



LINC ENERGY'S APPLICATION TO FORM THE ANGEL UNIT DIRECTOR'S REMAND DECISION

Introduction

Linc Energy (Alaska), Inc. (Linc), as unit operator and only working interest owner, is the sole signatory to the unit agreement, which it filed for approval by DNR and the TLO on May 22, 2012. Linc, the appellant, used DNR's multiple royalty owner unit agreement model form in its unit application. That form includes joint management and an arbitration provision. The Trust Land Office (TLO) Executive Director approved the Angel Unit Agreement on May 30, 2012. The Alaska Mental Health Trust Authority (Trust) is a state corporation that manages its cash and non-cash assets to ensure that the State has a comprehensive long term mental health program for the Trust beneficiaries. The Alaska Permanent Fund and the Department of Revenue Treasury Division manage the Trust's cash assets. The TLO within the Department of Natural Resources (DNR) manages the land and other non-cash assets, like the Trust lease proposed for inclusion in this unit.

I disapproved the Agreement on September 10, 2012 for two reasons--I found that Linc did not demonstrate the existence of a potential hydrocarbon accumulation and its proposed Plan of Exploration (POE) did not provide for timely development of the State's resources. I did not discuss the model form joint management and arbitration issues in my decision disapproving the unit and the DNR Commissioner requested in his January 15, 2013 remand that I address those issues, and further address the potential hydrocarbon accumulation issue, in my remand decision.

Joint Management and Arbitration

The proposed Angel Unit contains two leases--one issued by DNR and one issued by the Trust. The proposed Angel Unit Agreement generally provides for unit management based on a land ownership concept so that some decisions are made jointly and others are made by either the DNR Commissioner (and upon delegation by the Division of Oil and Gas Director) or the TLO Executive Director. For example: unit plans (Article 8) are subject to approval by both the Commissioner and the TLO Executive Director; participating areas (Article 9) are subject to joint approval by the Commissioner and the Executive Director if the reservoir underlies State land and Trust land, by the Commissioner if the reservoir underlies State land, and the Executive Director if the reservoir underlies Trust land; and expansions and contractions of the unit area (Article 13) are also subject to joint approval.

This is not a new model for the management of units with multiple land and royalty owners. For example, the Colville River, Kachemach, and Tofkat units are managed similarly by DNR and the Arctic Slope Regional Corporation (ASRC). There are two relevant differences between those units and the proposed Angel Unit: 1) the parties, a Regional Native corporation and a state corporation; and 2) some of the leases in Colville and Kachemach are individually owned and some are jointly owned by the State and ASRC and all the lease in Tofkat are jointly owned, but the two leases in the proposed Angel Unit are individually owned by the State and the Trust.

Under the criteria set out in 11 AAC 83.303 the Commissioner will approve a proposed unit agreement if it will promote conservation of all natural resources, promote the prevention of economic and physical waste, and provide for the protection of all parties of interest, including the State. Generally, the prevention of waste is conservation. Ultimately, the Commissioner must find that the unit agreement is necessary or advisable to protect the public interest. To the extent that the State's interests, conservation and the prevention of waste, are best served by prompt exploration and development of the State's oil and gas, I believe that this joint management model could be inconsistent with that interest when applied to individually owned lands.

Under the joint management model, if the Commissioner and Executive Director are constantly at loggerheads over unit-related decisions, prompt exploration and development of the State's oil and gas would not occur. For example, the Division Director could approve and the TLO Executive Director could disapprove a unit POE under Article 8 of the unit agreement. An eligible person must seek reconsideration of the Executive Director's decision under 11 AAC 99.060 before appealing that decision to court. And, this could have the effect of delaying exploration and production in the unit to the possible detriment of the State. Conversely, the Executive Director could approve and the Division Director could disapprove a POE under Article 8. An eligible person must appeal the Director's decision under 11 AAC 02 before appealing the decision to court. And, this could have the effect of delaying exploration and production in the unit to the possible detriment of the Trust and its beneficiaries.

The Colville River, Kachemach, and Tofkat Unit Agreements all contain arbitration provisions to resolve disputes that might arise between the land owners. The Colville provision contains a detailed dispute resolution mechanism that includes arbitration, but the Kachemach and Tofkat provisions are substantially similar to the Angel Unit provision. The proposed Angel Unit Agreement does not set out specific arbitration terms and procedures, unlike the Colville River Unit Agreement, and approving the unit agreement without first establishing those terms and procedures could work against the State's interests. But it is difficult to make that determination now without any specific arbitration terms to analyze.

Article 21.1 of the proposed Angel Unit Agreement provides:

The State, The Trust and the Working Interest Owners anticipate entering an arbitration agreement that will govern resolution of all disputes between the State, The Trust or the Working Interest Owners arising from the obligations of the State, The Trust or the Working Interest Owners with respect to the Angel Unit. If and when the State, The Trust and the Working Interest Owners enter into an arbitration agreement, this Agreement will be amended to incorporate that arbitration agreement and all disputes arising after that time will be governed solely by the arbitration agreement. Until an arbitration agreement is entered, all disputes will be governed by applicable statutes and regulations.

This provision does not require the parties of interest to enter into an arbitration agreement. While the proposed unit agreement anticipates using arbitration, it does not set out specific arbitration provisions. The parties may never reach an arbitration agreement. And, if an arbitration agreement is proposed as an amendment to the unit agreement that amendment will be subject to a public interest determination under 11 AAC 83.303.

Potential Hydrocarbon Accumulation

There are four main reasons why Linc, in both its unit application and its appeal, failed to demonstrate that the proposed unit includes a hydrocarbon trap.

First, Linc did not provide supporting data that reasonably defined and delineated a structural or stratigraphic entrapping mechanism. Specifically, Linc's data did not establish the presence of a four-way closure--a structural entrapping mechanism. Linc provided only one seismic line and that demonstrated a two-way closure. Absent from the data is a strike line that would demonstrate four-way closure.

Second, Linc's "direct hydrocarbon indicators" assertion is unconvincing. Linc states that there are direct hydrocarbon indicators on the seismic sections (such as high amplitudes and velocity pull-downs) directly over the closure. Absent other analyses, these appear to be non-gas related features.

Third, Linc provided one structure map that does not match the supporting data. Linc's Revised Top Hemlock Structure Map does not match Linc's Top Hemlock well picks in the supporting cross sections.

Fourth, in its appeal, Linc references a structure at the Tyonek that appears as a southwest plunging nose. Linc did not provide a structure map at the Tyonek level to substantiate its statements.

Because much of the data that led to the conclusions above is confidential, a separate, confidential enclosure contains a more detailed explanation as to why Linc has not demonstrated the existence of a potential hydrocarbon accumulation under these lands.

A person affected by this decision may appeal it, in accordance with 11 AAC 02.010 through 11 AAC 02.900. Any appeal must be received within 20 calendar days after the date of "issuance" of this decision, as defined in 11 AAC 02.040 (c) and (d), and may be mailed or delivered to Daniel S. Sullivan, Commissioner, DNR, 550 W. 7th Avenue, Suite 1400, Anchorage, Alaska 99501; faxed to (907) 269-8918, or sent by electronic mail to dnr.appeals@alaska.gov. This decision takes effect immediately. An eligible person must first appeal this decision in accordance with 11 AAC 02.010 through 11 AAC 02.900 before appealing this decision to Superior Court. A copy of 11 AAC 02.010 through 11 AAC 02.900 may be obtained from any regional information office of the Department of Natural Resources.



W.C. Barron
Director
Division of Oil and Gas

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Date

Enclosure: Confidential Information and Discussion
Geological, Geophysical and Engineering Discussion of Linc Energy's Angel Unit
Application

Pages 5 -7 of the Director's Remand decision are Confidential in nature and are stored in the 8th floor vault as well in the secure drive.