

NIKOLAEVSK UNIT

APPROVAL OF EXTENSION TO THE TERM OF THE NIKOLAEVSK
UNIT AGREEMENT

Findings and Decision of the Director
of the Division of Oil and Gas,
Under Delegation of Authority
from the Commissioner of the State of Alaska
Department of Natural Resources

MAY 11, 2009

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I. INTRODUCTION AND DECISION SUMMARY

By letter dated January 26, 2009, the Nikolaevsk Unit Operator, Union Oil Company of California (Union) requested, under Article 14.2 of the NU Agreement and 11 AAC 83.336(a)(2), an extension (Extension Request) until March 31, 2011 of the Nikolaevsk Unit Agreement (NUA) Agreement . Under 11 AAC 83.336 and Article 14.2 the NUA automatically terminates five years from the effective date unless certain conditions are met. Without extension, the NUA (Agreement) will terminate effective January 30, 2009. The State of Alaska, Department of Natural Resources (DNR), Division of Oil and Gas (Division) gave notice under 11 AAC 83.311 of the proposed extension on January 27, 2009. The period for public comment closed March 9, 2009. No comments were received.

The NU, formed effective January 29, 2004, is located on the Kenai Peninsula near the unincorporated community of Nikolaevsk and contains nine leases: seven State of Alaska leases and two Cook Inlet Region Incorporated (CIRI) leases. The NU contracted twice, on March 2, 2006, and on March 31, 2009, and now covers approximately 5,766 acres in six oil and gas leases: four State of Alaska leases and the two CIRI leases. The Division is responsible for the management of the NU.

The Division finds that approval of the Extension Request promotes conservation of all natural resources, prevents economic and physical waste, provides for the protection of all parties of interest, including the State, and meets the requirements of 11 AAC 83.336(2). DNR approves the extension in accordance with the criteria under 11 AAC 83.303. This Approval constitutes the written findings and decision required under 11 AAC 83.303 and is fully appealable.

II. DISCUSSION OF DECISION CRITERIA

AS 38.05.180(p) gives DNR the authority to approve an oil and gas unit. The Commissioner of DNR (Commissioner) reviews unit agreement extensions under 11 AAC 83.336 (2), subject to the criteria specified in 11 AAC 83.303. By memorandum dated September 30, 1999, the Commissioner approved a revision of Department Order 003 and delegated this authority to the Division Director.

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

1. The Environmental Costs and Benefits

Extending the NUA will have no environmental costs and benefits beyond those considered in the Division's original approval of the unit and subsequent plans of exploration and development.

2. Geologic and Engineering Characteristics and Prior Exploration and Development Activities

The Division previously considered the geologic and engineering characteristics and development activities in its approval of the NUA and NUA plans of exploration and development. Since that time, the Division has received the following additional information: seismic data acquired in the unit, well logs and mud logs for Red 1 and Red 2, a depth structure map, a cross section, and formation tops.

The Red #1 well (API 502312002100) was tested through perforations at 8768-8777, 8795-8820, and 9056-9075 feet measured depths at rates ranging from 3.2 – 6.8 mmcf/d for approximately 26 hours in August 2004. The well pressure ranged from 2494 to 2161 psi on chokes of 14/64" to 20/64". The test indicates resource potential in the area surrounding Red #1. The size of the accumulation has yet to be delineated.

The Red #2 well (API 502312002500) was drilled and completed in August 2004. The well was perforated at 6,732 to 6,792, 8,038 to 8,088', and 9,298 to 9,344 measured depths during September 2004. Tests at various choke settings indicated no measureable hydrocarbons according to the AOGCC completion report.

North Fork Unit 11-04 was drilled to a depth of 12462 feet measured depth and completed in March 1970 at which time it was plugged and abandoned. There were no testing operations performed on the well.

Exploration and development activities since the Division's original approval of the NUA clearly demonstrate the presence of hydrocarbons. Extending the NUA will aid in delineating the size and extent of the accumulation.

3. Plans of Exploration and Development

Approval of the NU included an Initial Plan of Exploration (1st POE), effective January 31, 2004 through January 31, 2007. The POE described three Exploration Blocks, (I, II, and III), and specified seismic and drilling requirements for each Exploration Block. Under the POE, failure to complete a specific drilling requirement resulted in the contraction of the Exploration Block and payment for the contraction acreage. The POE included provisions for the automatic and voluntary terminations of the NU. Under the 1st POE Union drilled and completed two wells in Exploration Block I and acquired, processed, and interpreted seismic data to satisfy the seismic requirement, but drilled no well in Exploration Block II. Under the terms of the POE, Exploration Block II and a portion of Exploration Block III contracted from the unit on March 2, 2006. The state received the stipulated payment.

The Division approved the 2nd POE effective March 31, 2007 through March 31, 2008. The 2nd POE required Union to conduct geologic and engineering studies of analogous

fields to better understand formation evaluation, completion/stimulation techniques, and resource estimation at NU.

The Division approved the NU First Plan of Development (1st POD) effective March 31, 2008 through March 31, 2009. The 1st POD required Union to drill or cause to be drilled a well in the Red Prospect (Exploration Block I) by March 31, 2009, and a second well in the Blue Prospect, (remaining portion of Exploration Block III), by March 31, 2010. Failure to drill the Red well would result in the contraction of the Blue Prospect.

Union submitted the 2nd POD on January 12, 2009 which was approved on February 5, 2009. Due to market conditions, Union planned to re-schedule Cook Inlet exploration efforts and not drill the Red well. Lack of pipeline infrastructure to transport NU-produced gas to market further impeded NU development plans. In the 2nd POD Union described efforts to farm out the drilling of the Red well before the drilling deadline of March 31, 2009. Union neither drilled nor caused the Red well to be drilled. On March 31, 2009, under the terms of the 1st and 2nd PODs, the NU contracted.

Union has conducted exploration and development activities under approved plans of exploration and development. When it did not meet drilling requirements, Union voluntarily contracted the unit as required by the approved plans. The Division approved the 2nd POD for the period March 31, 2009 through March 31, 2010, to give Union until March 31, 2010 to complete the Red well.

The requested twenty sixth month extension to the NUA coincides with the annual POD approval period. The current POD ensures that the lease extensions under 11 AAC 83.336 continue only so long as Union proceeds diligently with the development of the unit area. The requested extension meets the requirements of 11 AAC 83.336(2) and provides adequate time for Union to consider and implement development options.

4. The Economic Costs and Benefits to the State and Other Relevant Factors

Under 11 AAC 83.336 and Article 14.2 of the NUA, the NUA automatically terminates five years from the effective date unless certain conditions are met. By approving the Extension Request, Union may sooner produce the wells and the State may sooner receive royalties. Union has fulfilled obligations under the NU Agreement and plans of exploration and development. The State received compensation for bid deferral as part of the earlier unit contractions.

Denial of the Extension Request will effectively terminate the NUA. Since all NU leases are past the primary term, the leases would expire and the acreage would return to the State and be available for the next Cook Inlet Areawide lease sale. However, termination of the unit agreement would also result in the loss of the potential development of the State's resource under an approved unit plan of development. Unitized development promotes the conservation of all natural resources, protects all parties of interest, and

prevents economic and physical waste. The short term benefit of receiving bonus bid revenue is outweighed by the benefits of timely unitized development.

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

1. Promote the Conservation of All Natural Resources

Extension of the NUA will have no impact on conservation of all natural resources beyond those previously considered by the Division when it approved the NUA, POEs and PODs. The Approval extends the term of the NUA for twenty six months, requires development and production to occur under an approved unit POD and promotes conservation of all natural resources.

2. The Prevention of Economic and Physical Waste

Extension of the NUA will have no impact on the prevention of economic and physical waste beyond the impacts previously considered by the Division. The extension continues the equitable allocation of costs and revenues, efficient consolidated reservoir management under a unified plan of development, and eliminates redundant facilities thereby lessening the environmental impact.

3. The Protection of All Parties of Interest, Including the State

Approval of the Extension has no impact on the Division's prior determination that the NUA protects all parties of interest, including the State. Union's track record under the NUA of fulfilling agreed upon work commitments or abiding by the consequences of failing to do so establishes the State is adequately protected if the NUA is extended. Extension of the NUA protects the interests of the NUA participants by affording Union the opportunity to continue the development efforts already undertaken in the unit.

III. FINDINGS AND DECISION

A. The Conservation of All Natural Resources

1. The approval of the Extension Request will conserve all natural resources, including hydrocarbons, gravel, sand, water, wetlands, and valuable habitat.

B. The Prevention of Economic and Physical Waste

1. Approval of the Extension Request prevents economic and physical waste.

C. The Protection of All Parties in Interest, Including the State

1. The Approval of the Extension Request adequately and equitably protects the public interest, and is in the State's best interest.

For the reasons discussed in these Findings and Decision, I hereby approve the Extension Request to the term of the NU Agreement effective January 30, 2009 through March 31, 2011.

This decision takes effect immediately. 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 Tom Irwin, 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. 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.



Kevin R. Banks,
Director
Division of Oil and Gas

5-11-09

Date

IV. ATTACHMENTS

1. Request for Approval of the Extension to the Term of the Nikolaevsk Unit Agreement

ATTACHMENT ONE

Request for Approval of the Extension to the Term of the Nikolaevsk Unit Agreement



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Land Representative
MidContinent/Alaska

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January 26, 2009

RECEIVED

JAN 26 2009

Mr. Kevin Banks, Acting Director
Alaska Department of Natural Resources
Division of Oil and Gas
550 West 7th Avenue, Suite 800
Anchorage, AK 99501-3560

DIVISION OF
OIL AND GAS

NIKOLAEVSK UNIT
STATE OF ALASKA
EXTENSION OF NIKOLAEVSK UNIT AGREEMENT

Dear Mr. Banks:

Article 14.2 of the Nikolaevsk Unit Agreement provides: "...this agreement terminates five years from the effective date unless ... [14.2.2] The unit term is extended with the approval of the Commissioner. The effective date of the Nikolaevsk Unit Agreement is January 30, 2004.

Union submitted the Nikolaevsk Unit First Plan of Development ("1st POD") on March 28, 2008, and proposed the following work commitments:

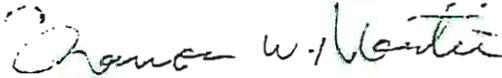
- To drill or cause a well to be drilled in the Red prospect by March 31, 2009, followed by a second exploration well in the Blue prospect by March 31, 2010;
- If Union Oil fails to drill (or cause the drilling of) the first (Red) well by March 31, 2009, then the Nikolaevsk Unit will contract down to the Red prospect, and Union Oil will lose the right to drill the second (Blue) well;
- If Union Oil drills (or causes the drilling of) the first (Red) well by March 31, 2009, but then fails to drill the second (Blue) well by March 31, 2010, then the Nikolaevsk Unit will contract down to the Red prospect;

By letter dated April 1, 2008, the Division of Oil and Gas adopted the terms set forth above, and approved the 1st POD. The parties therefore implicitly agreed to extend the unit term beyond January 30, 2009, yet no specific extension term or formal extension request/approval was documented. The purpose of this letter is therefore to confirm and officially request an extension of the Nikolaevsk unit term for a period of two years, or until March 31, 2011, to afford Union the time which is necessary to pursuing the commitments set forth in both the 1st POD, and the 2nd POD submitted on January 12, 2009.

Extension of Nikolaevsk Unit Agreement
January 26, 2009
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Thank you in advance for your professional courtesy.

Very truly yours,



Shannon W. Martin

APPROVED:

ALASKA DEPARTMENT OF NATURAL RESOURCES
Division of Oil and Gas

This _____ day of _____, 2009

By:

cc: Paul Winslow, CVX
Dave Whitacre, CVX
Daniel T. Seamount, AOGCC