



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Natural Resources

DIVISION OF OIL AND GAS

550 W. 7th #1100
Anchorage, AK 99501
Main: 907.269.8800
Fax: 907.269.8939

June 30, 2016

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Scott Digert, Manager of Reservoir
Management BP Exploration (Alaska) Inc. P.O.
Box 196612
Anchorage, AK 99519-6612

RE: Prudhoe Bay Unit – Initial Participating Area Plan of Development

Dear Mr. Digert:

On April 1, 2016, the Department of Natural Resources (“DNR”) timely received the proposed Prudhoe Bay Unit (“PBU”) – Initial Participating Areas (“IPA”) 2016 Plan of Development (“POD”). The POD was proposed by BP as operator for the PBU on behalf of all the working interest owners (“WIOs”). The purpose of this letter is to inform you of the status of the proposed POD in accordance with the provisions of 11 AAC 83.343.

Background

By letter dated April 11, 2016, the DNR commissioner informed BP Exploration (Alaska) Inc. (“BPXA”), as operator, that the POD submitted for the PBU IPA for 2016 was not complete with respect to its treatment of marketing discussions related to the development and production of natural gas in preparation for Major Gas Sales (“MGS”)—and suggested modifications that could make it complete. BPXA’s response to the notice and suggested modifications as operator, plus individual WIO responses from BPXA, ConocoPhillips, and Exxon, have not provided complete information or made the modifications as requested,¹ and DNR has not received a modified POD.

As the agency charged with reviewing and approving the development plans for short-term and long-term development activities, DNR has a responsibility to thoroughly evaluate plans of development and assess their potential impacts on the State. DNR has reviewed the proposed 2016 PBU IPA POD, including information received in technical review meetings, and determined that it is not complete and does not fulfill the requirements of 11 AAC 83.303 and 11

¹ DNR requests that any responsive information held by ConocoPhillips, Exxon and BPXA, as WIOs, be submitted in writing. Upon review of written submissions, DNR may schedule meetings as follow-up to the submissions, if necessary. If there is information that cannot be provided in writing, please provide a detailed written description of such information and an explanation as to why it cannot be provided in writing.

AAC 83.343(c). Because the 2016 POD submittal continues to be incomplete, DNR cannot evaluate it under the regulatory criteria.

1. THE PROPOSED POD'S DISCUSSION OF OIL COMPLIES WITH 11 AAC 83.303

The proposed POD contains sufficient information with respect to development and production of oil and the operator was so informed on April 11, 2016. Following is DNR's review of the proposed POD as it pertains to development and production of oil.

A. The 2015 annual report

The Prudhoe Bay reservoir management strategy continues to emphasize optimizing base field production within facility constraints through wellwork, reservoir pressure maintenance, flood optimization, and continued well sidetracking and new well development drilling. In 2015, BPXA again conducted a high level of drilling and wellwork in the IPA with 8 grassroots wells and 52 sidetrack wells. BPXA also performed 413 rate adding jobs and ~1,400 non-rate adding jobs. Rig workovers ("RWO") have continued to increase over the past four years with 27 RWOs in 2015. Drilling and wellwork in all categories has been increasing for the last four POD periods in the IPA. In 2015, the IPA produced an average of 196,400 barrels of oil per day (71.7 million barrels total) and approximately 6.9 billion standard cubic feet of gas per day ("bscf/d"), of which 6.24 bscf/d was reinjected as lean gas and miscible injectant ("MI") into the field for enhanced oil recovery. The remainder of the produced gas is used for fuel gas, minor gas sales, and making natural gas liquids to be delivered to TAPS.

Drilling activity was extensive in all six IPA depletion areas. Three wells were drilled in the FS-2 area, referred to as the "East of Sag" drilling campaign, and successfully tested the pattern rotation concept. Two wells drilled in 2014 and one in 2015 will test the conversion from inverted 9 spot to 5 spot patterns. In the northern portion of FS-2 area, three more wells were drilled in 2015 to target Zone 1A where the initial results show promising oil saturation levels. There were 12 wells drilled and completed in the Western Waterflood area (five Sag River wells and 7 Ivishak wells) in 2015 with four rig workovers to repair mechanical integrity. The UZI Project progressed in 2015 after continuing to demonstrate improved oil recovery in areas where the gas cap has expanded and gravity drainage process is less effective. Installation of the N-Pad UZI project was completed in 2015 and three more producers will be converted to injectors. In the Sag River Development area, 11 wells were drilled and completed, mostly in the NW Fault Block. Of the 11 wells, eight are producers which are all on production and three are MI/waterflood injectors. Sag River horizontal injector-producer pairings have not proven viable due to high well costs and lower-than-expected rates. Finally, two new coil sidetrack wells were drilled in the East West End/ NW Eileen area as voidage replacement ratios are maintained around the target level of 1.

The facility work to debottleneck western PBU fluid and gas handling was completed in 2015 with the commissioning of a jumper line at U-Pad. Two turnarounds ("TARs") were also completed at the Gathering Center 1 and Flow Station ("FS") 1 in 2015. Other projects

completed during the 2015 POD period were the N-Pad UZI and Drill Site 16 and 17 pipeline replacements. Continued facility and integrity management activities such as additional upgrades to the seawater treatment plant (“STP”) and pipeline in-line inspection or smart pigging work occurred in 2015. Nearly 104 miles of pipelines were inspected. Facility and pipeline work is important for maintaining field operations and preparation for future Major Gas Sales.

B. The 2016 proposed plan of development for oil

For the 2016 POD period, BPXA anticipates reduced drilling and wellwork activity as three drilling rigs will be removed from service in the PBU due partly to market price conditions. In 2016, BPXA estimates four planned RWOs, eight rotary penetrations, and 24 coil penetrations. The higher success rate of non-rig workover repairs enables more wells to be returned to service without use of a rig, reducing the need for rig workovers. BPXA has focused on drilling and RWOs in the Gravity Drainage depletion area; however, the drilling is increasingly challenged by gas cap expansion and water encroachment. Increases in oil production in FS2 have resulted through shutting in water injector wells and re-perforating wells higher in the oil columns at Drill Site 03, 04, 09, and 11. This program has been successful in adding oil production and BPXA plans to continue an uphole add-perforation campaign in the remaining wellbore candidates. Another significant plan for 2016 is expansion of MI injection into two more MI sidetrack wells and injection into one Updip Zone 4 Injection (“UZI”) pattern on N-Pad. UZI’s long-term viability is dependent upon future allocation of MI and injection water which makes water handling and gas handling capacity important.

Facility upgrades continue to be major investments necessary to maintain field operations. There are no TARs scheduled for 2016. A substantial project began in 2014 with the replacement of the Stock Tank Vapor & Intermediate Pressure turbine-driven gas compressors at FS-1, FS-2, and FS-3. The compressor replacement was completed for FS-1 in 2014, the FS-3 compressor will be installed in 2016 with the FS-2 compressor installation in 2017. Evaluations are planned for the Seawater Treatment Plant to continue seawater injection efficiency for the Gas Cap Water Injection project pressure support and other water injection projects. BPXA also plans piping modifications at Skid 50 (FS-3), pipeline modification for the STP 36-inch flowline from Point McIntyre, and more than 110 miles of pipeline in-line inspections.

C. Analysis

When considering a POD, DNR must consider the criteria in 11 AAC 83.303(a) and (b). Accordingly, DNR considered the public interest, conservation of natural resources, prevention of economic and physical waste, protection of all interested parties including the State, environmental costs and benefits, geological and engineering characteristics of the reservoirs or potential hydrocarbon accumulations, prior exploration activities, plans for exploration or development, economic costs and benefits to the State, and any other relevant factors, including mitigation measures. 11 AAC 83.303(a)-(b).

The 2016 POD period predicts a reduction in oil-related drilling and RWO work for the coming year. However, the 2015 POD period reported another year of high levels of oil-related drilling

and workovers at the IPA. The activities conducted at the IPA over the last four years have seen record levels of drilling, RWOs, and rate adding jobs along with heavy investment in facility upgrades, pipeline replacements and inspection, and TARs. The IPA experienced an average daily production decline of only about 7,000 barrels of oil per day in 2015. The Prudhoe Bay field has exceeded its original recovery factor estimate by 2.7 billion barrels of oil due to investments beyond drilling wells. BPXA is progressing and developing new reservoir projects such as UZI, new MI targets, Sag River, and “pattern rotation” or pattern inversion in the east of Sag area. After such extensive drilling activities and pilot programs, a period of evaluation and assessment is acceptable. BPXA continues major facilities investments targeting debottlenecking constrained facilities and enhanced water and gas injection.

As the field has matured, the investments to maintain and replace aging infrastructure are key components to process and handle gas and fluids as efficiently as possible. The continuing investments in 2015 and proposed plans for 2016 are preventing physical and economic waste and continuing to provide economic benefits to the State. Finally, increasing pipeline integrity management and facility maintenance activities promotes the protection of all natural resources and the public interest.

BPXA provided a correction to a sentence on page 18 of the 2016 POD’s Production Forecast which the Division will incorporate with the 2016 POD. The sentence containing the production forecast should read (correct figures noted in bold):

The average annual IPA crude and condensate production for 2016 is expected to be between ~~137-176~~**157-196** MB/D. The total NGL production for the 2016 is expected to be between ~~29-37~~**36-45** MB/D.

Having considered the 11 AAC 83.303 (a) and (b) criteria, DNR finds that the discussion of oil development and production and the use of natural gas to the extent needed to enhance oil production in the proposed 2016 POD complies with the provisions of 11 AAC 83.303. However, because the 2016 POD submittal continues to be incomplete regarding marketing for the development and production of natural gas, the POD cannot be fully evaluated under the regulatory criteria.

2. THE PROPOSED 2016 PBU IPA POD IS INCOMPLETE

For reasons that follow, the Director finds that the proposed 2016 PBU IPA POD is not complete.

A. Background facts about the gas resources at PBU

The Alaska Oil and Gas Conservation Commission reports that “[t]he operator, BP, estimates ... gas in place” at Prudhoe Bay to “be 46 trillion cubic feet.”² Furthermore, the size of these resources has made Prudhoe Bay gas the backbone upon which any gas pipeline that will transport gas from any unit on the North Slope will be built.

The Alaska legislature has specifically determined that the responsible development of such gas resources is in the best interests of the people of Alaska. In the enabling legislation for DNR, the legislature directly spelled out that the State has an interest in maximizing the development of both its oil and gas resources. Thus, AS 38.05.180, “Oil and gas and gas only leasing” provides as follows:

- (a) The legislature finds that
 - (1) the people of Alaska have an interest in the development of the state's oil and gas resources to
 - (A) maximize the economic and physical recovery of the resources;
 - (B) maximize competition among parties seeking to explore and develop the resources;
 - (C) maximize use of Alaska's human resources in the development of the resources

B. The duty to market the PBU gas

DNR regards it as established law that the WIOs, individually and as a unit, are obligated to diligently develop, produce, and market gas from the PBU. This obligation is inherent in the broad requirements for development of the unitized resources under Alaska law, the Prudhoe Bay Unit Agreement, and the express and implied terms of the PBU leases. Without an obligation to market, the express terms of the leases and Prudhoe Bay Unit Agreement that extend development duties to all of the oil and gas resources would be meaningless for this remote field. An implied duty to market also applies under a standard implied-covenant analysis.

The leases within the PBU include express requirements for “reasonable development;” “drill[ing] such wells as a reasonably prudent operator would drill having due regard for the interests of Lessor as well as the interest of Lessee;” “reasonable diligence in...producing;”

² Alaska Oil and Gas Conservation Commission website, AOGCC Pool Statistics, Prudhoe Bay Unit, Prudhoe Oil Pool, available online at: http://doa.alaska.gov/ogc/annual/current/18_Oil_Pools/Prudhoe%20Bay%20-%20Oil/Prudhoe%20Bay,%20Prudhoe%20Bay/1_Oil_1.htm.

“reasonable diligence in...operating;” and “to carry on all operations hereunder [the lease] in a good and workmanlike manner in accordance with approved methods and practices.” While the operator has been diligent in the development of oil at PBU, like diligence is required for the gas in order to accomplish a MGS.

Even in the absence of such express obligations, courts have universally found standard lease requirements supportive of an implied duty to market. This obligation extends to the full unit; once leases are unitized, it has long been established that implied duties extend to the larger unit area now operated as a single property. *See, e.g., Maurice Merrill, Implied Covenants, Conservation and Unitization*, 2 Okla. L. Rev. 469, 477 (1949). In addition, DNR’s approval powers over unit plans of development are broader, and serve broader purposes, than merely enforcing the traditional duty of reasonable development, whether express or implied. Judge Gleason emphasized this breadth of power in her first decision in the Point Thomson litigation.

The adequacy of plans for development and production cannot artificially be divorced from plans for marketing the resources developed and produced. In the case of the PBU, DNR cannot adequately protect the interests of all parties and perform its approval responsibility without receiving both marketing and development information.

C. The need to plan for development and sale of all PBU resources

While DNR acknowledges the proposed use of gas in the current POD time period to enhance the production of oil, the State and the WIOs must prepare for the time when such use will no longer be necessary or appropriate. Major Gas Sales, in the relatively near future, are necessary to realize the benefit of the enormous gas resource within the PBU to the people of Alaska, and planning for MGS must be done now.

The State and the WIOs began the PBU relationship with the understanding that MGS were both important and an entirely proper subject for a POD. When the PBU was formed, several decades ago, the WIOs assured Alaska that MGS would occur within five years after first oil production at Prudhoe Bay. Exhibit “E” Plan of Development to the Prudhoe Bay Unit Agreement, 1977, p. E-2 (“It is planned to commence gas pipeline deliveries of 2 BCF/D as soon as pipeline and plant to condition the gas to specification can be completed. This is currently estimated to be about five (5) years after the start of oil production.”). Nevertheless, the proposed 2016 POD does not offer a meaningful plan or information that reflects what the WIOs are actually doing towards planning, preparing, or accomplishing MGS. Instead, the proposed POD contains only a simplistic truism that “Major Gas Sales (MGS) from Prudhoe Bay remains dependent upon a number of factors, including market demand and the availability of an offtake project.”³

Given the production, development, and marketing requirements within the PBU leases, the Prudhoe Bay Unit Agreement (“PBUA”), and the law, Alaska is entitled to a firm commitment to

³ 2016 Proposed PBU IPA Plan of Development at 21.

move the PBU toward MGS. Meaningful progress on the development and marketing of Prudhoe Bay gas inherently requires a commitment of the resource toward a development and marketing program. Alaska is entitled to specific, detailed information concerning what the WIOs are doing to plan and prepare for MGS, including the timeline and measurable milestones that can be evaluated during the next POD review period.

D. Plan of Development for MGS incomplete

Given the importance of PBU MGS to the State of Alaska and the necessity that the WIOs actively commit the PBU gas for MGS to occur, the plans to make this happen are of vital interest to DNR and Alaska. Notwithstanding DNR's January request for detailed information regarding plans for MGS, the entirety of the PBU POD "plan" with respect to MGS in Section 3.6 fails to meet the regulatory requirements for a plan of development. In its entirety, the proposed plan for this vitally important state resource reads as follows:

3.6 Major Gas Sales

Major gas sales (MGS) from Prudhoe Bay remains dependent upon a number of factors, including market demand and the availability of an acceptable offtake project. In the meantime, the PBU working interest owners will continue to use gas to enhance and accelerate oil recovery and for NGL production for shipment through TAPS or use in enhanced oil recovery operations.

The PBU working interest owners will continue to evaluate viable plans and incorporate [sic] into the current plan of development to further optimize gas and oil recovery, and to address facilities, equipment, wells, and operational changes to position for major gas sales.

These three sentences are not sufficient to adequately plan to develop the PBU in order to accomplish MGS.

The first sentence states two basic facts--that MGS will require demand for the gas and a pipeline to transport that gas. These truisms just raise questions. DNR has previously suggested what information could be given to answer those questions. Stated in more general terms, DNR would like to understand the following: What are the specific factors upon which MGS depend, and what are the WIOs doing to address those factors? What type of market demand is required? What is an "acceptable offtake project"? What are the WIOs doing to explore or evaluate the market demand? What are the WIOs doing to develop an "acceptable offtake project"? What are the WIOs doing to allow an "acceptable offtake project" to be developed by third parties? What are specific obstacles preventing the WIOs from committing to MGS and what are the WIOs doing to address any obstacles?

The second sentence discusses what the WIOs will do until MGS - i.e., use the gas to enhance oil recovery. While DNR appreciates the critical importance of this gas use, this tells DNR nothing

about if, when, or how, the WIOs are planning and preparing to accomplish MGS. As stated above, the State and the WIOs are looking at the time where use of the gas for enhanced oil recovery will no longer be necessary or appropriate. Planning and development required for MGS in the relatively near future is necessary now.

The third sentence is too general to be adequate or indicate meaningful planning. It states that the WIOs will “continue to evaluate viable plans,” but it does not describe what plans the WIOs are evaluating, if any, let alone any details about such plans or what the result of the WIOs’ evaluation is or has been. The general commitment to “address facilities, equipment, wells and operational changes to position for major gas sales,” likewise lacks any specific details that could be considered as specific commitments or milestones for DNR to evaluate the WIO’s actions in this regard. Again, DNR previously suggested the type of information and details that could answer some of the fundamental questions raised by this statement, but the WIOs have not provided any such information and details. If the WIOs wish to incorporate by reference the dates in the AOGCC order as specific commitments, they should state so explicitly in a modified 2016 PBU IPA POD.

The simple “plan” presented in Section 3.6 does not represent “long-range proposed development activities” for bringing the unit’s “underlying gas reservoirs . . . into production, and maintain[ing] and enhanc[ing] production once established,” as required by 11 AAC 83.343(a)(1). Even if the POD proposes some general, vague activities moving toward MGS, it does not offer specific, verifiable “details of the proposed operations for at least one year following submission of the plan,” as required by 11 AAC 83.343(a)(3).

Given the amount of natural gas at PBU and its importance to the State, the Section 3.6 “plan” for how the PBU will be developed with respect to natural gas and what the WIOs are doing to prepare for PBU MGS does not offer DNR sufficient information to evaluate its compliance with the criteria found in 11 AAC 83.303. The proposed 2016 PBU POD is therefore incomplete in this regard.

E. Additional suggestions as to information and action that will make the POD complete

DNR believes that meaningful progress on the development and production of Prudhoe Bay gas inherently requires a commitment of the resource toward a marketing program. History shows that this is not a situation where pipelines can be expected to be built absent a prior commitment. Historically, Alaska has found itself in a “Catch-22” circumstance whereby the WIOs have cited the lack of a pipeline to justify not achieving MGS while simultaneously not taking firm strides toward making gas available for a third party project. This is not consistent with the WIOs’ obligations to take reasonable steps to market the natural gas found at the PBU, and to act diligently towards achieving such sales.

The WIOs’ interest (or lack thereof) in developing MGS by investing in a pipeline project must not preclude other means of developing production and MGS at Prudhoe Bay. The WIOs are not required to guarantee that a third party ultimately builds a pipeline. However, DNR believes that

it is directly adverse to the State's interests for the WIOs to use their refusal to market gas to third parties to effectively veto otherwise viable pipeline projects.

DNR believes that the WIOs' lease obligations (both express and implied) as well as their duties under the Prudhoe Bay Unit Agreement and otherwise applicable law require reasonable diligence on the WIOs' part to market gas. This includes a duty to make gas available from Prudhoe Bay to third-party projects on commercially reasonable terms in the absence of a binding commitment to progress a WIO-sponsored MGS project.

DNR has attempted to secure information regarding what the unit operator and PBU WIOs are doing to plan and prepare for PBU MGS and how MGS will be accomplished, and it has provided suggestions to the unit operator and PBU WIOs by which they might bring the 2016 POD into compliance with the relevant regulations.⁴ While the following (and the previous suggestions) is not suggested as the only means by which the WIOs might submit a complete POD with respect to the PBU natural gas resources, DNR provides the following additional guidance as to what DNR believes is necessary in the current POD for it to be approved in order to assist the WIOs in completing this POD process and moving towards reasonable development and marketing efforts with respect to Prudhoe Bay gas.

The POD must discuss what actions will be taken in the coming POD year and show specifically how and when the WIOs will undertake reasonable and diligent efforts to develop the PBU gas for MGS, including how and when they plan to get the gas to market. This may require a showing as to how and when the WIOs have met or will meet with potential purchasers of gas and/or potential sponsors of gas transportation projects, including but not limited to the state of Alaska, to negotiate in good faith over the various aspects of a gas commitment with respect to natural gas produced at Prudhoe Bay. It is understood that a gas commitment would ultimately involve the WIOs dedicating PBU gas to a project that would transport that gas to market. DNR suggests that, for purposes of a modified POD, showing how and when the WIOs will achieve a gas commitment is necessary.

DNR expects and will enforce Alaska's rights to have the WIOs take all reasonable steps to develop and produce PBU gas, including getting it to market, whether by themselves or by making it available to third parties.

As submitted, the proposed POD is incomplete and insufficient to allow DNR to evaluate its compliance with the regulatory requirements. In order to be complete and allow DNR to evaluate its adequacy, the WIOs must submit a modified POD that provides additional, detailed information concerning marketing plans and activities that will result in and are related to the commencement of MGS. The proposed plan must adequately explain what specific, measurable, verifiable actions the WIOs will take during this POD period that demonstrate a diligent and adequate effort and commitment towards marketing for and accomplishing PBU MGS. While DNR has previously provided suggestions as to what information would be adequate to make the

⁴ See letter dated January 14, 2016, and follow-up email dated March 14, 2016; DNR letters to BPXA, as operator, dated April 11, 2016, and May 12, 2016.

POD complete, the unit operator and WIOs should submit whatever information they believe will cause the proposed POD to comply with 11 AAC 83.343 and 11 AAC83.303 as part of a modified proposed POD, and DNR will evaluate it under those criteria. If it is the unit operator's and WIOs' position that they cannot provide any of the requested information because such information does not exist, DNR requests that the unit operator state this in writing as part of a modified POD.

3. DNR'S RESPONSE TO CHALLENGES

The unit operator and two WIOs responded to DNR's April 11, 2016 request for additional information in a May 2, 2016, letter from BPXA (as unit operator), signed by Mr. Scott Digert, a May 2, 2016, letter from BPXA (as an individual WIO), signed by Mr. David Van Tuyl, and a May 4, 2016 letter from ConocoPhillips (as individual WIO), signed by Jon Schultz. The letter from ConocoPhillips did not present any discussion of the issues, but contained a request to meet to discuss DNR's requests for information, subject to a confidentiality agreement and "entirely separate from any discussions related to the Division's review of the IPA POD submitted by the PBU Operator." Because the information requested by DNR regarding development for MGS will be part of the 2016 POD, a meeting outside the POD process cannot provide the information necessary to make the POD submittal complete or adequate. As noted above, DNR requests that the unit operator and WIOs submit additional information in a revised 2016 POD. The letters from BPXA as unit operator and WIO raised several objections and challenges to DNR's requests that DNR would like to briefly respond to.

A. DNR's authority

Both the unit operator and individual WIOs have asserted that DNR's requests for plans regarding how they will get PBU gas to market constitute rulemaking because the requests allegedly require a new POD in an entirely new area. They also argue that the request exceeds DNR's authority because it is "outside the scope of the regulations," and that DNR would have to initiate a rulemaking procedure in order to secure the requested information. This is not correct.

DNR is called upon each year under its regulations to undertake a fresh analysis of an updated POD under 11 AAC 83.303 and 11 AAC 83.343(c). As the unit operator and the WIOs themselves point out, in 2015 AOGCC, at the WIOs' request, approved a significant expansion of potential gas offtake rates at PBU, thus positioning PBU for MGS in the relatively near future. Further, 11 AAC 83.343(a) specifically requires a POD to include, among other things, information concerning "long-range proposed development activities for the unit, including plans to delineate all underlying oil or gas reservoirs, bring the reservoirs into production, and maintain and enhance production once established." Arguing that this regulation cannot be read to allow DNR to require information on the WIOs marketing plans ignores the broad implications of "maintaining and enhancing production," which cannot be accomplished without marketing.

In addition, DNR is not permanently bound to only one approach to secure the development of its resources. The fact that the PBU unit operator and WIOs have not been required to provide

DNR with objective verifiable milestones with respect to MGS in the past does not prevent DNR from imposing such requirements in the future. The factors DNR should consider, and the information it has a right to request when needed, can (and must) vary with time and technology, and with reference to the stage of PBU development.

DNR's existing powers allow the specific information needed to change as circumstances change. Nothing in the PBUA or the governing law suggests that the WIOs can avoid providing a plan of development for a valuable resource by claiming that DNR has not asked for such information in the past and, therefore, must engage in a new rulemaking process before it can ask now. It is the WIOs' duty under their leases, under the PBUA, and under the law to provide a complete plan of development of all resources. Given the current status of the field, it is now time to take measurable, verifiable steps towards MGS, and DNR is entitled to know what those plans and steps are and will be.

B. Antitrust arguments

The letters from BPXA also claim, in conclusory fashion, that DNR's requests raise antitrust concerns because the State may someday compete with individual WIOs in marketing ANS gas. Providing information specifically requested by a state in pursuit of its responsibilities under the PBUA and related statutory and regulatory provisions does not raise antitrust concerns. As discussed above, the information sought is required by 11 AAC 83.343. The antitrust laws are not violated when information is disclosed to the state as required by agreement or law. Moreover, the State is seeking and has consistently been seeking, a path to bring north slope gas to Alaskan, U.S., and world markets – a procompetitive, not anticompetitive result – and therefore something the antitrust laws are designed to encourage, not bar. Also, as the unit operator and the WIOs know, the AKLNG project information is not available to DNR for use in the POD approval process and therefore cannot fulfill the WIOs' responsibility to provide information necessary to that process unless the WIOs separately provide DNR with that information through the POD process.

Trade secret and confidentiality agreement arguments

Together, the unit operator and WIOs also claim multiple violations of confidentiality and trade secrets laws. These arguments do not have merit. As previously discussed, DNR has statutory and regulatory power to ask for this information. Any legitimate confidentiality concerns can be addressed by protective agreements, but the fact that some pertinent information may need to be confidential in some settings cannot prevent disclosure when the information is needed to determine whether the WIOs are complying with the intended purposes of unitization. The claim that the Alaska Uniform Trade Secrets Act (“Act”) protects the information sought by the State is also mistaken. That statute allows the owner of a trade secret to ask the court to enjoin the actual or threatened misappropriation of a trade secret. “Misappropriation” is defined as the acquisition of a trade secret by improper means, or disclosure of a trade secret without express or

implied consent.⁵ “Improper means” is further defined to include “theft, bribery, misrepresentation, breach of a duty to maintain secrecy, or espionage”⁶ Nothing in DNR’s demand for marketing information implicates any of the protections provided under this Act because acquisition of this information, even if it is a trade secret (which the division does not believe it is), is not being sought in an improper way and is not a misappropriation of the information as defined by the statute.

C. Duty to market beyond the North Slope

The WIOs also claim that they have no duty to market beyond the Alaska North Slope because there is no “non-local” market, and that in the absence of someone building a pipeline they have no duty outside the Alaska North Slope (“ANS”). This objection also is misplaced. First, the State is entitled to a commitment from the WIOs to take specific, measurable action sufficient to secure a pipeline from others if the WIOs will not act. The State is entitled to receive information showing that the WIOs are actually pursuing all reasonable efforts to develop and market the full gas resource, and not simply assertions from the WIOs that they will be ready when demand increases to some unstated level. Second, the focus on an ANS/non-ANS boundary is inappropriate. One purpose of the requests is to determine whether the WIOs are meeting their responsibility to develop the gas resource by also enabling other parties to consider building a pipeline, thus leading to optimal development and production of gas from the PBUA. It never has been likely that local ANS sale of oil or gas would sustain adequate development and production of those resources over any long-term. Third, as discussed above, a prudent operator’s responsibility is not so narrowly limited even under implied covenants. DNR is entitled to consider a wider range of factors than the reasonably prudent operator standard in determining the WIOs’ compliance with their duties to develop and market. DNR’s POD approval and oversight responsibility is not limited by implied-covenant law but instead is based upon the broader set of concerns enshrined in statute, regulation, and the PBUA. DNR needs a modified POD, with substantially more specific, detailed information to determine whether the proposed plan for development of PBU for MGS really conserves all resources, avoids waste, protects all parties in interest, and meets other unit requirements.

D. Information already produced, offer for a technical MGS workshop, and confidentiality

The unit operator argues that DNR already has access to information relevant to information it is seeking, citing information from AOGCC hearings, a FERC hearing, and non-confidential AKLNG project information. If the unit operator wants to rely on specific public information, it is required to produce the specific information on which it relied in response to DNR’s request as part of the proposed POD. At the very least, it must identify that information specifically. The unit operator cannot avoid its responsibility to provide a specific, detailed plan of development of gas by talking about other proceedings generically. DNR is entitled to specific responses in

⁵ AS 45.50.940 (2).

⁶ AS 45.50.940 (1).

order to evaluate the specific plans of the PBU unit operator and WIOs for getting PBU gas to market.

Similarly, the PBU WIOs have offered to have “technical meetings” to discuss their plans for gas. Although a “technical” meeting might be helpful to follow up on a written proposed POD regarding plans to develop and market PBU gas, it is not a substitute for submitting a modified POD to objectively manifest the unit plan for development. The unit operator and WIOs must submit responses to DNR’s requests in writing as part of a modified POD that DNR may evaluate.

Finally, some of the WIOs have indicated that they may be willing to provide certain information if it is held confidential under AS 38.05.035(a)(8). DNR has made clear that it will keep information confidential under AS 38.05.035(a)(8) if requested and applicable.

4. THE PLAN OF DEVELOPMENT OBLIGATIONS ARE CLEAR

Section 4.2 of the PBUA provides as follows with respect to the “Method of Development and Operation”:

To the end that Unitized Substances economically recoverable may be increased and waste prevented, Working Interest Owners shall with due diligence develop the Unit Area in accordance with good engineering and production practices. Such engineering and production practices shall include a plan of development and operation on a Reservoir basis (or portion thereof), designed to efficiently and economically produce Unitized Substances.

A plan of development and operation for each subsequently established Participating Area shall be submitted to the Director for approval as information upon which to base such plan is developed.

The PBUA language thus reiterates the WIOs’ broad development and operational obligations—obligations also existing under their leases “[t]o the end that Unitized Substances economically recoverable may be increased and waste prevented”—and requires “due diligence [to] develop the Unit Area in accordance with good engineering and production practices.” Furthermore, it recognizes that “[s]uch engineering and production practices shall include a plan of development and operation on a Reservoir basis (or portion thereof), designed to efficiently and economically produce Unitized Substances.” This obligation extends to the production of gas, which cannot be accomplished with respect to the PBU without marketing that gas or committing it to a project on reasonable terms. DNR is entitled to know how the unit plans to proceed to get PBU gas to market.

Section 4.2 of the PBUA set up and approved the original plan of development. The Original POD, Exhibit E to the PBU Agreement, provided as follows with respect to gas development:

It is planned to commence gas pipeline deliveries of 2 BCF/D as soon as a pipeline and plant to condition the gas to specification can be completed. This is currently estimated to be about five (5) years after the start of oil production. Studies have shown that the Prudhoe Bay (Permo-Triassic) Reservoir could be managed so that the planned deliveries would not affect ultimate oil recovery. Depending upon the reservoir performance, it might be possible to increase gas deliveries to 2.5 BCF/D.⁷

The argument that a gas plan is a substantively new obligation is contrary to the PBUA and the WIOs' prior actions.

The WIOs have suggested that long-range information does not exist and that they are not required to provide it. Clearly, if information does not exist, it cannot be provided. However, DNR expects the WIOs to specifically identify information that does not exist—e.g., “There have been no communications with third parties concerning gas commitments.” Further, the WIOs' suggestion that they are not required to produce long-range information is contrary to the explicit language of 11 AAC 83.343 and does not comport with the very purpose of a plan of development.

5. DNR WILL ALLOW ONE FINAL OPPORTUNITY TO PROVIDE A COMPLIANT PLAN OF DEVELOPMENT


As previously indicated, the proposed 2016 POD cannot be approved at this time because it is not yet complete. Given the importance of the gas resource to the State and the need to protect all parties in interest, including the WIOs, DNR will allow yet more time for an adequate submission on this topic. The PBU WIOs shall, in accordance with 11 AAC 83.343(c), be given additional time within which to propose an adequate POD regarding MGS. In that regard, DNR reiterates that the information requested by DNR in its previous letters and herein is the information that DNR suggests would make the POD complete, but the WIOs may submit whatever specific information they believe will comply with 11 AAC 83.343 and 11 AAC 83.303 to show how and when they are marketing the gas resource and moving toward MGS, and DNR will evaluate it under those criteria. A modified proposed POD shall be due by September 1, 2016.

In the meantime, DNR hereby amends the existing 2015 PBU IPA POD to allow operations consistent with oil development and local gas sales as described in the proposed 2016 POD and discussed herein in Section 1, and will temporarily extend the 2015 POD (as amended) to allow continued operations at PBU consistent with that amended POD. The 2015 POD (as amended) will expire on November 1, 2016.

⁷ Original PBU POD, Exhibit E.

If you have questions regarding this matter, contact Kyle Smith with the Division at (907) 269-8807, or via email at kyle.smith@alaska.gov.

Sincerely,



Corri A. Feige
Director

cc: DOL

David Van Tuyl, Regional Manager, BP Exploration Inc.

Jon Schultz, Manager – Great Prudhoe Area, ConocoPhillips Alaska, Inc.

Gilbert S. Wong, OBO Asset Manager, ExxonMobil Production Company