

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 13, 2011**

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## **I. INTRODUCTION AND DECISION SUMMARY**

By letter dated March 15, 2011, the Nikolaevsk Unit Operator, Union Oil Company of California (Union) requested, under Article 14.2 of the Nikolaevsk Unit (NUA) Agreement and 11 AAC 83.336(a)(2), an extension (Extension Request) of the NUA. Under 11 AAC 83.336 and Article 14.2 the NUA automatically terminates effective March 31, 2011 unless certain conditions are met. Union's request to extend the Nikolaevsk Unit (NU) term is based on the time necessary to meet its commitments in an amended plan of development to enable them to place the unit in production by 2013. 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 March 27, 2011. The period for public comment closed April 25, 2011. 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(a)(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.

## **3. Plans of Exploration and Development**

Approval of the NU included an Initial Plan of Exploration (1<sup>st</sup> 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. 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 2<sup>nd</sup> POE effective March 31, 2007 through March 31, 2008. The 2<sup>nd</sup> 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 (1<sup>st</sup> POD) effective March 31, 2008 through March 31, 2009. The 1<sup>st</sup> 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.

Union submitted the 2<sup>nd</sup> POD on January 12, 2009 which was approved on February 5, 2009. As required under the terms of the 1<sup>st</sup> POD, the NU contracted to the Red Prospect and Union relinquished the acreage identified as the Blue Prospect, effective March 31, 2009.

Under Article 14.2 of the NUA and 11 AAC 83.336(1), the NUA would have terminated on January 30, 2009, but on May 11, 2009, the Division approved an extension of the NUA, effective January 30, 2009, through March 31, 2011.

The Division received the 3<sup>rd</sup> POD and notified Union on December 18, 2009 that the 3<sup>rd</sup> POD was deemed complete. The Division disapproved the 3<sup>rd</sup> POD on February 12, 2010.

Under 11 AAC 83.343(a)(1), a unit plan of development must include 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. Union planned no development activities and did not indicate that it planned to coordinate development activities with the North Fork Unit and KKPL pipeline projects in order to bring any NU wells into production. Under 11 AAC 83.343(b) the Commissioner proposed modifications that would qualify the plan for approval:

1. by March 31, 2010, Union shall initiate permitting activities for a pipeline that will allow for production from the NU;
2. by September 30, 2010, Union shall secure a gas sales contract for NU production; and
3. by March 31, 2011, Union shall commence production from the NU.

Union applied to establish the Red Participating Area (RPA) by letter dated February 18, 2010 and appealed the disapproval of the 3<sup>rd</sup> POD by letter dated March 3, 2010. Union submitted the 4<sup>th</sup> POD by letter dated December 15, 2010. The Division notified Union by letter dated December 22, 2010 that the 4<sup>th</sup> POD was incomplete and that for the 4<sup>th</sup> POD to be considered complete for consideration of approval, Union needed to resubmit a 4<sup>th</sup> POD that proposed unit development.

The Division denied the formation of the RPA effective January 18, 2011 because Union had no plan to construct a pipeline or other means of transport for sustained unit production of sales quality gas. Union did not appeal the decision.

The Division received the NU Amended Fourth Plan of Development (Amended 4<sup>th</sup> POD) on March 17, 2011. The Amended 4<sup>th</sup> POD was deemed complete because it

proposed unit development by committing to construct a pipeline which would enable sustained unit production.

During the Amended 4th POD Union will complete the work necessary, including project sanction, surveying, permitting, and engineering, to construct a pipeline with the objective of having production from the NU in 2013. Union also would request an extension to the unit term, which would expire on March 31, 2011. As a part of that request, Union would voluntarily contract the NU to include Sections 5, 6, 7, and 8 of Township 4 South, Range 13 West, Seward Meridian, Alaska. Union is currently marketing its Cook Inlet assets, including the NU. If Union sells its NU interest, any new Operator is bound by the commitments in the Amended 4th POD.

The Amended 4th POD provided assurances to complete the pipeline, or to relinquish the leases. If the Operator decides to proceed with pipeline construction, the Nikolaevsk 5th POD will provide a schedule which will enable unit production by 2013, as agreed to by the Division in the approval of the Amended 4th POD. By January 1, 2012, if the Operator decides not to sanction the project as described in the Amended 4th POD, effective upon written notification from the Operator to the Division, the NU will automatically terminate and the Operator will voluntarily relinquish the NU leases.

The Amended 4th 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(a)(2) and provides adequate time for Union to consider and implement development options. Extending the NUA under the approved Amended 4th POD will provide for the construction of a pipeline to transport sales gas.

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

Under the approval of the May 11, 2009 extension request, 11 AAC 83.336 and Article 14.2 of the NUA, the NUA automatically terminated effective March 31 2011 unless certain conditions were met. By approving this Extension Request, Union may sooner produce the wells and the State may sooner receive royalties.

Denial of the Extension Request would 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.

Absent the approval of Union's request to extend the term of the NUA, the unit would terminate, and the leases would expire. AS 38.05.180(m) provides that upon extension, the commissioner may increase lease rentals so long as the increased rental rate does not exceed 150 percent of the rate for the preceding year. The Division has proposed, and Union has agreed, that effective March 31, 2011, annual rental rates for each of the remaining NU leases will be paid at the rate of \$4.50 per acre instead of \$3.00 per acre. The rental increase provides economic benefit to the state.

**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 four 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.
2. Effective March 31, 2011, the NU contracts to include only Sections 5, 6, 7, and 8 of T 4 S, R. 13 W, Seward Meridian, Alaska.
3. Effective March 31, 2011, ADL 389227 is segregated as to the portion remaining within the NU and the portion contracted out of the NU. The portion contracting from the NU is T 4 S, R. 13 W, Seward Meridian, Alaska, Section 7: NE1/4, N1/2SE1/4. The portion remaining in the NU is T 4 S, R. 13 W, Seward Meridian, Alaska, Section 5: S1/2, 320 acres; and Section 6: SE1/4SE1/4, 240 acres.
4. Effective March 31, 2011, the annual rental rate for ADLs 388109, 389227, and 390514 is \$4.50 per acre.
5. If Union sells its NU interest, any new Operator is bound by the commitments in the Amended 4th POD.
6. By January 1, 2012, if the Operator decides not to sanction the project as described in the Amended 4th POD, effective upon written notification from the Operator to the Division, the NU will automatically terminate and the Operator will voluntarily relinquish the NU leases.
7. The Operator will submit revised Exhibits A and B within 30 days of the issuance of this decision.

For the reasons discussed in these Findings and Decision, I hereby approve the Extension Request to the term of the NU Agreement effective March 31, 2011, through March 31, 2013.

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 Daniel S. Sullivan, 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](mailto: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

5-13-2011

Date

#### IV. ATTACHMENTS

1. Request for Approval of the Extension to the Term of the NUA

**ATTACHMENT ONE**

Request for Approval of the Extension to the Term of the NUA



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March 15, 2011

Mr. Kevin Banks, Director  
Alaska Department of Natural Resources  
Division of Oil and Gas  
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Anchorage, AK 99501



**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 was extended through March 31, 2011, per Decision Letter dated May 11, 2009.

The purpose of this letter is to request a Nikolaevsk Unit term extension to afford Union Oil Company of California ("Union Oil") the time necessary to pursue commitments as set forth in the Amended Fourth Plan of Development ("4<sup>th</sup> POD") to the Nikolaevsk Unit. Contemporaneous to this request for extension, Union Oil has submitted under separate cover letter the 4<sup>th</sup> POD.

Additionally, Union Oil hereby voluntarily contracts the Nikolaevsk Unit boundary down to include all of Sections 5, 6, 7, and 8 of Township 4 South, Range 13 West, Seward Meridian, Alaska.

We appreciate your favorable consideration and approval. Please contact the undersigned with any questions.

Sincerely,

Kevin A. Tabler

cc: Erin O'Brien-Authier, CVX  
Dave Whitacre, CVX  
Daniel T. Seamount, AOGCC