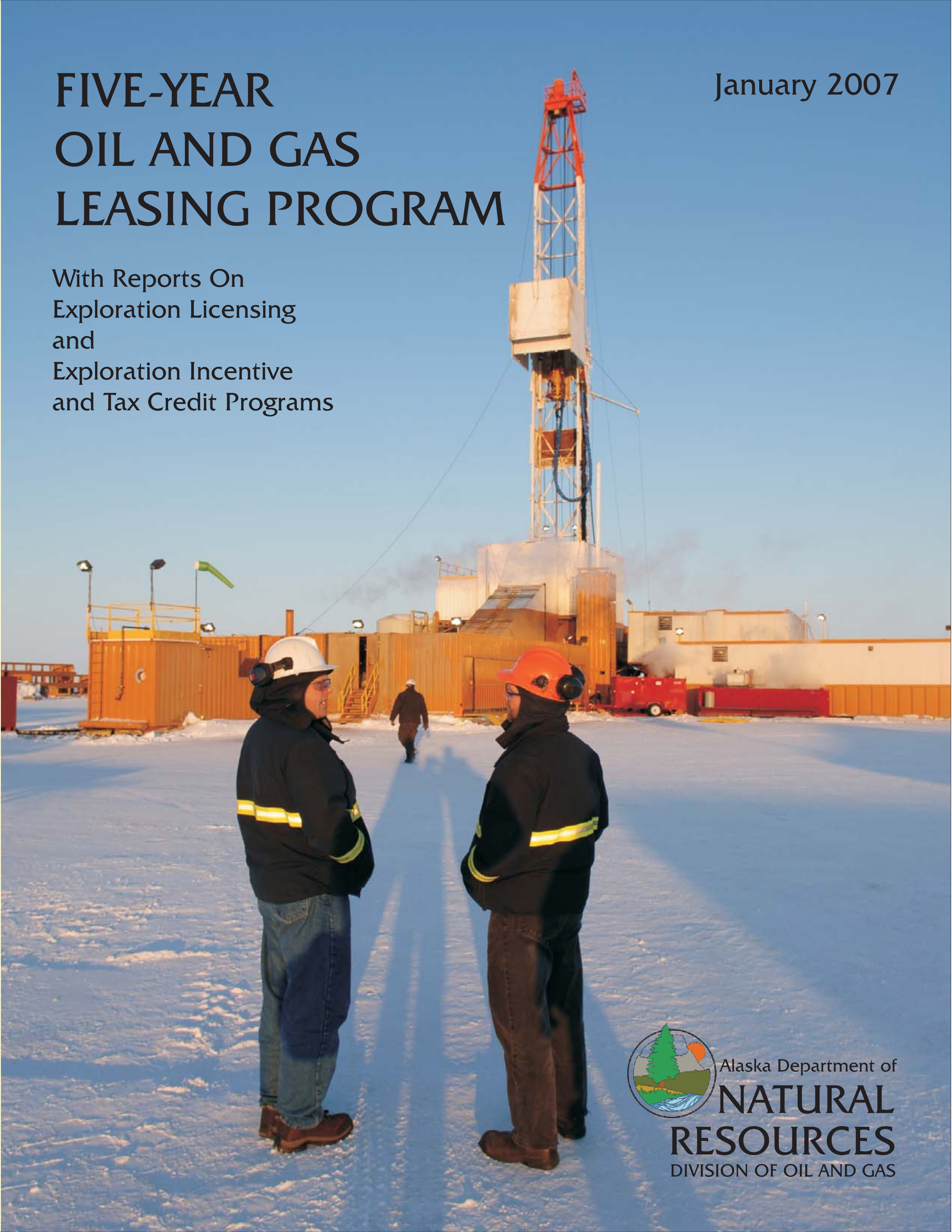
FIVE-YEAR OIL AND GAS LEASING PROGRAM

January 2007

With Reports On
Exploration Licensing
and
Exploration Incentive
and Tax Credit Programs



Alaska Department of
NATURAL RESOURCES
DIVISION OF OIL AND GAS

Division of Oil and Gas natural resource specialist Steven Schmitz (right) discusses drilling operations with Pioneer Natural Resources field environmental coordinator Zane Henning at the Hailstorm 1 prospect.

Photo by Aaron A. Weaver/Division of Oil and Gas

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STATE OF ALASKA

FIVE-YEAR OIL AND GAS LEASING PROGRAM

With Reports On Exploration Licensing and Exploration Incentive and Tax Credit Programs

Sarah Palin
Governor

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Acting Commissioner
Department of Natural Resources

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INTRODUCTION

Oil and gas lease sales are the initial step in a process that generates nearly 80 percent of the state's income. The Alaska State Legislature has found that "the people of Alaska have an interest in the development of the state's oil and gas resources" and has specified in AS 38.05.180 that the commissioner of the Department of Natural Resources (DNR) prepare a five-year proposed oil and gas leasing program. The program is updated annually and is available on the Division of Oil and Gas Web site. This document presents DNR's proposed lease sales for 2007 through 2011.

The Five-Year Oil and Gas Leasing Program provides a stable and predictable schedule of proposed lease sales which, if held, could result in the further development of Alaska's petroleum resources. The petroleum industry has come to rely on this program to plan for exploration and development expenditures. Business and labor use the program to prepare for resultant economic opportunities.

Although the primary purpose of leasing state lands is to provide for oil and gas development and the subsequent economic benefits[1], the program itself has been a significant revenue source. During 2006, 380 lease tracts were sold in six sales, resulting in an estimated $33,293,845[2] in bonus-bid income to the state. Because the North Slope Areawide and Beaufort Sea Areawide lease sales scheduled for October 2005 were postponed, leases for those regions were offered twice in 2006 (on March 1, and again on October 25). Alaska Peninsula leases were not offered in 2006. A report on the results of the 2006 lease sales begins on Page 29.

A brief description of lands included in each sale is found under "State Competitive Sale Areas" (Page 68). All lease sales held since 1959 are listed in the "Summary of State Competitive Lease Sales" (Page 70).

Sale Areas: A total of 25 proposed areawide lease sales are scheduled over the next five years, with one sale scheduled annually for each of the following areas: Alaska Peninsula, North Slope Foothills, Cook Inlet, Beaufort Sea, and North Slope. Fact sheets and maps describing these proposed sale areas begin on Page 13.

[1] As a result of oil and gas revenue from bonus bids, rentals, and royalty payments (including federal shares), and settlements during Fiscal Year 2006, approximately $1.784 billion was deposited into the general fund and $.612 billion into the Permanent Fund and School Fund.

[2] Preliminary results, subject to title and administrative review.

AREAWIDE LEASING

To achieve stability and predictability in the leasing program, and in response to industry's request for more frequent sales, the state has implemented competitive annual areawide leasing. Under areawide leasing, the state annually offers for lease all available state acreage within the Alaska Peninsula, North Slope Foothills, Cook Inlet, North Slope, and Beaufort Sea sale areas. Conducting annual areawide sales allows companies to fiscally plan for and develop their exploration strategies and budgets years in advance. The result is more efficient exploration, leading to earlier development. The state's first areawide sale was conducted on the North Slope in June 1998. Since then, the state has conducted 31 areawide sales.

Administrative Process

Areawide leasing necessitated changes to DNR's administrative process prior to and following a sale. Previously, industry was asked to nominate areas to include in a sale, and DNR sought public comment on the proposed sale areas being considered for addition to the program. Since areawide leasing includes all available state acreage within each geographic region, there is no longer a need for industry nominations. Additionally, since the sale area within each region remains the same, it is no longer necessary to solicit public comment on the inclusion of these lands prior to issuing the five-year schedule.

DNR has divided each sale area into tracts that will remain fixed for future sales. Because of the large number of tracts involved, the extent of the state's ownership interest in these tracts is no longer determined prior to a sale. Instead, after a sale, DNR verifies title only for the acreage within tracts that receive bids. Should a potential bidder require title or land status information on state land for a particular tract prior to the sale, it is the bidder's responsibility to obtain that information from DNR's public land records. State land records are maintained at the department's Public Information Center, located in Anchorage at 550 West 7th Ave., Suite 1260; phone (907) 269-8400; or on its Web site at http://plats.landrecords.info/. A tract may contain land that the state cannot legally lease (i.e., land that is part of an existing lease; federal, Native, or private land; etc.). For bidding purposes, DNR assigns an estimated acreage figure to each tract, which in many cases is greater than the actual acreage available, and the per acre bonus bid must reflect that assigned acreage. Once title has been verified, bids are adjusted to reflect the actual acreage available and the lease is issued. Depending upon the number of tracts and the complexity of the land ownership, it may take several months following the lease sale before all of the leases are issued.

The lease sale consists of a public opening and reading of sealed bids received by DNR during the time period specified in the sale. The highest qualified bidder on a tract is awarded that lease.

Best Interest Finding Process

In 1996, to facilitate areawide leasing, the Legislature passed legislation establishing that a best interest finding developed for a lease sale be valid for 10 years (previously, a finding was good for only five years). Once a finding for an area is written, DNR can conduct lease sales in that area for 10 years without having to repeat the entire process. However, prior to each subsequent sale, DNR is required to solicit information from the public and make a determination on whether substantial new information has become available, justifying a supplement to the most recent best interest finding.

The planning and execution of an oil and gas lease sale that requires a new best interest finding is a lengthy process beginning years before a sale. The process involves the participation of a number of state agencies, with DNR serving as the lead, along with federal agencies, industry, local communities, environmental organizations, and the public. DNR researches and analyzes social, economic, environmental, geological, and geophysical information about a sale area and develops a preliminary best interest finding.

A preliminary finding describes the sale area and discusses the potential effects that may occur as a result of oil and gas exploration, development, production, and transportation. It also contains mitigation measures to be imposed on plans of operation as lease terms designed to reduce or eliminate negative effects. The preliminary finding is published at least six months before the sale and is followed by a public comment period of at least 60 days. DNR gives public notice of the preliminary finding through a public mailing, display ads and legal notices in newspapers, postings in local post offices and libraries, and public service announcements.

During the public comment period, DNR may conduct workshops or hold public meetings in one or more of the affected communities. Local boroughs and municipalities may also conduct hearings, which division personnel attend. Comments received during the comment period help in developing a final finding. DNR releases the final finding, including a decision determining whether the sale is in the state's best interests, at least 90 days before a scheduled sale. The final finding is also public noticed.

Concurrent with a best interest finding, when a sale involves land within the state's coastal zone, DNR analyzes a proposed lease sale for consistency with the Alaska Coastal Management Program (ACMP), including any affected local coastal management plans. The ACMP consistency analysis is published with the preliminary finding; the final ACMP consistency determination is issued concurrently with the final finding.

When A New Finding Is Not Required: In the years following the issuance of a best interest finding (up to 10 years), DNR issues a "Call for New Information" prior to the notice of a lease sale. The Call for New Information requests any new information made available since the most recent best interest finding or supplement to the best interest finding for that region was completed. The Call for New Information is public noticed and interested parties have at least 60 days to submit new information. Based on the information received, DNR determines whether a supplement to the best interest finding is justified. At least 90 days prior to a sale, DNR issues either a supplement or a decision that there is no substantial new information requiring a supplement. The supplement or finding of no substantial new information are public noticed, usually with the notice of the lease sale.

Mitigation measures identified in the best interest finding are included as terms of the lease in all sales during the effective period of a finding. A new coastal management consistency review is done whenever the commissioner determines that new information or conditions suggest a proposed lease sale may no longer be consistent with ACMP standards.

LEASING METHODS
AND
EXPLORATION INCENTIVE AND TAX CREDIT PROGRAMS

Leasing Methods:

Alaska has several leasing method options designed to encourage oil and gas exploration and maximize state revenue. These methods include combinations of fixed and variable bonus bids, royalty shares, and net profit shares. Minimum bids for state leases are generally $5 or $10 per acre. Fixed royalty rates are generally 12 1/2 percent or 16 2/3 percent, although others have been as high as 20 percent. A sliding scale royalty has also been used on occasion. Lease terms are set at five, seven, or 10 years, depending on geographical location.

Exploration Incentive Credit (EIC) and Tax Credit Programs:

AS 38.05.180(i): This statute authorizes the commissioner of the Department of Natural Resources to establish an EIC system under which a lessee drilling an exploratory well on state-owned land may earn credits based upon the footage drilled and the region in which the well is located. This EIC must be designated by the commissioner as a lease sale term. Drilling information is held confidential for two years. If demonstrated by the lessee as necessary, confidentiality may be extended. The statute also provides for an EIC for geophysical work on state land, if that work is performed during the two seasons immediately preceding an announced lease sale and is on land included within the sale area. The geophysical information must then be made public after the sale. Credits are granted by the commissioner for a limited period and may be assigned. A credit may not exceed 50 percent of the cost of the drilling or geophysical work. Credits may be applied against royalty and rental payments to the state, or taxes payable under AS 43.55. Amounts due the Alaska Permanent Fund (AS 37.13.010) are considered before the application of credits.

Since the state began offering EICs under this program, 22 exploratory wells qualifying for credit have been drilled on state leases. There have been no applications for geophysical EICs.

AS 41.09.010: This program was adopted in 1994, and allows the commissioner of the Department of Natural Resources to grant an EIC for exploratory drilling, the drilling of a stratigraphic test well, and for geophysical work on land in the state regardless of whether the land is state-owned. This program is designed to encourage oil and gas exploration within remote parts of the state and to provide a means for the state to obtain exploration data from federal lands and certain private lands. As with the first program, credits may be applied against oil and gas bonus bids, royalties, and rentals payable to the state, or taxes payable under AS 43.55, or the credits may be assigned. Data derived from drilling will be kept confidential for two years, but no extensions are allowed. Copies of geophysical data may be shown to interested parties by the state but may not be transferred to third parties. Credits may be as high as 50 percent of eligible costs if performed on state land, and as high as 25 percent of eligible costs if performed on private or federal land. A credit may not exceed $5 million per eligible project, and the total of all credits issued under this program may not exceed $30 million. Drilling credits are based upon the footage drilled. All activity qualifying for this EIC must be completed by July 1, 2007.

AS 43.55.025: This program allows for a production tax credit of 20 percent of the cost of an exploratory well if the bottom hole location is three or more miles from the bottom hole location of a pre-existing well that was spud more than 150 days, but less than 35 years, prior to the spud date of the eligible exploration well, and 20 percent of the cost of an exploratory well if the bottom hole location is at least 25 miles from the boundary of any unit. The credits can be combined if both criteria are met to total a 40 percent credit. The program also offers seismic exploration tax credits of 40 percent of eligible costs for those portions of activities outside of a unit. Seismic data qualifying for this credit will be held confidential for 10 years and 30 days. This tax credit is transferable. This program expires on July 1, 2007, for the North Slope, and July 1, 2010, elsewhere. The expenses that qualify for credits under this tax program cannot be claimed as qualified capital expenditure under AS 43.55.011 (Petroleum Profits Tax), so an expense cannot qualify for multiple credits.

AS 43.020.043: This program was adopted in 2003, and is applicable only to operators and working interest owners engaged in exploration for and development of gas resources and reserves south of 68 degrees north latitude. The program allows for a 10 percent tax credit equivalent of qualified capital investments made after June 30, 2003, and 10 percent of the annual cost of activity in the state during each tax year. The total allowable yearly tax credit may not exceed 50 percent of the taxpayer’s total tax liability. Unused tax credit may be carried forward for up to five years. Credit is transferable only as part of a conveyance, assignment, or transfer of the taxpayer’s business. Credit under this program may be used in conjunction with any other credit authorized by AS 43.20, but not for tax credit or royalty modification provided under any other title. This program expires January 1, 2013.

Nonconventional Gas Incentive: Under AS 38.05.180(n)(2), if the lessee under a gas-only lease demonstrates that the potential resources underlying the lease are reasonably estimated to be nonconventional gas, the rental payment on the lease will be reduced and the royalty may be reduced to 6.25 percent.

Royalty Reduction: The state also allows for royalty reduction under certain circumstances. These reductions are explained in AS 38.05.180(f)(5) and AS 38.05.180(j).

As 43.55.011 (Petroleum Profits Tax): In 2006, the Legislature replaced the oil and gas production tax with a tax based on oil and gas profits. The new tax regime also includes an additional 20 percent tax credit for certain oil- and gas-related expenses. The expenses that qualify for credits under this tax program are exclusive of the other EIC programs, so an expense cannot qualify for multiple credits. Explorers interested in pursuing these tax credits are encouraged to contact the Alaska Department of Revenue for more information on the program. In addition, the Commercial Section of the Division of Oil and Gas is available to provide information on the application of the program to oil and gas projects.

QUALIFYING TO APPLY FOR, OBTAIN, OR TRANSFER AN INTEREST, PERMIT, OR LEASE RELATING TO OIL AND GAS IN ALASKA

Who Must File

Every individual, association or partnership, corporation, or person authorized to act on behalf of another party must qualify with the Division of Oil and Gas prior to bidding for lease tracts. Qualification also must be obtained prior to applying for, obtaining, or transferring interest in a permit or lease issued under AS 38.05.135 - 38.05.184.

Where to File

Address any required information or inquiries regarding qualifications to State of Alaska, Department of Natural Resources, Division of Oil and Gas, 550 West 7th Avenue, Suite 800, Anchorage, Alaska 99501-3560. Hand-carried material should be delivered to the same address.

How to File

The following is a list of the information and documents required when qualifying under 11 AAC 82.200 - 11 AAC 82.205. Information and documents that have been filed previously and are still current may be sufficient to qualify individuals or other entities.

A. Individuals

11 AAC 82.205(a)(2). Individuals must submit a signed, dated statement that includes the applicant's name, address, and telephone number, preferably notarized, attesting that:

> The individual has reached the age of majority (in Alaska the age of majority is 18 years, except for those who are emancipated earlier by marriage or by court order).

Forms may be obtained from the division upon request or a statement including the necessary information may be composed and submitted by an individual.

Any legal representative, guardian, or trustee for an individual must submit a certified copy of the court order authorizing the representative to act in that capacity and to fulfill, on behalf of the individual, all obligations arising under the lease or permit. The representative must also submit a signed statement as to the age of the individual and themselves.

Agents for an individual must submit an original or certified copy of a notarized power of attorney instrument authorizing the agent to act on behalf of the individual.

B. Corporations

Corporations must submit:

1) the current address of the corporation;

2) a list of the individuals authorized to act on its behalf with respect to oil and gas leasing or permitting;

3) an original or certified copy of a notarized power of attorney authorizing any agent who is not a current officer but who has been authorized by the corporation to act on its behalf with respect to the mineral specified in the permit or lease;

4) a Certificate of Compliance (Certificate of Good Standing) for those corporations qualified to do business in Alaska;

-or-

5) if filing for the first time, either a Certificate of Incorporation (Certificate of Organization for an LLC) from those corporations which have been incorporated in the state of Alaska (also known as "domestic" corporations), or a Certificate of Authority (Certificate of Registration for an LLC) from those corporations which have been incorporated outside the state of Alaska (also known as "foreign" corporations).

Certificates may be purchased online at www.dced.state.ak.us/occ/.

These documents may also be obtained from:

Alaska Department of Commerce, Community and Economic Development (DCCED)
Attention: Corporations Section
9th Floor, State Office Building
P. O. Box 110808
Juneau, Alaska 99811-0808
(907) 465-2530
e-mail: corporations@commerce.state.ak.us

-or-

Alaska Department of Commerce and Economic Development
Attention: Corporations Section
550 W 7th Ave., Suite 1500
Anchorage, Alaska 99501
(907) 269-8173

Inquiries about incorporating in the state of Alaska, or qualifying as a foreign corporation to do business in the state of Alaska should be addressed to personnel at either of the above addresses.

C. Unincorporated Associations

Unincorporated Associations, partnerships or joint ventures must submit:

1) a statement describing the business relationships between members of the association, partnership or joint venture;

2) a statement of qualifications for each member of the association, partnership, or joint venture (outlined in Section A);

-and/or-

if some or all of the members are incorporated entities, all information required for corporations (described in Section B) must also be submitted; and

3) in the case of an agent acting on behalf of an individual, an original or certified copy of a notarized power of attorney defining the agent's authority to sign with respect to the mineral specified in the permit or lease on behalf of the partnership, association or joint venture.

If still current, material previously filed with the department satisfying all or part of the requirements of this section may be incorporated in an application by appropriate reference together with a statement as to any material changes or amendments.

Sources

11 AAC 82.200
11 AAC 82.205
AS 38.05.020
AS 38.05.145(a)

Further Information

Should you have any further questions regarding qualifying for Alaska oil and gas leases, please contact the State of Alaska, Department of Natural Resources, Division of Oil and Gas, 550 West 7th Avenue, Suite 800; Anchorage, Alaska 99501-3560; Phone number (907) 269-8816; or visit our website at http://www.dog.dnr.state.ak.us/oil/.

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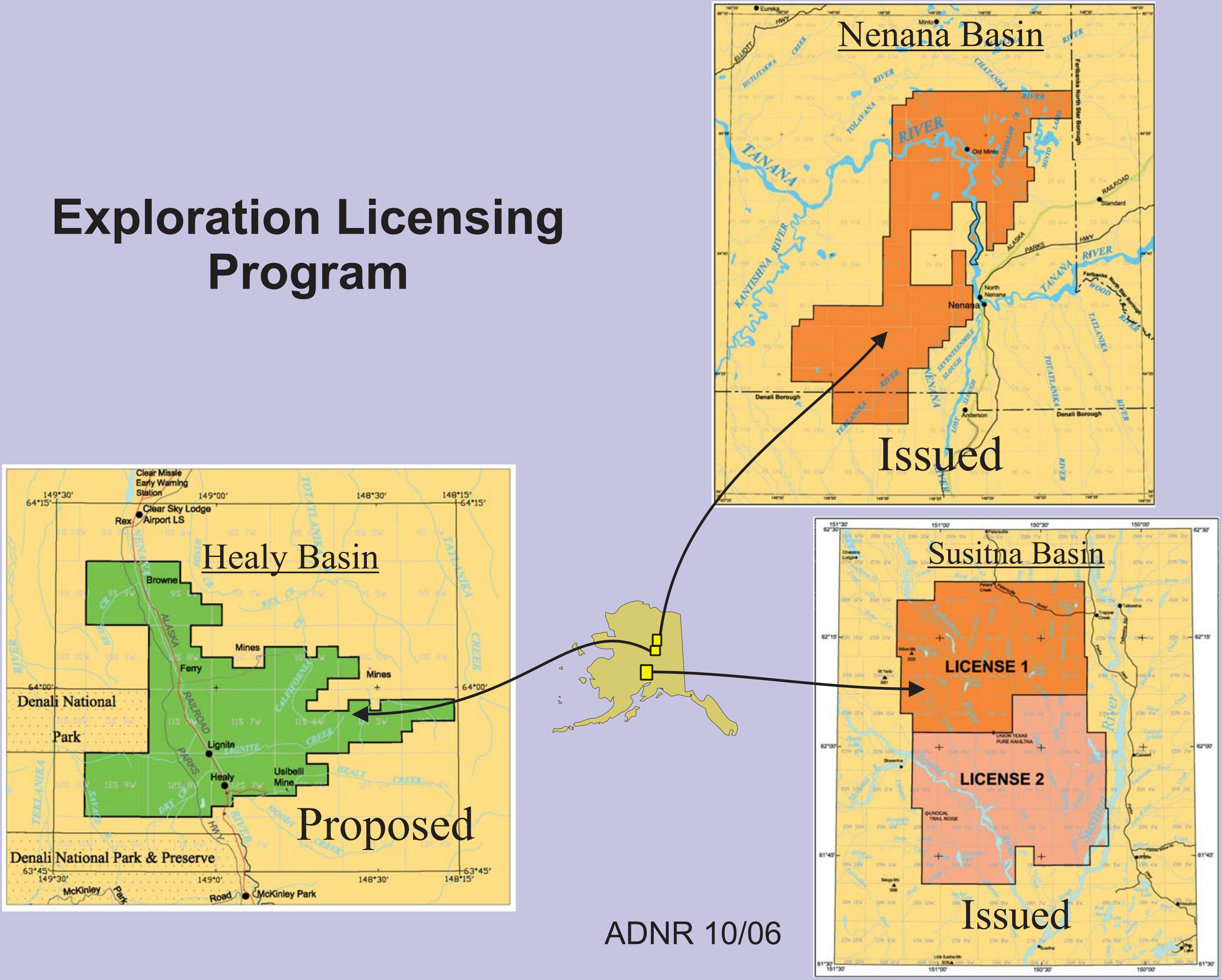
Exploration Licensing Program



EXPLORATION LICENSING

Exploration licensing supplements the state's oil and gas leasing program and encourages oil and gas exploration outside of the known oil and gas provinces — the North Slope, Beaufort Sea, Cook Inlet, and Alaska Peninsula. The holder of an exploration license has the exclusive right to explore an area between 10,000 and 500,000 acres in size for a term of up to 10 years. Rather than an upfront bonus payment to the state as is done in conventional leasing, a licensee must commit direct expenditures for exploration. If there is competition for a license, the party committing the most dollars to exploration is granted the license. Since there are no annual rental payments for a license, the only money guaranteed the state is a $1 per acre licensing fee, which is paid upon acceptance. The state is, however, provided all of the geological and geophysical information acquired by the licensee, and so can gain a better understanding of an area's resource potential.

Once the work commitment is met, the licensee may convert all or a portion of the license area into oil and gas leases. Upon conversion, the lessee begins paying the state annual rental fees of $3 per acre. Should exploration lead to development and production, the state is entitled to a royalty share that cannot be less than 12.5 percent.

Five-Year Licensing Program

The Department of Natural Resources accepts all proposals for consideration that are submitted during the month of April of each year, as specified in 11 AAC 82.909. Areas not eligible for licensing are specified in AS 38.05.131.

LICENSES IN EFFECT

Location	Licensee	Acres	Work Commitment	Effective Date	Term
Nenana Basin	Andex Resources	482,942	$2,525,000	10/1/2002	7 Yrs
Susitna Basin No. 1	Forest Oil Corp.	386,207	$2,520,000	11/1/2003	7 Yrs
Susitna Basin No. 2	Forest Oil Corp.	471,474	$3,000,000	11/1/2003	7 Yrs

PROPOSED LICENSE

Location	Licensee	Acres	Work Commitment	Effective Date	Term
Healy Basin	Usibelli Coal Mine Co.	208,630	$500,000	TBD	10 Yrs

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