Findings and Decision of the Director
of the Division of Oil and Gas

APPROVAL OF THE NIKAITCHUQ UNIT SCHRADER BLUFF
PARTICIPATING AREA

Under a Delegation of Authority
from the Commissioner of the State Of Alaska
Department of Natural Resources

January 21, 2011
I. DECISION SUMMARY

On December 16, 2010, Eni US Operating Company, Inc. (Eni), as Nikaitchuq Unit (NU) Operator, applied to form the Schrader Bluff Participating Area (SBPA) (Application). The company submitted geological, geophysical, engineering, and economic data that justify the formation of the SBPA. The aerial extent of the SBPA includes “only the land reasonably known to be underlain by hydrocarbons and known or reasonably estimated through use of geological, geophysical, or engineering data to be capable of producing or contributing to production of hydrocarbons in paying quantities.” 11 AAC 83.351(a). The State of Alaska Department of Natural Resources (DNR), Division of Oil and Gas (Division), approves the formation of the SBPA.

II. APPLICATION AND LEASE SUMMARY

Eni proposed that the SBPA include ADLs 391283, 390615, 390616, and the eastern half of ADL 388577. The Division proposed that the initial SBPA include only ADLs 391283, 390615 and 390616. Eni submitted revised exhibits to the Application (Attachments 1 & 2). The Division determined that the data submitted with the Application was sufficient to consider approval of the Application under 11 AAC 83.303, 11 AAC 83.351, and 11 AAC 83.371. The Application contains confidential geologic, geophysical, engineering and economic data to support the SBPA formation.

ADL 391283 has a 12.5 percent royalty rate and 30 percent net profit share (NPS). ADLs 390615 and 390616 have 16.666667 percent royalty rates.

The three leases received royalty modification under a January 11, 2008 DNR decision. For the first 25 years following the date of first sustained production, when Alaska North Slope West Coast (ANS WC) delivered crude prices fall below a threshold price per barrel (initially $42.64 per barrel, adjusted annually for inflation), leases allocated production from the Nikaitchuq Schrader Bluff OA reservoir will be subject to a five percent royalty rate.

III. DISCUSSION OF DECISION CRITERIA

The DNR Commissioner (Commissioner) reviews applications related to units, including the formation of participating areas, under 11 AAC 83.303--11 AAC 83.395. By memorandum dated September 30, 1999, the Commissioner approved a revision of Department Order 003 and delegated this authority to the Division Director (Director). The Division’s review of the Application is based on the criteria set out in 11 AAC 83.303. Subsection (c), paragraph (4), directs the Commissioner to consider the criteria in subsections (a) and (b) when evaluating an approval of a participating area. A discussion of the subsection (b) criteria, as they apply to the Application, is set out directly below, followed by a discussion of the subsection (a) criteria.
A. Decision Criteria considered under 11 AAC 83.303(b)

1. The Environmental Costs and Benefits of Unitized Exploration and Development

Approval of the SBPA has no direct environmental impact. This decision is an administrative action and does not authorize any on-the-ground activity.

A unit operator must obtain approval of a plan of operations from the State, and other permits from various agencies, before drilling a well or wells or initiating development activities. DNR considered environmental issues during the lease sale process, NU formation, and NU expansion. Eni has obtained the required permits for the current SBPA wells and is operating under an approved plan of operations.

Formation of the SBPA will promote efficient development of the State’s resources, while minimizing impacts to the region’s cultural, biological, and environmental resources. Such impacts would be significantly greater if the Nikaitchuq Schrader Bluff Reservoir were developed on a lease-by-lease basis, rather than on an integrated unitized basis.

2. The Geological and Engineering Characteristics of the SBPA

A participating area may be formed to include "only the land reasonably known to be underlain by hydrocarbons and known or reasonably estimated through use of geological, geophysical, or engineering data to be capable of producing or contributing to the production of hydrocarbons in paying quantities." 11 AAC 83.351(a).

A. Exploration History:

In 2004, Kerr McGee (KMG) drilled the Nikaitchuq No.1 well. The primary exploration target was the Sag River Formation; the Kuparuk Formation was a secondary target. Although the well did not encounter reservoir quality sand in the Kuparuk, the Nikaitchuq No. 1 is considered the discovery well for the Schrader Bluff Formation because log analysis indicated that sands in the shallower Schrader Bluff Formation OA interval were prospective. The Nikaitchuq No.2 well confirmed the presence of hydrocarbons within the Schrader Bluff formation. In 2005, KMG drilled an additional 4 wells to delineate the commercial extent and viability of the Schrader Bluff sands: Tuvaaq St No. 1, Kigun No. 1, and the Nikaitchuq No. 3 and No. 4 wells.

KMG then adjusted the exploration program to thoroughly evaluate the Schrader Bluff Formation. In 2006/2007 KMG drilled two additional pre-development wells from Oliktok Point to further delineate and test the Schrader Bluff sandstone.

ENI took over the Nikaitchuq project from KMG in 2007 and integrated seismic surveys over the Nikaitchuq area with the well, core, production test, and fluid data they collected.
to map the geological structure, extent, and potential reservoir distribution of the Schrader Bluff sands to define the Nikaitchuq Schrader Bluff PA.

**Structure:**
Within the proposed development area, the structure of the proposed Nikaitchuq Schrader Bluff PA forms a monocline that dips gently toward the northeast and is cut by numerous, northwest-trending, normal faults that have vertical displacements ranging up to 80 feet. Within the proposed area, the base of the permafrost is mapped between -1,800 and -1,900 feet TVDSS. The proposed Schrader Bluff PA top OA sand is present at depths approximately between -3,000 and -4,300 ft tvdss. Well log and seismic information indicate that the Schrader Bluff accumulation is trapped by both structural and stratigraphic elements. The reservoir is separated into discrete compartments that are defined by faults, facies changes, and oil properties.

**Stratigraphy:**
The Schrader Bluff Formation is part of a larger accumulation collectively referred to as the Shallow Oil Sands that include the Ugnu and West Sak Sands of the Kuparuk River Unit and the Schrader Bluff Formation within the Prudhoe Bay and Milne Point Units. The O sands are lateral stratigraphic equivalents of the West Sak reservoir sands A through D in the Kuparuk River Field and are Maastrichtian (Latest Cretaceous) in age. The O sands are the primary developed producing sands within the Schrader Bluff Formation, with local secondary accumulations of thickened N sandstones. The West Sak and Schrader Bluff sandstones were deposited as laterally extensive, coarsening upward delta-front sequences comprised of sandstones, siltstones, and mudstones that were part of a northeasterly prograding deltaic system that was deposited on an extensive, relatively flat (one to two degree) open marine shelf of late Cretaceous to early Paleocene age. The paleoshelf extended in a northwest to southeast direction over the present Prudhoe, Kuparuk, Milne Point, and Nikaitchuq units.

Specifically within the Nikaitchuq Unit, the Schrader Bluff is late Cretaceous in age and consists of (in ascending order) the “OB”, “OA” and “N” sands. In the Kigun No. 1 well, the OA sand lies between 3,780 and 3,822 feet (md) and the N sands are present in the interval between 3,627 to 3,663 feet (md). In this well the Schrader Bluff OA is overlain by approximately 40’ of mudstone/siltstone and underlain by hundreds of feet of interbedded mudstone/siltstone and thin and infrequently present sandstone interbeds. These sediments consist of laminated sandstones and siltstones deposited as marine shelfal lobes within a foreland basin. They were sourced from the southwest, where the Schrader Bluff Formation interfingers with the marginal marine to non-marine sediments of the Prince Creek Formation.

**Reservoir Properties:**
Within ENI’s proposed Nikaitchuq Unit, Schrader Bluff PA, reservoir sandstones are fine to very fine-grained and lithic-rich. Gross thickness for the OA sand ranges from 30 to 40 true vertical feet. Porosity ranges from 25% to 35%, permeability ranges from 100 to 600 millidarcies, and water saturation ranges from 23% to 45%, with 45% likely representing a transition zone near the oil-water contact.
Well Tests:
To date, nine wells have penetrated the Nikaitchuq reservoir within the Nikaitchuq Unit. Three of the wells tested oil from the viscous Schrader Bluff or Sag River formations. Below is a summary of well, test, and core information and analyses:

KMG Nikaitchuq #4 (2005)

Approximately 3,000 feet of gross horizontal Schrader Bluff OA sand was drilled in this well, with approximately 2,270 feet of horizontal or lateral net pay, from a 30foot TVD net pay thickness. A two-week production test was performed on the well using an electric submersible pump (ESP) to aid in producing the 16–17 degree API crude. The well tested at rates up to 1,200 barrels of oil per day during periods of the initial test. Permeability values estimated from the test were greater than 350 millidarcies. The values were confirmed from the analysis of the flow tests conducted on a whole core obtained from the well.

KMG Tuvaaq #1(2005)

The well was not tested and not cored. It penetrated 30 feet net pay Schrader Bluff OA Sand and 12 feet net Schrader Bluff N sand. Schrader Bluff N sand was interpreted to be oil-filled in both the Tuvaaq #1 and the Kigun #1 wells and appeared unconsolidated with permeability estimated from 100-1000 millidarcies and porosity 25-35 percent.

KMG Kigun #1 (2005)

The well was not tested. It penetrated 29 feet net pay Schrader Bluff OA sand and 30 feet net N sand. A MDT (Modular Formation Dynamics Tester tool) run sampled the Schrader Bluff OA fluids and measured 18 degree API oil with a GOR of 59 SCF/STB at reservoir temperature. (Contamination of the samples with oil-based mud caused concern about the reliability of the sample estimates and properties.) Schrader Bluff OA sand core data indicated 25 percent to 38 percent porosity and up to 1,000 millidarcies permeability in the sandstone intervals.

KMG Oliktok Point I-1 (2006)

The well encountered productive OA sand within the Schrader Bluff Formation. A fluid sample collected within the OA sand measured 16 degree API crude and 136 SCF/STB gas-oil ratio, at bubble point pressure of 1232 psi. Based on well log analysis, the well also encountered hydrocarbons and reservoir quality sands within the Schrader Bluff N sand.
KMG Oliktok Point I-2 (2007)

The well encountered net pay in the OA and overlying ‘N’ sands within the Schrader Bluff Formation. Fluid properties of the OA sand were 19 degree API crude and 72 SCF/STB gas-oil ratio and a low saturation (bubble point) pressure of 446 psi.

A horizontal lateral was drilled from the pilot hole in January 2007 to evaluate the feasibility of developing the OA sands with horizontal lateral completions similar to those planned in the Nikaitchuq development. The lateral was drilled to at total depth (length) of 12711’ MD (3590’ TVD). A 6102’ lateral was drilled with 5343’ within the OA sand. Net lateral pay amounted to 4011’. A 150 hour well test stabilized at a flow rate of approximately 2100 BPD of 19 degree API oil. The well tests demonstrated that the horizontal and multilateral would outperform the deviated wells because more formation is exposed and the completions are more efficient. Difference in individual lateral productivity is most dependent on the oil encountered; higher API values and lower viscosity oil result in higher oil production. Fluid quality in other developing areas of West Sak and Schrader Bluff accumulations varies from 15-24 degree API and 5 – 130 centipoise viscosity.

Reservoir Fluid Contacts:
In the OA sand, an oil-water contact is estimated at approximately -4,177 feet TVDSS in the Nikaitchuq No. 2 well. The depth of the oil-water contact in the N sand reservoirs is less certain, lying somewhere between the deepest-known-oil depth of -3,643 feet TVDSS in well Oliktok Point No. I-1 and the shallowest-known-water depth of -3,949 feet TVDSS in well Nikaitchuq No. 4. At present, there is no evidence of different oil-water contacts within separate reservoir compartments.

Reservoir Fluid Properties:
Oil samples recovered from the Nikaitchuq No. 4, Kigun No. 1, Oliktok Point No. I-1, and Oliktok Point No. I-2 exploratory wells measure between 16° and 19° API gravity, with viscosity ranging from about 100 to 200 centipoise. The solution gas-oil ratio (GOR) measures from 80 to 140 standard cubic feet per stock tank barrel, and the bubble point pressure ranges from about 1,150 psia in the reservoir compartment containing Oliktok Point No. I-1 to approximately 750 psia in the compartment containing Oliktok Point No. I-2. Initial Nikaitchuq reservoir pressure is about 1,700 psi at a depth of -3,760 feet TVDSS in Kigun No. 1 and Oliktok Point No. I-1. The bubble point pressures of the reservoir compartments vary between 750 and 1,150 psi. Reservoir temperature is about 80° F.

Oil Recovery:
ENI has estimated that original oil in place (OOIP) for the OA sands is in the range of 800 – 930 MMSTB. Primary recovery is estimated at 30 – 45 MMSTB and with waterflood the estimated recovery is in the range of 120 – 200 MMSTB. Because the OA sands in the NU Schrader Bluff PA appear compartmentalized, by faults and reservoir properties, ENI plans to initially develop the OA sand within the Nikaitchuq Schrader Bluff PA as a water-injection enhanced oil recovery project with 26 horizontal production
wells, 21 horizontal injection wells, two disposal wells and three water source wells. Most of the production and injection wells will trend northwest, parallel with the normal faults that cut the reservoir. The horizontal sections of these wells will range in length from 4,000 to 8,500 feet within the reservoir, will be spaced about 1,200 feet apart, and will be arranged end-to-end, forming alternating rows of producers and injectors in a line-drive flood pattern flanked by outboard production wells. Production and injection voidage will be balanced to maintain reservoir pressure at or near the original measured pressure. Injection water will consist of produced water and water derived from the underlying Ivishak Formation. Because of the low GOR in the proposed PA, injection of gas or miscible injectant to maintain reservoir pressure to enhance recovery is not considered feasible.

The well tests summarized above in conjunction with the confidential geological, geophysical, and engineering data provided by ENI confirm and justify the size and areal extent of the SBPA that includes “only the land reasonably known to be underlain by hydrocarbons and known or reasonably estimated through use of geological, geophysical, or engineering data to be capable of producing or contributing to production of hydrocarbons in paying quantities.” 11 AAC 83.351(a). The areal extent of the SBPA coincides with the expected drainage areas of the development wells drilled to date.

3. The Plan of Development for the Participating Area

The Division approved the NU 3rd POD on September 17, 2010. The NU 3rd POD describes the activities completed to date to achieve sustained production from the onshore drill site (ODS), as well as development activities associated with future production from the offshore, Spy Island drill site (SID). Eni plans to drill extended reach wells and to utilize advanced completion technologies. To date, Eni has drilled seven development wells within the proposed SBPA boundary and will drill two additional wells during the NU 3rd POD. Eni plans to commence sustained production by 1Q 2011.

Eni has drilled, constructed, and installed two drill sites, ODS and SID, the Nikaitchqu Production Facility, and a 10-inch sales quality crude line tying the facility to the Kuparuk Pipeline (KPL). The Alaska Oil and Gas Conservation Commission (AOGCC) approved the Nikaitchqu Schrader Bluff Oil Pool Rules in Conservation Order Number 639 on November 19, 2010. The Regulatory Commission of Alaska approved the connection to the KPL in an order dated December 13, 2010. Eni has completed the development work necessary to commence and maintain sustained production (drill sites, wells, facility capacity necessary to process production from the current set of development wells, pipeline transportation to processing facility and export line), and has obtained the necessary permits (pool rules and connections to common carrier lines).
4. The Economic Costs and Benefits to the State and Other Relevant Factors

The SBPA will provide economic benefits to the State through royalty and tax payments on production. The initial allocation methodology provides an equitable production allocation between the leases. Eni submitted tract participation schedules for the leases in the proposed SBPA (Attachment 1) as required under 11 AAC 83.351. The proposed allocation distributes expenses and production among the tracts/leases on a surface acreage basis. Future determinations of participation will be on a volumetric basis, which will be adjusted to reflect expansions of the participating area. Eni is the sole working interest owner, and the State the sole royalty owner, of the leases. ADL 391283, the NPS lease, is allocated 55.18 percent of the production.

DNR’s January 11, 2008 royalty modification decision may result in a cost to the State. When ANS WC delivered crude prices fall below a threshold price per barrel (initially $42.64 per barrel, adjusted annually for inflation), leases allocated production from the Nikaitchuq Schrader Bluff OA reservoir will be subject to a five percent royalty rate. Eni stated, and the State independently determined, that a prudent-investor would not have proceeded with the project without the royalty modification. Approval of the SBPA, in conjunction with the royalty modification, will facilitate Eni’s efforts to develop and produce resources. Current and future lessees near the NU who do not own facilities may also benefit from the Unit’s facility and pipelines.

ENI submitted confidential paying quantities data for the ODS demonstrating that the area underlain by the SBPA is capable of producing hydrocarbons in paying quantities, as required by 11 AAC 83.351 (a). SBPA contains only the acreage required for the wells to meet the paying quantities definition set out in 11 AAC 83.395(4).

The people of Alaska have an interest in the development of the State’s oil and gas resources to maximize the economic and physical recovery of the resources. AS 38.05.180(a). Approval of the SBPA under the NU 3rd POD and future annually approved plans of development will provide for continued review and approval of Eni’s plans to develop the SBPA in a manner which will maximize economic and physical recovery of the resources.

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

1. Promote the Conservation of All Natural Resources

The unitization of oil and gas reservoirs and the formation of participating areas within unit areas to develop hydrocarbon-bearing reservoirs are well-accepted means of hydrocarbon conservation. Formation of a participating area within an existing unit, with development occurring under the terms of a unit agreement, promotes efficient evaluation and development of the State’s resources, and minimizes impacts to the area’s cultural, biological, and environmental resources.
2. **Promote the Prevention of Economic and Physical Waste**

Approval of the formation of the SBPA will promote prevention of economic and physical waste. Approval of the SBPA will not result in economic waste given the current well spacing, market demand, and anticipated production rates. Annual approval of the SBPA development activities as described in the future plans of development must also provide for the prevention of economic and physical waste.

3. **Provide for the Protection of All Parties of Interest, Including the State**

Diligent exploration and development under a single approved unit plan promotes the State’s interest. The formation of the SBPA advances the efficient development of the State’s resources, minimizes impacts to the area’s cultural, biological, and environmental resources, all of which protects the State’s interest.

Formation of the SBPA protects the economic interests of all parties. Combining interests and operating under the terms of the NU Agreement and NU Operating Agreement ensures an equitable allocation of costs and revenues for the resources underlying the SBPA. The NU Agreement provides for accurate reporting and record keeping, State approval of plans of exploration and development and operating procedures, in-kind taking, and emergency storage of oil and gas, all of which further the State’s interest.

IV. **FINDINGS AND DECISION**

Considering the facts discussed in this document and the administrative record, I hereby make the following findings and decision.

A. **The Conservation of All Natural Resources**

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

b. The development and operation of these leases under the NU Agreement and the SBPA will reduce the amount of land and fish and wildlife habitat that would otherwise be disrupted by individual lease development. This reduction in environmental impacts and preservation of subsistence access is in the public interest.

c. All unit development must proceed according to an approved plan of development. The State, Division, and local agencies have issued various approvals for NU development. Future operations will require similar review and approval. DNR may condition its approval of a future unit plan of operations or permits on performance of mitigation measures. Compliance with mitigation measures will minimize, reduce, or completely avoid adverse environmental impacts.
B. The Prevention of Economic and Physical Waste

1. With the approval of the NU 3\textsuperscript{rd} POD, the Division considered the prevention of economic and physical waste criteria under 11 AAC 83.303(a)(2). The SBPA development activities must be conducted under an annually approved plan of development, which will provide for the future promotion of prevention of economic and physical waste.

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

1. The formation of the SBPA meets the requirements of 11 AAC 83.351 and 11 AAC 83.371, adequately and equitably protects the public interest, and is in the State's best interest.

2. The geological and engineering data provided reasonably justify the inclusion of the proposed acreage within the SBPA under the terms of the applicable regulations governing formation and operation of oil and gas units (11 AAC 83.301 – 11 AAC 83.395) and the terms and conditions under which these lands were leased from the State.

3. The formation of the SBPA will not diminish access to public and navigable waters beyond those limitations (if any) imposed by law or already contained in the oil and gas leases covered by the NU Agreement.

4. The SBPA overlies the Schrader Bluff Formation. The stratigraphic limits of the SBPA are the depths common to and correlating with the interval from 3,530 feet measured depth (MD) to 3,867 MD on the Electromagnetic Wave Resistivity log recorded in the Kigun #1 Well.

5. The Division approves the SBPA tract allocation schedule effective January 1, 2011 for allocating production and costs among the leases in the SBPA. Eni shall report production from the SBPA to royalty accounting unit code NQSB.

6. This approval satisfies the requirement of Article V.C.10 of the decision approving the 1\textsuperscript{st} Nikaitchuq Expansion and the decision approving the extension of the NU. ADL 391283 is committed, in part, to the SBPA, is covered under the NU 3\textsuperscript{rd} POD, and will not contract from the NU.

For the reasons discussed in this Findings and Decision, I hereby approve the formation of the SBPA, effective January 1, 2011.

A person affected by this decision may appeal it, in accordance with 11 AAC 02. This decision takes effect immediately. 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, DNR, 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.

If you have any questions regarding this decision, contact Temple Davidson with the Division at 907-269-8784.

Kevin R. Banks, Director
Division of Oil and Gas

Date

Attachments:
1. Nikaitchuq Unit Exhibit C
2. Nikaitchuq Unit Exhibit D
ATTACHMENT ONE:

Nikaitchuq Unit Exhibit C
# NIKAITCHUQ UNIT AGREEMENT: Exhibit C

## SCHRADER BLUFF PARTICIPATING AREA

### Nikaitchuq Unit Area

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<th>No.</th>
<th>Section</th>
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Total Acres Within Participating Area: 5,711.50

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**Note:** This page contains information about the Nikaitchuq Unit Agreement, specifically regarding the SCHRADER BLUFF PARTICIPATING AREA within the Nikaitchuq Unit Area. The table lists sections and descriptions of lands within the participating area, along with the owners and their respective royalty interests.
ATTACHMENT TWO:

Nikaitchuq Unit Exhibit D
Exhibit D
Nikaitchuq Unit Agreement
Schrader Bluff Initial Participation Area
January 13, 2011