



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Natural Resources

COMMISSIONER'S OFFICE

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November 4, 2016

David W. Brown
Manager, Land & Business Development
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PO Box 100360, ATO: 1406
Anchorage, AK 99501-0360

Dear Mr. Brown:

This is the decision of the Commissioner of the Department of Natural Resources (DNR) on ConocoPhillips Alaska, Inc.'s (CPAI) July 27, 2016 appeal of the July 21, 2016 decision of the Division of Oil & Gas (Division) rejecting CPAI's Application for the Fifth Expansion of the Colville River Unit (CRU). I have reviewed CPAI's appeal and the Division's decision. For the reasons discussed herein, I hereby reverse the Division's decision.

I. Factual Background

On May 13, 2016, the Division received assignment applications from Caracol Petroleum LLC, TP North Slope Development LLC, MEP Alaska LLC, AVCG LLC, and Nabors Drilling Technologies USA, Inc. to transfer 100% of their working interests in twenty-two leases that formerly comprised the Tofkat Unit to CPAI. On June 15, the Division issued a decision approving seven of the assignments and denying the remaining fifteen. CPAI appealed the Division's denial of those fifteen assignments to the DNR Commissioner on June 28.

On June 28, 2016, CPAI also submitted an application for the Fifth Expansion of the CRU (the Application) to the Division. The Application requested that the CRU be expanded to include the twenty-two leases that were formerly part of the Tofkat Unit.

On June 29, 2016, Arctic Slope Regional Corporation (ASRC), which jointly with the State of Alaska owns the subsurface under the twenty-two leases, issued a letter approving the twenty-two assignments.

On July 21, 2016, the Division rejected the Application as filed because it included the fifteen leases in which CPAI had not received an approved working interest assignment from the state and did not have an interest. The Division also returned the fee that CPAI had submitted with the Application.

On July 27, 2016, CPAI appealed the Division's decision rejecting the Application.

II. Legal Background

11 AAC 83.306 provides: “Any person owning an interest in a lease which is proposed to be committed to a unit which would include a state oil and gas lease may propose a unit agreement by applying to the commissioner for approval of the agreement.”

Section 18 of the leases that CPAI sought to have added to the CRU states in relevant part: “No assignment, sublease, or other transfer of an interest in this lease, including assignments of working or royalty interests and operating agreements and subleases, will be binding upon the lessors unless approved by both lessors.”

Under 11 AAC 82.625, if the commissioner approves an application for transfer of an interest in a lease, “the effective date of the transfer is the first day of the month following the date on which the assignment application is filed with the state,” absent prior written request.

III. Analysis

Citing 11 AAC 83.306, the Division rejected the Application as filed because CPAI did not own an interest in fifteen of the twenty-two leases that CPAI sought to be added to the CRU. The Division had rejected the working interest assignment applications for those fifteen leases on June 15, 2016. CPAI's appeal of the assignment decision was pending on July 21, 2016 when the Division rejected the Application.

Appellant contends that, at the time the Division rejected the Application, it did own an interest in all of the leases it sought to include in the CRU expansion. To support this contention, appellant cites ASRC's June 29, 2016 approval of all twenty-two assignment applications, including the fifteen the Division had denied.

ASRC and the State of Alaska jointly own the subsurface under the twenty-two leases that formerly comprised the Tofkat Unit. Pursuant to section 18 of those leases, no assignment of an interest in such leases is binding upon ASRC and the State of Alaska unless both lessors approve the assignment. CPAI is correct that ASRC had approved the assignment applications for the twenty-two leases that CPAI sought to be added to the CRU at the time of the Division's decision to reject the Application. However, the Division had denied fifteen of those twenty-two assignment applications. As such, only seven of the twenty-two assignments were effective and binding on the state at the time the Division rejected the Application.

The Division correctly concluded that CPAI did not have an interest in all twenty-two of the leases it sought to have added to the CRU when the Division rejected the Application. However, I have since reviewed CPAI's appeal of the Division's decision denying the assignment applications for the fifteen leases CPAI did not have an interest in. On November 3, 2016, I reversed that decision and approved the assignment of those fifteen leases. Pursuant to 11 AAC 82.625 and as requested by CPAI, those fifteen assignments are retroactively effective

as of June 1, 2016.¹ In light of that decision and the retroactive effective date of those assignments, I reverse the Division's rejection of the Application.

III. Findings and Decision

1. I find that ASRC's June 29, 2016 approval of all twenty-two assignment applications did not give CPAI an interest in the fifteen leases for which the Division had denied the assignment applications.
2. I find that the Division correctly found, at the time it issued its decision, that CPAI did not have an interest in fifteen of the twenty-two leases it sought to have included in the CRU.
3. On November 3, I approved the assignment of those fifteen leases. Pursuant to 11 AAC 82.625 and as requested by CPAI, the fifteen lease assignments are retroactively effective as of June 1, 2016. CPAI now has an interest in those leases, retroactive to June 1, 2016.
4. Accordingly, I reverse the Division's rejection of the Application and accept it as filed, subject to CPAI resubmitting the application fee under 11 AAC 05.010(10)(E).
5. If CPAI resubmits the application fee within 10 days of the date of this decision, the Application will be considered timely filed within the 90-day extension period under 11 AAC 83.140,² and the Division shall thereafter process the application.
6. If CPAI fails to resubmit the application fee within 10 days of the date of this decision, the Application shall be deemed incomplete and rejected.

This Commissioner's Decision is the final administrative order and decision of the Department for the purpose of an appeal to the Alaska Superior Court. An appellant affected by this final administrative order and decision may appeal to the superior court within 30 days in accordance with the Alaska Rules of Court and to the extent permitted by applicable law.

11/4/2016

Date

Andrew T. Mack

Andrew T. Mack
Commissioner

¹ Pursuant to section 18 of the leases, those assignments became binding on both the State of Alaska and ASRC on June 29, 2016 when ASRC approved the leases.

² The 90-day extension period under 11 AAC 83.140 began April 1, 2016 and ended June 29, 2016.



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November 3, 2016

David W. Brown
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Anchorage, AK 99501-0360

Dear Mr. Brown:

This is the decision of the Commissioner of the Department of Natural Resources (DNR) on ConocoPhillips Alaska, Inc.'s (CPAI) June 28, 2016 appeal of the June 15, 2016 decision of the Division of Oil & Gas (Division) denying undivided working interest lease assignment applications for ADLs 390672, 390673, 390674, 390675, 390676, 390677, 390679, 391015, 391016, 391914, 391915, 391916, 391917, 391918, and 391919 (the Leases). I have reviewed CPAI's appeal and the Division's decision. For the reasons discussed herein, I hereby reverse the Division's decision and approve the assignment applications.

I. Factual Background

The Leases were part of the Tofkat Unit, which automatically terminated on March 31, 2016.¹ On April 5, 2016, CPAI received notice that the Unit had automatically terminated but that, pursuant to 11 AAC 83.140, the Leases would continue "in full force and effect" for 90 days, and "so long thereafter as drilling or re-drilling operations are being conducted on it and so long thereafter as oil or gas is produced in paying quantities." On May 13, 2016, the Department of Natural Resources (DNR) Division of Oil and Gas (Division) received assignment applications from Caracol Petroleum LLC, TP North Slope Development LLC, MEP Alaska LLC,² AVCG LLC, and Nabors Drilling Technologies USA, Inc. (together, assignors), to transfer 100% of their working interests in the twenty-two leases that formerly comprised the Tofkat Unit to CPAI (assignee).

On June 15, 2016, the Division approved in part the lease assignment applications, approving the assignments for seven of the twenty-two leases. The Division denied the working interest assignments as to the other fifteen leases, finding that transfer of the

¹ The Division's decision initially states that the Tofkat Unit terminated on April 5, 2016. This is the date that CPAI received notice that the Unit had automatically terminated.

² TP North Slope Development, Caracol Petroleum, and MEP Alaska together as a partnership own the operating company Brooks Range Petroleum Corporation (BRPC). BRPC was the operator of the Tofkat Unit during the period of unitization.

assignors' interests in those leases would adversely affect the state's interests.³ On June 28, 2016, CPAI appealed the Division's decision denying the working interest assignments on those fifteen leases.

II. Legal Background

Under 11 AAC 82.605(b), no transfer of an interest in an oil and gas lease, including assignments of working or royalty interest, is binding upon the state unless approved by the commissioner. Under 11 AAC 82.605(c), the commissioner will approve a transfer of an undivided interest in a lease unless the commissioner makes a written finding that the transfer would adversely affect the interests of the state, or the application does not comply with applicable regulations. In determining whether or not to approve the proposed assignments, the state's interests include developing the state's oil and gas resources to maximize economic and physical recovery, competition, and use of Alaska's human resources, and encouraging assessment of Alaska's oil and gas resources while minimizing the adverse impacts of exploration, development, production, and transportation activity.⁴

III. Assignment of the Leases will not adversely affect the interests of the state and is permitted by regulation.

The Division found that assignment of the fifteen Leases would adversely affect the interests of the state because the assignors and assignee had demonstrated lack of diligence in exploration and operational activities in connection with the Leases, the Leases are overburdened, and approving the assignments would preempt the state's right to offer the Leases in a lease sale. The Division also found that seeking assignments during the 90 day extension period would circumvent the intent of 11 AAC 83.140.

Appellant argues that the Division based its decision upon inappropriate grounds, that assignments of the Leases would not adversely affect the interest of the state, and that there is no limitation on assignment during the 90 day period provided by 11 AAC 83.140.

For the reasons described herein, I find that assignment of the Leases alone will not adversely affect the interests of the state, and that assignment is permitted during the 90 day period provided by 11 AAC 83.140.

A. Lack of prior good faith development by the assignors and assignee is not determinative of the assignee's current intent or commitment to develop the leases.

In its decision, the Division cited the assignors' lack of diligent efforts in exploration and operation of the leased lands as support for its finding that the assignments would be adverse to the state's interests. Specifically, the Division noted that on January 27, 2016, the DNR Commissioner affirmed the Notice of Default decision for the Tofkat Unit, and that unit operator BRPC chose not to appeal the decision of default to the Alaska Superior Court. The Division also discussed assignee's previous lack of diligent exploration efforts

³ See Division's decision at 5.

⁴ See AS 38.05.180(a).

on the lands in the Leases, noting that CPAI held the lands at issue in the mid-1990s but ultimately relinquished them back to the state.

An assignee's previous lack of diligent exploration and development on lands is an appropriate factor to consider when determining whether an assignment of an interest in those lands would be adverse to the state. However, an assignee's earlier failure to explore or develop leased lands is not alone determinative of that assignee's later intent or commitment to develop those lands. I therefore find that CPAI's prior lack of diligent exploration and operation of the lands included in the Leases does not require me to find that the assignments would be adverse to the state's interests.

B. The Leases' combined royalty interest, ORRI, and resulting NRI alone are not sufficient to deny the lease assignments.

The Division also found that the assignments would be adverse to the state's interest in maximizing revenue because the combined royalty interest and overriding royalty interest (ORRI) on the Leases could provide additional hurdles to development. The Leases, comprised of lands that are jointly owned with ASRC, have a combined royalty interest of 16.66667% and an ORRI of 3.33333%. This results in a net revenue interest (NRI) of 80% for the lessee's investment and operating costs during project development. The Division found that the assignments would be adverse to the state's interest in maximizing revenue because the 3% ORRI and resulting 80% NRI on the Leases could shorten the economic life of the field and limit reinvestment capital needed for operations.

The Division's decision recognizes that the Leases are currently burdened by ORRIs and indicates that the requested assignments would result in "potential overburdening" through creation of additional ORRIs on the Leases.⁵ The Division has consistently found that leases with an NRI of less than 80% are overburdened. But DNR must approve any additional ORRIs on the Leases and can therefore prevent further reduction of NRI. Although the current NRI of 80% could negatively impact development of the leases, the Division has approved assignments for other leases with 80% NRI. The Leases' combined 16.66667% royalty interest, 3.33333% ORRI, and resulting 80% NRI alone are therefore not sufficient to find that assignment of the Leases would be adverse to the state's interest.

C. The assignments will not adversely impact the state by preempting the state's right to offer the Leases in a future lease sale.

The Division found that approving the assignments would adversely impact the state because doing so would preempt and subvert the state's right to offer the Leases to the public, in order to maximize competition and development of natural resources on the North Slope. In making this finding, it appears that the Division incorrectly assumed that the Leases, if assigned, would be incorporated into an expanded unit with a producing well, and that no drilling or production could then be required on the assigned leases.

⁵ See Division's decision at 5 ("Under the present facts and circumstances, the considerations for the denial of the assignments includes . . . the potential overburdening of the assignee's interests by creating ORRI in the leases . . .").

This appeal concerns the assignment applications only and not the assignee's unit expansion application, which is the subject of a separate pending appeal. Approving the requested assignments will give the assignee only that which the assignors had under the terms of the Leases and 11 AAC 83.140 and will not, absent further action by the Division, preempt the state's right to offer the Leases in a future lease sale.

D. Assignment is permitted during the 90 day extension period provided by 11 AAC 83.140.

Finally, the Division found that, by the express language and terms of 11 AAC 83.140, the intent of the 90 day extension provision was to extend leases solely to the current lessee to allow for either drilling or proving production within those 90 days, not to allow an assignee to drill or prove production from the leases. As such, the Division found that, by seeking assignment of the Leases during the 90 day extension period provided by 11 AAC 83.140, the assignors and assignee sought to circumvent the intent of the regulation.⁶

11 AAC 83.140 provides:

If any lease or a portion of one is eliminated from the unit plan or recovery program, or if the unit plan or recovery program is terminated, then the lease or portion of it so eliminated continues in full force and effect as may be provided in the unit or cooperative agreement, but for not less than 90 days from the date of the elimination or termination and so long thereafter as drilling or redrilling operations are being conducted on it and so long thereafter as oil or gas is produced in paying quantities.

The plain language of the regulation does not address which entity must conduct drilling, redrilling, or production operations. In addition, the plain language of 11 AAC 83.140 neither explicitly permits nor explicitly prohibits assignment during the 90 day extension period. I therefore find that assignment is permitted during the 90 day extension period provided by 11 AAC 83.140.

IV. Findings and Decision

1. I find that prior lack of good faith development by assignors and assignee is not determinative of an assignee's current intent or commitment to develop the leases.
2. I find that the existing royalty interests and resulting NRI alone are not sufficient to find that assignment of the Leases would be adverse to the state's interests.
3. I find that the assignments merely permit the assignee to do with the Leases what the assignors could do with them and that approving the assignments alone will not adversely impact the state's right to offer the Leases in a future lease sale.
4. I find that assignment is permitted during the 90 day extension period provided by 11 AAC 83.140.

⁶ The Division's decision states "regulations," but discusses only 11 AAC 83.140. Division Decision at 5.

5. I therefore find that assignment of the leases would not adversely affect the interests of the state, and that the assignment applications comply with applicable regulations.

6. Accordingly, I reverse the Division's decision. The applications for assignment of an undivided working interest in ADLs 390672, 390673, 390674, 390675, 390676, 390677, 390679, 391015, 391016, 391914, 391915, 391916, 391917, 391918, and 391919 to assignee are approved. Pursuant to 11 AAC 82.625 and as requested in CPAI's June 28, 2016 appeal, the assignments are effective June 1, 2016.

This Commissioner's Decision is the final administrative order and decision of the Department for the purpose of an appeal to the Alaska Superior Court. An appellant affected by this final administrative order and decision may appeal to the superior court within 30 days in accordance with the Alaska Rules of Court and to the extent permitted by applicable law.

11/3/2016
Date


Andrew T. Mack
Commissioner