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 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

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

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<td>Oooguruk</td>
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<tr>
<td>Northstar</td>
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<td></td>
<td>2001 Northstar</td>
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<td>2012 Northstar Fido</td>
<td>2013 Hooligan (pending)</td>
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<tr>
<th>Location</th>
<th>1987</th>
<th>1989</th>
<th>1998</th>
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<tbody>
<tr>
<td>Duck Island</td>
<td></td>
<td>Sag Delta North</td>
<td>Eider</td>
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<tbody>
<tr>
<td>Milne Point</td>
<td></td>
<td>Kuparuk</td>
<td>Schrader Bluff</td>
<td>Sag River</td>
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<thead>
<tr>
<th>Location</th>
<th>1981</th>
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<tbody>
<tr>
<td>Prudhoe</td>
<td>IPA Oil Rim/Gas Cap</td>
<td>Lisburne</td>
<td>Pt McIntyre</td>
<td>West Beach</td>
<td>N Prudhoe Bay</td>
<td>Combined Niauk</td>
<td>Borealis</td>
<td>Raven</td>
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<tbody>
<tr>
<td>Prudhoe</td>
<td>Midnight Sun</td>
<td>Polaris</td>
<td>Borealis</td>
<td>Orion</td>
<td>Raven</td>
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1977 Prudhoe Bay IPA (Initial Participating Area)

1983 Lisburne

1993 Point McIntyre
1993 N. Prudhoe Bay

1993 West Beach

1998 Midnight Sun
1994 Combined Niakuk

1999 Polaris

2000 Aurora

2001 Borealis

2002 Orion

1977 Prudhoe Bay IPA (Initial Participating Area)

1993 N. Prudhoe Bay

1998 Midnight Sun

1994 Combined Niakuk

2000 Aurora

2001 Borealis

2002 Orion

1999 Polaris

Schrader Bluff

Kuparuk

Sadlerochit, Sag & Shublik

Lisburne

1983 Lisburne

1993 West Beach

2008 Raven

1998 Midnight Sun

1994 Combined Niakuk

1999 Polaris

2000 Aurora

2001 Borealis

2002 Orion

Schrader Bluff

Kuparuk

Sadlerochit, Sag & Shublik

Lisburne
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
### NAKITCHUQ UNIT AGREEMENT: Exhibit C

**SCHRADER BLUFF PARTICIPATING AREA**

**Nakaichuq Unit Area**

<table>
<thead>
<tr>
<th>Lessee</th>
<th>CPO</th>
<th>Title</th>
<th>Tract</th>
<th>Acres</th>
<th>NAIP</th>
<th>Field</th>
<th>Remarks</th>
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<td>0/0/0</td>
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<td>423.00</td>
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**Exhibit D**

**Nakahchuq Unit Agreement**

**Schrader Bluff Initial Participation Area**

**September 20, 2010**

**Legend**

- Schrader Bluff PA
- Nakaichuq Unit
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)

Cumulative Barrels (KPA)

- 0 - 50,000
- 50,000 - 250,000
- 250,000 - 500,000
- 500,000 - 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?