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DECISION AND FINDING OF THE COMMISSIONER
DEPARTMENT OF NATURAL RESOURCES

MILNE POINT UNIT
SECOND EXPANSION OF THE UNIT AREA

DECEMBER 8, 1983

AGO 1313782

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I. INTRODUCTION AND BACKGROUND

The Milne Point Unit was approved by the State of Alaska on October 29, 1979. It is located on the Alaska North Slope to the northwest of the Prudhoe Bay Unit and to the northeast of the Kuparuk River Unit. The Unit Area was expanded on August 19, 1981, and currently covers eleven tracts totalling 21,072 acres, more or less, of State of Alaska leased lands. The Unit is operated by Conoco Inc., on its own behalf and on behalf of 20 other Working Interest Owners.

On September 2, 1983, Conoco Inc., submitted an application to the Director of the Division of Minerals and Energy Management (DMEM) requesting a second expansion of the Milne Point Unit Area pursuant to Article 2 of the Milne Point Unit Agreement. The applicant requested an effective date of June 1, 1983 for the expansion. This second expansion would add an additional seven tracts of Alaska leased land comprising 14,672 acres, more or less, to the current Unit Area, for a total Unit Area of 35,744 acres. The proposed expansion area lies directly to the west of the existing Milne Point Unit, and is bounded on the south and west by the Kuparuk River Unit. At the present, Working Interest Owners holding leases on 28,085 acres within the Unit Area have ratified the Unit Agreement. Working Interest Owners holding leases on the remaining 7659 acres within the Unit Area have not yet ratified the Unit Agreement. All of the leases in the proposed expansion area are conditional leases with no fixed expiration dates.

The proposed expansion of the Unit Area is supported by geologic and engineering data obtained from the Simpson Lagoon #22-14A well and seismic data indicating potential production from the Kuparuk River formation, with possible Upper Cretaceous/Tertiary production a secondary objective.

The Unit Operator notified all Working Interest and Royalty Owners of the proposed expansion in a notice dated May 13, 1983. Subsequently, in a letter dated June 13, 1983, Arco Alaska, Inc. ("Arco") objected to the proposed Milne Point Unit Area expansion on procedural grounds, claiming that Arco had not been properly informed as to the geologic and engineering bases for expansion of the Unit Area. Arco also had a concern as to whether it was proper to include two of the leases proposed to be included in the expansion (ADL-25514 and ADL-25517), as it believed that geologic and engineering data existed to suggest that these leases should be included in the Kuparuk River Unit rather than the Milne Point Unit. Following Arco's objection to the expansion, Conoco provided Arco with additional technical information regarding the expansion. Based on that additional information, Arco withdrew its objection to the expansion on October 4, 1983. However, at this time, Arco continues to decline to commit its interests in the area to the Milne Point Unit.

Exxon Company U.S.A., in a letter dated June 8, 1983, also objected to the proposed expansion of the Milne Point Unit for reasons similar to those given by Arco, namely the lack of technical data to confirm a basis for inclusion of the proposed leases in the Milne Point Unit. Conoco also provided Exxon with additional technical information at the same time it briefed Arco. After reviewing these data, Exxon notified the State by letter dated November 11, 1983 that it was withdrawing its objection to the expansion, but that it was not committing its interests in the area to the unit.

Finally, Cities Service Company, in a telex dated June 10, 1983, notified Conoco that it had no objections to the proposed expansion provided that two delineation wells are drilled to evaluate the Kuparuk River formation at the expense of Chevron and its partners; that sufficient data from these and/or previous wells are provided to Cities Service to prove the existence of the inferred 26.9 million barrels recoverable hydrocarbon reservoir; and after the completion of the above, all proven producing areas be included in the Milne Point Participating Area, and future ownership allocations be based upon volumetric considerations. Cities Service and Conoco entered into a Memorandum of Understanding dated August 12, 1983 to resolve their concerns on these points.

II. ROYALTY AND RENTAL CONSIDERATIONS

At the time the Milne Point Unit application was approved (October, 1979), Commissioner Robert LeResche required several concessions from the applicants in terms of rental and royalty provisions. Paragraphs 14, 15, and 18 of the Unit Agreement required specific modifications of this original lease terms as follows:

- The determination of value of oil, gas, and associated substances for the purposes of determining royalty payments on future production is to be determined by a system of valuation identical to that set out in 1979 model oil and gas leases.
- All royalty, whether taken in value or in kind, is to be free and clear of all lease expenses, including any portion of those expenses incurred away from the leased area, including but not limited to expenses for separation, cleaning, dehydration, gathering, salt water disposal, and preparing the oil, gas, or associated substances for transportation off the leased area.
- Royalty in kind must be delivered in good and merchantable condition, and must be of pipeline quality.
- Lessees must provide storage for royalty oil and natural gas liquids produced from the Unit Area to the same extent that each lessee provides storage for its own share of oil and natural gas liquids.

All leases proposing to commit to the Milne Point Unit in this expansion must ratify the Unit Agreement, and thus will also be modified to include the above provisions.

In addition to the modifications noted above, royalty rates on expiring leases were raised from 12.5% to 20%, and their annual rental rates were increased from \$1.00/acre to \$3.00/acre when the Milne Point Unit was created. However, as none of the leases proposed to be added to the Unit are expiring, it is not proposed to alter any of their rental and royalty terms.

III. DISCUSSION OF DECISION CRITERIA

In accordance with the applicable regulations (11 AAC 83.301 -- 11 AAC 83.395), the Commissioner will approve an expansion of an existing oil and gas unit if the Commissioner finds that such an expansion is necessary or advisable to protect the public interest. In determining whether a proposed expansion is in the public interest, the Commissioner will consider the following factors: (1) the conservation of all natural resources; (2) the prevention of economic and physical waste; and (3) the protection of all parties of interest, including the State. A discussion of these factors follows:

(1) The Conservation of All Natural Resources. Unitized development and production from a reservoir has been recognized as a conservation mechanism for some time. By unitized exploration and operation of the prospective productive area, drilling operations can be optimized and surface impacts can be reduced. Unitized exploration also provides a means for several parties to combine expertise and resources to explore an area that might be beyond the capabilities of a single party to explore efficiently, especially if the prospective area is only marginally economic.

There are sufficient geological, geophysical, and engineering data available to indicate probable confirmation of a significant hydrocarbon reservoir in the expansion area, but there is also evidence that this hydrocarbon reservoir will be only marginally economic under today's conditions, and in fact may never meet a strict "commercial quantities" definition. Above and beyond the consideration of any financial gain to the State which may result from development within this area, the State stands to gain substantial additional subsurface information from delineation drilling to develop the area.

(2) The Prevention of Economic and Physical Waste. Assuring the proper allocation of produced hydrocarbons to each affected lease is just one concern in resource conservation; economic and physical waste can still occur if there is not an equitable cost sharing formula and a well reasoned exploration and development plan. These components are necessary to ensure that physical and economic recovery from all unit reservoirs is maximized. In addition, the selection of a single Unit Operator encourages rational decisions to be made regarding reservoir delineation and evaluation, well-spacing, and a consistent drilling program, and minimizes the number of separate surface facilities necessary to adequately explore and develop the Unit Area. Unitization prevents economic and physical waste by eliminating redundant expenditures for a given level of exploration or production, and avoids loss of ultimate recovery through a unified reservoir management strategy.

The benefits of unitization are particularly applicable to marginally economic reservoirs. In such areas, added reserves are often gained through unitized operations. Capital savings as a result of not duplicating facilities and consolidating reservoir evaluation and management allows less profitable areas of a reservoir to be tested, developed, and produced. The operation of the expanded area as part of the Milne Point Unit will significantly enhance the possibility of production from the area.

(3) The Protection of All Parties of Interest. The principle aim of unitization is the protection of all parties having an economic interest in a common hydrocarbon reservoir. Unitization conserves natural resources and prevents economic waste by eliminating the many competing interests for delineation and operation of a common reservoir, while retaining separate interests and accounts for equitable sharing of costs and benefits based on original ownership. By ratification of the Unit Agreement, all parties are assured an allocation of costs and production commensurate with the value of their leases.

The expansion of the Milne Point Unit extends these benefits and protection to leases reasonably capable of contributing to the exploration and development of the Milne Point Unit reservoirs. The State's economic interest is protected by maximizing any physical recovery of hydrocarbons that may be discovered in the area, and thereby the production-based revenue accruing to the State is maximized. Unitized operations within the expansion area also minimize impacts to the area's cultural, biological, and environmental resources.

The State has not received patent to the lands covered by the proposed expansion. As a result, the primary terms of the oil and gas leases in the proposed expansion area have not commenced, and the leases remain in a "conditional" status. Disapproval of the proposed expansion would not result in the expiration of any of the leases. Therefore, unlike many North Slope leases recently committed to exploration units, these leases would not be available soon for re-lease by the State. However, the amendments to the leases as contained in the unit agreement affecting field costs, storage, and value determination are certainly in the State's best interest.

IV. FINDINGS AND DECISION

Considering the facts discussed in this finding and the administrative record, I find:

1. Based on available geologic and engineering data submitted to the State, the area proposed to be added to the Milne Point Unit Area is proper. The Milne Point Unit Agreement provides for further expansions or contractions of the Unit Area in the future as warranted by additional information. Therefore, the public interest and the correlative rights of all parties are protected.

2. Approval of the second expansion of the Milne Point Unit is necessary and advisable to protect the public interest. Ratification by the lessees of the Unit Agreement will insure a fair and equitable return to the State should hydrocarbons be produced from the expanded Unit Area.
3. The Unit Plan of Exploration provides for diligent exploration of the Unit Area. Should producible hydrocarbons be delineated, a Plan of Development providing for diligent development and production of those hydrocarbons will be submitted to the State for approval in accordance with the Unit Agreement.
4. The economic benefits to the State in the form of unitized exploration and development of the expanded Unit Area outweigh the economic costs to the State in approving such expansion.
5. Expansion of the Milne Point Unit to include the additional leases will provide for the increased conservation of all natural resources, including hydrocarbons, gravel, sand, water, wetlands, and other valuable habitat.
6. Expansion of the Milne Point Unit to include the additional leases will prevent the waste of oil and gas, and will reasonably increase the probability of economically recovering substantially more oil and gas from the area.
7. Expansion of the Milne Point Unit to include the additional leases will reduce the amount of surface lands and fish and wildlife habitat that would otherwise be used if the area were to be explored and developed on a lease-by-lease basis. This reduction in the impact on the environment and on subsistence activity in the area is in the public interest.
8. Extension of the Milne Point Unit to include the additional leases will not limit or diminish access to public and navigable waters beyond any limitations already contained in the oil and gas leases proposed to be added to the Unit Area.

For these reasons I hereby approve the second expansion of the Milne Point Unit.



Kay Brown, Director
Division of Minerals and Energy Management

12-8-83
Date

For:
Esther C. Wunnicke, Commissioner
Alaska Department of Natural Resources

Attachment: Delegation of Authority from Commissioner, Alaska Department of Natural Resources, to Director, Division of Minerals and Energy Management