.

COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 81, am H, was referred to the Secretary for enrollment.

SJR 45 — A message dated April 21, 1969, was read, stating the House has passed SENATE JOINT RESOLUTION NO. 45 and SENATE BILL NO. 235 and returning same.

SB 235 — SENATE JOINT RESOLUTION NO. 45 and SENATE BILL NO. 235 were referred to the Secretary for enrollment.

A message, dated April 21, 1969, was read, transmitting the enrolled copies of the following resolutions for the signatures of the President and Secretary:

HOUSE JOINT RESOLUTION NO. 5

HOUSE JOINT RESOLUTION NO. 6

HOUSE JOINT RESOLUTION NO. 54 am

HOUSE JOINT RESOLUTION NO. 44

HOUSE JOINT RESOLUTION NO. 45

HOUSE JOINT RESOLUTION NO. 3.

The enrolled copies of the above resolutions were signed by the President and Secretary and returned to the House.

CSSB 23 (Jud.) am — A message dated April 21, 1969, was read, stating the House has passed COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 23 (Judiciary), amended, with the following amendment, and returning same:

HOUSE COMMITTEE SUBSTITUTE FOR COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 23 as amended by the House: the amendments follow:

Page 1, line 11: Insert after "operates", the words: "or drives".

Page 1, lines 16, 19 and 20: Insert "operating or" before the word "driving". Delete "or in actual physical control of".

Senator Thomas moved that the Senate concur in the House amendments to COMMITTEE SUBSTITUTE FOR SENATE BILL NO. 23 (Judiciary). On voice vote, the Senate did not concur in the House amendments. The Secretary was instructed to so inform the House and ask it to recede from its amendment.

A message dated April 21, 1969, was read, stating the House has passed HOUSE JOINT RESOLUTION NO. 57, am, and transmitting same.

FIRST READING AND REFERENCE OF HOUSE RESOLUTIONS

HJR 57 am — HOUSE JOINT RESOLUTION NO. 57, am, by Messrs. Metcalf and Rettig requesting the construction of two additional sea-train slip facilities at the Port of Seward, was read the first time and referred to the State Affairs Committee.

COMMUNICATIONS

"April 19, 1969

The Honorable Brad Phillips
President of the Senate
Alaska State Senate
Juneau, Alaska

Dear Brad:

I wish to express my appreciation and thanks to you and all my friends in the Senate. I have spent many happy birthdays, but the Senate birthday party on Tuesday topped them all.

Again, many thanks to you, the other senators and the Senate staff memebers who made the celebration possible.

Sincerely,

s/ Mark Jacobs, Sr.
Mark Jacobs, Sr."

• • •

Senator Hammond moved and asked unanimous consent that the Secretary send a message to the House requesting the members to meet in joint session with the Senate members at 3:00 p.m. Thursday, April 24, 1969, to consider the confirmation of recent appointments by the Governor. There being no objection, it was so ordered; the Secretary was instructed to transmit the message.

REPORTS OF STANDING COMMITTEES

ENCLOSURE 24

COOK INLET DISCOVERY ROYALTY APPLICATIONS

Name of Well	Lessee (present names)	ADL Number	Date of Discovery	First Affidavit or claim of discovery	Date of written decision granting discovery royalty	Effective date of the 10-year discovery royalty	Commencement of commercial production	Date 12 1/2% royalty replaced 5% discovery royalty rate	Period royalty actually reduced
Falls Creek Unit No. 1	Chevron ARCO	00590	4/10/61	12/3/63	2/18/64	5/1/61	None	No royalty ever paid	Never used
Middle Ground Shoal No. 1	AMOCO Getty Phillips	17595	6/10/62	11/12/62	1/15/63	6/10/62	5/66	6/10/72	6 years 1 month
Cook Inlet State No. 1	Phillips	17589	8/21/62	11/12/62	11/24/64	9/1/62	3/69	9/72	3 years 6 months
Beluga River Unit No. 1	Chevron ARCO Shell	17599	12/1/62	9/17/63	12/19/62	1/1/63	3/68	1/73	4 years 10 months
Granite Point No. 1	Mobil Union	18761	5/16/65	5/21/65	9/14/65	6/1/65	5/67	6/75	8 years 1 month
Trading Bay No. 1-A	Union Marathon	18731	5/23/65	6/18/65	8/27/65	6/1/65	1/67	6/75	8 years 5 months
Grayling No. 1-A	Union Marathon	17594	9/29/65	10/28/65	1/19/82	10/1/65	10/67	10/75	8 years 1 month
Nicholai Creek State No. 1	Texaco Superior	17598	4/28/66	5/23/66	8/19/66	5/1/66	10/68	No production after 1972	About 4 years

APPLICATIONS DENIED

Name of Well	ADL Number
Trading Bay No. 1 and No. 2	17597
Shell Middle Ground Shoal	18754
W. Foreland Unit No. 3	18777
Redoubt Shoal No. 2	29690
Trading Bay State No. 1	35431

Enclosure 24

ENCLOSURE 25

NORTH SLOPE
DISCOVERY ROYALTY APPLICATIONS

Lease ADL	Well Name	Field Name	Applicant	Date of Application	Status of Application
28303	Prudhoe Bay State #1	Prudhoe Bay	ARCO	3/12/68	Granted
25633	Ugnu #1	Kuparuk	ARCO-BP	4/7/69	Granted
34633	Sag Delta #4	Endicott	BP	2/14/78	Granted
34635	Niakuk #5	Niakuk	BP	4/7/85	Granted
28297	Pt. McIntyre #3	Pt. McIntyre	ARCO	5/12/89	Granted
25906	Milne Point G-1	Milne Point	Conoco	12/7/89	Denied

Note:

Between 1968 and 1977 nine additional notice of discovery applications were filed, but the applicants never completed the full application procedure. Those nine applications are now expired.

Enclosure 25

ENCLOSURE 26

Tom Painter
Division Manager

Conoco Inc.
3201 C Street
Suite 200
Anchorage, AK 99503

September 7, 1989

Mr. James Eason
Director, Division of Oil and Gas
Department of Natural Resources
P. O. Box 7034
Anchorage, AK 99510-7034

Dear Mr. Eason:

Pursuant to paragraph 12 of lease ADL 25906 and 11 AAC 83.210(a), Conoco Inc. is submitting the attached Statement of First Discovery of Oil and Gas in Commercial Quantities in a Geologic Structure precedent to filing an application for discovery royalty for ADL 25906.

As indicated in the attached Statement and Exhibits, oil and gas has been encountered in sufficient showing in well no. G-1 to cause Conoco, a reasonable and prudent operator, to conduct further operations to complete said well in the discovery zone so that the well can be tested for potential oil or gas production in commercial quantities.

As required in 11 AAC 83.210(b), Conoco will undertake production tests in well no G-1 to establish that oil and gas has been discovered in commercial quantities. This testing will take place in the latter half of September, 1989, and we will furnish you sufficient notice and transportation (if requested) for a representative of your department to witness the testing. The geologic data required in 11 AAC 83.210(c) will be furnished in a timely manner.

If you need additional information concerning this Statement, please contact Al Hastings at 564-7650. Conoco respectfully requests that the information contained in the Statement and attached Exhibits remain confidential until the conclusion of the application and certification process.

Very truly yours,

T. R. Painter
Division Manager

AEH(jr)
File 500.58.08

Enclosure 26

Conoco Inc.
Suite 200
3201 C Street
Anchorage, AK 99503
(907) 564-7600

December 7, 1989

Mr. James Eason
Director, Division of Oil and Gas
Department of Natural Resources
P. O. Box 7034
Anchorage, Alaska 99510-7034

Dear Mr. Eason:

Pursuant to 11 AAC 83.215, Conoco Inc., as Operator of the Milne Point Unit and the sole Working Interest Owner of ADL 25906, requests discovery well certification for Well No. G-1. Conoco is in compliance with the filing provisions of 11 AAC 83.210.

It is my understanding that the Division of Oil and Gas will publish the appropriate notice of this application for discovery royalty. If you need additional information concerning this discovery royalty application, please contact me at 564-7601.

Attached to this application is a brief discussion of the Pre-Drilling Expectation and the Post-Drilling Verification for Well No. G-1. This discussion summarizes the other criteria that have been used in the more recent discovery royalty decisions.

Very truly yours,

David L. Bowler
Division Manager

AEH(jr)
Attachment
File 500.58.08

ENCLOSURE 27

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

P.O. BOX 7034
ANCHORAGE, ALASKA 99510-7034
PHONE: (907) 762-2553

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

April 4, 1991

DECISION

Conoco, Inc.	:	Oil and Gas Lease
Suite 200	:	ADL 28297
3201 C Street	:	Milne Point Unit
Anchorage, Alaska 99503	:	

MILNE POINT UNIT G-1 WELL DENIED CERTIFICATION AS A DISCOVERY WELL

The Division of Oil and Gas (division) hereby denies certification of the Milne Point Unit G-1 well (G-1) as a discovery well. As discussed in greater detail below, this denial is based on the determination that overwhelming evidence, including that submitted by Conoco, Inc. (Conoco), clearly establishes that the G-1 well fails the essential "first discovery" requirement. The Shallow Oil Sands (SOS) and the larger structure of which it is a part was clearly discovered by previous exploration, and was publicly known.

Previous discovery is evidenced by: (1) several hundred earlier exploratory, Kuparuk River Unit and Milne Point Unit well penetrations which yield substantial electric log and/or core data to recognize the accumulation, and (2) previous successful flow tests of the accumulation from at least five other wells in the Milne Point Unit, and a pilot project within the Kuparuk River Unit. The division's evaluation is supported by the geological, geophysical, and engineering information submitted by Conoco, as well as by in-house data.

Enclosure 27

THE HISTORICAL BACKGROUND

The legal basis for the discovery royalty

The statute that authorized the granting of a reduced royalty rate for a discovery of a separate geologic structure was the former AS 38.05.180(a), which stated in part:

> the holder of a lease who drills and makes the first discovery of oil or gas in commercial quantities in a geologic structure shall pay a royalty on all production under the lease of five percent for ten years following the date of discovery and thereafter the royalty rate of twelve and one half percent.

Although this provision was subsequently repealed, it was in effect when ADL 25906 was issued. Paragraph 12 of the lease describes the discovery royalty provision as follows:

> If Lessee shall drill on said land and make the first discovery of oil or gas in commercial quantities in any geological structure, the royalty rate under this lease shall, instead of the rates prescribed in Paragraph 11, be five percent for a period of ten years following the date of such discovery, and thereafter the royalty rates shall be those prescribed in Paragraph 11. If this lease is committed to a unit agreement approved or prescribed by Lessor as provided in the regulations, the five percent royalty rate shall not apply to all, but only, the production allocated to this lease under such agreement.

Regulations implementing the discovery royalty statute were initially adopted in August 1963 and were published at 11 AAC 505.74 - 11 AAC 505.748. They were subsequently amended and renumbered as 11 AAC 83.200 - 11 AAC 83.230. In January 1980, these regulations were repealed. In adjudicating the Conoco request for discovery royalty, the department has used the repealed regulations as a reference only, and does not consider them to be controlling.

Lease History

Humble Oil and Refining Company and Richfield Oil Corporation, in a 50-50 partnership, purchased Oil and Gas Lease ADL 25906 on December 9, 1964 at Competitive Oil and Gas Lease Sale 13.

The lease was issued as a conditional lease effective March 1, 1965, with a ten-year primary term and a fixed royalty rate of twelve and one half percent. Humble later became Exxon Corporation (Exxon), and Richfield became ARCO Alaska Inc. (ARCO). ADL 25906 was added to the Milne Point Unit during the second expansion of the Unit, effective June 1, 1983. Conoco acquired Exxon's interest in the lease on July 28, 1987 and ARCO's interest on November 2, 1988. Conoco currently retains 100 percent working interest and ownership in ADL 25906.

Drilling History

Four wells have been drilled on ADL 25906. The first well drilled on the lease was the Milne Point Unit G-1, which was spudded on August 10, 1989 and completed on August 22, 1989. The well was drilled to a measured depth of 4745 feet. The operator logged, cored, and tested the Shallow Oil Sands (SOS), which were, as anticipated, productive. Subsequently, three additional development wells have been drilled on G pad and four well each on H, I, and J pads.

Discovery Royalty Application History

Conoco submitted a Statement of First Discovery on September 7, 1989. The statement claimed to have discovered oil in "Upper Cretaceous Formation sandstones" in the Milne Point Unit G-1 well, located on ADL 25906, on August 15, 1989. On December ., 1989 Conoco tendered an application for discovery well certification for the G-1 well based upon well tests conducted on October 31, 1989. In the discussion attached to and made part of the application, Conoco characterized the claimed discovery in terms of the "Shallow Oil Sands." On December 14, 1989 Conoco submitted "geologic data to establish the geologic structure from which the G-1 well produced oil in commercial quantities." That document also directed itself to the Shallow Oil Sands, and expressly equated intervals within the sands with what ARCO Alaska, Inc. calls the "West Sak" and the "upper Ugnu."

Division staff met with Conoco representatives on January 24 and February 6, 1990 to discuss the application. On November 1990, Conoco submitted additional geological and geophysical data in support of its claim. On December 10, 1990, after division technical staff determined that the application was complete, the division published notice and separately mailed notice of the discovery royalty application to known potentially interested parties.

The division received no responses during the thirty day comment period. Therefore, the application stands unopposed

by any third party. No one has requested a public hearing, and the division has not requested a hearing in light of the vast amount of available data and the fact that the applicant has had a full opportunity to make both formal and informal presentations of its technical and legal positions.

DISCUSSION

The G-1 well did not make a first discovery.

The fatal deficiency of the application, demonstrated unequivocally by materials submitted by Conoco itself, is the absence of any "first discovery." The location and distribution of the SOS have been known for almost two decades. Published maps of the geologic structure and the oil accumulation for the SOS existed prior to the drilling of the Milne Point G-1 well. The application itself makes clear that the operator of the G-1 well had a pre-drilling expectation that the well would in fact penetrate a productive pool within the same geologic structure and interval as had been penetrated by hundreds of other wells within the Milne Point and Kuparuk River Units. In light of the amount of available information prior to drilling, it is clear that the G-1 well can best be described as Conoco's first planned production well within the SOS. Below are listed a few of the facts demonstrating that the structure containing the SOS was discovered long before the G-1 well.

- The East Ugnu No. 1 Well

In 1969, twenty years before the G-1 well was drilled, the East Ugnu No. 1 well discovered[1] two structures containing hydrocarbons: the deeper Kuparuk Formation (which forms the basis of production from both the Kuparuk River Unit and the initial participating area of the Milne Point Unit), and a shallower structure (which contains the intervals Conoco refers to as the SOS). The shallower structure was tested and flowed heavy oil at a rate of 20 barrels per day.

The East Ugnu No. 1 well is located four and three-fourths miles to the southwest of the G-1 well. The geologic isopach and structure maps, cross sections and interpreted seismic data supplied by Conoco show that the SOS, present in both the

[1] Based upon this discovery by the East Ugnu No. 1 Well, the owners of ADL 25633 were granted discovery royalty rights for any production of oil and gas and associated hydrocarbons attributed to that lease from any zone of production, including the shallow sands, during the first ten years after the date of discovery, i.e., for the period from May 1, 1969 through April 30, 1979.

G-1 and East Ugnu wells, are contained within the same geologic structure. Furthermore, the sands present within the Shallow Sands Interval in both the G-1 and East Ugnu No. 1 well are part of the same reservoir. These sands are part of a large Late Cretaceous and Paleogene deltaic system, and are interpreted as being deposited in shelf, delta front, delta plain and fluvial environments.

Reservoirs found in these environments typically contain multiple stacked and partially isolated sands. The individual sand bodies which make up the SOS clearly demonstrate this reservoir heterogeneity. However, geological, geophysical, and engineering data indicate that, disregarding localized reservoir discontinuities and small faults, the SOS reservoir is continuous between East Ugnu No. 1 and Milne Point G-1.

O Conoco's discovery royalty certification application

On December 7, 1989, Conoco filed its application for discovery royalty certification. Attached to and made part of that application was a discussion of pre-drilling expectations for the G-1 well. That documents admits

> The risk of geologic nonsuccess for the shallow sands at Milne Point is small. Sufficient regional data in existence before the drilling of [illegible] No. G-1 minimized the risk of not finding the geologic structure.

The next paragraph of the document generally discusses the SOS in the Milne Point Unit and the West Sak in the Kuparuk River Unit as the same structure, and estimates that in excess of $150 million had been expended in drilling, testing and pilot project work. The document bluntly characterizes the difficulty with establishing sustained production from the SOS prior to the G-1 well as a "completion and production problem, and not a question of finding sufficient in-place hydrocarbons."

The attachment to the application goes on to state that pre-drilling expectations were confirmed:

> The post drilling confirmed that the basic geologic structural definition before drilling commenced was correct. Minor changes in sand thickness and fluid content slightly altered oil in place values.

This proves beyond any doubt that Conoco did not discover the structure. It knew to a high degree of confidence and specificity what it would encounter.

O The application for a participating area for production from the SOS

On November 16, 1989, Conoco applied to the Division of Oil and Gas for establishment of a participating area within the Milne Point Unit for purposes of production of hydrocarbons from the SOS. That application states that "The Shallow Oil Sands have been tested by six wells within the Milne Point Unit." The G-1 well was drilled in 1989. Of the other five, one, the A-1 well, was drilled in 1980, and the four others were drilled in 1982.

Nothing suggests that the SOS tested in the Milne Point G-1 well contains oil or reservoir rock of significantly better quality or quantity than revealed in the five previously tested wells within the Milne Point Unit. Thus, even without any consideration of the many wells drilled into and testing the SOS in the Kuparuk River Unit, Conoco's own submissions reveal the fact that five prior wells within the Milne Point Unit drilled into and tested the SOS many years prior to Conoco's claimed "first discovery."

O Geologic analysis submitted on December 14, 1989 and in November 1990.

That the SOS was discovered well before the G-1 well is further proven by Conoco's geologic interpretations submitted on December 14, 1989 an in November 1990. The December 14, 1989 document, entitled "Geologic Evidence in Support of the Discovery Royalty for the Shallow Oil Sands" states:

> The Shallow Oil Sands (SOS) of Milne Point comprise 17 individual beds that are readily traced between 78 wells in and around the Milne Point Unit. The type log for the SOS at Milne Point is Conoco's A-1 well. ... Although these sands were originally found in 1969 by the SOCAL Kavearak 32-25 well, the nearby A-1 well was chosen as the type well because of its modern (1981) [sic] well log suite.

Emphasis added. This statement admits that the SOS was originally discovered in 1969, and that 78 wells predating the G-1 had explored it to the extent that it could be "readily traced." Indeed, Figure 3 to the document, entitled "SOS Regional Structure," includes a large area of the Kuparuk River Unit within its mapping of the SOS, and traces between four wells within the Milne Point Unit and five wells within the Kuparuk River Unit.

This quotation is also significant because of its use of the A-1 well as the type well. Although well logs from 1989 G-1 well (the claimed discovery well) were available, Conoco chose well logs from the nearby 1982 A-1 well for purposes of discussion of the geology.

The December 14, 1989 submission also correlates the nomenclature used by Conoco in describing the SOS with the nomenclature used by ARCO in describing the West Sak and the upper Ugnu in the Kuparuk River Unit. See second paragraph of the first page, and Figure 2.

The November 1990 submission also correctly encompasses the entire SOS, including West Sak, in its discussion of the geologic structure for which the discovery is claimed. While both the December 14, 1989 and the November 1990 submissions lend support to the conclusion that the SOS is separate from the Kuparuk Formation and the Prudhoe Bay field, they do not support the conclusion that the SOS in the Milne Point Unit are part of a geologic structure that is separate from the previously drilled and tested West Sak or the other SOS intervals previously drilled and tested within the Milne Point Unit.

- Information submitted in support of royalty reduction

In support of its efforts to obtain a royalty reduction for production from the Milne Point Unit (separate from this discovery royalty application), Conoco previously submitted to the Division a copy of a Conoco document entitled "Initial Development Plan for the Shallow Oil Sands in the Milne Point Unit." This document, prepared in 1985 (four years before the G-1 well was drilled), described the "wealth of information" that had been compiled and analyzed about the SOS. Page IV-1. While the document concluded that there was a need for further delineation, it nonetheless described the geology, made estimates of oil in place, and described production methods and scenarios. See, e.g., pages II-1 and II-2.

Tellingly, four years before the G-1 well made what Conoco claims is the "first discovery" of the Shallow Oil Sands, Conoco had developed a "Shallow Oil Sands Development Philosophy":

> The shallow oil sands have always been targeted for development after the Kuparuk zone was fully developed and excess facility capacity became available.

Page IV-6.

Conoco misapprehends the "commerciality" issue.

In the "Pre-drilling Expectation and Post-drilling Verification" discussion submitted with the December 7, 1989 application for discovery royalty certification, Conoco appears to suggest that risks relating to "completion and producing techniques, and crude price and perceived price stability" are somehow pertinent to the issue of whether Conoco's G-1 well made the "first discovery of oil or gas in commercial quantities in a geologic structure." I disagree for the following reasons.

First, the statute and lease term speak in terms of commercial quantities. The basic information about the quantity and quality of hydrocarbons was known before the G-1 well was drilled. As noted above, the well only resulted in "minor" or "slight" adjustments to Conoco's pre-drilling estimates. In short, there is nothing about the drilling of the asserted discovery well that could be characterized as a discovery of a heretofore unknown quantity of oil.

Second, Conoco argues that no well has been certified as capable of producing in "paying quantities" prior to the G-1 well. This argument is irrelevant. There is no evidence that any other party has ever sought a "paying quantities" determination for a well targeted for the SOS. Moreover, the "paying quantities" determination is made only for particular purposes, unrelated to the discovery royalty issue. See, e.g., Pan American Petroleum Corp. v. Shell Oil Co., 455 P.2d 12, 23-24 (Alaska 1969).

Third, the risks Conoco faces in putting the SOS into production are production related, not discovery-related risks. Conoco stresses the "costs of continued experimentation with completions, the risks concerning oil prices and transportation costs." While these are genuine risks, they are not discovery risks, were not unique to this well, and the G-1 well did not resolve those risks.[2] These

---

[2] Conoco explicitly states that the "[p]roduction history also verified that the completion technique utilized in G-1 will not provide the long term completion needed for full scale development. Additional experimentation with completions will be required before economic development is a reality." Thus the G-1 well, besides not being the discovery well for the SOS, did not resolve all production-related impediments either. It is just as clear that there is no nexus between the G-1 well and the resolution of other risks. Nothing about the drilling of the well could possibly affect future taxes, oil prices, and the like.

kinds of risks are common to all development projects. The discovery royalty was designed as a reward for undertaking discovery risks, not development risks. Conoco's 1985 "Initial Development Plan for the Shallow Oil Sands in the Milne Point Unit" and attachment to its December 7, 1989 discovery royalty application demonstrate that the development decision was a matter of timing (in relationship to the production from the Kuparuk Formation), oil prices, transportation prices, taxes, completion and production techniques and other such issues. In other words, actual development was determined by factors unrelated to any discovery efforts made by means of the G-1 well.

The statute was changed to explicitly focus on discovery rather than commercial production.

The Territorial Legislature enacted royalty provisions in 1955 that provided for issuance of oil and gas leases

> with a royalty fixed by the Commissioner, with the approval of the Attorney General and the Commissioner of Mines, at not less than five percentum (5%) the first ten years of new production, and twelve and one-half percentum (12%) each year thereafter ....

Sec.3, ch.189 SLA 1955. Emphasis added.

In 1957, the incentive was limited to the first producer in a new area. The statute provided, as a general rule, for a floor of 12 1/2%, with the following proviso:

> provided that a royalty of not less than five percentum (5%) for the first ten years will be allowed the first producer in a new area.

Art. IX, sec. 2, Ch 184 SLA 1957.

In 1959, the legislature rejected the earlier incentives triggered by commencement of production, and restricted the five percent royalty to the lease upon which a "first discovery of oil and gas in commercial quantities in a separate geologic structure" is made. Section 7, ch. 169 SLA 1959. This leaves no room to award a discovery royalty in this case. The risks and costs of commencing production (whether "new production" generally or as the "first producer in a new area") were rejected by the legislature as a basis for a reduced royalty. The legislature replaced an incentive

tied to commencement of production with an incentive tied to "first discovery." The division has no authority to attempt to circumvent that clear intent.

CONCLUSION

The intent of the repealed statute was clearly to provide an incentive to discover and place on production new fields in previously untested structures. The statute foremost required the holder of the lease to "drill and make the first discovery" in a geologic structure (AS 38.05.180 repealed). Conoco exposed the fact that the G-1 well is not a discovery well in the attachment to its December 7, 1989 application by stating "The risk of geologic nonsuccess for the shallow oil sands at Milne Point is small."

Accordingly, the Milne Point G-1 well clearly does not meet the criteria for a discovery well. This well penetrated the Shallow Oil Sands in a geologic structure that had been discovered and determined to be productive over 20 years ago. Since 1969, the SOS has been penetrated and been found to be a hydrocarbon reservoir by hundreds of wells in the same geologic structure. Therefore, it is clear that the Milne Point G-1 fails to meet either the requirements or the intent of the repealed discovery royalty statute.

James E. Eason
Director

WALTER J. HICKEL, GOVERNC

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

P.O. BOX 107005
ANCHORAGE, ALASKA 99510-7005
PHONE: (907) 762-2463

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

January 16, 1992

DECISION

Conoco, Inc.	:	Oil and Gas Lease
Suite 200	:	ADL 25906
3201 C Street	:	Milne Point Unit
Anchorage, Alaska 99503	:	

DECISION AFFIRMING DIRECTOR'S DENIAL OF DISCOVERY CERTIFICATION BASED ON MILNE POINT UNIT G-1 WELL

I have carefully reviewed the decision ("Decision") of the Director of the Division of Oil and Gas denying a "discovery royalty" to Conoco, Inc. ("Conoco"). The Decision concludes that Conoco's G-1 well in the Milne Point Unit did not qualify the lease for an award of the reduced "discovery royalty" rate because the well did not make a "first discovery of oil or gas in commercial quantities in any geologic structure." In essence, the Decision concludes that both the existence of the geologic structure (referred to variously as the "Schrader Bluff Formation" the "West Sak," and the "Shallow Oil Sands" ("SOS")) and the quantities of oil accumulated in the structure were known prior to the drilling of the well. The Decision determined that it was most accurate to describe the G-1 Well as "Conoco's first planned production well within the SOS" (Decision at 4, emphasis added), not as a "discovery well."

I have also carefully reviewed Conoco's appellate brief. Conoco does not deny that the structure had previously been discovered through the drilling of other wells, and that prior exploration had yielded confirmation that the structure contained a large accumulation of oil. Brief of Appellant ("Br.") at 1-2, and 3 at n.1. See also Affidavit of Alan Hastings, paragraph 10 ("Hastings Aff."), where it admitted that in 1985, four years before the G-1 Well was drilled, a study by the Milne Point Unit had estimated that there were "over 366 million barrels of oil in place" on the lease at issue alone. In light of this admission that the G-1 Well broke no new exploration ground, it is not surprising that Conoco tries to diminish the significance and common sense meaning of the "discovery" requirement. Thus, Conoco argues that the key requirement is not a discovery at all, but rather the mere drilling of the first well that establishes "commercial quantities." The term "commercial quantities" is, in turn, equated with actual

"commerciality" (Br. at 4, 1.1) and "capability of commercial production" (Br. at 2, 11.14-15, emphasis added).

My review of the record of this appeal, and a common sense application of former AS 38.05.180(a) and the lease to the facts, compel me to affirm the Decision of the Director.

The former statute and regulations intended to encourage the discovery of new oil bearing structures and once a new discovery is made, to encourage rapid development of and production from the structure.

The plain language of AS 38.05.180(a) shows that the legislature intended to encourage drilling to discovery previously unknown oil bearing structures and once a discovery is made, to encourage rapid development of and production from the structure. "Discover" means to "be the first to find, learn of, or observe." Am. Her. Dictionary 376 (1970). In this instance, it means to find an oil bearing structure, not previously known. This requirement is emphasized by the term "first discovery." Importantly, the statute ties the finding with "drill(ing)". Thus, the statute obviously seeks to encourage exploratory drilling. The statute also plainly encourages rapid production by limiting the reduced rate to a ten year period following the date of discovery.

The Alaska Supreme Court has stated that the former regulations implementing the statute specified the three elements required by the statute for discovery well certification: date of discovery, commercial quantities, and geologic structure. See Union Oil Co. v. State, 574 P.2d 1266, 1269 (Alaska 1978). The regulations suggest that these elements are separate and distinct, and can be established at different times. When read as a whole these regulations foster the dual purposes of the statute--to encourage exploratory drilling and rapid production.

The regulations define the date of discovery element as the date that an operator first finds oil or, in the exact of language of the regulations, "first encounters sufficient evidence of oil or gas in a particular geologic structure". 11 AAC 83.200. This event starts the running of the ten year reduced rate period. 11 AAC 83.215. At this point, the operator is not required to show that the evidence is sufficient to prove production in commercial quantities, only that the evidence is enough to cause the reasonable operator to continue operations. In order to preserve his priority, he must provide a sworn statement of the first encounter within thirty days of the encounter.

The regulations do not require the operator to provide evidence of the second element, commerciality, until later. This is consistent with the reality that an operator first encounters or discovers oil, and then tests or evaluates a find to determine whether it is commercial. See Shoni Uranium Corp. v. Federal-Radrock Gas Hill Partners, 407 P.2d, 712 (Wyo. 1965) ("Upon the discovery . . . there was an implied obligation on the part of the lessee to do whatever was necessary under the circumstances (1) to ascertain whether the deposit existed in commercial quantities; and (2) thereafter to reasonably develop") (deletions in original). The regulations provide that the operator must continue to work diligently to "complete a well in the discovery zone . . . that can be tested for . . . commercial quantities." 11 AAC 83.210. The second event occurs when the operator establishes commercial quantities. 11 AAC 83.210(b)(1).

The third event occurs when the operator establishes that the discovery is in a separate geologic structure. This can occur up to ninety days after the date of the commercial quantities potential test.

Conoco's argument equating the "first to drill and discover oil" with the "first to produce oil" is inconsistent with the statute's plain language and would frustrate its purposes.

The director denied Conoco's application because he found that the G-1 well was not the first well to discover oil in the SOS structure. Both the East Ugnu No. 1 well and the A-1 well had encountered oil long before the G-1 well. Conoco argues that the discovery requirement and the commercial requirement should be collapsed into one test. It asserts that who discovered the oil is irrelevant. Br. 8. According to Conoco, in order to be the discovery well, the well itself must be shown to be "capable of production in commercial quantities." Br. 8.[1] Thus, discovery

---

[1] I need not address whether the repealed regulations are binding or not Conoco's argument, which is premised on the regulations continued validity and on Conoco's interpretation of former 11 AAC 83.205(1) which defined "discovery," ignores the entire context of the regulations and is nonsensical. Under the regulations, the first or initial discovery of a discovery zone in a structure is the first encounter. 11 AAC 83.210. The commercial quantities test of the zone may be demonstrated in the first encounter well or a later well in the same structure. 11 AAC 83.200-.215. By misinterpreting 11 AAC 83.205(1), Conoco would (continued...)

depends not upon new knowledge of an oil-bearing structure acquired through drilling, but upon technological improvements, new tax benefits, projected oil price, and the operator's internal economics. See App. Br. 3; Affidavit of Harold D. Haley at 3, paragraph 6.

Conoco's interpretation would change the statutory language whoever "drills and makes the first discovery" to whoever "first completes a production well." The Decision pointed out, this would in essence make the statute read as it formerly did in the territorial days. It would reward purely production risks as opposed to discovery and production risks. As discussed in the preceding section, discovery royalty was intended to reward those who successfully undertook the geologic and economic risks associated with exploration tied to rapid development. While oil prices, cost of production, and efficiency of production influence when an accumulation of oil may be brought into production and what level

---

[1](...continued)
require that both discovery and commercial quantities be proved in the same well. Br. 8-9.

Conoco's incorrect reading of 11 AAC 83.205 ignores the provisions of 11 AAC 83.200, .210, and .215, all of which contemplate that discovery and commercial quantities may be shown at different times and in different wells. Reading 11 AAC 83.205(1) consistently with these other provisions, "first acceptable evidence in a drilling well of the existence of oil or gas" refers to the first encounter while the modifying clause "which can be produced in commercial quantities after well completion" refers to the requirement that a well in the structure must meet the commercial quantities test. It is noteworthy that 11 AAC 83.205 does not require that the well which provides the first acceptable evidence be tested or produced. 11 AAC 83.205(1) refers to whether the structure can be produced in commercial quantities and refers to a future test in some well, not necessarily the well providing the first acceptable evidence of oil. The commercial quantities test only confirms that the first encounter has met the statutory requirement of a "discovery of oil or gas in any geologic structure." AS 38.05.180(a) (emphasis added). This is consistent with the division's and industry's twenty year history with discovery royalty that "discovery occurs upon the first encounterment of oil and gas, not upon the date of a drill stem test confirming the extent of the discovery of oil and gas." See Niakuk 34635 No. 5 Certified as Discovery Well ADL 34635 Conditionally Granted Five Percent Discovery Royalty (September 2, 1988) at 5.

of profits or loss the producer may enjoy, they do not determine when a "discovery" has taken place, or change the quantity of oil that has been discovered. Conoco's interpretation would frustrate the statute's dual purposes.

Conoco's interpretation would allow the operator to choose his discovery well and thereby manipulate the date of discovery to frustrate the rapid production intent of the statute. Since the ten year reduced rate commences on the date of discovery, an operator, who encountered a good show of oil, could delay the commencement of the period by delaying completion of testing of commerciality to coincide as closely as possible with the initiation of actual production.

Conoco's interpretation would also lead to absurd results as illustrated by a hypothetical example. Assume that lessees A and B purchased adjoining leases over the same prospect. However, only lessee A undertook the costs and risks of exploration, discovering a large accumulation. Assume, however, that the low quality of the oil and the high cost of production rendered it uneconomic to produce the accumulation at forecasted oil prices. Further, assume that after the results of lessee A's discovery efforts became public, a war in the mideast caused large price increases. Finally, assume this causes both lessee A and lessee B to commence drilling in order to produce oil from this known accumulation. Under Conoco's theory, lessee B would be credited with making the "first discovery of oil in commercial quantities in a geologic structure" if it were first in completing its well, despite the fact that lessee A had actually undertaken the discovery risks some years earlier, and lessee B did nothing except more quickly respond to a changed economic opportunity. This makes no sense.

The decision in Joseph I. O'Neill, Jr. 77 Interior Dec. 181, IBLA 70-39 (1970), supports my interpretation. In that case an argument similar to Conoco's argument that "discovery of oil and gas in commercial quantities" means "a well that is capable of production in commercial quantities" was rejected by the federal Board of Land Appeals. The Mineral Leasing Act provided that leases segregated from a primary lease would be extended for two years from the date of "discovery of oil or gas in paying quantities" upon any other segregated portion of the lease. The Board of Appeals rejected an argument that a well capable of producing oil or gas in paying quantities was required before an extension would be granted. After stating that "discovery" means "to find something not known before" the Board refused to read into the statute a predicate of a well capable of producing in paying quantities. Id. at 61. It