

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

DIVISION OF OIL & GAS

SEAN PARNELL, GOVERNOR

550 WEST 7TH AVENUE, SUITE 800
ANCHORAGE, ALASKA 99501-3560

PHONE: (907) 269-8800

FAX: (907) 269-8938

July 1, 2011

Carrie A Lockhart, President
Marathon Alaska Production LLC
P.O. Box 196168
Anchorage, Alaska 99519-6168

M. Colleen Starring, President
Enstar Natural Gas Company
3000 Spenard Road
P.O. Box 190288
Anchorage, Alaska 99519-0288

Subject: Cannery Loop Unit Contraction

Dear Ms. Lockhart and Ms. Starring:

On June 28, 2011, Cook Inlet Natural Gas Storage Alaska, LLC (CINGSA), as the operator of a new Storage Project in the Cook Inlet region of South Central Alaska, and Marathon Alaska Production Company LLC (Marathon), as the Operator of the Cannery Loop Unit, jointly requested contingent approval of a contraction of that unit under Section 2 of the Joint Federal State Unit Agreement for the Development and Operation of the Cannery Loop Unit.

The purpose of the contraction is to remove the area that comprises the Sterling C Pool from the Cannery Loop Unit. CINGSA intends to convert this area into a natural gas storage facility and supply storage to the public for compensation under Certificate of Public Convenience and Necessity No. 733, granted by the Regulatory Commission of Alaska to CINGSA in Docket No. U-10-51. This request will allow CINGSA to operate a facility with a separate and distinct function and operatorship outside of the Cannery Loop Unit.

“Develop, Conserve, and Enhance Natural Resources for Present and Future Alaskans.”

CINGSA and Marathon further requested that the contraction be contingent upon issuance of a superior court order prior to August 1, 2011, granting CINGSA possession of those remaining property interests in the Sterling C Pool, which CINGSA has not acquired via negotiated transactions. CINGSA and Marathon also requested that the unit contraction approval occur simultaneously (to be effective August 1, 2011) with the related requests for approval by the Department of Natural Resources (DNR) of assignments from Marathon to CINGSA for leases ADL 2397, ADL 324602, ADL 359153 and ADL 365454, CINGSA's Plan of Operations (LOC1 10-003) for the Storage Project, and the issuance of a Gas Storage Lease to CINGSA.

As described below, DNR approves these requests.

I. The Cannery Loop Unit

The Cannery Loop Unit is an oil and gas unit located on the Kenai Peninsula near the mouth of the Kenai River that was jointly approved as a unit by the DNR and the U.S. Geological Survey on June 29, 1978, as a result of the CLU 1 gas discovery in the Tyonek formation. Production commenced in 1978.

There are currently four participating areas in the Cannery Loop Unit: the Beluga Formation Undifferentiated Gas Sands Participating Area; the Upper Tyonek Formation Undifferentiated Gas Sands Participating Area; the Tyonek "D" Zone Gas Sands Participating Area; and the Sterling Gas Sands Participating Area.

Since its discovery, the Sterling Gas Sands Participating Area, the area relevant to this decision, has produced approximately 22 billion cubic feet (Bcf) of gas. The reservoir is estimated to have originally contained 26.5 Bcf of gas. However, the reservoir is now nearly depleted. To operate its gas storage facility, CINGSA will have to inject base gas back into the reservoir to raise the reservoir's pressure and then inject working gas (the gas that will be injected for storage and withdrawal).

II. Contraction Area

CINGSA and Marathon have requested that the following area, which corresponds to the boundaries of the gas storage facility, be contracted from the Cannery Loop Unit:

Storage Project Area
(Limited Vertically and Horizontally)

That portion of each lease that is within the "Cannery Loop Sterling C Pool" defined: (i) vertically as the underground formations comprising the C1 and C2 sands and the correlative buffer geological formation directly adjacent thereto at the equivalent stratigraphic interval, bounded by the base of the B5 coal formation (C1 top) and the top of the Upper Beluga formation (Upper Beluga Top); further vertically defined in the "Pool Type Log" Cannery Loop Unit (CLU) #8 well

(API #50-133-20534-00) as the interval between the depths of 6690 feet measured depth [MD] (4871 feet true vertical depth subsea [TVDSS]) and 6945 feet MD (5101 feet TVDSS); and (ii) horizontally to include all interests within the Cannery Loop Sterling C Pool Boundary, defined to include the following lands:

Township 5 North, Range 11 West, Seward Meridian, Alaska
Section 4: SWSW, W2SESW, S2NWSW, S2N2NWSW
Section 5: S2SE, S2N2SE, E2SESW, SENESW, S2N2NESE, S2NENWSE
Section 7: E2E2SE
Section 8: S2, NE, S2NW, NENENW, S2NENW, SENWNW
Section 9: W2NW, W2E2NW, N2NWSW, SWNWSW, NWSWSW
Section 17: N2NW, NWNE, W2NENE, N2NWSWNW, NESWNW, N2SENW, N2SWNE, NWSENE
Section 18: NENENE, NESENE

This area consists of both the Sterling Sands Participating Area, and additional acreage outside the Participating Area.

III. Notice

The Cannery Loop Unit Agreement was modeled after the Joint Federal-State Unit Agreement form, which provides for operation of the leases within the unit area as a single entity. Effective March 26, 2010, the United States Department of Interior, Bureau of Land Management, waived administration of the Cannery Loop Unit, leaving administrative management to the State of Alaska.

Section 2(b) of the Unit Agreement requires that notice of an application for unit contraction be delivered to "each working interest owner, lessee, and the lessor whose interests are affected" advising that a 30-day period be allowed for submission to the Unit Operator of any objection. Together, CINGSA and Marathon own all of the working interests in the Cannery Loop Sterling C Pool. Marathon is the current lessee of the affected leases, and plans to assign its interests to CINGSA. With respect to the State Leases, Marathon has filed the appropriate Applications to Assign with the DNR.

As mentioned above, the proposed area for contraction consists of the Sterling Sands Participating Area, and additional acreage outside of the Participating Area. Currently there are five property owners, in addition to CINGSA and Marathon, who have interests in land in the Cannery Loop Unit in the additional acreage within the boundaries of the gas storage project area, but outside the Sterling Gas Sands Participating area. They do not receive proceeds from any production in the Sterling Sands Participating Area (although they may receive proceeds from production in other participating areas in the Cannery Loop Unit, which will be unaffected by this Decision). Unit contraction and the gas storage project will thus not impact the receipt of royalties under existing oil and gas leases of any lessor who owns property within the boundaries of the gas storage project, but outside of the Sterling Sands Participating Area.

Moreover, CINGSA is in the process of acquiring property interests from all lessors with interests in the gas storage project area located outside of the Sterling Sands Participating Area. CINGSA has negotiated the purchase or lease of these interests from the majority of the interest holders. The remaining interest owners and/or lessors are named parties to CINGSA's condemnation action, *Cook Inlet Natural Gas Storage Alaska, LLC v. R.J.R. Nabisco Realty Inc., et al*; Case No. 3KN-11-252 CI. A hearing in this case is scheduled for July 8, 2011.

CINGSA and Marathon requested that the contraction be contingent upon issuance of a superior court order prior to August 1, 2011, granting CINGSA possession of those remaining property interests in the Sterling C Pool which CINGSA has not acquired via negotiated transactions. DNR finds that to be an appropriate request in this case. This situation presents unique facts in that CINGSA is a certificated public utility with the power of eminent domain to acquire property for public utility purposes.

Because both Marathon and CINGSA have requested the contraction of the unit, in the event that CINGSA acquires possession of all property interests in the gas storage project area by August 1, 2011, this decision shall be effective on August 1, 2011. If, on the other hand, such an order is not received by August 1, 2011, and CINGSA has not otherwise acquired all possession of all property interests in the gas storage area, this unit contraction decision will not take effect.

IV. Termination of the Sterling Sands Participating Area

Under 11 AAC 83.351, before sustained unit production, a unit operator is required to form a participating area.

Because the CINGSA project will be contracted from the Cannery Loop Unit, in the event that native gas is ever produced from the gas storage area, it will not be produced in conjunction with a unit and therefore a participating area is not required. If native gas is produced however, there must be an appropriate allocation to insure that affected royalty owners, in this case the State, receive appropriate royalties from production. As described above, CINGSA has proposed, in its gas storage lease, a royalty allocation schedule that follows the allocation schedule of the current Sterling Sands Participating Area. Therefore, in the event that native gas is produced from the gas storage facility, the interests of the State will be unaffected.

For these reasons, DNR also finds it appropriate to terminate the Sterling Sands Participating Area, effective August 1, 2011, in conjunction with the other portions of this decision.

V. Decision Criteria considered under 11 AAC 83.303(b) and (a)

While this decision stems from a request under the terms of the Cannery Loop Unit Agreement and is not made under the unit contraction provisions of 11 AAC 83.356, DNR has, nonetheless, considered the criteria set out in 11 AAC 33.303 in reaching it.

A. Decision Criteria considered Under 11 AAC 83.303(b)

1. The Environmental Costs and Benefits

Contraction of the Cannery Loop Unit will have no environmental costs and benefits beyond those previously considered at the time of formation. Activities associated with the CINGSA gas storage project are themselves subject to independent reviews of the Plan of Operations and written finding associated with that project.

2. Geologic and Engineering Characteristics, Prior Exploration and Development Activities, and Plans of Exploration and Development

As described above, the Sterling Gas Sands Participating Area is nearly depleted. Contraction of the Cannery Loop Unit and development of the CINGSA gas storage project will allow this area to continue to have a useful function. This site is well suited for a gas storage facility. CINGSA has examined many potential sites in and around Cook Inlet. After reviewing 49 defined gas pools within the Cook Inlet Basin based on criteria related to onshore location, reservoir size and geologic properties, production characteristics and state of depletion, and proximity to pipelines and other infrastructure, CINGSA identified the Cannery Loop-Sterling C Gas Pool reservoir as the best candidate for large natural gas storage.

3. The Economic Costs and Benefits to the State

There are no economic costs to the State associated with contraction of the Cannery Loop Unit. To the extent that native gas is ever produced from the area currently within the Sterling Sands Participating Area, it will be allocated based on a formula that calls for the same allocation as currently used by the Participating Area.

B. Decision Criteria Considered Under 11 AAC 83.303(a)

1. Conservation of All Natural Resources, Prevention of Economic and Physical Waste, and Protection of All Parties of Interest, Including the State

Contraction of the Cannery Loop Unit for purposes of conversion to a gas storage project will not result in economic or physical waste. As described earlier, all parties in interest are protected. If CINGSA acquires possession of all property interests in the area to be contracted, there is no conflict with other non-State interests. The State's interests in any future production of native gas are addressed in the gas storage lease.

In addition, a strong public policy interest is served through creation of the gas storage project.

The gas storage project has the potential to benefit many stakeholders in Southcentral Alaska that cannot be realized without a storage project. Natural gas storage is the preferred mechanism for providing reliable peak natural gas deliverability throughout the year in the future as it addresses this current need and has other benefits to offer.

CINGSA, as an open access storage project, will allow consumers' needs to be met most economically. Increased levels of storage improves the economics of exploration and development, as well as fields currently in production, because it allows production from a field to be managed to optimize production rather than to meet seasonal demand swings.

The project is also beneficial because it allows Kenai Peninsula oil and gas operators to more efficiently drain the gas pools by leaving them flowing during summer months when they would be shut-in due to lack of demand. Leaving wells open allows a more efficient recovery of the hydrocarbon resources because once shut-in, most gas wells never return to their original productive capacity. In this regard, the project is needed from a conservation perspective as well as improves the reliability and deliverability of our regional energy security.

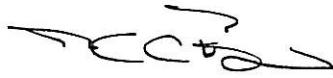
Based on all of the above, DNR approves contraction of the Cannery Loop Unit, effective August 1, 2011, and contingent upon issuance of a superior court order prior to that date granting CINGSA possession of those remaining property interests in the Sterling C Pool, which CINGSA has not acquired via negotiated transactions as of the date of this decision.

A person affected by this decision may request reconsideration in accordance with 11 AAC 02. Any reconsideration request must be received by July 21, 2011, 4:30 p.m., Alaska time, (as defined in 11 AAC 02.040(c) and (d)), and may be mailed or delivered to:

Daniel S. Sullivan, Commissioner
Alaska Department of Natural Resources
550 W. 7th Ave., Suite 1400
Anchorage Alaska 99501
faxed to 1-907-269-8918

or sent by electronic mail to dnr.appeals@alaska.gov

If reconsideration is not requested by the deadline, this decision becomes a final administrative order and decision of the department on August 1, 2011. Failure of the commissioner to act on a request for reconsideration within 30 days after issuance of this decision is a denial of reconsideration and is a final administrative order and decision for purposes of an appeal to Superior Court. The decision may then be appealed to Superior Court within a further 30 days in accordance with the rules of the court, and to the extent permitted by applicable law. An eligible person must first request reconsideration of this decision in accordance with 11 AAC 02 before appealing this decision to Superior Court. A copy of 11 AAC 02 may be obtained from any regional information office of the Department of Natural Resources.



W.C. Barron, Director
Division of Oil and Gas

7/1/11

Date

I concur:



Daniel S. Sullivan, Commissioner
Department of Natural Resources

7/1/11

Date

cc's

R.J.R. Nabisco Realty, Inc.
3 Lakes Drive
Northfield, Illinois 60093
Attn: MikeWavrek

Agnes Louis Thomas
1330 N Brady Street
Ridgecrest, CA 93555

Carryl Hufstetler
1681 Mustang Drive
Henderson, NV 89002

Melissa Foute
812 Wilson Avenue
Bakersfield, CA 93308

Judith McGuire
300 Day Avenue
Bakersfield, CA 93308