

SLUGGER UNIT AGREEMENT

AMENDMENT TO

MARCH 30, 2001 FINDINGS AND DECISION OF THE COMMISSIONER

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

APPROVING REVISED PLAN OF EXPLORATION

May 2, 2001

The Department of Natural Resources (DNR) issued a findings and decision on March 30, 2001 conditionally approving formation of the Slugger Unit. That decision required all working interest owners to agree in writing by April 30, 2001 to the terms of the plan of exploration set forth in the decision (“the Decision Plan”). On April 30, 2001 the deadline for written acceptance of the Decision Plan was extended to May 2, 2001.

After issuance of the March 30, 2001 decision, DNR and the working interest owners discussed the Decision Plan. During these conversations DNR and the working interest owners largely agreed on several changes to the Decision Plan. The working interest owners then signed a revised plan, referred to herein as “the Revised Plan.” The major changes between the Decision Plan and the Revised Plan are addressed below:

The Decision Plan required the drilling of two wells within three years. It divided the unit acreage into two areas, Area A and Area B, based on certain geologic features. It required that one well be drilled in Area A and one well be drilled in Area B during the three year term of the plan. It provided for a payments to the state and unit termination if two wells were not drilled. Further, it provided for a payment to the state and unit contraction if both wells were drilled in Area A, but no well was drilled in Area B (or vice versa).

The Revised Plan also requires two wells. An attempt must be made to drill the two wells within three years, but the working interest owners are allowed a fourth year to drill the second well if needed, on condition that they pay the state \$400,000. The Revised Plan retains Area A and Area B, but further divides Area A into the area inside the four-way closure and the area outside the four-way closure. Generally, the working interest owners are allowed to drill both wells in Area A during the first three (or four) years of the unit, as long as one well is inside the four-way closure, and one-well outside the four-way closure. It provides that if the working interest owners drill both wells during the period of the Revised Plan within the four-way closure, they will pay the state \$400,000. Finally, it puts the working interest owners on notice that DNR wants both Area A and Area B delineated relatively early in the unit life, and will require wells in both areas under the second plan, or unit contraction.

DNR has evaluated the Revised Plan under 11 AAC 83.303 and finds that it is in the public interest, largely for the reasons expressed in the March 30, 2001 decision. However, certain changes to the plan, and how those changes protect the public interest, need to be addressed. First, the Revised Plan permits the working interest owners to take an additional year to drill the second well; but if they take that extra year, they must pay the state \$400,000. The \$400,000 is designed, in part, to compensate the state for a year’s delay in reoffering certain leases, should the unit terminate for any reason, including failure to drill a second well. DNR concludes that \$400,000 is appropriate and adequate compensation for the purposes intended. DNR also concludes that, once compensated, allowing an extra year for drilling the second well is reasonable in light of the remote location of the unit, the lack of infrastructure nearby, the high cost of drilling the wells, and the possibility that other regulatory agencies may require the completion of drilling by April 30, rather than the later dates historically allowed.

Second, the Revised Plan permits the working interest owners to drill both wells in Area A during the first three (or four) years of the unit. However, like the Decision Plan, it requires that

the wells delineate what currently appears to be two separate geologic structures—inside and outside the four-way closure. Additionally, it provides for a payment of \$400,000 to the state should the working interest owners drill two wells in the same geologic structure, but no other wells, which is similar to the \$360,000-\$380,000 payment required under the Decision Plan if the working interest owners drilled both wells only in Area A or Area B. The Revised Plan does not provide for unit contraction during its term, as the Decision Plan did, but it puts the working interest owners on notice that contraction may be required as a condition for approval of a second plan.

Third, the Decision Plan required drilling in Area B, on pain of unit contraction; the Revised Plan does not. However, it puts the working interest owners on notice that DNR intends to require a well or wells in Area B, on pain of unit contraction, under the second plan, which will begin in either the fourth or fifth year of the unit's life. While this represents a delay in delineation of Area B, the delay may be as short as one year, and the state still receives the benefit of two wells during the period of the initial plan. DNR also expressly maintains its right to contract the unit should it not be appropriately delineated early in the life of the unit. Moreover, DNR does not limit options otherwise available to it when the second plan is submitted for approval, it only makes several of its options express.

Fourth, the Revised Plan adds language stating, in essence, that the state's remedies for any failure to drill did not include specific performance—that is, compulsory drilling of the two wells—but only remedies otherwise available to the state (such as the payment of the charges specified in the plan, unit contraction, and unit termination). Since DNR did not intend to create a right to specific performance with regard to the drilling of wells in the Decision Plan, this addition to the Revised Plan does not change the rights and remedies otherwise available to the state.

While DNR and the working interest owners were able to agree on the changes to the plan discussed above (as well as other inconsequential changes), one working interest owner—Phillips Alaska, Inc.—was not willing to agree that DNR would be the party to determine whether there still appeared to be a four-way closure in Area A after the drilling of the first well. Phillips postulated that if it believed there was not a four-way closure after the drilling of the first well, but DNR believed there was, DNR could limit the area available for the drilling of a second well, or charge the working interest owners \$400,000. However, BP and Chevron were willing to agree that DNR, and not the working interest owners, would make a decision on the four-way closure, and that BP and Chevron alone would pay the entire \$400,000 due the state if both wells were drilled in what appeared to DNR to be a four-way closure. Since the state is adequately compensated by the payment of \$400,000—regardless of whether the \$400,000 is paid by all three working interest owners, or only two—DNR agreed to delete language from the plan giving it alone the final word on the four-way closure on condition that BP and Chevron provide a separate written guarantee that they would pay the entire \$400,000 if DNR, in its sole discretion, determined that both wells were within a four-way closure.

For the foregoing reasons, DNR finds that formation of the Slugger Unit remains in the public interest under the Revised Plan. Accordingly, DNR hereby amends its March 30, 2001 decision

by substituting the Decision Plan with the Revised Plan and accepts the BP/Chevron written guarantee of payment.

A person adversely affected by this amendment to decision may appeal this amendment, in accordance with 11 AAC 02, to Pat Pourchot, Commissioner, Department of Natural Resources, 550 W. 7th Avenue, Suite 1400, Anchorage, Alaska 99501-3561. Any appeal must be received at the above address, or by fax to 1-907-269-8918, within 30 calendar days after the date of "delivery" of this amendment to decision, as defined in 11 AAC 02.040. A copy of 11 AAC 02 may be obtained from any regional information office of the Department of Natural Resources.

Mark D. Myers, Director
Division of Oil and Gas

Date

cc: Bonnie Robson, Department of Law