

Section Two

Leasing Licensing & Incentives

Leasing

Areawide Leasing

Oil and gas lease sales are the initial step in a process that generates nearly 80 percent of the State's General Fund Revenue. Although the primary purpose of leasing State lands is to provide for oil and gas development and the subsequent economic benefits, the program in itself has been a significant revenue source. Through lease sale bonus bids alone, the State has received over \$2 billion in revenue.

Since 1959 the State has held 101 competitive lease sales in which it has offered millions of acres throughout Alaska. Several leasing methods, authorized under the AS 38.05, were used to encourage responsible oil and gas exploration and development and maximize State revenue. These methods include combinations of fixed and variable bonus bids, royalty shares and net profit shares. The fixed lease terms generally involve an obligation to remit royalty payments in the form of a 12^{1/2} or 16^{2/3} percent share of gross production paid in-kind or in-value. Occasionally, the State has imposed a fixed royalty rate of 20 percent. The minimum royalty obligation is 12^{1/2} percent. The State has also used sliding-scale royalty terms in its leases based on production or oil price or gross revenue.



Areawide Leasing
ADNR, DO&G

The most common bid variable used by the State is the cash bonus. The State may require minimum bids of \$5 to \$10 per acre (and sometimes higher). The State may also use the royalty rate or the net profit share as the bidding variable, though this has happened only rarely (Sale 30, the joint federal-state Beaufort Sea sale held in 1979 was one of these occasions).

The Division annually issues a new *Five-Year Oil and Gas Leasing Program* that sets out the sale schedule for the succeeding five years. All proposed lease sales are Areawide sales held each year. An Areawide sale is one in which all available State acreage within a geographic region is included. Traditionally, the four geographic regions have been the North Slope, North Slope Foothills, Beaufort Sea, and Cook Inlet. The first such sale was the North Slope Areawide held in June 1998. Since then, Areawide sales have been held in the other three regions. In addition, the State has added Areawide sales on the Alaska Peninsula, located in Southwest Alaska, beginning in 2005. Areas outside these regions are available for exploration through other oil and gas programs.

ALASKA OIL AND GAS LEASING PROGRAM



Sale Areas

A total of 24 lease sales are proposed over the next five years; five in each region of northern Alaska and in Cook Inlet, and four on the Alaska Peninsula beginning in 2005.

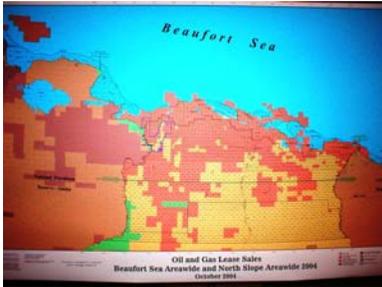
STATE OF ALASKA FIVE-YEAR OIL AND GAS LEASING PROGRAM

2004 through 2008

<u>Sale</u>	<u>Annually Held In</u>
North Slope Foothills Areawide	May
Cook Inlet Areawide	May
North Slope Areawide	October
Beaufort Sea Areawide	October
Alaska Peninsula	October (beginning in 2005)

Leasing

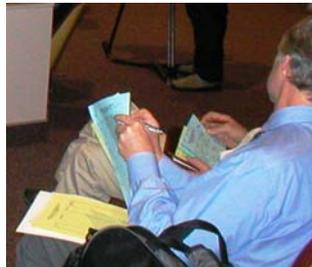
If the decision is to proceed with a sale, a Sale Announcement, including the sale terms, bidding method, tract map, and mitigation measures will be issued 90 days prior to that sale. If a best interest finding or a supplement to a previous finding is required, it will be released at the same time as the Sale Announcement.



Areawide Leasing



Competitive sealed bid



Highest bidder wins

Shallow Gas Leasing

Alaska's Shallow Gas Leasing Program underwent much change in 2004. This program originally allowed the Division of Oil and Gas to issue non-competitive leases to explore for and develop natural gas from fields if part of the field was within 3,000 feet of the surface. In 2004, the legislature repealed the program and replaced it with provisions added to the areawide leasing and exploration licensing programs that allow for gas-only leases and licenses. The new program includes lease and license terms that encourage competitive leasing for development of unconventional gas resources.



Susitna Basin
Exploration Licensing
C. Beaty

The 2004 legislation addressed a number of concerns raised by the public associated with the shallow gas leasing program and the related topic of coalbed methane development. In particular, the legislation ensures that all future oil and gas leasing and licensing decisions will be based upon a finding that issuance of the lease or license is in the best interest of the state. Also, the legislation provides for protection of drinking water sources, requires noise mitigation and setback standards, and provides additional surface owner protections. Additionally, after a comprehensive public process, ADNR adopted enforceable standards for CBM development in the Mat-Su Borough to further address public concerns.

At present, there are 4 shallow natural gas leases active in Northwest Alaska in the vicinity of Red Dog Mine and 8 shallow natural gas leases active in South-central Alaska in the vicinity of Homer. All other shallow natural gas leases (in the Mat-Su and Delta areas) have either expired or are in the process of being relinquished. All shallow natural gas lease applications (in the Mat-Su, Holitna and Healy areas) pending at the time of passage of the 2004 legislation have either been closed or converted to exploration licenses.

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SUMMARY OF STATE COMPETITIVE LEASE SALES

1/24/1989	52	Beaufort Sea	175,981	52,463	29.81%	\$33.12	43	15	\$1,737,513	Bonus; \$10/acre Min	12.5% Royalty
1/24/1989	72A	North Slope	677	677	100.00%	\$671.90	1	1	\$454,977	Bonus; \$10/acre Min	12.5% Royalty
1/29/1991	*67A	Cook Inlet	549,364	191,588	34.87%	\$28.77	140	55	\$5,511,338	Bonus; \$5/acre Min	12.5% Royalty
1/29/1991	*70A	North Slope	532,153	420,568	79.03%	\$65.88	135	109	\$27,707,541	Bonus; \$5/acre Min	12.5% Royalty
6/4/1991	64	North Slope	754,542	34,143	4.52%	\$7.10	141	6	\$242,389	Bonus; \$5/acre Min	12.5% Royalty
6/4/1991	*65	Beaufort Sea	491,091	172,865	35.20%	\$40.46	108	36	\$6,993,949	Bonus; \$5/acre Min	16.67% Royalty
9/24/1991	*74A	Cook Inlet	605,851	26,605	4.39%	\$12.06	134	5	\$320,853	Bonus; \$5/acre Min	12.5% Royalty
1/22/1992	61	North Slope	991,087	260,550	26.29%	\$9.32	181	46	\$2,429,551	Bonus; \$5/acre Min	12.5% Royalty
6/2/1992	68	Beaufort Sea	153,445	0	0.00%	\$0.00	36	0	\$0	Bonus; \$10/acre Min	12.5% Royalty
12/8/1992	75	North Slope	217,205	124,832	57.47%	\$78.11	90	55	\$9,750,111	Bonus; \$10/acre Min	State =12.5% & ASRC =16.67%
1/26/1993	76	Cook Inlet	393,025	141,504	36.00%	\$461.25	86	36	\$65,269,167	Bonus; \$5/acre Min	12.5% Royalty
1/26/1993	67 A-W	Cook Inlet	282,577	129,810	45.94%	\$18.75	69	33	\$2,433,864	Bonus; \$5/acre Min	12.5% Royalty
5/25/1993	77	North Slope	1,260,146	45,727	3.63%	\$25.47	228	8	\$1,164,555	Bonus; \$5/acre Min	12.5% Royalty
5/25/1993	70 A-W	North Slope	37,655	28,055	74.51%	\$48.41	11	8	\$1,358,027	Bonus; \$10/acre Min	12.5% Royalty
9/21/1993	57	North Slope	1,033,248	0	0.00%	\$0.00	196	0	\$0	Bonus; \$5/acre Min	12.5% Royalty
9/21/1993	75A	North Slope	14,343	14,343	100.00%	\$31.36	11	11	\$449,847	Bonus; \$10/acre Min	16.67% Royalty
10/30/1994	78	Cook Inlet	396,760	136,307	34.36%	\$12.14	90	34	\$1,654,137	Bonus; \$5/acre Min	12.5% Royalty
11/14/1995	67A-W2	Cook Inlet	152,768	13,804	9.04%	\$7.29	36	3	\$100,638	Bonus; \$5/acre Min	12.5% Royalty
11/14/1995	74W	Cook Inlet	66,703	17,015	25.51%	\$31.76	16	4	\$540,406	Bonus; \$5/acre Min	12.5% Royalty
11/14/1995	76W	Cook Inlet	251,614	14,220	5.65%	\$5.61	50	4	\$79,722	Bonus; \$5/acre Min	12.5% Royalty
11/14/1995	78W	Cook Inlet	260,453	36,478	14.01%	\$7.06	56	11	\$257,583	Bonus; \$5/acre Min	12.5% Royalty
12/5/1995	80	North Slope	951,302	151,567	15.93%	\$22.02	202	42	\$3,337,485	Bonus; \$10/acre Min	12.5% Royalty
10/1/1996	86A	North Slope	15,484	5,901	38.11%	\$343.40	13	5	\$2,026,247	Bonus; \$100/acre Min	16.67%&16.67-33.33% SSR
12/18/1996	85A	Cook Inlet	1,061,555	173,503	16.33%	\$17.92	234	44	\$3,109,603	Bonus; \$5/acre Min	12.5% Royalty
11/18/1997	86 **	Beaufort Sea	365,054	323,835	88.70%	\$86.42	181	162	\$27,985,125	Bonus; \$10/acre Min	16.67% Royalty
2/24/1998	85A-W	Cook Inlet	757,878	98,011	12.90%	\$8.46	157	24	\$828,807	Bonus; \$5/acre Min	12.5% Royalty
6/24/1998	87	North Slope	Areawide	518,689	N/A	\$99.86	N/A	137	\$51,794,173	Bonus; \$5/acre Min	12.5% Royalty
2/24/1999	NS 1999	North Slope	Areawide	174,923	N/A	\$14.85	N/A	40	\$2,596,838	Bonus; \$5/acre Min	12.5% Royalty
4/21/1999	CI 1999	Cook Inlet	Areawide	114,514	N/A	\$10.75	N/A	41	\$1,436,685	Bonus; \$5/acre Min	12.5% Royalty
8/16/2000	CI 2000	Cook Inlet	Areawide	100,480	N/A	\$9.15	N/A	27	\$919,750	Bonus; \$5/acre Min	12.5% Royalty
11/15/2000	BS 2000	Beaufort Sea	Areawide	25,840	N/A	\$13.13	N/A	11	\$338,922	Bonus; \$10/acre Min	12.5% & 16.67% Royalty
11/15/2000	NS 2000	North Slope	Areawide	652,355	N/A	\$15.41	N/A	145	\$10,052,665	Bonus; \$5/acre Min	12.5% & 16.67% Royalty
5/9/2001	CI 2001	Cook Inlet	Areawide	102,523	N/A	\$9.05	N/A	29	\$928,085	Bonus; \$5/acre Min	12.5% Royalty
5/9/2001	NSF 2001	NS Foothills	Areawide	858,811	N/A	\$11.41	N/A	170	\$9,799,277	Bonus; \$5/acre Min	12.5% Royalty
10/24/2001	BS 2001	Beaufort Sea	Areawide	36,331	N/A	\$94.90	N/A	24	\$3,447,734	Bonus; \$10/acre Min	12.5% & 16.67% Royalty
10/24/2001	NS2001	North Slope	Areawide	434,938	N/A	\$15.89	N/A	146	\$6,911,572	Bonus; \$5/acre Min	12.5% & 16.67% Royalty
5/1/2002	CI 2002	Cook Inlet	Areawide	64,923	N/A	\$7.05	N/A	21	\$421,841	Bonus; \$5/acre Min	12.5% Royalty
5/1/2002	NSF 2002‡	NS Foothills	Areawide	213,374	N/A	\$14.32	N/A	51	\$2,889,532	Bonus; \$5/acre Min	12.5% Royalty
10/24/2002	BS 2002	Beaufort Sea	Areawide	19,226	N/A	\$26.34	N/A	15	\$506,405	Bonus; \$10&\$100/ac Min	12.5%, 16.67% & 20% Royalty
10/24/2002	NS 2002	North Slope	Areawide	32,316	N/A	\$17.94	N/A	12	\$579,728	Bonus; \$10/acre Min	12.5%, 16.67%&16.67-33.33% SSR
5/7/2003	CI 2003	Cook Inlet	Areawide	73,869	N/A	\$9.34	N/A	27	\$689,949	Bonus; \$5/acre Min	12.5% Royalty
5/7/2003	NSF 2003	NS Foothills	Areawide	5,760	N/A	\$6.35	N/A	1	\$36,576	Bonus; \$5/acre Min	12.5% Royalty
10/29/2003	BS 2003	Beaufort Sea	Areawide	36,995	N/A	\$33.96	N/A	20	\$1,358,187	Bonus; \$5 & \$10/ac Min	12.5% 16.67% Royalty
10/29/2003	NS 2003**	North Slope	Areawide	210,006	N/A	\$17.08	N/A	75	\$3,586,400	Bonus; \$10/acre Min	12.5% 16.67% Royalty
5/19/2004	CI 2004	Cook Inlet	Areawide	363,520	N/A	\$7.23	N/A	72	\$2,629,820	Bonus; \$5/acre Min	12.5% Royalty
5/19/2004	NSF 2004	NS Foothills	Areawide	28,800	N/A	\$5.37	N/A	5	\$154,656	Bonus; \$5/acre Min	12.5% Royalty
10/29/2004	BS 2004	Beaufort Sea	Areawide	125,440	N/A	\$42.09	N/A	28	\$5,280,384	Bonus; \$10/acre Min	12.5% - 16.67% Royalty
10/29/2004	NS 2004	North Slope	Areawide	225,280	N/A	\$41.94	N/A	61	\$9,447,757	Bonus; \$10/acre Min	12.5% - 16.67% Royalty
TOTAL: 101 Sales			17,001,049			\$121.79	6,145		\$2,070,539,118		

**Economic Incentive Credits were offered for these sales.

** Sale 86A: State received \$259,435; ASRC received \$1,766,812.

‡ Sale NSF 2002 Bonus does not include 20% of Bonus bid (\$1.25 million) retained by the state for relinquished tracts.

** NS 2003: State received \$3,546,578; ASRC received \$39,822.

Licensing

Exploration Licensing

Exploration Licenses are designed to stimulate exploration in Alaska's frontier basins, and complement the State's oil and gas leasing program. The North Slope and Cook Inlet, which are the main thrust of the State's competitive leasing program, remain off limits to Exploration Licensing.

There are, however, several large sedimentary basins within interior Alaska, some of which are virtually unexplored. The highly variable structural geology of these basins offers the potential for structural traps in overthrust belts and strike slip systems. Various types of clastic and carbonate stratigraphic traps may also be present. Exploration Licensing will allow companies to explore these frontier basins with minimal initial costs.

An area selected for Exploration Licensing must be between 10,000 to 500,000 acres. A license will be awarded to the applicant who has committed the most dollars to an exploration program. The recipient of a license will be required to post a bond in the amount of the work commitment and pay a \$1 per acre license fee. There are no additional charges during the term of the license, which can be up to 10 years.

During its term any portion of the licensed area may be converted to oil and gas leases. The term of the leases can then extend beyond the original term of the license. If converted, annual lease rentals are set at \$3 per acre.



Mat-Su coring program
C. Ruff



Susitna Basin
Aeromagnetic survey
K. Dirks

Licensing Process

The licensing process will be initiated in one of two ways: Each year during the month of April applicants may submit to the Commissioner of the Department of Natural Resources a proposal to conduct exploratory activity within an area they have specified. Or the commissioner, at anytime, can issue a notice requesting the submittal of proposals to explore an area designated by the commissioner. Once a request for proposals has been issued applicants will have 20 days to notify the commissioner of their intent to submit a proposal, and 60 days in which to submit.

Within 30 days of receiving any proposal the commissioner will either reject it in a written decision or give public notice of the intent to evaluate the proposal's acceptability. This notice will solicit public comments on the proposal(s) and request competing proposals. The commissioner may also modify any proposal and request a new one based on those modifications.

Submitted proposals must (1) describe the area proposed to be subject to licensing, (2) state the specific minimum work commitment expressed in dollars, (3) describe the amount and form of security to be posted based on the projected cost of the planned exploration work, (4) propose the term of the license (unless already established by the commissioner) and (5) verify that a prospective licensee meets minimum qualifications.

Licensing

Best Interest Finding

After considering all submitted proposals and public comment on those proposals the commissioner shall issue a written finding determining whether or not granting the Exploration License is in the State's best interests. The finding must describe the limitations, conditions, stipulations or changes from the initiating proposal or competing proposals that are required to make the issuance of the license conform to the best interests of the State. If only one proposal was submitted, the finding must also identify the prospective licensee.

If the finding concludes that an Exploration License should be awarded and there has only been a single applicant, that applicant will have 30 days after issuance of the finding to accept or reject the license award.



Alaska Peninsula seep
M. Myers

Bidding Process

If competing proposals are submitted and the commissioner determines that an Exploration License should be awarded, the commissioner will issue an invitation to submit a sealed bid. A bid deposit equal to 20 percent of the license fee must be submitted with the bid. The successful bidder will be the applicant who submits the highest bid in terms of exploration expenditures.

Once notified a successful bidder will have 10 days in which to accept or reject the license award. If the successful bidder fails to accept the award within the allotted time the bid deposit and the right to accept the award are forfeited. The next successive highest bidders will then have an opportunity to accept the award.

Relinquishment of Lands

If by the fourth anniversary of the Exploration License the licensee has completed less than 25 percent of the total work commitment the license will be terminated, with the remainder of the security forfeited to the State. If the licensee has completed less than 50 percent of the total work, then 25 percent of the licensed area will be relinquished, with an additional 10 percent relinquished each successive year until half of the original acreage has been relinquished.

License Applications

The State has issued four Exploration Licenses covering 1.66 million acres and currently has one pending in the northern portion of the Bristol Bay basin.

Licenses Issued:

Copper River

Licensee:	Forest Oil Corporation
Size:	318,756.35 Acres
Exploration Commitment:	\$1,420,000
Term:	5 years
Effective Date:	October 1, 2000

Nenana Basin

Licensee:	Andex Resources
Size:	483,942 Acres
Exploration Commitment:	\$2,525,000
Term:	7 years
Effective Date:	October 1, 2002



North Slope mosquitoes
S. Schmitz

Susitna Basin I

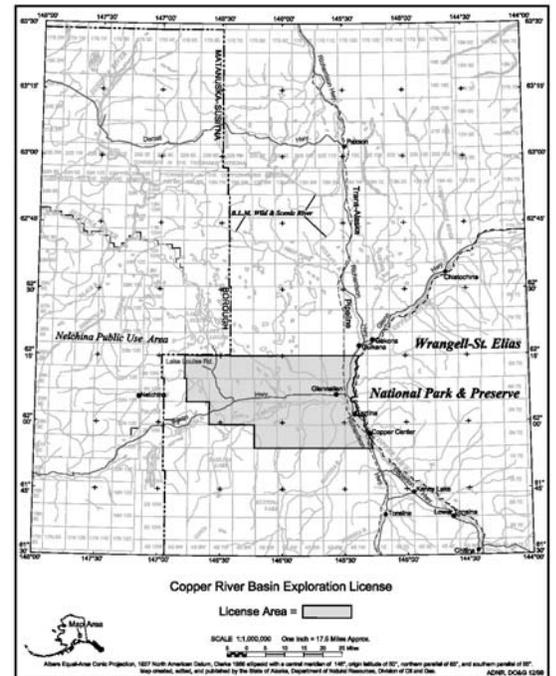
Licensee: Forest Oil Corporation
 Size: 386,204 Acres
 Exploration Commitment: \$2,520,000
 Term: 7 years
 Effective Date: November 1, 2003

Susitna Basin II

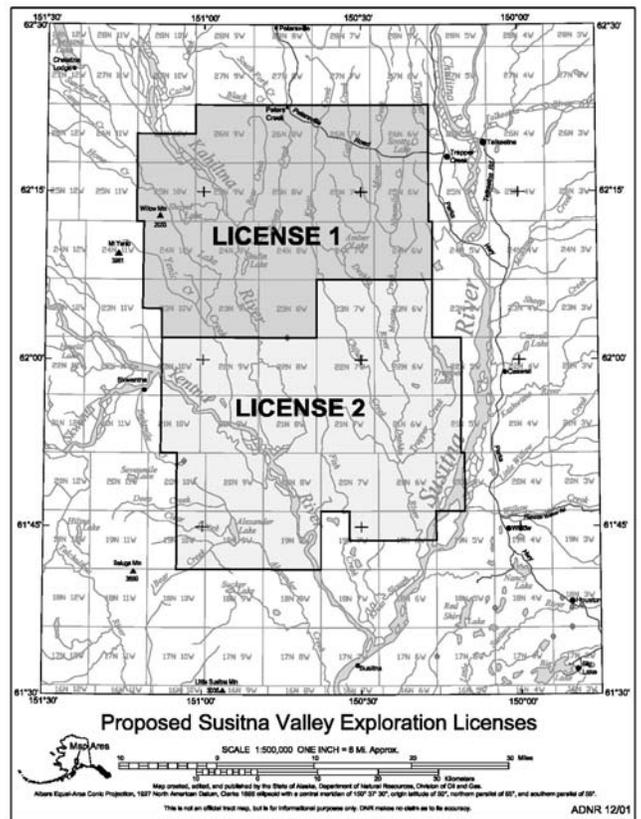
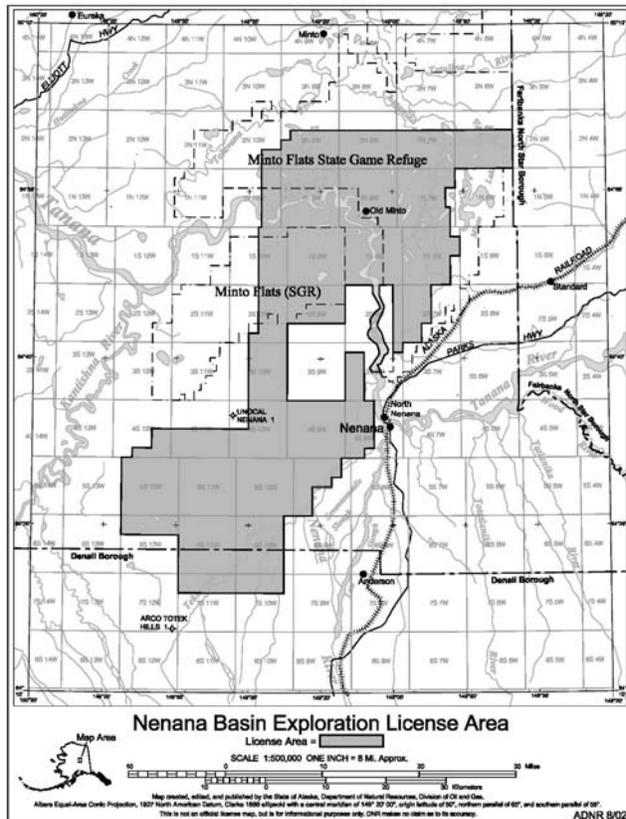
Licensee: Forest Oil Corporation
 Size: 471,474 Acres
 Exploration Commitment: \$3,000,000
 Term: 7 years
 Effective Date: November 1, 2003

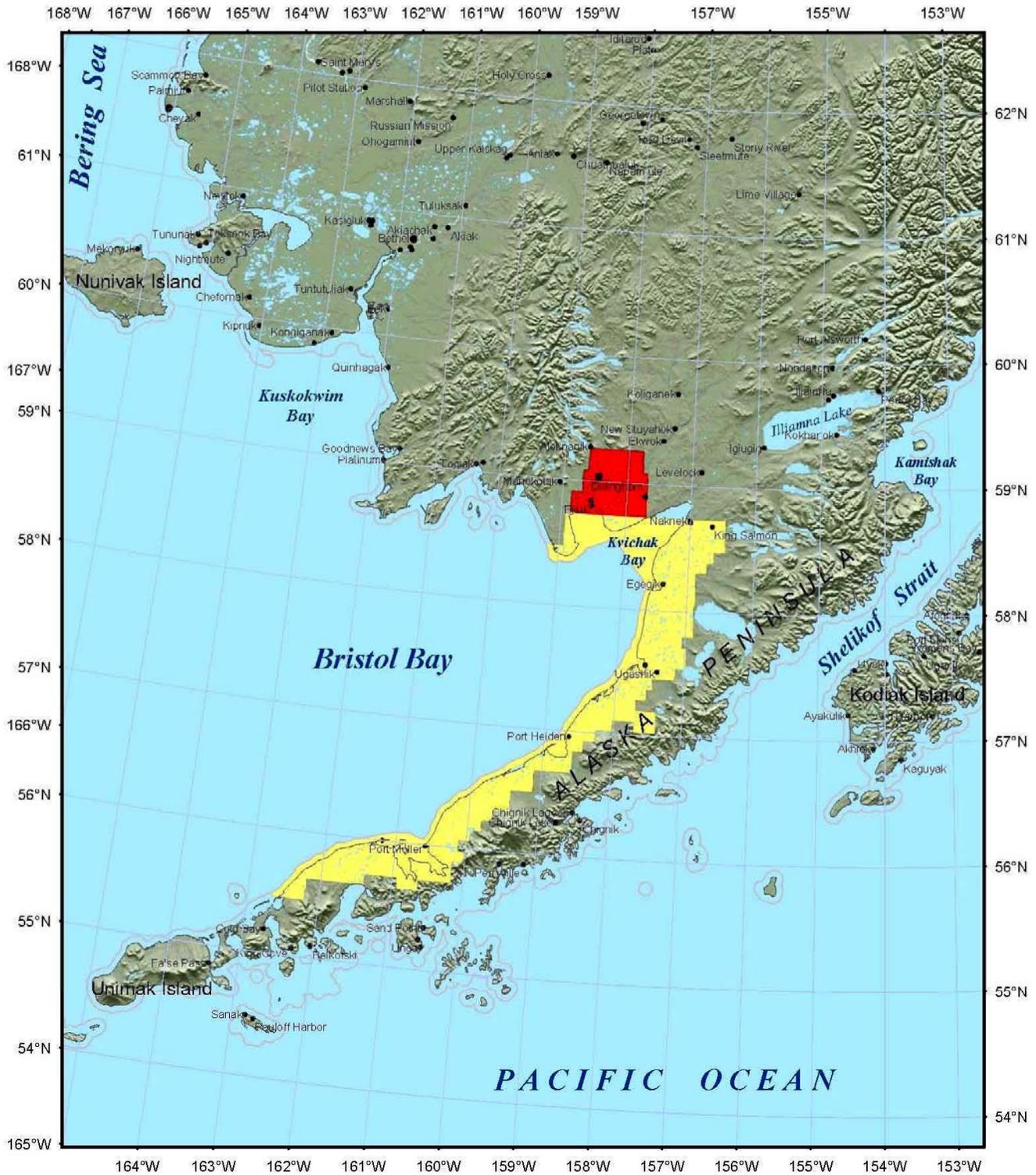
Bristol Bay (Proposed)

Licensee: Bristol Shores LLC
 Size: 329,113 Acres
 Exploration Commitment: \$3,200,000
 Term: 7 years
 Effective Date: Not Yet Issued



Current Exploration License Areas





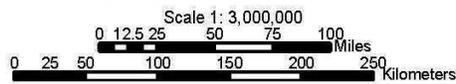
Alaska Peninsula & Bristol Bay Proposed Oil & Gas Programs

Exploration License Area No. 1 Proposed Ak Peninsula Lease Sale Area

3 Mile Limit



Map Area



Source: ADNR, June 2004.

Incentives & Credits

Exploration Incentive Credit and Tax Credit Programs

AS 38.05.180(i): Exploration Incentive Credits (EIC)

This EIC is included as a term of every lease. AS 38.05.18(i) provides for a system in which a lessee of State land drilling an exploratory well may earn credits depending on the footage drilled and the region in which the well is located. The statute also provides for an EIC for geophysical work on State land if that work is performed during the two seasons immediately preceding an announced lease sale and on land included within the sale area. The geophysical information obtained is made public following the sale. Information is held confidential for two years, but confidentiality may be extended if the lessee meets certain requirements. The Department of Natural Resources Commissioner grants credits as high as 50 percent of the costs. Credits may be applied against State royalty and rental payments or taxes, or they may be assigned. Since the State began offering this program, lessees have earned \$54.7 million in credits for exploratory drilling.

AS 41.09.010: Exploration Incentive Credits

This EIC, adopted in 1994 under AS 41.09.010, allows the Natural Resources Commissioner to grant an EIC for exploratory drilling, the drilling of a stratigraphic test well, and for geophysical work on land in the State, regardless of whether the minerals are State-owned. This program is designed to encourage oil and gas exploration within remote parts of the State and to provide a means for the State to obtain exploration data from federal, private, and Native Corporation lands. As with the Title 38 program, the credits may be applied against oil and gas royalties, rentals, lease sale bonus bids and taxes, or they may be assigned. Drilling data will be kept confidential for two years, with no extension of this period. Copies of geophysical data may be shown to interested parties by the State, but may not be transferred to third parties. Credits may be as high as 50 percent of eligible costs if performed on State land, and as high as 25 percent when performed on federal or private land. A credit may not exceed \$5 million per eligible project, and the total of all credits may not exceed \$30 million. Drilling credits are based upon the footage (measured depth) drilled. All activity qualifying for this EIC must be completed by July 1, 2007.

AS 43.55.025: Oil and Gas Exploration Tax Credit

This program, adopted in 2003, allows for a production tax credit of 20 percent of the cost of an exploratory well if the bottom hole location is three or more miles from the bottom hole location of a preexisting well that was spud more than 150 days, but less than 35 years, prior to the spud date of the eligible exploration well. The program also allows for a production tax credit of 40 percent of the cost of an exploratory well if the bottom hole location is 25 miles or more from the boundary of any unit under a plan of development as of July 1, 2003. The program also offers seismic exploration tax credits of 40 percent of eligible costs for those portions of activities outside of a unit that is under a plan of development or plan of exploration. Seismic data qualifying for this credit will be held confidential for 10 years and 30 days. This tax credit is transferable. This program only applies to wells drilled between July 1, 2003 and July 1, 2007.



Imnaitchiak Cherts
P. Decker

AS 43.20.043: Gas Exploration and Development Tax Credit

This program, adopted in 2003, is applicable only to operators and working interest owners engaged in exploration for and development of gas resources and reserves south of 68 degrees North latitude (excludes North Slope and Beaufort Sea). The program allows for a 10 percent tax credit equivalent of qualified capital investments made after June 30, 2003, and 10 percent of the annual cost of activity in the State during each tax year. The total allowable yearly tax credit may not exceed 50 percent of the taxpayer's total tax liability. Unused tax credits may be carried forward for up to five years. Credit is

transferable only as part of a conveyance, assignment, or transfer of the taxpayer's business. Credit under this program may be used in conjunction with any other credit authorized by AS 43.20, but not for tax credit or royalty modification provided under any other title. This program expires January 1, 2013.

Royalty Reduction

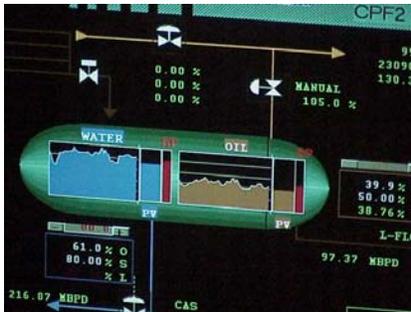
Since 1995, Alaska law has allowed the Commissioner of Natural Resources to adjust the royalty reserved to the State in order to encourage otherwise uneconomic production of oil and gas. If a delineated field or pool has not previously produced, the royalty can be lowered to 5 percent. If an existing producing field or pool, the royalty may be reduced to as low as 3 percent in order to prolong its economic life as costs per barrel or barrel equivalent increase. In order to establish production of shut-in oil or gas, the royalty may also be reduced to as low as 3 percent. These royalty reduction provisions expire on July 1, 2015.

Discovery Royalty

Alaska law permits the granting of reduced royalty for wells in the Cook Inlet sedimentary basin that have discovered oil or gas in a previously undiscovered oil or gas pool, providing that the wells are capable of producing in paying quantities. The discovery royalty is established at 5 percent for 10 years following the discovery of a pool. The discovery royalty applies to all oil or gas from that pool that is attributable to the lease.



B. Webb



S. Schmitz

Cook Inlet Royalty Reduction

In 1998 the governor signed legislation granting a 5 percent temporary royalty rate on the first 25 million barrels of oil and the first 35 billion cubic feet of gas produced in the first ten years of production from six specified fields in the Cook Inlet sedimentary basin. The six fields eligible for royalty reduction were discovered before January 1, 1988 and have been undeveloped or shut-in. The fields identified in the law are Falls Creek; Nicolai Creek; North Fork; Point Starichkof; Redoubt Shoal; and West Foreland. Production from these fields had to begin before January 1, 2004 to be eligible for the royalty reduction.