

PLACER UNIT

APPROVAL AFTER REMAND OF THE PLACER UNIT EXPANSION APPLICATION

AND

APPROVAL AFTER REMAND OF THE REQUEST TO AMEND THE PLAN OF EXPLORATION

FINDINGS AND DECISION OF THE DIRECTOR

DIVISION OF OIL AND GAS

UNDER DELEGATION OF AUTHORITY FROM THE COMMISSIONER

DEPARTMENT OF NATURAL RESOURCES

STATE OF ALASKA

NOVEMBER 4, 2013

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I. INTRODUCTION

This is the decision after remand of the Alaska Department of Natural Resources, (DNR) Division of Oil and Gas (Division) on the August 17, 2012, application of ASRC Exploration, LLC (AEX) to expand the Placer Unit (PLU) area and to amend the PLU Plan of Exploration (POE) to extend the deadline flow testing of the Placer #1 well or to drill a new delineation well.¹ (Application). The request to expand the unit and to amend the POE is approved on the terms set forth herein.

II. FACTS

The Division approved the PLU on September 8, 2011 based on the application of AEX. AEX supported its unit formation application with an initial or First Plan of Exploration (POE) that promised to: 1) reprocess and reinterpret newly-licensed seismic data set shot across the unit acreage by December 31, 2011, and 2) either drill and log a new unit exploratory well or re-enter and test the existing Placer #1 well by June 30, 2013.

The PLU is located on the shore of the North Slope of Alaska, southwest of the Kuparuk River Unit. AEX is the PLU Operator and the sole working interest owner of the unit. The Placer #1 well was drilled on ADL 391023 prior to unit formation, but neither that well nor the unit has ever been in production.²

The PLU was formed out of portions of four state leases, ADLs 391023, 391024, 391027, and 391028. The PLU is 1,480 acres in size. The portions of the leases not included in the unit were severed from the portions of the leases included in the unit, given new lease numbers, and granted a two-year extension of the primary term to January 31, 2014. The severed leases outside the unit were renumbered as follows: 391023 became 391910, 391024 became 391911, 391027 became 391912, and 391028 became 391913. The severed leases excluded from the unit amounted to 7,288 acres.

¹ This decision is issued pursuant to a September 30, 1999 delegation of authority from the DNR Commissioner.

² In 1997, ARCO Alaska shot a 3D seismic survey covering the Placer area and in 2004, ConocoPhillips and partners (AEX farmed in for a 35 percent working interest in the project) drilled two wells – Placer #1 and Placer #2. Placer #1 found an oil-bearing reservoir in the thin Kuparuk C sand. Although no production test was attempted at the time the Placer #1 well was drilled, the wellbore was suspended rather than plugged and abandoned to preserve the ability to test the well at a later date. Ultimately, after drilling the Placer #2 well, the partnership decided, without testing, that the reservoir discovered in Placer #1 was not economic to develop and the leases were subsequently dropped. AEX re-acquired the leases in the 2006 lease sale with a five-year primary term. At the time AEX applied to form the Placer Unit, AEX had secured ownership of the Placer #1 wellbore from ConocoPhillips to maintain the option of testing the original well and was also in the process of acquiring a license to conduct 3D seismic over the area.

AEX reprocessed and reinterpreted the PLU seismic data prior to the December 31, 2011 deadline and the data was submitted to the Division. However, AEX failed to drill and log a unit exploratory well or re-enter and test the Placer # 1 well prior to June 30, 2013.

On August 17, 2012, AEX submitted an application to expand the unit by 7,288 acres to include the portions of ADLs 391023, 391024, 391027, and 391028 severed and excluded from the unit. AEX also requested to extend the deadline to either drill and log a new unit exploratory well or re-enter and test the existing Placer #1 well from June 30, 2013 to June 30, 2014. If granted, the Application would expand the unit area from 1,480 acres to 8,768 acres.³

On January 14, 2013, the Division Director issued a decision denying the August 17, 2012 application.⁴ The Director declined to expand the unit after AEX failed to meet the work commitments upon which unit formation was based: reentering the Placer #1 well or drilling a new delineation well. On February 4, 2013, AEX appealed to the DNR Commissioner from the Director's decision.

By letter dated July 25, 2013, the Commissioner notified AEX that it had elected to proceed with the default and cure process and demanded that by June 30, 2014, AEX either drill and log a unit exploratory well or re-enter and test the Placer #1 well. The Division received the Placer Unit 2013 Annual Report on August 20, 2013, which included the second POE. The Division deemed the second POE incomplete on August 29, 2013. AEX responded with a modified second POE (Second POE) on September 6, 2013 which the Division deemed complete via email on September 10, 2013.

The Second POE proposed the following cure:

1. Before June 30, 2014 conduct a flow test of the Placer #1 well.
2. Before June 30, 2015 drill a second well on a lease outside the Placer Unit or drill a side track from the Placer #1 well to a bottom-hole location on acreage currently outside to the Placer unit area.
3. The updated POE would expire on September 7, 2015.

On September 12, 2013, AEX and Brooks Range Petroleum Company (BRPC) met with the Division and presented a confidential slide deck which described four options by which the Placer delineation would proceed. By letter dated September 18, 2013 to the DNR Commissioner, AEX requested that the Commissioner issue a decision on the still pending appeal from AEX's August 17, 2012 application to expand the unit and defer the drilling commitment. The September 18, 2013 letter described a timeline which provided for the drilling of a Placer #3 well outside the unit to be drilled during the 2014 drilling season. The letter included a copy of the confidential slide deck presented to the Division.

³ The August 17, 2012 application was titled: "Placer Unit Request to Expand Unit and to Modify the Plan of Exploration."

⁴ The decision was titled "Denial of the Placer Unit Expansion Application and Denial of the Request to Amend the Plan of Exploration."

On September 24, 2013, the DNR Commissioner issued a decision⁵ remanding the appeal from the Director's denial of AEX's August 17, 2012 application to expand the unit and to defer the drilling commitment back to the Division. The Decision stated in part:

On September 12, 2013, [AEX] and Brooks Range Petroleum Corporation LLC (BRPC) met with the Division to present a unified position with respect to a work commitment for the greater Placer area. BRPC brought a broader data set and geological and geophysical interpretations of the area, including resource potential outside the existing unit, to support a proposed unit expansion. In addition, [AEX] has a desire to farm out its lease interests in the greater Placer area to BRPC and BRPC in turn has a desire to farm in. The result of this transaction would be a new well drilled in 2014.

DNR is willing to work together with [AEX] to finalize the requested expansion of the Placer Unit and to modify the Plan of Exploration. It is in the State's interest to see a new exploration well that assesses the resources of multiple leases this winter. It is also in the State's interest to secure financial surety in the event the work commitments are not fulfilled.

Accordingly, the appeal is remanded to the Director for additional findings in accordance with the following direction and objectives:

- Amend the POE with timelines for work commitments that result in a well being drilled in 2014;
- Evaluate the proposed expansion of the unit to ensure that any expanded area does not reset the five-year clock on the initial unit formation (approved September 8, 2011);
- Require that farm in and farm out agreements (Agreements) be provided to the division; and
- Impose a performance bond sufficient to protect the State's interest.

By letter dated September 27, 2013, the Division requested that AEX provide the Division with copies of the Agreements. As of this date, they have not been provided.

III. RELEVANT STATUTORY, REGULATORY, AND UNIT AGREEMENT PROVISIONS

The statutory standard for unitization is whether it would be necessary and advisable in the public interest:

To conserve the natural resources of all or a part of an oil or gas pool, field, or like area, the lessees and their representatives may unite with each other, or

⁵ The decision was titled: "Placer Unit Remand by the Commissioner of the Department of Natural Resources for the State of Alaska appeal from the January 14, 2013 Denial of the Placer Unit Expansion Application and Denial of the Request to Amend the Plan of Exploration" (Decision).

jointly or separately with others, in collectively adopting or operating under a cooperative or a unit plan of development or operation of the pool, field, or like area, or a part of it, when determined and certified by the commissioner to be necessary or advisable in the public interest.

DNR has set forth unitization decision criteria in regulation that retain the public interest as the primary criterion:

11 AAC 83.303. Criteria. (a) The commissioner will approve a proposed unit agreement for state oil and gas leases if he makes a written finding that the agreement is necessary or advisable to protect the public interest considering the provisions of AS 38.05.180(p) and this section. The commissioner will approve a proposed unit agreement upon a written finding that it will

- (1) promote conservation of all natural resources, including all or part of an oil or gas pool, field, or like area;
- (2) promote the prevention of economic and physical waste; and
- (3) provide for the protection of all parties of interest, including the state.

(b) In evaluating the above criteria, the commissioner will consider

- (1) the environmental costs and benefits of unitized exploration or development;
- (2) the geological and engineering characteristics of the potential hydrocarbon accumulation or reservoir proposed for unitization;
- (3) prior exploration activities in the proposed unit area;
- (4) the applicant's plans for exploration or development of the unit area;
- (5) the economic costs and benefits to the state; and
- (6) any other relevant factors, including measures to mitigate impacts identified above, the commissioner determines necessary or advisable to protect the public interest.

(c) The commissioner will consider the criteria in (a) and (b) of this section when evaluating each requested authorization or approval under 11 AAC 83.301 - 11 AAC 83.395, including

- (1) an approval of a unit agreement;
- (2) an extension or amendment of a unit agreement;

- (3) a plan or amendment of a plan of exploration, development or operations;
- (4) a participating area; or
- (5) a proposed or revised production or cost allocation formula.

A unit terminates five years after formation unless certain conditions are met.

11 AAC 83.336. Effective date and term of unit agreement

(a) A unit agreement becomes effective upon approval by the commissioner and automatically terminates five years from the effective date unless

(1) a unit well in the unit area has been certified as capable of producing hydrocarbons in paying quantities, in which case the unit agreement will remain in effect for so long as hydrocarbons are produced in paying quantities from the unit area, or for so long as hydrocarbons can be produced in paying quantities and unit operations are being conducted in accordance with an approved unit plan of exploration or development, or, should production cease, for so long after that as diligent operations are in progress to restore production and then so long after that as unitized substances are produced in paying quantities; or

(2) exploration operations have been conducted in accordance with an approved unit plan of exploration, and the commissioner, after issuing written notice under 11 AAC 83.311, issues a written decision extending the unit term in which he states the basis for his decision, considering the provisions of 11 AAC 83.303; no single extension will exceed five years.

(b) If a suspension of unit operations or production on all or part of the unit area has been ordered or approved under federal, state, or local law, or, if the commissioner determines that the unit operator has been prevented, despite good-faith efforts, from complying with any express or implied promise, term, condition, or covenant of the unit agreement, or from conducting exploration, development, production, transportation, or marketing operations on or from the unitized area by reason of force majeure, the unit operator's obligation to comply with the provision will be held in abeyance, but not voided, and the commissioner will extend the term of the unit agreement for a period of time equal to the time lost under the unit term due to the suspension or prevention by force majeure. . . .

Placer Unit Agreement

Article 13 of the unit agreement addresses unit expansion. It states in relevant part:

13.1. The Unit Operator, at its own election may, or at the direction of the Commissioner shall, apply to expand the Unit Area to include any additional lands determined to overlie a Reservoir that is at least partially within the Unit Area, or to include any additional lands that facilitate production. . . .

IV. DECISION

The DNR Commissioner has remanded AEX's appeal from the Director's denial of the August 27, 2012 application to expand the PLU and defer the June 13, 2013 drilling commitment with directions implicitly to grant the unit expansion if AEX agrees to the following express requirements: (1) the drilling of a delineation well in 2014, (2) no modification to the 11 AAC 83.336 five year unit term, (3) AEX provides performance bonds, and (4) AEX provides copies of the farm in and farm out agreements.

The PLU will be expanded to include ADLs 391910, 391911, 391912, and 391913, (Expansion Leases) if AEX commits to the following terms:

1. Before June 30, 2014 drill and test a well within the area of the Expansion Leases. AEX will furnish a performance guaranty of \$4,500,000.00 in the favor of DNR to support this work commitment. If the well is not drilled and tested by June 30, 2014, the bond will be retained by DNR. If the well is drilled and tested by June 30, 2014, DNR will return the bond to AEX.
2. Before June 30, 2014, conduct a flow test of the Placer #1 well and conduct a transmissibility test between the two wells. AEX will furnish a performance guaranty of \$900,000.00 in the favor of DNR to support this work commitment. If the well is not tested including the transmissibility test by June 30, 2014, the bond will be retained by DNR. If the well is tested including the transmissibility test conducted by June 30, 2014, DNR will return the bond to AEX.
3. The effective date of the Placer Unit Agreement is September 8, 2011. Unless the conditions stated in 11 AAC 83.336 are met, the unit will automatically terminate effective September 8, 2016.
4. AEX shall provide to the Division a fully-executed legal agreement setting forth the terms for farming out AEX's Placer Unit position, the adjoining non-unitized acreage, and any other affected acreage.

The above conditions are necessary to protect the state interest given AEX's prior failure to comply with work commitments. Inclusion of the expansion leases in the PLU is in the public interest if these conditions are met.

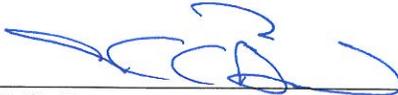
This decision becomes effective upon the Division's receipt of the performance bonds, the Agreements, and an updated POE which comports with the terms set forth herein. If these items are not provided by December 15, 2013, the unit expansion is denied, the unit remains in default with a cure date of June 30, 2014, and AEX may appeal from the instant decision. If all three items are provided by December 15, 2013, the pending AEX appeal from denial of the unit

expansion and extension of the well deadline is resolved and dismissed and the unit terminates five years from its original formation date of September 8, 2011 unless the requirements of 11 AAC 83.336 are met.

The leases approved for inclusion in the expanded PLU are summarized below.

ADL	Acres	State Royalty Interest %	Lease Effective Date	Working Interest Owners and Percentages	Lease Expiration Date	Legal Description
391910	480	16.66667	2/1/2007	AEX 100%	1/31/2014	T. 11N., R. 7 E., Umiat Meridian, Alaska Sec 4: NE1/4NE1/4, 40 ac Sec 9: E1/2NE1/4, SW1/4NE1/4, S1/23, 440 ac
391911	1909	16.66667	2/1/2007	AEX 100%	1/31/2014	T. 11N., R. 7E., Umiat Meridian, Alaska Sec 5: W1/2SW1/4, N1/2NW1/4, SW1/4NW1/4, 200 ac Sec 6: All, 593 ac Sec 7: All, 596 ac Sec 8: SW1/4NE1/4, S1/2, NW1/4, 520 ac
391912	2480	16.66667	2/1/2007	AEX 100%	1/31/2014	T. 12 N., R. 7 E., Tract A, Umiat Meridian, Alaska Sec 27: All, 640 ac Sec 28: All, 640 ac Sec 33: E1/2, N1/2SW1/4, NW1/4, 560 ac Sec 34: All, 640 ac
391913	2419	16.66667	2/1/2007	AEX 100%	1/31/2014	T. 12 N., R. 7 E., Tract A, Umiat Meridian, Alaska Sec 29: All, 640 ac Sec 30: All, 588 ac Sec 31: All, 591 ac Sec 32: N1/2, N1/2SE1/4, SW1/4SE1/4, SW1/4, 600 ac
TOTAL	7288					

A person affected by this decision may appeal it, in accordance with 11 AAC 02.010 through 11 AAC 02.900. 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 Joe Balash, Acting Commissioner, DNR, 550 W. 7th Avenue, Suite 1400, Anchorage, Alaska 99501; faxed to (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 02.010 through 11 AAC 02.900 before appealing this decision to Superior Court. A copy of 11 AAC 02.010 through 11 AAC 02.900 may be obtained from any regional information office of the Department of Natural Resources.


 W.C. Barron
 Director
 Division of Oil and Gas

11/4/13
 Date