



THE STATE  
of **ALASKA**  
GOVERNOR BILL WALKER

Department of Natural Resources

COMMISSIONER'S OFFICE

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August 1, 2017

VIA HAND DELIVERY AND ELECTRONIC MAIL

John F. Schell, Jr.  
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Anchorage, AK 99510

Re: Reconsideration of the "Colville River Unit Denial of the Fifth Expansion of the Unit Area with Modifications Under Which Approval Will Be Granted – Findings and Decision of the Commissioner of the State of Alaska Department of Natural Resources" date February 17, 2017

Dear Mr. Schell:

Please find my final decision on ConocoPhillips Alaska Inc.'s (CPAI) request for reconsideration of the Department of Natural Resources (DNR) decision denying the 5<sup>th</sup> unit expansion of the Colville River Unit enclosed.

Based on arguments raised by CPAI in its March 15, 2017 request for reconsideration, I find that modifications different than those set forth in the February 17, 2017, "Denial of the Fifth Expansion of the Unit Area with Modifications under which Approval will be Granted" (5<sup>th</sup> Expansion Denial) would better serve the interests of the state. A new decision is warranted to address these different modifications, which are set forth in Section IV of the decision. This decision replaces the 5<sup>th</sup> Expansion Denial.

If CPAI agrees to the modifications (detailed in Section IV of the decision) to their Revised Application for the 5<sup>th</sup> Expansion of the Colville River Unit, then it will be approved as amended with an effective date of June 28, 2016. If CPAI fails or refuses to agree to these modifications by August 14, 2017, the Revised Application will be denied effective August 15, 2017, and thereafter may be appealed as described in the decision. To accept these modifications, please sign and date a copy of the decision and to return it to me on or before August 14, 2017.

Sincerely,

A handwritten signature in blue ink that reads "Andrew T. Mack".

Andrew T. Mack  
Commissioner  
Department of Natural Resources

## **COLVILLE RIVER UNIT**

### **RECONSIDERATION OF THE DENIAL OF THE FIFTH EXPANSION OF THE UNIT AREA WITH MODIFICATIONS UNDER WHICH APPROVAL WILL BE GRANTED**

Findings and Decision of the  
Commissioner of the State of Alaska  
Department of Natural Resources

August 1, 2017

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

This is the Department of Natural Resources (DNR) Commissioner's decision on reconsideration of ConocoPhillips Alaska, Inc.'s (CPAI) June 28, 2016 revised application for the 5<sup>th</sup> Expansion of the Colville River Unit (Revised Application).

On reconsideration, the Commissioner may affirm his decision, issue a new or revised decision, or remand to the Division of Oil and Gas (Division) for further proceedings. 11 AAC 02.020(d). After reviewing CPAI's March 15, 2017 request for reconsideration (Request for Reconsideration) and DNR's relevant public files, the Commissioner again finds that with certain modifications, the Commissioner will approve the Revised Application. As written, without the proposed modifications detailed in Section IV, the Revised Application does not satisfy the factors set forth in 11 AAC 83.303 for approving a unit expansion and cannot be approved.

Based on arguments raised by CPAI in its Request for Reconsideration, the Commissioner finds that modifications different than those set forth in the February 17, 2017, "Denial of the Fifth Expansion of the Unit Area with Modifications under which Approval will be Granted" (5<sup>th</sup> Expansion Denial) would better serve the interests of the state. A new decision is warranted to address these different modifications, which are set forth below in Section IV. This decision replaces the 5<sup>th</sup> Expansion Denial.

If CPAI agrees to the modifications (detailed in Section IV, below) to the Revised Application by signing this decision and returning it to the Commissioner's office on or before August 14, 2017, the 5<sup>th</sup> expansion of the Colville River Unit then will be approved as amended with an effective date of June 28, 2016. If CPAI fails or refuses to agree to these modifications by such date, the Revised Application will be denied effective August 15, 2017.

## **II. BACKGROUND**

The Colville River Unit (CRU) consists of State of Alaska oil and gas leases, ASRC oil and gas leases, jointly-owned State and ASRC oil and gas leases, and United States Bureau of Land Management (BLM) oil and gas leases, and is jointly managed by the State, ASRC, and BLM under the Colville River Unit Agreement (CRU Agreement). CPAI applied to expand CRU to include 21 joint State/ASRC leases to the south of the unit (5<sup>th</sup> Expansion Area). Currently, working interest ownership is not aligned for the proposed 5<sup>th</sup> Expansion Area as CPAI holds 76.63% of the unit excluding the Expansion Area and 100% of the Expansion Area<sup>1</sup>.

These same leases were part of the 2<sup>nd</sup> Expansion of CRU in 2002, referred to then as the Titania Expansion Area. In support of the Titania Expansion, CRU's working interest owners (WIOs) agreed to drill wells by certain deadlines or the WIOs would forfeit payments to DNR and ASRC

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<sup>1</sup> An application to align the interests in the Expansion Area with the rest of the CRU has been received by the Division, but is pending until this reconsideration is resolved.

and the leases would contract from CRU. The WIOs failed to drill and thus the Titania Expansion leases contracted from CRU in 2004 and expired.

DNR re-leased the Titania Expansion acreage to AVCG in multiple sales from 2004-2009. In 2008, AVCG-affiliate Brooks Range Petroleum Corporation (BRPC) drilled three exploration wells (Tofkat #1, Tofkat #1A, and Tofkat #1B) in the eastern portion of that acreage. BRPC discovered hydrocarbons and formed the Tofkat Unit in 2011. BRPC did not take the actions necessary to extend the unit, so the Tofkat Unit expired at the end of its five year term, effective March 31, 2016.

Of the 21 Tofkat Unit leases, 15 were past their primary term and extended only by being included in the Tofkat Unit. AS 38.05.180(m). The Tofkat Unit Agreement extended the expired leases for 90 days past termination of the unit, to June 29, 2016. 11 AAC 83.140. After June 29, the leases would expire unless the lessees were drilling, producing, or had again unitized them. AS 38.05.180(m); 11 AAC 83.140.

The same day the Tofkat Unit expired, CPAI applied to expand the CRU with the Tofkat Unit leases. Unit expansion requires approvals from both DNR and ASRC. (CRU Agreement ¶ 12.1.) The Division rejected the application April 5, 2016 because CPAI held no working interest in the leases and had not proposed including the working interest owners in the unit, as required by 11 AAC 83.328(a).<sup>2</sup>

Six weeks later, on May 13, 2016, CPAI submitted assignment applications to transfer the former Tofkat Unit leases from Caracol Petroleum, LLC, TP North Slope Development, LLC, MEP Alaska LLC, AVCG, LLC, Ramshorn Investment, Inc. and Nabors Drilling Technologies USA, Inc. to CPAI. Under the terms of these leases, an assignment is not effective until approved by both DNR and ASRC.<sup>3</sup> On June 15, 2016, the Division granted the assignments for the 6 unexpired leases and denied assignment of the 15 leases that were past their primary term and had only 19 days remaining in their 90 day extensions.

On June 28, 2016, the day before the 15 leases would expire, CPAI appealed the Division's denial of the 15 lease assignments. That same day, CPAI submitted the Revised Application, but asked the Division to "hold this application in abeyance" pending the outcome of the lease assignment appeal. The Division rejected the Revised Application because CPAI still had no interest in 15 of the 21 leases it was seeking to include in CRU and CPAI had not included the working interest owners of those leases, as required by regulation. 11 AAC 83.328. CPAI appealed DNR's decision to reject its Revised Application. On June 29, ASRC approved the assignment of all the leases, including the 15 that were expiring that day.

On October 3, 2016, CPAI submitted a Plan of Operations to drill the Putu 1 well on the expansion acreage in the first half of 2017. The Plan was consistent with the POD that CPAI had

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<sup>2</sup> Where a decision was issued by the Division, it was by authority delegated by the Commissioner under Department Order 003.

<sup>3</sup> The assignment application included one additional lease, ADL 391924, that was not formerly part of the Tofkat Unit and is not part of the proposed CRU 5<sup>th</sup> Expansion.

submitted as Exhibit D to its Revised Application, which committed to “drill at least one exploration well by June 1, 2017” on the expansion acreage.

On November 3, 2016, the Commissioner reversed the Division’s decision denying the lease assignments for the 15 expired leases, and approved those assignments effective June 1, 2016. The following day, November 4, the Commissioner reversed the Division’s rejection of the Revised Application, finding that the Division had correctly rejected the application at the time but that the Commissioner’s approval of the lease assignments provided CPAI with the interest in the leases it needed to apply for a unit expansion. CPAI resubmitted the filing fee for its expansion application the same day, re-activating the application and starting the clock for a decision. Article 20.4.4 of the CRU Agreement requires DNR and ASRC to decide a unit expansion decision within 120 days of the application or it is deemed denied. DNR and ASRC thus had until March 4, 2017 to issue a decision.

The Division published public notice of CPAI’s Revised Application on November 17, 2016, as required by 11 AAC 83.311. The public comment period closed December 19, 2016 with no public comments received.

On December 12, 2016, CPAI submitted a letter to the Permitting section of the Division, which was reviewing CPAI’s Plan of Operations, stating that it no longer intended to drill the Putu 1 well as planned. CPAI stated that “[d]ue to the proximity of the project to the community of Nuiqsut, CPAI has determined that more time is needed to engage the community and educate residents about the project.” CPAI nevertheless did not amend its Revised Application, which continued to include a POD that committed to drilling at least one well by June 1, 2017.

In its Request for Reconsideration, CPAI stated that some time before or during December 2016, Kuukpik Corporation and ASRC requested that CPAI defer drilling. Request for Reconsideration, p. 7. CPAI further explained in its Request for Reconsideration that residents of Nuiqsut often raise concerns in the local permitting process, and it needed adequate time to engage with the residents regarding its drilling plans. However, CPAI did not submit any such requests to DNR to consider as part of CPAI’s Revised Application, and no persons or entities responded to DNR’s call for public comment. Thus, DNR was unaware of the requests made by ASRC and Kuukpik Corporation, and of the engagement lead time believed necessary for the local residents.

The Commissioner denied the 5<sup>th</sup> Expansion on February 17, 2017. In that decision, the Commissioner found that the Revised Application did not support expanding CRU, but that with certain modifications, he could grant the expansion. Those modifications consisted of (1) a \$2.5 million performance bond to secure CPAI’s commitment to drill and test a well by May 31, 2017; (2) a commitment to drill, log, and test a second well by May 31, 2018 if the first well was unsuccessful; (3) a commitment to start sustained production from the 5<sup>th</sup> Expansion Area by May 31, 2022, guaranteed by a \$10 million production bond; (4) a \$1.5 million bonus bid replacement to partially offset the bonus bids DNR was foregoing by not re-leasing the expansion leases<sup>4</sup> that expire upon denial of a unit expansion; and (5) a commitment to submit a

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<sup>4</sup> The 5<sup>th</sup> Expansion Denial references 15 expired leases. The remaining 6 leases have since expired as of June 30, 2017.

permitting progress report by May 31 each year following successful evaluation of the Nanushuk formation.

The 5<sup>th</sup> Expansion Denial gave CPAI 10 days to accept these modifications and required payment of the bonds and bonus bid replacement by March 1, 2017. CPAI did neither. Thus, the 5<sup>th</sup> Expansion was denied by DNR.

As of March 4, 2017, DNR had not received a decision from ASRC on CPAI's Revised Application. Under Article 20.4.4 the CRU Agreement, therefore, ASRC generally would have been deemed to have denied the 5<sup>th</sup> Expansion application as it was written. However, DNR's 5<sup>th</sup> Expansion Denial included proposed modifications to the application as a condition of approving it. Accordingly, ASRC would not have been able to approve or disapprove of the application as DNR proposed to revise it until after DNR issued its decision, which is now stayed.

CPAI timely submitted a Request for Reconsideration on March 15, 2017.<sup>5</sup> The Commissioner granted reconsideration and a stay of the 5<sup>th</sup> Expansion Denial.

CPAI bases its Request for Reconsideration on four points: (1) the 5<sup>th</sup> Expansion Denial is based on an incomplete record and denies CPAI due process; (2) the development bond modifications proposed in the 5<sup>th</sup> Expansion Denial are not appropriate and are inconsistent with past practice; (3) the 5<sup>th</sup> Expansion Denial erroneously contends that CPAI's surface use agreement by itself permits the drilling of the proposed exploration well; (4) the "protection of all parties in interest" analysis in the 5<sup>th</sup> Expansion Denial is incomplete and in error. Each of these arguments was considered by the Commissioner and detailed responses to these assertions are provided below in Section V.

Representatives from DNR and CPAI met several times to informally discuss the proposed 5<sup>th</sup> Expansion while reconsideration was pending. These meetings were not recorded and thus are not considered herein as part of the record. CPAI requested a hearing in its Request for Reconsideration, but later informed DNR that it no longer wanted a hearing.

### **III. COMMISSIONER'S RECONSIDERATION OF CPAI'S REVISED APPLICATION**

In deciding whether to expand a unit, the Commissioner considers: (1) environmental costs and benefits; (2) geological and engineering characteristics; (3) prior exploration activities; (4) the applicant's plan of exploration or plan of development; (5) economic costs and benefits to the State; (6) conservation of natural resources; (7) economic and physical waste; (8) protection of all parties, including the State; and (9) any other relevant factors, including mitigation measures. 11 AAC 83.303(a)-(c). The Commissioner considers all of these factors and no one factor is

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<sup>5</sup> The Commissioner signed the 5<sup>th</sup> Expansion Denial on Friday February 17, but because of travel schedules and the following holiday weekend, DNR did not email and mail the decision until the following Tuesday, February 21, 2017. CPAI received the decision by certified mail on February 23, 2017, making that the day of "issuance" for purposes of a reconsideration request under 11 AAC 02.040.

dispositive of whether to expand a unit.<sup>6</sup> Pursuant to paragraph 12.1 of the CRU Agreement, the CRU may be expanded to include “additional lands determined to overlie any Reservoir, any part of which is within the Unit Area or to include any additional lands regarded as reasonably necessary for the purposes of this Agreement.”

Article 12.1 of the CRU Agreement further states that unit expansion requires the approval of the State and ASRC (and the United States, as appropriate). Because the 5<sup>th</sup> Expansion consists of joint State/ASRC leases, a unit expansion is not effective until both the DNR Commissioner and ASRC President separately approve the expansion.

In correspondence to DNR dated April 10, 2017, ASRC indicated that it supports the 5<sup>th</sup> Expansion of the CRU, but it has not yet issued a formal decision approving the expansion, likely because ASRC would not have been able to approve or disapprove of the application as DNR proposed to revise it until after DNR issued its decision, which is now stayed. Should CPAI accept the modifications to its Revised Application set forth in this decision, ASRC must still issue a formal approval.

#### **A. Environmental Costs and Benefits**

DNR considers environmental issues during the lease sale process and the unit plan of operations approval process. Alaska statutes require DNR to give public notice and issue a written finding before disposal of the State’s oil and gas resources. AS 38.05.035(e); AS 38.05.945; 11 AAC 82.415. In the written best interest finding, DNR may impose additional conditions or limitations beyond those imposed by law. AS 38.05.035(e). Leases in the 5<sup>th</sup> Expansion Area include lease stipulations to mitigate the potential environmental impacts from oil and gas activity and DNR will evaluate compliance with those stipulations through the separate plan of operations review process. CPAI is operating under an approved plan of operations and has applied for a plan of operations for the 5<sup>th</sup> Expansion Area.

Although oil and gas activity in the proposed unit area may affect some wildlife habitat and subsistence activity, approval of the 5<sup>th</sup> Expansion itself has no direct environmental impact. This decision is an administrative action and does not authorize any on-the-ground activity. The unit expansion does not entail any environmental costs in addition to those that may occur when permits to conduct lease-by-lease exploration or development are issued for the same acreage. To the contrary, expanding the unit may provide efficiencies to minimize environmental impact compared to a separate, lease-by-lease development of this acreage.

#### **B. Geological and Engineering Characteristics and Exploration History**

Three wells have been drilled in the proposed expansion acreage: Tofkat #1 and its sidetracks Tofkat #1A and Tofkat #1B. Tofkat #1 is a directional well that reached a total depth of 13,174’ Measured Depth (MD) in the southeast quarter of Section 16, Township 10 North, Range 6 East,

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<sup>6</sup> Certain issues are also relevant to more than one factor, so the Commissioner’s discussion of an issue in relation to one factor should not be understood as excluding that issue from another factor. For example, an environmental issue might relate to environmental costs and benefits and conservation of natural resources, but for efficiency, the Commissioner might not repeat the same discussion in both sections.



Umiat Meridian (Sec. 16, T10N, R6E, UM). Sidetrack Tofkat #1A reached a total depth of 11,297' approximately 0.7 miles to the southeast of the Tofkat #1 in the southeast quarter of Section 15, T10N, R6E, UM. Sidetrack Tofkat #1B reached a total depth of 15,575' MD approximately 0.8 miles to the northwest of Tofkat #1 in the southwest quarter of Section 9, T10N, R6E, UM. A comprehensive review of the drilling results of the Tofkat wells was included as part of the October 28, 2011 Findings and Decision of the Director, Approval in Part of the Application to Form the Tofkat Unit. This discussion will highlight prospective reservoir zones sand thicknesses encountered in the wellbores within the following geologic intervals (listed from shallower to deeper); Cretaceous Nanushuk Group, Cretaceous Torok Formation, lower Cretaceous Kuparuk C sandstone, and the Alpine sandstone within the Jurassic Kingak Formation within the proposed expansion acreage.

#### Cretaceous Nanushuk and Torok Formations

As mentioned in the October 28, 2011 Findings and Decision of the Director, Approval in Part of the Application to Form the Tofkat Unit, the three Tofkat wells (#1, #1A, and #1B) encountered two intervals of hydrocarbon bearing strata within the Nanushuk Formation. In the Tofkat #1 well, the Nanushuk intervals were penetrated between approximately 6,119' and 6,317' MD (-4,100' to -4,198' subsea). The Tofkat #1 well also encountered a hydrocarbon bearing zone in the Albian-age Torok Formation turbidite interval between 10,995' and 11,190' MD (-6,547' to -6,648' subsea).

Tofkat #1 recovered oil samples from both the Nanushuk and Torok Formations via Modular Dynamic Tester (MDT) logging tool. Three fluid samples were taken from a Nanushuk sandstone at 6,168' MD. The MDT tool recovered oil of approximately 23 degree API gravity when corrected for oil-based mud contamination (35 degree API uncorrected). Two fluid samples were taken from a second Nanushuk sandstone at 6,294' MD. The MDT recovered oil corrected to approximately 14 degree API (35 degree API uncorrected). The sample from the Torok turbidites at 11,000' MD recovered 38 degree API gravity oil.

Drawdown mobility was also measured in the upper and lower Nanushuk intervals via MDT tool in the Tofkat #1. The MDT measurements from the upper Nanushuk, between 6,135' and 6,160' MD, indicate draw-down mobility in the range of 0.05 to 0.29 millidarcy/centipoise viscosity (md/cp), generally considered non-pay in conventional reservoir terms. The MDT draw-down mobility measured in the lower Nanushuk interval at 6,294' MD ranged from 2-7 md/cp, suggesting likely conventional pay depending on the expected fluid viscosity.

#### Kuparuk C sandstone

The Tofkat #1 well encountered approximately 8 feet True Vertical Thickness (TVT) of hydrocarbon bearing sandstone within the Kuparuk Formation between 11,932' -11,950' MD (-7027' and -7035' subsea). The upper 6 feet TVT of the interval penetrated by the well bore appears to contain secondary siderite cement. One fluid sample was taken from the lower portion of the Kuparuk C unit at 11,943' via MDT. The MDT sample contained 42 degree API gravity oil, similar to the oil gravity in the Nanuq-Kuparuk Participating Area at CRU (40 to 41 degree API).

The two sidetracks were drilled from the Tofkat #1 wellbore in an attempt to delineate the extent of the Kuparuk C accumulation. Tofkat #1A well encountered approximately 4 feet TVT of non-reservoir Kuparuk C sandstone between 11,112' and 11,121' MD (-7,033' and -7,037' subsea). Tofkat #1B well encountered approximately 6 feet of non-reservoir Kuparuk Formation between 15,374' and 15,388' MD (-7,061' and -7,067' subsea).

### Jurassic Alpine Potential

The west side of the proposed expansion area is along trend with the CRU Alpine production in the CD4 area. The southernmost row of production and injection wells in the CRU Jurassic Alpine C reservoir abuts against the northern boundary of proposed expansion acreage. Well logs indicate the Tofkat #1 well penetrated 6 feet TVT of Alpine C sandstone (12,779' to 12,790' MD (-7,454' to -7,460' subsea). As mentioned in the October 28, 2011 Findings and Decision of the Director, Approval in Part of the Application to Form the Tofkat Unit, the Alpine C penetrated by the Tofkat 1 well may be interpreted as a non-reservoir quality transgressive lag preserved atop the Upper Jurassic Unconformity surface. No cores, well tests, or MDT sampling was attempted in this interval in Tofkat #1. The Tofkat #1A and #1B sidetracks were not drilled to a sufficient depth to penetrate and evaluate the Jurassic potential.

The Revised Application is sufficiently supported by technical data submitted by the operator. Data submitted to DNR include maps, well log cross-sections through prospective reservoirs, seismic attribute displays, annotated seismic lines through prospective reservoirs, and an explanation of CPAI's proposed exploration drilling program.

Review of the geological, geophysical, and engineering data has allowed DNR to reasonably establish the potential for the Kuparuk, Alpine, and Brookian intervals in the proposed expansion acreage. Each of these prospective intervals currently produces oil in the adjacent CRU and satisfies the criteria in 12.1 of the Unit Agreement.

### **C. Plans of Development**

The Revised Application included a Plan of Exploration/Plan of Development at Exhibit D, describing plans to drill at least one exploration well by June 1, 2017 within the 5<sup>th</sup> Expansion Area. The well was to be drilled from an ice pad and tested if results were encouraging. CPAI planned to review the results of the well data in 2017 and 2018. If an additional appraisal well was needed, CPAI would drill during the 2020 winter drilling season.

The Division approved the 19th CRU Plan of Development (POD) effective May 9, 2017 for the period May 16, 2017 through May 15, 2018. The POD describes plans to continue drilling development wells in the Nanuq-Kuparuk and Alpine participating areas, including one well within the 5<sup>th</sup> Expansion Area subject to the approval of the Revised Application.

The risk that this expansion, as described in the Revised Application, may not result in any production, or may not result in accelerated production (compared to a new lessee's capability if the 5<sup>th</sup> Expansion Area leases are made available in the next North Slope Areawide lease sale), requires CPAI to make strong work commitments to evaluate the potential for development on a

reasonable timeline. A POD that includes a specific series of work commitments to steadily progress the 5<sup>th</sup> Expansion Area to production would support unit expansion. The Commissioner has set forth POD modifications below to provide these commitments. The modifications include commitments to drill two wells, one by 2018 and one by 2020. At the same time, the modifications consider the possibility of unsuccessful wells and of CPAI electing not to pursue development in the 5<sup>th</sup> Expansion Area.

The POD modifications described in this decision regarding an obligation to drill the first well are generally consistent with the modifications proposed in the 5<sup>th</sup> Expansion Denial, but on a one year delay, and they allow the voluntary contraction and relinquishment of the leases to replace the \$2.5 million drilling bond requirement previously proposed. In its Request for Reconsideration, CPAI suggested that voluntary relinquishment of the 5<sup>th</sup> Expansion Area leases if it failed to meet work commitments would protect the State's interests in ensuring diligent work towards production or would allow the leases to be put into a lease sale on a reasonable timeline equally or better than a \$2.5 million development bond. DNR agrees.

The State has a significant interest in diligently moving these leases towards production, which would be accomplished by a well drilled by 2018. If such a well is not drilled, or if CPAI chooses not to move towards production, then the prompt relinquishment of the leases in order to allow them to be re-leased is equal or better protection than a \$2.5 million development bond, where the leases would remain undeveloped. This change in the proposed POD modification by the Commissioner does not mean that the 5<sup>th</sup> Expansion Denial was in error by requiring a bond. Rather, it indicates that the voluntary contraction proposed by CPAI in its Request for Reconsideration accomplishes the same goal and is an acceptable modification to protect the State's interest. As voluntary contraction was not offered in the Revised Application, the financial penalty of a performance bond was an appropriate approach at the time of the 5<sup>th</sup> Expansion Denial. The offer and commitment by CPAI to forego its lease interests in the event of non-performance accomplishes the same objective.

The modifications to CPAI's Revised Application proposed in this decision also take into consideration the issues raised by CPAI in its Request for Reconsideration relating to the premature financial commitment to produce from the 5<sup>th</sup> Expansion Area prior to the opportunity to evaluate the options to do so. CPAI suggests that a \$10 million production bond requirement, where there is insufficient information to even evaluate production prospects is not appropriate. After reconsideration, this decision requires two appraisal wells to be drilled in order to evaluate development options prior to making a commitment to develop the area. This decision also replaces the \$10 million production bond which the state would have received if CPAI held the leases without establishing production by May 31, 2022, with \$7 million in payments to the state if CPAI drills the appraisal wells and intends to move towards production after such wells are drilled. It also requires an earlier return of the leases if CPAI fails to drill the wells. While either option adequately protects the State's interests, the proposed modifications in this decision provide a better balance of diligent work towards production and actual compensation to the State, backed by the ability to promptly re-lease the acreage if the leases are not being moved diligently towards production, while also considering CPAI's concerns about premature financial commitments.

#### **D. The Economic Benefits and Costs to the State**

As the Commissioner explained in 5<sup>th</sup> Expansion Denial, expanding the CRU poses both economic benefits and costs to the State, as the 5<sup>th</sup> Expansion Area leases would expire if not unitized. These resources may be developed either as part of CRU or by re-leasing the expired leases through a competitive lease sale. However, if the leases are unitized, it is possible that the expansion acreage could be held indefinitely by production from the unit rather than production from the expansion leases. In determining how to balance this potential benefit and cost, three factors are important: (1) the uncertainty around actual production from the expansion leases, (2) the time to production from the expansion leases by CPAI versus another lessee; and (3) the amount of the bonus bids that would likely be collected in a lease sale.

The first factor turns on whether or not CPAI would actually progress the expansion leases towards production from the leases, or whether it would hold them solely on the basis that they were included in a unit under AS 38.05.180(m). Allowing the leases to be unitized at a time when the leases were about to expire, only to result in no development towards production, would be contrary to the State's interests and would require denial of the expansion application.

Regarding the second factor, an additional concern is whether the 5<sup>th</sup> Expansion will result in more *expeditious* production than re-leasing the acreage in a competitive lease sale. Even if the State eventually recovers the same taxes and royalties from another lessee, a shorter delay in receiving those revenues is a quantifiable benefit to the State because of the time value of money. CPAI's POD indicates that it can reach portions of the 5<sup>th</sup> Expansion Area from the existing CD4 drilling pad with its Extended Reach Drilling (ERD) rig which is currently under construction. If this proves true, it supports CPAI's contention that it can produce the area more quickly than a new lessee since the existing pad and facilities likely will not need extensive new permitting, authorizations, or construction. But if CPAI cannot develop the 5<sup>th</sup> Expansion Area using existing facilities, its timeline may be no more expeditious than a new lessee's. The modifications proposed herein allow CPAI and the State to determine if expedited production is feasible, and for CPAI to relinquish the leases if it is not.

As for the third factor, the 5<sup>th</sup> Expansion also creates a potential economic cost to the State in the form of lost bonus bids. Without the expansion, the State could re-lease this acreage. In a competitive lease sale, the State receives payments called "bonus bids" from high bidders. If the 5<sup>th</sup> Expansion is granted and then the 5<sup>th</sup> Expansion Area is developed on the same schedule as a new lessee could conduct, the result would be equivalent revenue in royalties and taxes without a bonus bid.

While the Commissioner does believe that CPAI is in a better position to bring this area into production more quickly than another party, the State must ensure that there is a commitment to move this area into production, and must also receive some compensation for the risk of lost bonus bids without accelerated production if CPAI ultimately cannot develop the 5<sup>th</sup> Expansion Area more quickly than another lessee. In the 5<sup>th</sup> Expansion Denial, the Commissioner found that the combination of a \$1.5 million bonus bid replacement combined with a \$10 million production bond, conditioned on bringing the 5<sup>th</sup> Expansion Area into production within 5 years, was sufficient to compensate the state for that risk. Upon reconsideration, the Commissioner finds that a payment of \$3 million in 2018 and \$4 million in 2020, upon CPAI deciding to keep

the leases, better protects all parties, as described below, while adequately compensating the state for these risks.

Despite CPAI's argument that the State should not require a bonus bid replacement at all, the Commissioner finds that a risk-weighted estimate of the value of the lost bonus bids is appropriate and is consistent with past practice. The State has required bonus bid replacement payments in the past, including from CPAI when DNR delayed mandatory contraction of the CRU.

As for the potential loss from a lease sale, the Commissioner has reviewed the amount of past bonus bids in the area. Winning bonus bids for nearby acreage adjacent to the CRU have ranged from \$1000 to \$3500 per acre in recent years. Based on the State's interest in each of these leases, the State's share would range between \$4.5 million (based on \$1000 per acre) and \$15.8 million (based on \$3500 per acre).<sup>7</sup>

Considering this range, and deducting a portion of that amount to account for the value of possible accelerated production, the Commissioner finds that two bonus bid replacements of \$3 million and \$4 million adequately compensate the state for the risk of potential lost bonus bids if CPAI retains the leases. This finding differs from the 5<sup>th</sup> Expansion Denial which required a \$1.5 million bonus bid replacement and a \$10 million bond tied to establishing production by 2022. Upon reconsideration, the Commissioner finds that the faster, two-payment option, coupled with a voluntary contraction which would allow the Expansion Area leases to be available for the 2018 lease sale<sup>8</sup>, better, or at least equally, protects the interests of the State in terms of financial compensation and protection of all parties' interests.

Additionally, the State receives an economic benefit in the form of employment and economic activity if CPAI conducts its exploration and development using Alaska residents and businesses. Therefore, it is important to the State that CPAI attempt to acquire such labor, goods, and services from Alaskan residents and businesses to the extent possible.

#### **E. Promote the Conservation of All Natural Resources**

A unit may be formed under AS 38.05.180(p) "[t]o conserve the natural resources of all or a part of an oil or gas pool, field, or like area." Conservation of the natural resources of all or part of an oil or gas pool, field or like area means "maximizing the efficient recovery of oil and gas and minimizing the adverse impacts on the surface and other resources." 11 AAC 83.395(1). The unitization of oil and gas reservoirs or accumulations and the formation and expansion of unit areas to develop hydrocarbon-bearing reservoirs or accumulations are well-accepted means of hydrocarbon conservation. Unitization, with development occurring under the terms of a unit

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<sup>7</sup> These number was derived by multiplying the acreage in each lease by the rate per acre (\$1000 or \$3500) and then multiplying by the percentage of the State's ownership in that lease. The acreage and percentage State ownership for each lease are set forth in the "Application and Lease Summary" section of the 5<sup>th</sup> Expansion Denial, incorporated by reference into this decision.

<sup>8</sup> It is assumed that the leases could not be included in the 2017 lease sale due to logistical challenges associated with jointly-managed lands. Therefore, no potential economic harm is borne by the state until 2018, at which time a bonus bid replacement is required if the lands are not put into the lease sale.

agreement, can promote efficient evaluation and development of the State's resources, and minimize impacts to the area's cultural, biological, and environmental resources.

#### **F. The Prevention of Economic and Physical Waste**

Unitization, as opposed to activity on a lease-by-lease basis, may prevent economic and physical waste. Economic waste is often referred to as the drilling of wells in excess of the number necessary for the efficient recovery or delineation of the oil and gas in place. Physical waste, among other things, includes the inefficient, excessive, or improper use of, or unnecessary dissipation of, reservoir energy.

Unitization may also prevent economic and physical waste by eliminating redundant expenditures for a given level of production, or by avoiding loss of ultimate recovery with the adoption of a unified reservoir management plan. Annual approval of the CRU development activities, as described in the future plans of development, must also provide for the prevention of economic and physical waste. Using the CRU infrastructure and facilities would eliminate the need to construct stand-alone facilities.

Expanding the unit will do nothing to prevent economic and physical waste if the expansion area is not developed in concert with the rest of the unit. If leased through the competitive process, the working interest owners could combine this area into their own unit, thus preventing the economic and physical waste of lease-by-lease development. The potential development from existing facilities is a significant factor supporting CRU expansion.

#### **G. The Protection of All Parties in Interest, Including the State**

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). Development of the expansion area under future annually approved plans of development will provide for continued review and approval of CPAI's plans to develop the CRU in a manner which will maximize economic and physical recovery. Combining interests and operating under the terms of the CRU Agreement and CRU Operating Agreement assures an equitable allocation of costs and revenues commensurate with the resources.

Upon reconsideration of the 5<sup>th</sup> Expansion Denial, the Commissioner finds that the 5<sup>th</sup> Expansion of the CRU, with the modifications required by this decision, protects all parties in interest, including the state. The interested parties in the 5<sup>th</sup> Expansion include CPAI and the other CRU working interest owners, ASRC, residents of the Village of Nuiqsut, the State, and the public.

The expansion particularly benefits CPAI, who owns 100% working interest in the 5<sup>th</sup> Expansion Area leases and would lose the 21 expired leases if they are not included in the unit. In its Request for Reconsideration, CPAI contends that its interests are not fully considered by the requirement of a \$10 million production bond prior to the opportunity to evaluate the potential to explore the 5<sup>th</sup> Expansion Area. The Commissioner agrees, and has adjusted the modifications in this decision to instead require that future development plans and progress towards production be addressed in future PODs.

Anadarko's interests, as a working interest owner in the CRU, are not injured by inclusion of the 5<sup>th</sup> Expansion Area in the CRU area as they have voting rights within the unit operating agreement that manages the use of facilities and authorization for expenditures within the expanded unit.

The residents of Nuiqsut have an interest in surface activities in the 5<sup>th</sup> Expansion Area. The environmental and conservation benefits discussed above would also protect residents' interests in minimizing adverse impacts from oil and gas activities.

The 5<sup>th</sup> Expansion, under the modifications proposed herein, promotes the State's economic interests because it will maximize hydrocarbon recovery, providing additional production-based revenue from increased production. Diligent exploration and development under a unified plan of development without the complications of competing leasehold interests promote the State's interest. Operating under the CRU Agreement provides for accurate reporting and record keeping, State approval of plans of exploration and development and operating procedures, royalty settlement, in-kind taking, and emergency storage of oil and gas, all of which will further the State's interest.

Approving CPAI's Revised Application without the proposed modifications would represent an unacceptable risk of loss to the State as described above and must be mitigated through the modifications in Section IV to protect the State's interest.

In many respects, ASRC's and the State's interests align as co-lessors of the 5<sup>th</sup> Expansion Area, in particular the interests in development and production of the resources. As to ASRC's separate interests, ASRC submitted a letter on April 10, 2017 to DNR, taking issue with some of the proposed modifications in the 5<sup>th</sup> Expansion Denial. DNR believes that the different modifications proposed in this decision address ASRC's concerns. If CPAI accepts the modifications set forth below, ASRC will have an opportunity to approve or deny CPAI's Revised Application, as modified.

#### **IV. MODIFICATIONS NECESSARY TO APPROVE THE 5TH EXPANSION**

Considering the criteria in 11 AAC 83.303(a)-(b), the facts and arguments CPAI raised in its Revised Application and Request for Reconsideration, and public files related to 5<sup>th</sup> Expansion Area, the Commissioner has determined that the following modifications are necessary before the 5<sup>th</sup> Expansion can be approved. These modifications will become part of CPAI's CRU POD for May 16, 2017 through May 15, 2018 POD period, subject to the same unit agreement and regulatory requirements and enforcement as any POD. CPAI must further incorporate these modifications into each subsequent annual CRU POD until (1) CPAI begins sustained production from the 5<sup>th</sup> Expansion Area; or (2) the 5<sup>th</sup> Expansion Area is no longer part of CRU, whichever happens sooner.

1. By May 31, 2018, CPAI will drill a well in the 5<sup>th</sup> Expansion Area to the Nanushuk formation, log the Nanushuk formation, and if appropriate test the well (2018 Well Commitment).

2. If CPAI fails to timely complete the 2018 Well Commitment for any reason, CPAI will voluntarily contract the 5<sup>th</sup> Expansion Area from CRU and surrender the 5<sup>th</sup> Expansion Area leases. CPAI will submit this voluntary contraction and lease surrender paperwork on or before August 15, 2018.
3. If CPAI timely completes the 2018 Well Commitment but CPAI determines for any reason that it will not drill an additional well into the 5<sup>th</sup> Expansion Area by May 31, 2020, then CPAI will voluntarily contract the 5<sup>th</sup> Expansion Area from CRU and surrender the 5<sup>th</sup> Expansion Area leases. CPAI will make this determination and submit this voluntary contraction and lease surrender paperwork on or before August 15, 2018.
4. If CPAI timely completes the 2018 Well Commitment and determines that it intends to drill an additional well into the 5<sup>th</sup> Expansion Area by May 31, 2020, then on or before August 15, 2018, CPAI will:
  - a. Make a \$3 million bonus bid replacement payment to DNR; and
  - b. Submit a POD or POD amendment that commits to drill a second well into the 5<sup>th</sup> Expansion Area to the Nanushuk formation, log the Nanushuk formation, and if appropriate test the well by May 31, 2020 (2020 Well Commitment);
5. If CPAI fails to timely complete the 2020 Well Commitment for any reason, CPAI will voluntarily contract the 5<sup>th</sup> Expansion Area from CRU and surrender the 5<sup>th</sup> Expansion Area leases. CPAI will submit this voluntary contraction and lease surrender paperwork on or before August 14, 2020.
6. If CPAI timely completes the 2020 Well Commitment, but determines for any reason that it will not commit to a development plan for the 5<sup>th</sup> Expansion Area in its May 16, 2020 through May 15, 2021 POD period (2021 POD), then CPAI will voluntarily contract the 5<sup>th</sup> Expansion Area from CRU and surrender the 5<sup>th</sup> Expansion Area leases. CPAI will make this determination and submit this voluntary contraction and lease surrender paperwork on or before August 14, 2020.
7. If CPAI timely completes the 2020 Well Commitment and determines that it intends to continue operations towards bringing the 5<sup>th</sup> Expansion Area into sustained production, then on or before August 14, 2020, CPAI will:
  - a. Submit a POD or POD amendment that describes a development plan and commits to conducting operations during the 2021 POD period that will progress the 5<sup>th</sup> Expansion Area toward sustained production; and
  - b. Make a \$4 million bonus bid replacement payment to DNR; or
  - c. Upon providing documentation that the work performed to complete the 2018 Well Commitment and 2020 Well Commitment was conducted utilizing more than 15% North Slope residents and more than 80% Alaskan residents, make a \$3.5 million bonus bid replacement payment to DNR.
8. In its May 16, 2021 through May 15, 2022 POD submittal and thereafter in each annual POD submittal until sustained production is achieved, CPAI must show that it will conduct development activities and operations intended to bring the expansion area into production in a diligent manner and within a reasonable timeframe.



## **V. RESPONSES TO ISSUES RAISED IN THE REQUEST FOR RECONSIDERATION**

CPAI provided some additional facts and arguments in its Request for Reconsideration. While CPAI's Request for Reconsideration largely consists of legal and policy arguments that are mostly unfounded and thus did not factor into the Commissioner's reconsideration, because these arguments were raised and are somewhat troubling, DNR is providing responses to those arguments.

### **A. CPAI's Due Process Arguments Are Unfounded.**

CPAI contends that DNR based its 5<sup>th</sup> Expansion Denial on an incomplete record and denied CPAI due process. These arguments are factually and legally unfounded. As discussed below, DNR followed its regulatory processes to adjudicate the Revised Application — processes that have been upheld by courts and that provided CPAI with due process.

CPAI repeatedly argues that the Commissioner denied the 5<sup>th</sup> Expansion without first holding a hearing. But neither the CRU Agreement nor the relevant regulations provide for a hearing on an application to expand a unit. Nor does due process require a hearing before an initial decision on an application. The hallmarks of procedural due process are notice and an opportunity to be heard. Critically, due process calls for notice and opportunity to be heard during an agency's overall adjudication, not at a particular stage in the process. As with many DNR oil and gas matters, the process for a unit expansion involves an expansion application, then public notice and comment, then a decision by the Commissioner (or Commissioner's delegate), and finally an appellate process. 11 AAC 02.010 *et seq.*; 11 AAC 83.306; 11 AAC 83.311; 11 AAC 83.356. It is at the appeal stage when an applicant may request a hearing, and even then, it is within the Commissioner's discretion whether to grant a hearing to resolve factual issues. 11 AAC 02.050(a). Alaska courts have never held that DNR must provide a hearing on a unit action *before* the appeal stage. To the contrary, the Alaska Supreme Court has held that DNR's procedures, including its discretion to hold a hearing or limit the "opportunity to be heard" to written submissions complies with due process. *See, e.g., AU Int'l, Inc. v. State, Dep't of Natural Res.*, 971 P.2d 1034, 1040 (Alaska 1999) (DNR provided due process by allowing an appeal to be presented in writing, and did not violate due process by denying a hearing request).

Even if the argument was accepted that some aspect of the initial adjudication process violated CPAI's due process rights, the due process that the Commissioner provided to CPAI on reconsideration moots any earlier violation. *See, e.g., Gold Country Estates Pres. Group, Inc. v. Fairbanks North Star Borough*, 270 P.3d 787, 798 (Alaska 2012) (due process violations in initial proceeding mooted by due process provided in review proceeding); *City of North Pole v. Zabek*, 934 P.2d 1292, 1298 (Alaska 1997) (same); *McMillan v. Anchorage Cmty. Hosp.*, 646 P.2d 857, 866-67 (Alaska 1982) (same). CPAI had the opportunity to submit written materials in support of reconsideration, and it did so. CPAI had the opportunity to request a hearing, and it did so before choosing to withdraw that request.

CPAI further argues that the Commissioner denied it due process by not discussing his concerns with CPAI before issuing his decision. The claim that DNR did not discuss the 5<sup>th</sup> Expansion with CPAI is contradicted by CPAI's multiple references to meetings between CPAI and DNR

regarding this very topic. (Request for Reconsideration, pp. 3, 7.) The Commissioner also referred to these meetings in his decision. (5<sup>th</sup> Expansion Denial, pp. 10, 12.) To the extent there are any outstanding questions about the content of these discussions, the Commissioner need not resolve them because this reconsideration decision is based on CPAI's written submissions and public file documents. And even if these discussions had not taken place, CPAI has been provided its opportunity to be heard through the reconsideration process.

CPAI also refers to "delay[s]" by the Commissioner. (Request for Reconsideration, pp. 3, 7.) To the extent CPAI is arguing that a delay violated due process, that argument is unfounded. First, there is no evidence of undue delay. CPAI twice submitted a deficient expansion application that failed to comply with the regulatory requirement to include the WIOs of the 5<sup>th</sup> Expansion leases. 11 AAC 83.328. At the time of the first deficient expansion application, March 31, 2016, CPAI had not even applied for the lease assignments that would allow it to expand the unit without including other parties. It took another six weeks for CPAI to submit those assignment applications. It is common for lease assignment applications to take weeks or months for DNR to adjudicate — something CPAI had reason to know from its past experience with DNR lease assignments. DNR adjudicated this assignment application in about a month. CPAI then appealed the decision, and about three months later the Commissioner issued a decision on the assignments, which allowed CPAI to seek an expansion without bringing in additional parties. DNR then followed its regulatory process: it public noticed the Revised Application, allowed at least 30 days for comment, and issued a decision on the Revised Application within the 60-day regulatory time period. 11 AAC 83.311; 11 AAC 83.316. DNR's decision also fell well within the 120-day deadline set by the CRU Agreement. The overall process from initial deficient application in March 2016 to the February 17, 2017 decision did take nearly a year, as administrative processes are wont to do. But the time was largely dictated by CPAI's own actions and the time periods set forth in regulation and the unit agreement.

Second, even if there was delay, the Alaska Supreme Court has "never held that administrative delay alone, without prejudice, violates due process." *Alvarez v. State, Dep't of Admin., Div. of Motor Vehicles*, 249 P.3d 286, 293 (Alaska 2011); *see also Brandal v. State, Commercial Fisheries Enhy Comm'r*, 128 P.3d 732, 740 (Alaska 2006) ("[W]e have never held that delay alone, with no accompanying prejudice, constitutes a violation of the right to due process."). CPAI did not, and could not, demonstrate prejudice here; it was CPAI's own deficient applications that extended the administrative process. Furthermore, CPAI has not been deprived of any property right. Its applications for assignment and expansion conferred no property right in any particular outcome, and even though the leases expired on June 29, 2016, DNR has not asserted that CPAI may not obtain those leases and apply to include them in the CRU because of such expiration. Rather, because the expansion application was filed before the expiration date, DNR has adjudicated that application.

CPAI also argues that the Commissioner based his decision on an incomplete record. This argument assumes that the onus falls on DNR to create a record. To the contrary, it is up to CPAI, as the applicant, to provide the support for its application. If there were additional or different facts that CPAI wanted the Commissioner to consider, CPAI could have amended its application to provide those facts. Similarly, it was up to CPAI to present the facts and arguments it wanted the Commissioner to consider on reconsideration. The Commissioner's

decision is based on the facts and argument CPAI chose to submit and the record CPAI chose to create.<sup>9</sup>

### **B. CPAI's Argument About Development Plan Content is Misplaced.**

CPAI contends that it is not DNR's "standard practice" to require "a full development plan before a successful exploration well is drilled." (Request for Reconsideration, p. 4.) However, the proposed modifications in the 5<sup>th</sup> Expansion Denial only required that sustained production be established by 2022 and required that annual updates show how CPAI activities were progressing towards the production goal. This is not a full development plan. CPAI did not provide any factual basis for contending that DNR deviated from its purported "practice" or a specific regulatory interpretation by expecting development plans in a POD.<sup>10</sup> Fatally, CPAI's argument does not even identify which regulations DNR has allegedly "unilaterally change[d] its interpretation." DNR has not been able to itself discern which regulations CPAI believes it re-interpreted, and neither of the cases cited by CPAI are on point with its argument that DNR cannot change its interpretation of a regulation without undergoing an APA rulemaking process.<sup>11</sup> Even if DNR had changed any of its regulatory interpretations, the United States and Alaska Supreme Courts have both "recognized that an agency may 'flatly repudiate' previously devised norms . . . provided that the agency explains its departure." *May v. State, Commercial Fisheries Entry Comm'n*, 168 P.3d 873 (Alaska 2007) (quoting *Atchison, Topeka & Santa Fe Ry. Co. v. Wichita Bd. of Trade*, 412 U.S. 800, 808 (1973)). The Commissioner has the discretion to determine whether and when bonds may be appropriate modifications that would qualify a POD for approval under 11 AAC 83.303. See AS 38.05.020(b)(4); 11 AAC 83.343(b). This does not amount to unauthorized rulemaking.

### **C. The Commissioner's Timeline Was Based on CPAI's Representations.**

CPAI argues that it is unreasonable to expect production in five years because of various events such as permitting delays that could occur. The expectation for production by 2022 was based on CPAI's own statements in discussions with the Commissioner that it could do so within five years. This claim that CPAI could produce in five years was consistent with statements in its Revised Application indicating that portions of the 5<sup>th</sup> Expansion Area might be developed from CD4, and thus not need additional time for infrastructure. CPAI has also previously represented

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<sup>9</sup> In the course of asserting due process violations, CPAI attempts "[t]o clarify" its various statements about its commitment to drill in 2017. This too is a situation of CPAI's own making. CPAI submitted a POD in support of its Revised Application that stated it would drill in 2017. CPAI later informed the Permitting section that it did not intend to move forward on its Plan of Operation application for drilling this well, but never amended the POD that supported its Revised Application. CPAI is a sophisticated party. It should have known that when the basis for an application changes, an applicant needs to update the application.

<sup>10</sup> PODs must include both development plans for the entire unit and exploration plans for areas outside of a participating area. 11 AAC 83.343(a)(1), (a)(2). They must also comply with the provisions of 11 AAC 83.303. 11 AAC 83.343(b).

<sup>11</sup> *Jerrel v. State*, 999 P.2d 138, 143-44 (Alaska 2000) involved an informal agency policy that needed to be set forth in regulation and *State v. Nondalton Tribal Council*, 268 P.3d 293, 304 (Alaska 2012) involved an area plan, which did not impact the public enough to be a regulation. Neither case involves application of an existing regulation.

to DNR that its ERD rig would arrive in 2021, making production within five years reasonable. Nevertheless, this requirement has been changed.

#### **D. DNR Cannot Contract Away Its Regulatory Discretion.**

DNR has regulatory discretion to contract CRU at any time because the unit has been in place more than 10 years. 11 AAC 83.356(e). In the Revised Application, CPAI asked DNR to agree that the 5<sup>th</sup> Expansion Area will not be contracted before June 1, 2025. The Commissioner denied this request because it is prohibited from contracting away its regulatory discretion under *Exxon Corp. v. State*, 40 P.3d 786, 796 (Alaska 2001).

In its Request for Reconsideration, CPAI contends that it did not ask DNR to “contract away” its regulatory discretion, only to “agree” not to exercise that discretion. (Request for Reconsideration, pp. 5-6.) But DNR cannot agree not to exercise this discretion. There are limits to this discretion, and CPAI would have notice and opportunity to be heard before DNR ever exercised it. 11 AAC 83.356(e); *see also* CRU Agreement ¶ 12.6. But it remains a matter of discretion that DNR is simply without power to give up.

DNR may of course defer mandatory contraction under 11 AAC 83.356(a), and it has done so for CRU in the past. If CPAI understood previous delays of mandatory contraction to be agreements not to exercise discretionary contraction, that understanding was and is incorrect.

As far as discretionary contraction, DNR has not given the CRU working interest owners notice of any intent to contract the CRU. If that ever happens, CPAI may raise its arguments against contraction at that time.

#### **E. The 5<sup>th</sup> Expansion Denial Does Not State that CPAI’s Kuukpik Surface Use Agreement is a Permit.**

CPAI contends that the Commissioner erred by considering CPAI’s Surface Use Agreement with Kuukpik to be a permit. However, nowhere in the 5<sup>th</sup> Expansion Denial did the Commissioner characterize CPAI’s alleged Kuukpik surface use agreement as a permit. Rather, the Commissioner pointed out that if this agreement is what CPAI has represented, then the surface use owner, Kuukpik, has already consented to responsible oil and gas activities in the surface area. (5<sup>th</sup> Expansion Denial, pp. 10-11.) The Commissioner further pointed out that Kuukpik had already entered an agreement with ASRC in 1992 consenting for *any* lessee of joint State/ASRC land, such the 5<sup>th</sup> Expansion Area, to use the surface for “Oil and Gas Activities.”<sup>12</sup> The Commissioner did not refer to these agreements as permits, so CPAI’s argument that they are not permits is inapposite.

CPAI further contends that the 5<sup>th</sup> Expansion Denial did not recognize concerns of residents or CPAI’s efforts to engage residents. No such concerns were raised in the call for public

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<sup>12</sup> Section 1.9 of the 1992 agreement states that “‘Oil and Gas Activities’ shall mean any and all activities, including leasing, reasonably necessary for exploration, development, production and removal of oil, gas and associated hydrocarbons, and shall include any and all activities with respect to such oil, gas and associated hydrocarbons for which Kuukpik’s consent is required pursuant to Section 14(f) of ANCSA.”

comments on the Revised Application, nor did CPAI raise any such concerns before DNR's 5<sup>th</sup> Expansion Denial was issued. On reconsideration, the Commissioner considered CPAI's statements regarding the concerns of residents and the requests CPAI received to not drill the well in 2017.

**F. The 5<sup>th</sup> Expansion Decision Did Not Omit Public Comments.**

CPAI accuses the Commissioner of omitting information and comments that DNR received regarding the Revised Application. As the Commissioner stated in the 5<sup>th</sup> Expansion Denial, DNR received no public comments on the Revised Application. The Commissioner cannot err in failing to address documents if no such documents exist.

**G. CPAI Falsely Equates a Private Lease Assignment with a Public Lease Sale.**

CPAI argues that the Commissioner erred in raising the public's interest in competitive lease sales because "[t]he former Toklat Unit lessees were free to solicit interest for a potential transaction with any other party qualified to own state lease interests, which is the same regulatory hurdle for participating in a state competitive oil and gas lease sale." (Request for Reconsideration, p. 8.) CPAI is correct that the qualification to hold a lease is the same whether a lessee acquired the lease through an assignment or a competitive lease sale. 11 AAC 82.200. But the qualification requirements are irrelevant to the issue of the public's interest in competitive lease sales. As the Commissioner discussed in the 5<sup>th</sup> Expansion Denial, expanding the CRU prevents leases in the 5<sup>th</sup> Expansion Area from expiring, thus eliminating competition for these leases and potentially allowing them to be held by unit production rather than lease production. (5<sup>th</sup> Expansion Denial, pp. 11-12.) Eliminating competition deprives the State of both the bonus bids it would receive in a competitive lease sale and the potential development that a new lessee would provide. (*Id.*) The fact that a new lessee would need to qualify to hold leases the same as CPAI did for acquiring them by assignment has nothing to do with competition. Nor does the fact that the former lessees were free to assign the leases to any qualified person satisfy the State and public interest in competitive lease sales.

**H. The 5<sup>th</sup> Expansion Denial Discussed ASRC's Interest.**

CPAI contends that the Commissioner did not address ASRC's role in CRU, but the 5<sup>th</sup> Expansion Denial demonstrably discussed joint ownership of the 5<sup>th</sup> Expansion Area with ASRC. (5<sup>th</sup> Expansion Denial, p. 3.) The Commissioner quoted language from the CRU Agreement that requires approval by DNR, ASRC, and the United States (as appropriate) before a unit expansion is approved. (*Id.* at 7.) The Commissioner noted the agreement between Kuukpik and ASRC, under which Kuukpik agreed that lessees of joint State/ASRC land may use the surface for Oil and Gas Activities. (*Id.* at 11.) And the Commissioner discussed how the 5<sup>th</sup> Expansion would partially protect the interests of the WIOs, the State, and ASRC. (*Id.* at 14.)

Further discussion of ASRC's interests is a matter for ASRC to address in its own denial or approval of CPAI's Revised Application. At the time the Commissioner issued the 5<sup>th</sup> Expansion Denial, ASRC had not issued a decision whether to approve the expansion. Thus, there was no official divergence between the State and ASRC for DNR to address.

With this decision, the Commissioner is reaffirming his denial of the 5<sup>th</sup> Expansion, with specific modifications under which he would approve the expansion. As discussed above in relation to the modifications, if CPAI accepts the modifications, DNR would approve the expansion application as modified. ASRC will be free to address any disagreement it has with DNR's position in its own decision.

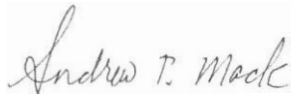
## **VI. FINDINGS AND CONCLUSION**

1. The 5<sup>th</sup> Expansion of the CRU will create net positive impacts on the environment relative to development outside the unit.
2. The available geological, geophysical and engineering data justify, but do not alone compel, including the 5<sup>th</sup> Expansion Area in CRU.
3. Prior exploration activities on the 5<sup>th</sup> Expansion Area leases suggest that CPAI is well suited to bring these leases into development due to its relationship with other interested parties and its access to infrastructure in the area.
4. The current Plan of Development for the 5<sup>th</sup> Expansion Area is not sufficient to meet the criteria in 11 AAC 83.303. If the POD is revised to incorporate the modifications in Section IV of this decision, that POD will satisfy the regulatory criteria for approval of the proposed 5<sup>th</sup> Expansion.
5. By expanding the CRU rather than re-leasing the 5<sup>th</sup> Expansion Area leases in a competitive lease sale, the state loses the economic benefit of bonus bids, but likely will gain the time value of money from accelerated production. The bonus bid replacements included in the modifications above adequately balance the potential economic risk, loss and gain to the state.
6. Joint development, such as under a unit agreement, can maximize the efficient recovery of oil and gas.
7. Developing the 5<sup>th</sup> Expansion Area under the proposed modifications will minimize the economic cost of development and the physical waste of hydrocarbons, gravel, sand, water, wetlands, and valuable habitat.
8. With the modifications set forth in Section IV, the 5<sup>th</sup> Expansion protects all parties' interests.
9. CPAI's request for DNR to agree to waive its regulatory discretion to contract the expansion area until June 1, 2025 is denied.

10. CPAI's offer to voluntarily contract the unit and relinquish the 5<sup>th</sup> Expansion Area leases if CPAI fails to meet the work commitments outlined in the modifications set forth above, is accepted in lieu of a drilling performance bond requirement.
11. The Commissioner has reconsidered the production performance bond and bonus bid replacement requirement, replacing them with the modifications set forth above, which have been determined to better balance and protect the interests of all parties.
12. The February 17, 2017, Denial of the 5<sup>th</sup> Expansion of the Colville River Unit with Modifications under Which Approval will be Granted is hereby withdrawn and replaced with this decision.
13. With the modifications set forth above, the Commissioner will find that the Revised Application meets the requirements of 11 AAC 83.303.
14. Without the modifications set forth in this decision, the Revised Application does not meet the requirements of 11 AAC 83.303 and the Commissioner will not approve it.
15. If CPAI agrees to the modifications (detailed in Section IV, above) to the Revised Application by signing below and return a fully executed copy of this decision to the Commissioner on or before August 14, 2017, the 5<sup>th</sup> Expansion of the Colville River Unit then will be approved as amended with an effective date of June 28, 2016.
16. If CPAI fails or refuses to agree to these modifications by such date, the Revised Application will be denied effective August 15, 2017.

This Commissioner's Decision on Reconsideration will be the final administrative order and decision of the department as of August 15, 2017, for the purpose of an appeal to the superior court. An appellant affected by this administrative order and decision may appeal to superior court within 30 days of August 15, 2017 in accordance with the Alaska Rules of Court and to the extent permitted by applicable law.

Sincerely,



Andrew T. Mack  
Commissioner

cc: Teresa Imm, Arctic Slope Regional Corporation  
Wayne Svejnoha, Bureau of Land Management

By its signature below, CPAI hereby accepts the modifications to its Revised Application as set forth in detail in Section IV, above, and acknowledges that such modifications must be incorporated into each future annual CRU POD until (1) CPAI begins sustained production from the 5<sup>th</sup> Expansion Area; or (2) the 5<sup>th</sup> Expansion Area is no longer part of CRU, whichever happens sooner.

Signed: \_\_\_\_\_  
Its: \_\_\_\_\_  
Date: \_\_\_\_\_