Oil Tax Reform: Gross Revenue Exclusion

House Finance Committee

April 6, 2013

Department of Natural Resources

- Joe Balash, Deputy Commissioner
- Bill Barron, Director, Division of Oil & Gas

How Does Production Qualify *for the* GRE?

There are three ways to qualify:

1. Production from a Unit formed after 2003
   - Nikaitchuq Unit, Oooguruk Unit
2. Production from a PA formed after 2012 which is in a unit formed prior to 2003
   - New PA at Prudhoe Bay
3. Production from acreage that was added to an existing participating area by DNR on and after January 1, 2014, and the producer demonstrates to DNR that the volume of oil or gas produced is from acreage added to an existing participating area

Leasing & Unitization

Leasing is the primary mechanism by which the State grants exclusive rights to explore and develop the oil and gas mineral rights of the State to private parties

- Competitive bidding
- Terms and conditions have varied over time
- Tracts are generally 3x3 miles, except in prime shale areas

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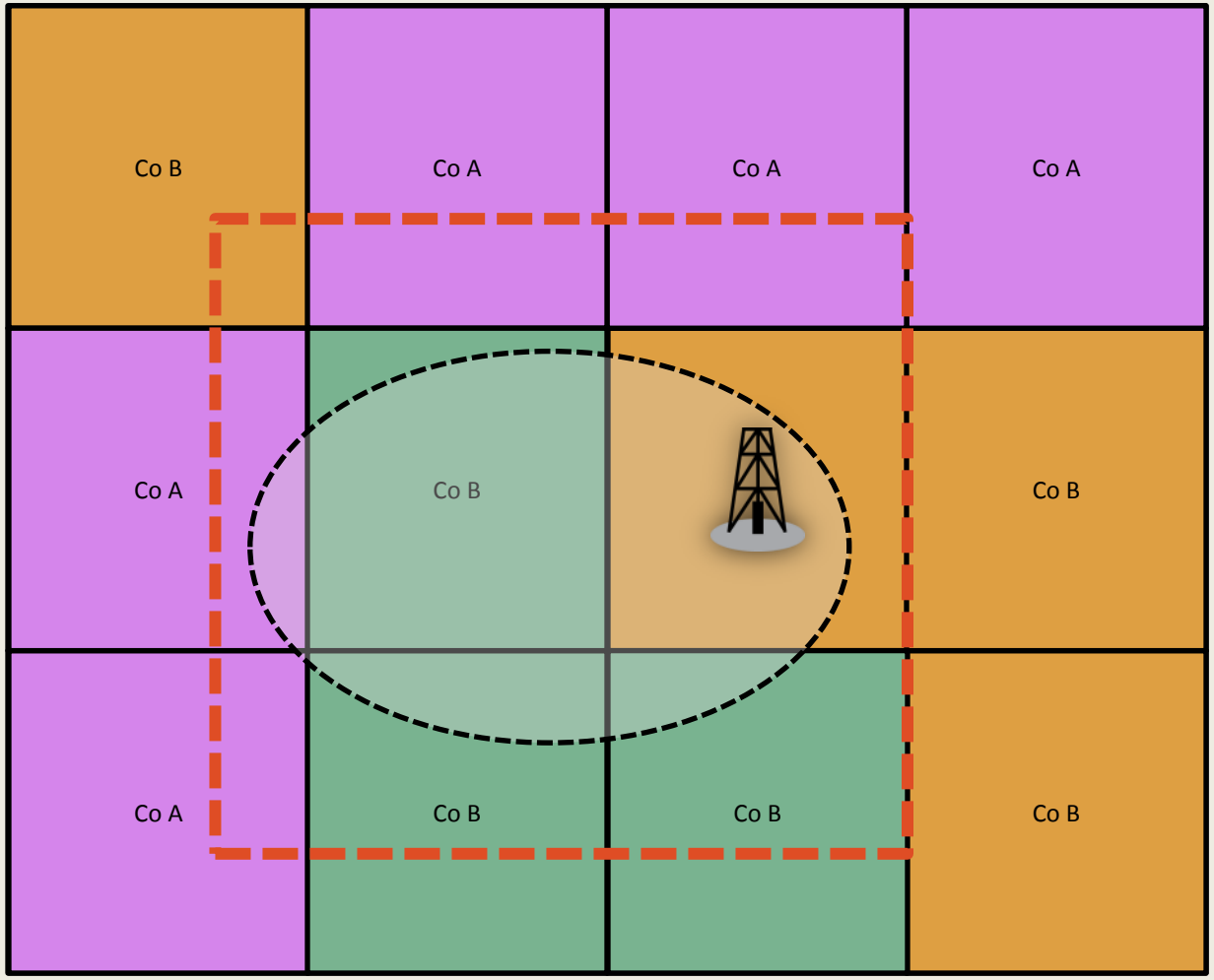
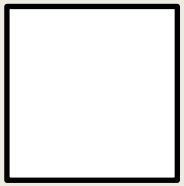
Unitization is the mechanism to join contiguous leased tracts together into a unit in order to

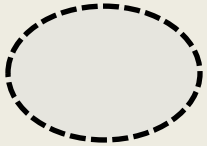
- Protect the interests of all parties, including the state
- Ensure proper reservoir management, and
- Enhance recovery of reserves

UNITIZATION





Tract Boundaries



Delineated Reservoir

Proposed Unit Boundary

What *is a* Participating Area (PA)?

A set of tracts within a Unit, overlying a reservoir which is on sustained production

- North Slope: 18 State Units, 38 PAs
- A unit may have multiple reservoirs at different depths – each PA is defined vertically as well as horizontally
- Leases approved for inclusion into a PA may not be severed
- PA provides mechanism to allocate costs and revenues

Regulations

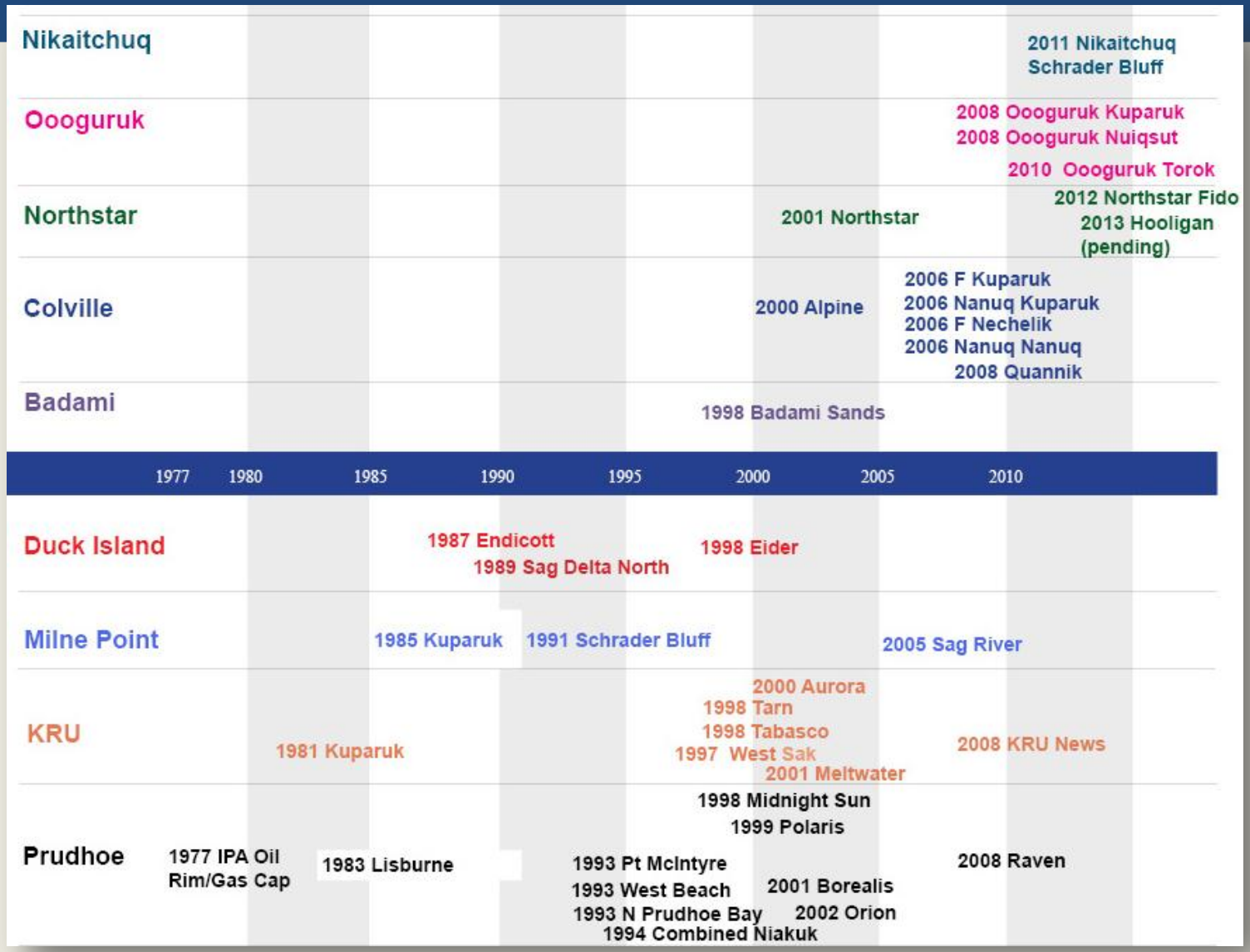
11 AAC 83.351 PA Formation, Expansion, Contraction

11 AAC 83.343 Plans of Development

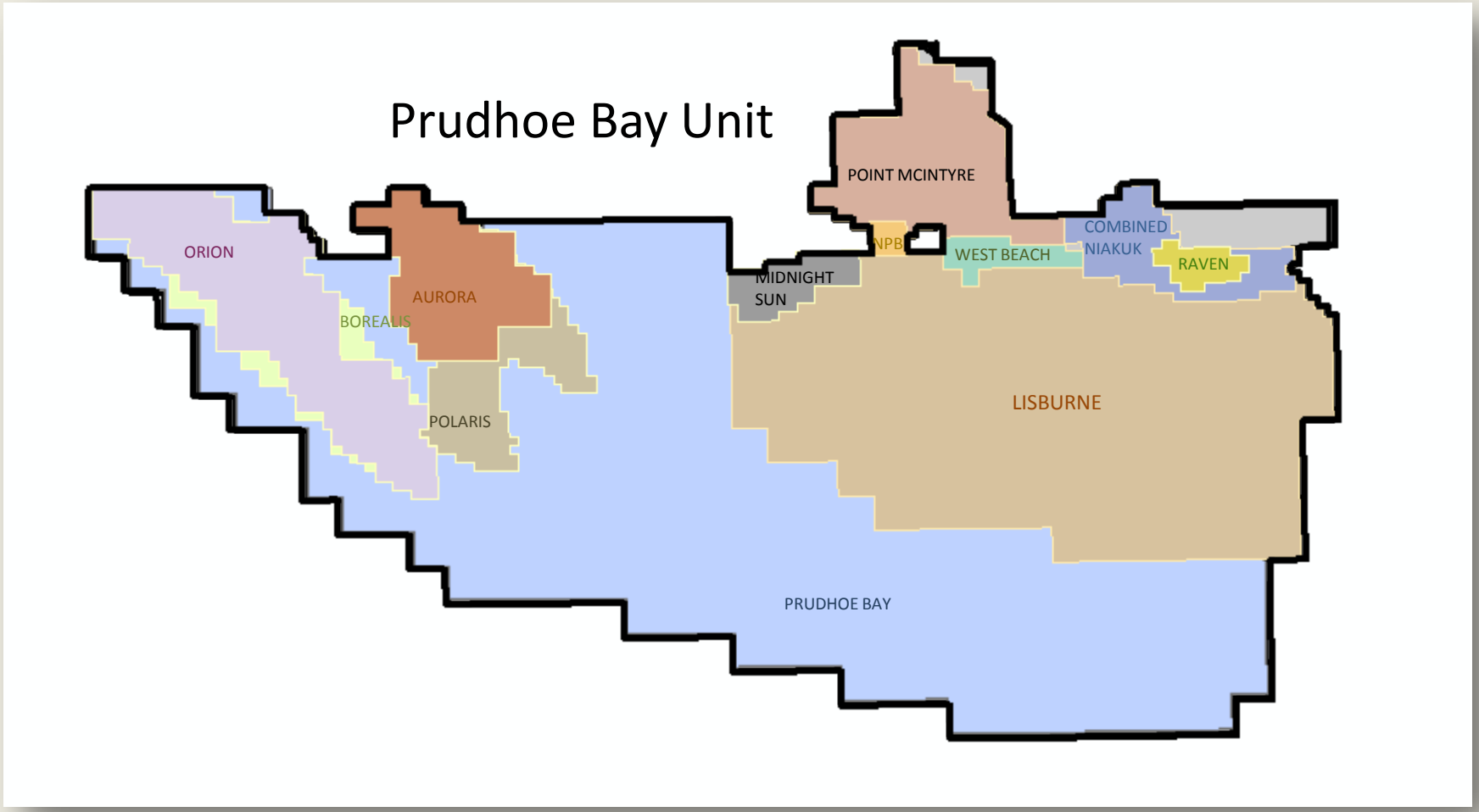
11 AAC 83.371 Allocation of Production and Costs

11 AAC 83.303 Protect all parties

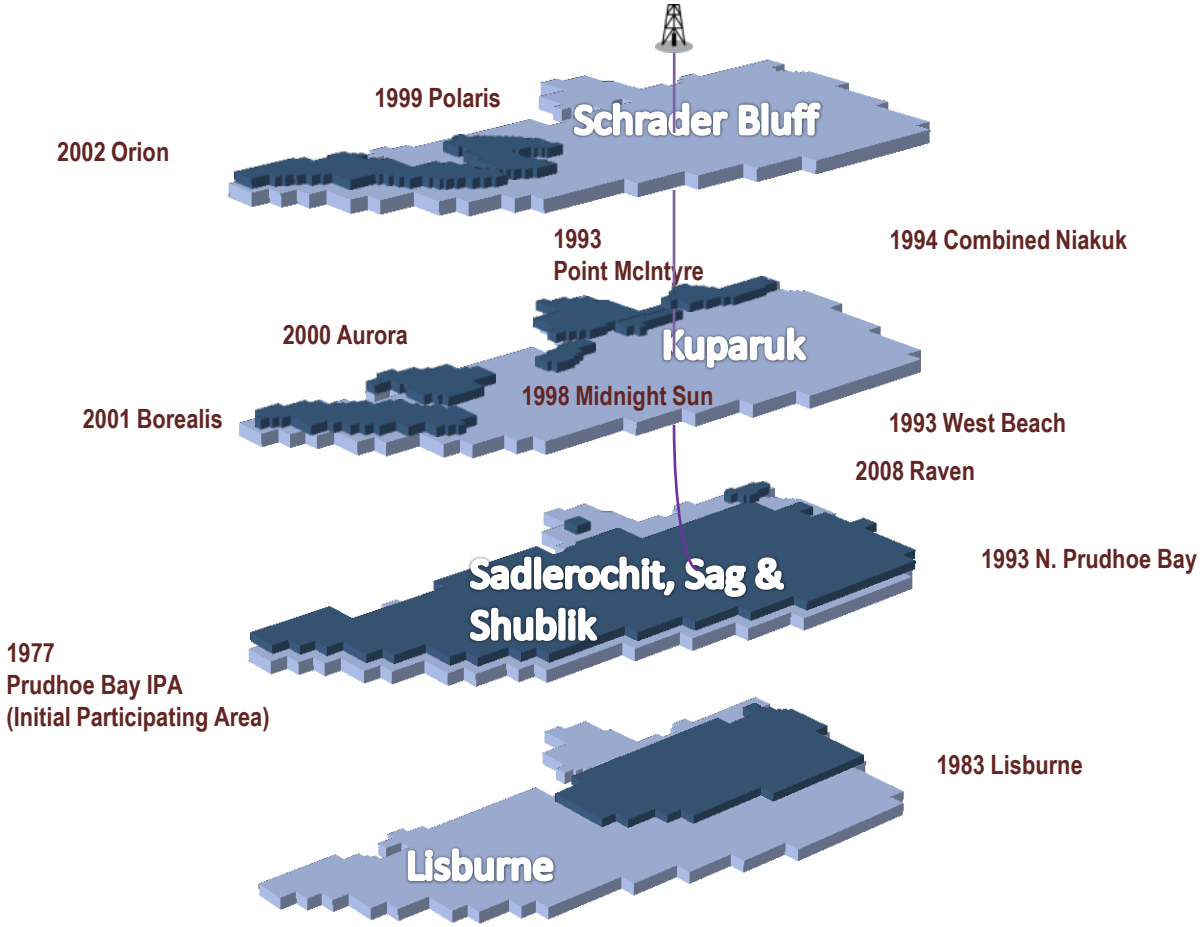
North Slope PAs



Prudhoe Bay Unit



Prudhoe Bay Unit



Evaluation *and* Approval *of* PAs

11 AAC 83.351: PA Formation, Expansion, Contraction

- PA may include only the land capable of producing or contributing to production of hydrocarbons in paying quantities
- PA must be contracted to exclude acreage incapable of contributing to production of hydrocarbons in paying quantities

11 AAC 83.303 Criteria

- Promote conservation
- Prevent waste
- Protect all parties

Evaluation *and* Approval *of* PAs

PA application has no regulatory deadline as with unit applications

- Operator submits application no later than 90 days prior to sustained production
- Submittal includes Exhibits C and D, legal description with allocation factors, and map
  - Allocation factors allocate production to each tract
- Must include Exhibits E and F if Net Profit Share (NPS) leases included
  - NPS leases require accounting of costs and revenues to determine "pay out". Exhibits E and F provides methodology and basis for cost allocation, used by Royalty Accounting and Audit

PA Exhibits C *and* D

NIKAITCHUQ UNIT AGREEMENT: Exhibit C

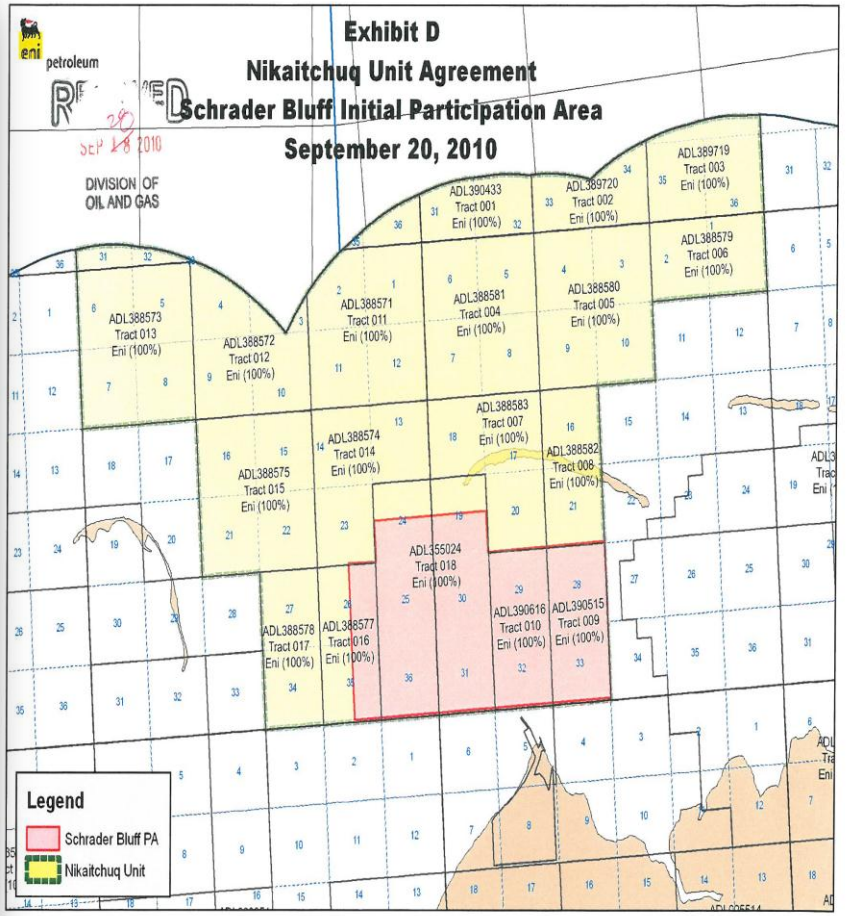
SCHRADER BLUFF PARTICIPATING AREA
Nikaitchuq Unit Area

September 20, 2010

RECEIVED
SEP 28 2010
DIVISION OF OIL AND GAS

Nikaitchuq Unit Tract Number	Lessor / Royalty Owner Lease Serial No.	Description of Unitized Lands	Unitized Acres Within Participating Area	Royalty Rate	ORRI Owners	Overriding Royalty Interest	Working Interest Owners & Percentage Working Interest	UnitTract Participation (Based on Surface Acres)
9	390615	**T14N., R.9 E., UMIAT MERIDIAN**						
		Sec: 28 Protracted, All	640.0000	0.16667	GMT Exploration North Slope Royalty Company, LLC	0.13333	Eni: 100%	20.15%
		Sec: 33 Protracted, All	640.0000		Wm D Armstrong	0.72797		
			1280.0000		Jesse V Sommer	0.02167		
					Edgar Kerr	0.02167		
					Jeffery A Lyslo	0.02167		
					Patricia M Reed	0.02167		
					Matthew X Furin	0.02167		
					Stuart W Gustafson	0.02167		
					Chester E Paris	0.00867		
					total	0.99999		
10	390616	**T14N., R.9 E., UMIAT MERIDIAN**						
		Sec: 20 Protracted, All	640.0000	0.16667	GMT Exploration North Slope Royalty Company, LLC	0.13333	Eni: 100%	20.15%
		Sec: 32 Protracted, All	640.0000		Wm D Armstrong	0.72797		
			1280.0000		Jesse V Sommer	0.02167		
					Edgar Kerr	0.02167		
					Jeffery A Lyslo	0.02167		
					Patricia M Reed	0.02167		
					Matthew X Furin	0.02167		
					Stuart W Gustafson	0.02167		
					Chester E Paris	0.00867		
					total	0.99999		
16	388577	**T14N., R.8 E., UMIAT MERIDIAN**						
		Sec: 26 Protracted, Tide and submerged lands, E/2	320.0000	0.16667	ConocoPhillips	4.250%	Eni: 100%	10.08%
		Sec: 35 Protracted, Tide and submerged lands, E/2	320.0000					
			640.0000		total	4.250%		
18	391283	**T14N., R.8 E., UMIAT MERIDIAN Segment 2**						
		Sec: 24 Protracted, S/2	320.0000	0.12500	ConocoPhillips	3.334%	Eni: 100%	49.82%
		Sec: 25 Protracted, All	640.0000	30% NPS	BP	2.357%		
		Sec: 36 Protracted, All	640.0000		Exxon	0.200%		
		T14N., R.9 E., UMIAT MERIDIAN			Unocal	0.297%		
		Sec: 19 Protracted, S/2	308.5000		William D. Armstrong	0.489070%		
		Sec: 30 Protracted, All	620.0000		Jesse V. Sommer	0.014560%		
		Sec: 31 Protracted, All	623.0000		Edgar Kerr	0.014560%		
			3151.5000		Jeffrey A. Lyslo	0.014560%		
					Patricia M. Reed	0.014560%		
		Total Unitized Land Within Participating Area:	6351.5000		Matthew X. Furin	0.014560%		
					Stuart W. Gustafson	0.014560%		
					Chester E. Paris	0.005830%		
					GMT Exploration Company, LLC	0.089570%		
		Total State Land:	6351.5000		total	6.849922%		
		Total BLM Land:	0.0000					
		Total Unitized Land:	**6,351.50**					

1 of 1



PA Plan *of* Development

Once development activities commence and/or a PA is formed, a Plan of Development (POD) is required under 11 AAC 83.343

- Describes plans to develop the reservoir
  - Development activities: facilities, pipelines, offshore production islands, gathering lines, and permanent drill sites
- POD is submitted annually for review and approval
- If POD deemed insufficient for approval, DNR may propose modifications. If Operator agrees to modification, POD approved
  - If modifications not accepted by Operated and reviewed POD not approved, current POD may expire

Tract Allocation Factors

11 AAC 83.371

- Approval of PA includes approval of Allocation Factors (Tract Factors or TF) to protect all parties
  - Exhibit C designates each PA tract a TF
  - Bases for calculating TF proscribed in Operating Agreement sometimes Unit Agreement or approval decision
    - Acreage
    - Original Oil in Place (OOIP)
    - Recoverable
    - Value Based
- Working Interest Owners receive revenue based on TF
  - Equity negotiations
- State of Alaska receives royalties based on TF
  - Commercial interest evaluation

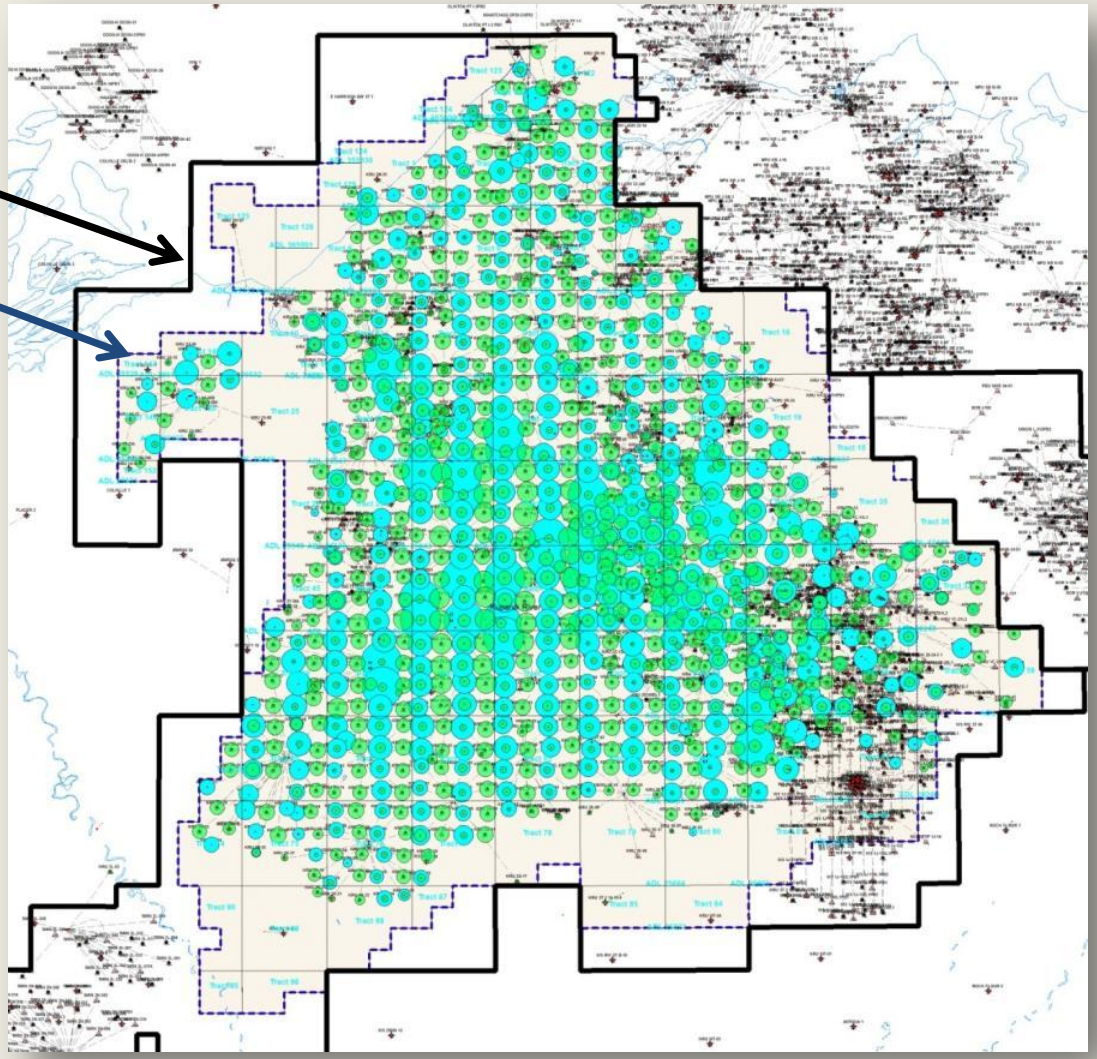
Revisions *to* Division *of* Interest: Reallocations

- **Production is reallocated**
  - As PA expands of contracts
    - Development wells identified and committed to in Plan of Development
    - Expansion of Milne Point Unit Sag River PA
    - Contraction of Milne Point Unit Sag River PA
  - As basis for allocation changes
    - Field matures, more technical information gathered and evaluated, production is reallocated
    - Revised Exhibit C designates each PA tract a TF
    - Bases for calculating TF proscribed in Operating Agreement sometimes Unit Agreement or approval decision
      - Acreage, OOIP, Recoverable, Value Based
  - Resource Evaluation, Commercial, Royalty Accounting, Audit Sections
    - Evaluation of protection of State's Interest
    - Protection of all parties

Kuparuk River Unit (KRU)

KRU Boundary

Kuparuk PA Boundary



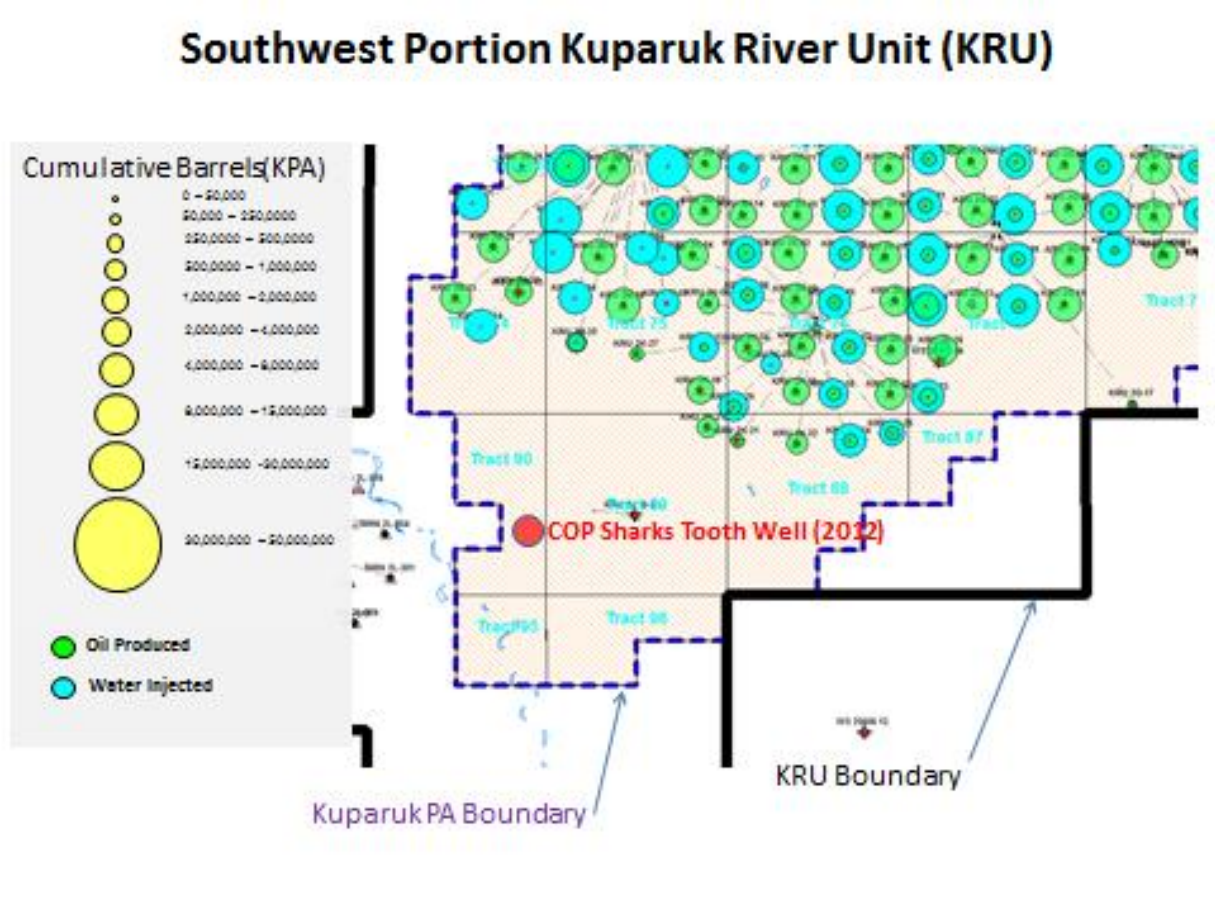
Cumulative Barrels (KPA)

- 0 – 50,000
- 50,000 – 250,0000
- 250,0000 – 500,0000
- 500,0000 – 1,000,000
- 1,000,000 – 2,000,000
- 2,000,000 – 4,000,000
- 4,000,000 – 8,000,000
- 8,000,000 – 15,000,000
- 15,000,000 -30,000,000
- 30,000,000 – 50,000,000

Oil Produced

Water Injected

Kuparuk River Unit (KRU)



Questions?