



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Natural Resources

DIVISION OF OIL & GAS
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September 7, 2018

CERTIFIED MAIL
RETURN SERVICE REQUESTED

Ms. Teresa Imm
ASRC Exploration, LLC
3900 C Street, Suite 1000
Anchorage, AK 99503

Re: Proposed 2018 Placer Unit 3rd Plan of Development – Approval

Dear Ms. Imm:

On June 11, 2018, the Department of Natural Resources, Division of Oil and Gas (Division), received the proposed 2018 3rd Plan of Development (POD) for the Placer Unit from AEX, ASRC Exploration, LLC (AEX). AEX submitted a supplement to the proposed POD on August 1, 2018. The Division then met with AEX on August 7, 2018, for a presentation regarding the proposed 2018 Placer POD. Subsequently, AEX also submitted an amended Placer Unit proposal for the 3rd POD on August 17, 2018. This decision approves the proposed 2018 3rd POD, as amended and as further conditioned below.

As discussed below, the decision to approve the proposed 2018 3rd POD was a close one. The expiration of the 2nd POD coincides with the term of the unit itself. Thus, in considering the proposed 2018 3rd POD, the Division also considered whether the unit itself will continue in force after September 7, 2018 and for how long. The unit automatically expires after September 7 unless AEX is conducting operations, and AEX has not conducted operations for more than two years and initially proposed no operations for next year. AEX has since proposed some minimal, short-term operations for this winter season. The Division views that activity as operations, but that alone will not keep the unit in force indefinitely.

Background

In a decision dated September 8, 2011, the State of Alaska, Department of Natural Resources, Division of Oil and Gas approved the Placer Unit under the terms and conditions of the Placer Unit Agreement. Article 14.2 of the Placer Unit Agreement states that the agreement will automatically terminate five years from the effective date in accordance with 11 AAC 83.336. As 11 AAC 83.336 states, there are two ways to extend a unit past this five-year term: (1) having a unit well certified as capable of producing in paying quantities and either producing or working towards production by conducting operations in the unit; or (2) having conducted exploration operations and seeking a discretionary extension from the Commissioner.

AEX extended the unit once through a discretionary extension. Before the end of the five-year term for Placer, in July 2016, AEX applied to certify the Placer #3 well and for a discretionary unit extension based on the exploration operations it had conducted. In a September 7, 2016 decision, the

Commissioner extended the unit through September 7, 2018. The Division later certified the well on December 22, 2016.

2016 POD

For its 2016 (1st) POD, AEX committed to several analysis and planning activities, but no operations. Specifically, AEX planned to:

- Analyze all geologic and engineering data from drilling and testing three wells;
- Discuss facility access and facility sharing with Brooks Range Petroleum Corporation (BRPC) and ConocoPhillips Alaska, Inc. (CPAI);
- Obtain Tabasco 3D seismic data from CGG Veritas and develop a plan for merging it with other data;
- Develop a high-level cost estimate for infrastructure.

AEX completed an initial design and cost estimate for infrastructure and completed an initial geologic and engineering study of the Placer #3 well data. AEX further completed thin section photography and description of the Side Wall Cores.

AEX also signed a Memorandum of Understanding with Brooks Range Petroleum Corporation to begin discussing the future use of Southern Miluveach Unit (SMU) production facilities and initiated discussions with CPAI regarding future use of Kuparuk River Unit (KRU) facilities.

2017 POD

For the 2017 POD (2nd POD), AEX again proposed no operations for that POD period. Instead, AEX planned to conduct further analysis and planning activities:

- Begin and complete reprocessing and merging Tabasco data with existing data;
- Map the extent of the Kuparuk C reservoir and generate geologic and dynamic reservoir models;
- Continue to analyze Placer #3 well data;
- Determine the type and locations of facilities and undertake Phase II engineering and cost studies for these facilities;
- Evaluate and continue negotiating facility sharing agreements with BRPC for SMU and CPAI for KRU;
- If appropriate, apply for a Participating Area.

AEX completed most of these activities, or portions and variations of these activities, but performed no operations.

In its approval of AEX's 2017 POD, the Division pointed out that these proposed activities were not operations. The Division emphasized the importance of this distinction because the Placer Unit was set to expire on September 7, 2018 unless AEX conducted operations.

Although the Division observed that unitized development was highly unlikely because production was not occurring and AEX had proposed no operations to extend the unit beyond the September 7,

2018 automatic termination date, the Division approved the 2017 POD because at that time it anticipated that AEX’s plans to analyze data and plan for infrastructure were activities that *would* lead to development. The Division, however, stated that the unit would expire at the end of the 2017 POD period unless AEX was actively producing or conducting operations under an approved amended POD.

Proposed 2018 POD

The Division notified AEX by email on June 20, 2018 that the POD submitted by AEX on June 11, 2018 was incomplete because the POD did not describe, as required by 11 AAC 83.343(c), the extent to which the requirements of the previously approved plan were achieved, or if actual operations deviated from or did not comply with the previously approved POD.¹ AEX’s July 2, 2018 amended proposed 2018 POD was deemed complete under 11 AAC 83.343(c), and AEX was notified of the same via email on July 12, 2018. AEX then filed a “Request to Supplement 2nd [sic] Plan of Development” on August 1, 2018, and then another amendment to the proposed 2018 POD on August 17, 2018.

When considering a POD, the Division must consider the criteria in 11 AAC 83.303(a) and (b). Accordingly, the Division considered the public interest, conservation of natural resources, prevention of economic and physical waste, protection all interested parties including the state, environmental costs and benefits, geological and engineering characteristics or 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 Division previously considered these factors in approving AEX’s earlier Placer PODs and incorporates those findings by reference.

Because of the impending unit expiration, the Division’s consideration of the proposed POD necessarily included consideration of whether that POD demonstrates that AEX has been and plans to continue conducting operations to keep the unit from expiring. A review of the proposed 2018 POD and amendments submitted shows that AEX has not conducted operations since mid-2016 and originally showed that AEX did not intend to conduct operations in the coming year.

For example, AEX’s 2018 POD long-range proposed development activities and “proposed operations” for the 2018 POD period reference the evaluation of and potential for early production:

- Analysis of an early production facility “for potentially [sic] early production in 2019/2020”; and
- Evaluation of early production using an ice road and Southern Miluveach Unit (SMU);

¹ AEX also submitted, concurrent with its proposed 2018 POD, a “Progress Report” supplemental to the 2018 POD and designated as confidential under AS 38.05.035 and 11 AAC 82.810. In that same June 20, 2018 email, the Division notified AEX that some of the information in the Progress Report needs to be included in the POD, which is a public document, and that substantial portions of the Progress Report do not appear to contain confidential information, despite its confidential designation. AEX was requested to provide a version of the Progress Report that contains only those portions that are confidential. To date, AEX has failed to do so.

The proposed 2018 POD further references the creation and evaluation of various modeling:

- evaluation of early production completion of a reservoir description for use in reservoir mapping and seismic analysis for generation of a 3-D geologic *model*;
- construction of an integrated reservoir hydraulic fracture *model* “to access the full vertical potential of Kubaruk C”;
- completion of a full field dynamic reservoir simulation *model* targeting the entire Kubaruk C accumulation and completion of simulations to optimize a development plan; and
- *model* hydraulic fracture simulation.

The proposed 2018 POD purports to “[e]valuate” the use of electric submersible pumps versus gas lifting, and “[p]rogress memorandum of understanding (MOU) with adjacent operators for joint Kubaruk C development and facility access.”²

The proposed 2018 POD also references various studies:

- conduct a development drilling cost *study*; and
- *study* the surface location of proposed facilities, drill pads, roads, docks, causeways, material sites, base camps, waste disposal sites, water supplies, airstrips, and any other operation or facility necessary for Placer Unit operations so that: (a) following completion of initial reservoir mapping and modeling, a well plan will be developed to optimally produce the Kubaruk C in the PLU; and (b) pending favorable results of facility access/sharing negotiations, finalize the review of adjacent facilities access options to determine location of roads and three-phase pipelines to processing facility.

The Division understands and values the importance of models and studies for progressing development. By focusing on planning work like studies and not also conducting on-the-ground operations, however, AEX cannot satisfy the regulatory requirements of 11 AAC 83.336 to keep the unit from automatically expiring.

Well certification alone does not extend a unit. The regulation specifically requires an operator to both have a certified well and either be producing in paying quantities or conducting operations. AEX has the certified unit well. But it is not producing in paying quantities. The only production from the Placer #3 unit well was in March 2016, and this was not sustained production, but rather well-test production. AEX further concedes in its 2018 POD cover letter that the Placer #3 unit well was suspended in 2016. AEX thus is not currently producing and the 2018 POD includes no plans to produce.

Nor has AEX been conducting operations. In the July 2, 2018 Amended POD, AEX contends that “11 AAC 83.343 and the Placer Unit Agreement describe operations to include such activities as, evaluation work, design work, contractor selection, procurement and financing.” This simply is incorrect. The Placer Unit Agreement does not define operations to include these activities. Nor does 11 AAC 83.343, which is the Plan of Development regulation. The Plan of Operations regulation, 11 AAC 83.346, specifies that a Plan of Operations is required for on-the-ground activities that, but

²As stated in its approval of the 2017 POD, the Division is not privy to the MOU or ongoing discussions, but observes that the SMU and KRU working interest owners are not currently authorized by DNR to process oil or gas from outside their respective units.

for an oil and gas lease, would require a Miscellaneous Land Use Permit. 11 AAC 83.346(b). No Plan of Operations is required for “evaluation work, design work, contractor selection, procurement and financing” or any other type of work that does not involve on-the-ground work in the unit. Those activities therefore are not operations.

Indeed, if a Plan of Operations was required for these activities, AEX would be in violation of its unit agreement and leases for conducting such activities without a Plan of Operations, and thus subject to default. AEX has a Plan of Operations for this Unit, but that Plan does not include administrative and commercial activities.

It is not just AEX’s Plan of Operations that does not include administrative and commercial activities. The Division’s longstanding practice is to require Plans of Operations for on-the-ground activities. Other activities are not operations and thus do not require a plan. To consider administrative and commercial activities to be operations would be a sea change in regulatory and contract interpretation for the Division, creating a considerable burden for lessees and operators needing to submit additional Plans of Operations and for the Division in adjudicating them.

Thus, the Division reviewed AEX’s activities for on the ground operations of the type that AEX would have needed a Plan of Operations to perform. AEX’s PODs reveal that it has done some studies and planning work, but no operations for approximately two years.

It is only AEX’s August 17, 2018 amended proposed 2018 POD that describes (albeit on one line, in section 3.c) the operations to which AEX is committed to conduct: “AEX plans to conduct winter operations by re-entering the suspended Placer #3 well.” And, it is only after seeking clarification from AEX that this proposed operation consists of performing bottom-hole pressure response testing of the Placer #3 well. AEX, upon request for clarification about where an activity like this might fit in the bigger picture of possible development, informed the Division that results from this testing “can be used for designing future early production operations with respect to reservoir pressure above bubble point,” and that “[t]his data could be included in our reservoir model for future well plans and design as well as simulation runs in the Kup C reservoir model.” Notwithstanding the seeming non-operations nature of the purpose of this testing in the greater scheme of future unit development, the Division only can speculate that this type of testing can be useful in designing future early production operations and may provide other informational value for AEX. Even so, it represents a minimal effort for purposes of conducting operations, particularly considering the dearth of operations since suspension of the Placer #3 well in 2016.

Nevertheless, because AEX commits to re-entry of the Placer #3 well for purposes of bottom-hole pressure testing, the requirement for conducting operations under 11 AAC 83.343 is satisfied, albeit just barely, and for a limited time. To approve the proposed POD, the Division therefore requires the following clarifications and conditions:

- AEX commits to and must re-enter the Placer #3 well and complete bottom-hole pressure testing by May 31, 2019.
- AEX must submit a detailed, written update to the Division on the progress of the Placer #3 work on or before January 31, 2019. Because AEX has proposed a single operation for the 2018–19 winter season, and because failure to continually conduct operations results in automatic expiration of the unit, this POD is approved for the period September 8, 2018

through May 31, 2019. AEX must submit a POD for the period June 1, 2019 through May 31, 2020 (2019 POD) on or before March 2, 2019.

Should AEX fail to submit a detailed, written update on or before January 31 or fail to complete the bottom-hole pressure testing on Placer #3 well by May 31, 2010, AEX faces the possibility both of being in default and unit expiration under the Unit Agreement and applicable regulation.

AEX further is instructed that its 2019 POD must include detailed substantive operations proposals to which AEX shall be committed and that shall be conducted by AEX during the 2019 through 2020 POD period. These proposed operations must be sufficient to demonstrate that AEX is continually conducting operations until sustained production starts.

The Division looks forward to the completion of AEX's work commitment under the 2018 POD to contribute to future development of and production from the unit. The Division anticipates that production by AEX at the Placer Unit will protect the State's economic interests in developing its natural resources. At the same time, the Division is seriously concerned about AEX's lack of operations over the past two years and minimal proposal for operations through May of next year. The Division thus will closely scrutinize AEX's activities and proposals when reviewing its 2019 POD to determine if the unit qualifies to remain in force past May 31, 2019.

Based upon both the 11 AAC 83.303 criteria and the operations proposed with this POD amendment, the Division approves the Placer Unit 2018 (3rd) POD with the conditions set forth above. As stated previously, the 2019 POD now is due on or before March 2, 2019.

A person affected by this decision may appeal it, in accordance with 11 AAC 02. Any appeal must be received within 20 calendar days after the date of "issuance" of this decision, as defined in 11 AAC 02.040(c) and (d) and may be mailed or delivered to Andrew T. Mack, Commissioner, Department of Natural Resources, 550 W. 7th Avenue, Suite 1400, Anchorage, Alaska 99501; faxed to 1-907-269-8918, or sent by electronic mail to dnr.appeals@alaska.gov. This decision takes effect immediately. An eligible person must first appeal 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.

If you have questions regarding this decision, please contact Ken Diemer with the Division at 907-269-8784 or via email at Ken.Diemer@Alaska.gov.

Sincerely,



Chantal Walsh
Director