GROSS REVENUE EXCLUSION

House Resources Committee
March 22, 2013

Department of Natural Resources
• Joe Balash, Deputy Commissioner
Three ways to qualify:

1. Production from a Unit formed after 2003
   - Nikaitchuq Unit, Oooguruk Unit

2. Production from a PA formed after 2012 which is in a unit formed prior to 2003
   - New PA at Prudhoe Bay

3. Production from a portion of a reservoir in any existing PA that has been shown to DNR as not previously contributing to production from that PA.
   - Kuparuk River Unit, Kuparuk PA, Shark’s Tooth
WHAT is a PARTICIPATING AREA (PA)?

A set of tracts within a Unit, overlying a reservoir which is on sustained production

- North Slope: 18 State Units, 38 PAs
- A unit may have multiple reservoirs at different depths – each PA is defined vertically as well as horizontally
- Leases approved for inclusion into a PA may not be severed
- PA provides mechanism to allocate costs and revenues

Regulations

11 AAC 83.351  PA Formation, Expansion, Contraction
11 AAC 83.343  Plans of Development
11 AAC 83.371  Allocation of Production and Costs
11 AAC 83.303  Protect all parties
# North Slope PAs

<table>
<thead>
<tr>
<th>Location</th>
<th>Years Known (Examples)</th>
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<tbody>
<tr>
<td>Nikaitchuq</td>
<td>2011 Nikaitchuq Schrader Bluff</td>
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<tr>
<td>Oooguruk</td>
<td>2008 Oooguruk Kuparuk 2008 Oooguruk Nuiqsut</td>
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<tr>
<td>Northstar</td>
<td>2001 Northstar, 2008 Northstar Fido (pending)</td>
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<tr>
<td>Colville</td>
<td>2000 Alpine</td>
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<tr>
<td>Badami</td>
<td>1988 Badami Sands</td>
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<tr>
<td>Duck Island</td>
<td>1987 Endicott 1989 Sag Delta North 1998 Eider</td>
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<tr>
<td>Milne Point</td>
<td>1985 Kuparuk 1991 Schrader Bluff 2005 Sag River</td>
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Evaluation and Approval of PAs

11 AAC 83.351: PA Formation, Expansion, Contraction

- PA may include only the land capable of producing or contributing to production of hydrocarbons in paying quantities
- PA must be contracted to exclude acreage incapable of contributing to production of hydrocarbons in paying quantities

11 AAC 83.303 Criteria

- Promote conservation
- Prevent waste
- Protect all parties
PA application has no regulatory deadline as with unit applications

- Operator submits application no later than 90 days prior to sustained production
- Submittal includes Exhibits C and D, legal description with allocation factors, and map
  - Allocation factors allocate production to each tract
- Must include Exhibits E and F if Net Profit Share (NPS) leases included
  - NPS leases require accounting of costs and revenues to determine “pay out”. Exhibits E and F provides methodology and basis for cost allocation, used by Royalty Accounting and Audit
PA Exhibits C and D
Once development activities commence and/or a PA is formed, A Plan Of Development (POD) is required under 11 AAC 83.343

- Describes plans to develop the reservoir
  - Development activities: facilities, pipelines, offshore production islands, gathering lines, and permanent drill sites.
- POD is submitted annually for review and approval
- If POD deemed insufficient for approval, DNR may propose modifications. If Operator agrees to modification, POD approved
  - If modifications not accepted by Operated and reviewed POD not approved, current POD may expire.
Tract Allocation Factors

• Approval of PA includes approval of Allocation Factors (Tract Factors, or TF) to protect all parties
  – Exhibit C designates each PA tract a TF
  – Bases for calculating TF proscribed in Operating Agreement sometimes Unit Agreement or approval decision
    • Acreage
    • Original Oil in Place (OOIP)
    • Recoverable
    • Value Based

• Working Interest Owners receive revenue based on TF
  – Equity negotiations

• State of Alaska receives royalties based on TF
  – Commercial interest evaluation

11 AAC 83.371
Revisions to Division of Interest: Reallocations

• Production is reallocated
  – As PA expands of contracts
    • Development wells identified and committed to in Plan of Development
    • Expansion of Milne Point Unit Sag River PA
    • Contraction of Milne Point Unit Sag River PA
  – As basis for allocation changes
    • Field matures, more technical information gathered and evaluated, production is reallocated
    • Revised Exhibit C designates each PA tract a TF
    • Bases for calculating TF proscribed in Operating Agreement sometimes Unit Agreement or approval decision
      – Acreage, OOIP, Recoverable, Value Based
  – Resource Evaluation, Commercial, Royalty Accounting, Audit Sections
    • Evaluation of protection of State’s Interest
    • Protection of all parties
Kuparuk River Unit (KRU)
Questions?