Petroleum news

Celebrating 20 years: 1996-2016

page 5 Q&A: Saddler — many unanswered AKLNG questions, lack of clarity

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This week's Mining News

NORTH OF 60 MINING news

page 10 Seabridge CEO Rudi Fronk: Deep Kerr may improve KSM economics

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NEWS NUGGETS

Filling the gap; added drill results reinforce Peak zones connection

EXPLORATION

Enter Trilogy Metals

NovaCopper rebrands to better reflect diversity of metals in Ambler district

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Ask Us About Differential Energy

Matt Budin 907-644-3966

NovaCopper rebrands to better reflect diversity of metals in Ambler district. Read more in North of 60 Mining News, page 9.

Colville River expansion approved

The state is expanding the Colville River unit to include three leases.

With an Aug. 22 decision, Division of Oil and Gas Director Corri Feige approved a request from operator ConocoPhillips Alaska Inc. to add approximately 5,085 acres from three federally managed leases to the southwest corner of the North Slope unit.

According to the decision, the exploration history of the surrounding area suggests potential for encountering a Kuparuk C sand reservoir in the expansion acreage: "The Division acknowledges that the Kuparuk C sand may be below seismic resolution; however, recent successful drilling and production of the Kuparuk C reservoir sands in the CD5 area as well as CPAI's continued effort to advance the infrastructure and resources capable of car-

see **COLVILLE UNIT** page 20

Papp argues for continued Arctic focus from US-chaired council

ROBERT PAPP

As the two-year period of the U.S. chairmanship of the Arctic Council, the intergovernmental forum of the Arctic nations, passes its halfway point, Adm. Robert Papp, U.S. special representative for the Arctic, has been focusing on raising awareness of the Arctic in the United States, to affirm the country's Arctic identity, Papp told a meeting of the Alaska World Affairs Council on Aug. 25.

Papp commented that other countries had become very excited about U.S. leadership in the Arctic Council, given the U.S. reputation for getting things done.

see **ARCTIC FOCUS** page 20

NATURAL GAS

Plan faces uphill slog

Consultants, tax attorneys point out weaknesses in governor's LNG plan

By TIM BRADNER
For Petroleum News

DAVE VAN TUYL

RACHEL WALDHOLZ, AK PUBLIC MEDIA

NIKOS TSAFOS

Gov. Bill Walker's proposal for a state-led natural gas pipeline is creative and could greatly improve the project's competitiveness, North Slope gas producers say. But can it work?

The problem is that two key tenets of the plan, tax-exempt status for a state-led gas project or cost reductions through a third-party investor, face huge hurdles, tax attorneys and a consultant to the Legislature told state lawmakers in a hearing Aug. 25.

Charles Schuetze, a tax attorney with Manley & Brautigam in Anchorage, said it might be possible to gain tax-exempt status for a project totally owned by the state but recent changes to regulations by the Internal Revenue Service will make it difficult.

If the state, through the state-owned Alaska Gasline Development Corp., brings in private partners as investors, as the governor is planning, it would make securing tax-exempt status very difficult, Schuetze said. The IRS lays out certain

see **LNG PLAN** page 19

UTILITIES

Railbelt pool plan moves

Utilities think Southcentral power pool should be operating around turn of year

By ALAN BAILEY
Petroleum News

A new power pooling arrangement in which Anchorage electric utilities Chugach Electric Association and Municipal Light & Power will make optimum combined use of their most efficient power generation facilities should go into operation in the fourth quarter of this year or the first quarter of 2017, utility executives told the Regulatory Commission of Alaska during an Aug. 24 commission meeting. Matanuska Electric Association expects to join the pool shortly afterwards.

The idea is to meet the continuously varying electricity load by making as much use as possible of the utilities' cheapest sources of power, thus

Chugach Electric and ML&P are especially anxious to achieve cost savings through maximum use their new high-efficiency, gas-fired, combined-cycle power plants: the jointly owned Southcentral Power Project and ML&P's Plant 2A.

minimizing the cost of electricity. The procedure, referred to as "economic dispatch," involves using an automated computer system to control the operation of the generators and then use an agreed settlement procedure to apportion the cost of the generation between the utilities involved.

see **POWER POOL** page 18

PIPELINES & DOWNSTREAM

Court: Back to FERC

Federal appeals court disagrees with commission's quality bank decision

By KRISTEN NELSON
Petroleum News

A decision by the Federal Energy Regulatory Commission on the Resid formula used in Quality Bank calculations has been rejected by the U.S. Court of Appeals for the District of Columbia Circuit and remanded to FERC.

FERC initiated an investigation into Resid pricing in 2013 and during that investigation Petro Star argued that Quality Bank methodology undervalued Resid in an unjust and unreasonable manner. FERC rejected Petro Star's argument.

Petro Star petitioned for review.

The court said in an Aug. 30 decision that FERC "failed to respond meaningfully to evidence

The court said Petro Star established a case that new evidence warranted re-examination of the Resid formula.

presented by Petro Star, rendering its decision arbitrary and capricious" and also said the argument that Petro Star failed to provide a viable methodology did not provide an independent ground for FERC's decision.

The Quality Bank, overseen by FERC, addresses the issue that the quality of crude oil shipped on the trans-Alaska oil pipeline varies, and provides a monetary adjustment for the difference in quality between oil put into the line and the oil a company

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Alaska - Mackenzie Rig Report

The Alaska - Mackenzie Rig Report as of August 31, 2016.
Active drilling companies only listed.

TD = rigs equipped with top drive units WO = workover operations
CT = coiled tubing operation SCR = electric rig

This rig report was prepared by Marti Reeve

Rig Owner/Rig Type	Rig No.	Rig Location/Activity	Operator or Status

Alaska Rig Status

North Slope - Onshore

Rig Owner/Rig Type	Rig No.	Rig Location/Activity	Operator or Status
Doyon Drilling			
Dreco 1250 UE	14 (SCR/TD)	Stacked	
Dreco 1000 UE	16 (SCR/TD)	Standby	BP
Dreco D2000 Uebd	19 (SCR/TD)	Alpine CD5-99	ConocoPhillips
AC Mobile	25	Standby	
OIME 2000	141 (SCR/TD)	Kuparuk 2X-13	ConocoPhillips
	142 (SCR/TD)	Kuparuk 2S-06	ConocoPhillips
Hillcorp Alaska LLC			
	Rig No.1	Milne Point	Hilcorp Alaska LLC
Nabors Alaska Drilling			
AC Coil Hybrid	CDR-2	Kuparuk 2F-18	ConocoPhillips
Dreco 1000 UE	2-ES (SCR-TD)	Deadhorse	Available
Mid-Continental U36A	3-S	Deadhorse	Available
Oilwell 700 E	4-ES (SCR)	Deadhorse	Available
Dreco 1000 UE	7-ES (SCR/TD)	Deadhorse	Available
Dreco 1000 UE	9-ES (SCR/TD)	Deadhorse	Available
Oilwell 2000 Hercules	14-E (SCR)	Deadhorse	Available
Oilwell 2000 Hercules	16-E (SCR/TD)	Mustang location	Available
Oilwell 2000 Canrig 1050E	27-E (SCR-TD)	Deadhorse	Available
Oilwell 2000	33-E	Deadhorse	Available
Academy AC Electric CANRIG	99AC (AC-TD)	Deadhorse	Available
OIME 2000	245-E (SCR-ACTD)	Oliktok Point, Stacked	ENI
Academy AC electric CANRIG	105AC (AC-TD)	Deadhorse	Available
Academy AC electric Heli-Rig	106AC (AC-TD)	Deadhorse	Available
Nordic Calista Services			
Superior 700 UE	1 (SCR/CTD)		Available
Superior 700 UE	2 (SCR/CTD)	Prudhoe Bay Drill Site 2, well 14	BP
Ideco 900	3 (SCR/TD)		Available
Parker Drilling Arctic Operating Inc.			
NOV ADS-10SD	272	Prudhoe Bay DS 18	BP
NOV ADS-10SD	273	Prudhoe Bay DSW-59	BP

North Slope - Offshore

Rig Owner/Rig Type	Rig No.	Rig Location/Activity	Operator or Status
BP			
Top Drive, supersized	Liberty rig	Inactive	BP
Doyon Drilling			
Sky top Brewster NE-12	15 (SCR/TD)	Stacked	
Nabors Alaska Drilling			
OIME 1000	19AC (AC-TD)	Oooguruk, Cold Stacked	Caelus Alaska

Interior Alaska

Rig Owner/Rig Type	Rig No.	Rig Location/Activity	Operator or Status
Doyon Drilling			
TSM 7000	Arctic Fox #1	Nenana, Stacked	

Cook Inlet Basin – Onshore

Rig Owner/Rig Type	Rig No.	Rig Location/Activity	Operator or Status
Glacier Oil & Gas			
	Rig 37	West McArthur River Unit Workover	Glacier Oil & Gas
All American Oilfield LLC			
IDECO H-37	AAO 111	In All American Oilfield's yard in Kenai, Alaska	Available
Aurora Well Services			
Franks 300 Srs. Explorer III	AWS 1	Stacked out west side of Cook Inlet	Available
Saxon			
TSM-850	147	Stacked	Hilcorp Alaska LLC
TSM-850	169	Stacked	Hilcorp Alaska LLC
Kuukpik Drilling	5	Offshore Modification	Hilcorp

Cook Inlet Basin – Offshore

Rig Owner/Rig Type	Rig No.	Rig Location/Activity	Operator or Status
Hilcorp Alaska LLC			
National 110	C (TD)	Platform C, Stacked	Hilcorp Alaska LLC
	Rig 51	Steelhead Platform, Stacked	Hilcorp Alaska LLC
	Rig 51	Monopod Platform, Drilling	Hilcorp Alaska LLC
Spartan Drilling			
Baker Marine ILC-Skidoff, jack-up		Spartan 151, Stacked Seward	
Furie Operating Alaska			
Randolf Yost jack-up		Drilling KLU A-2	Furie
Glacier Oil & Gas			
National 1320	35	Osprey Platform, activated	Glacier Oil & Gas

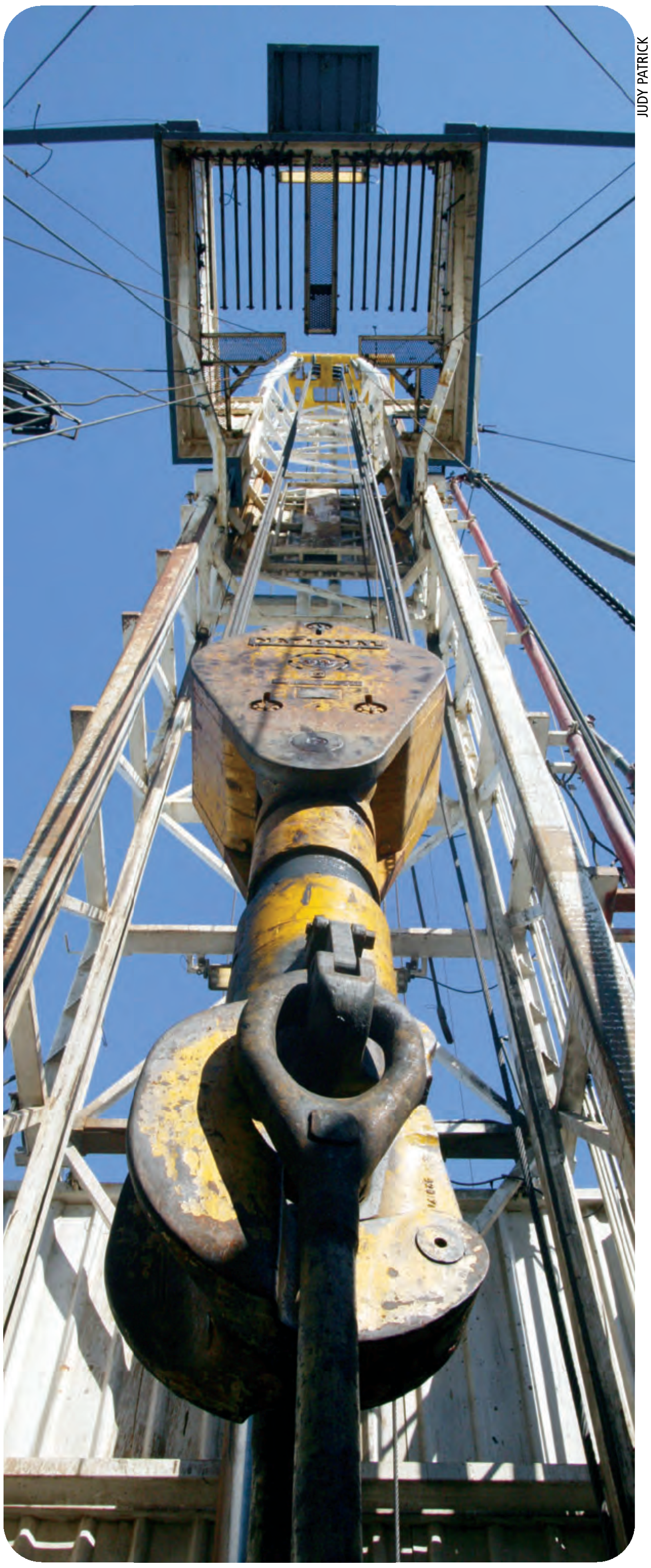
Mackenzie Rig Status

Canadian Beaufort Sea

Rig Owner/Rig Type	Rig No.	Rig Location/Activity	Operator or Status
SDC Drilling Inc.			
SSDC CANMAR Island Rig #2	SDC	Set down at Roland Bay	Available

Central Mackenzie Valley

Rig Owner/Rig Type	Rig No.	Rig Location/Activity	Operator or Status
Akita			
TSM-7000	37	Racked in Norman Well, NT	Available


JUDY PATRICK

Baker Hughes North America rotary rig counts*

	Aug. 26	Aug. 19	Year Ago
United States	489	491	877
Canada	146	121	196
Gulf of Mexico	17	18	29

Highest/Lowest

US/Highest	4530	December 1981
US/Lowest	404	May 2016

*Issued by Baker Hughes since 1944

GOVERNMENT

The complex story of state tax credits

A system to incentivize oil and gas exploration has evolved over the years, along with different tax regimes and changing priorities

By ALAN BAILEY
Petroleum News

Characterized as oil industry subsidies by some and as state resource investments by others, the various tax credits the state of Alaska offers for oil and gas exploration and development have become a major headache in balancing the state's fiscal books in an era of low oil prices. The tax credit system, which began more than 10 years ago, has evolved into a complex arrangement of interrelated laws and regulations.


KEN ALPER

The array of current tax credits needs to be viewed against the backdrop of the state's evolving oil and gas production tax regime; against the state's priorities for encouraging new oil and gas development; and against the impact of recent low oil prices.

Changing tax regime

From the perspective of the tax regime, the first major change came in 2006, with the implementation of the Petroleum Profits Tax, or PPT, in which the state moved from taxing production based on the wellhead value of oil to a tax based on production profits. In 2007 the state Legislature passed the Alaska's Clear and Equitable Share, or ACES tax. ACES, like PPT, was a profits based tax, but with a higher basic tax rate than PPT, and with tax progressivity to heightened rates at higher oil prices. The Senate Bill 21, or SB 21, tax law passed in 2013 eliminated the high oil price progressivity in ACES while increasing the basic tax rate. SB 21 also strengthened a tax floor, introduced in ACES, to prevent the state's tax take falling to zero in low oil profitability situations.

Under SB 21 the tax floor was set at 4 percent of the wellhead value of oil produced.

Against this scenario of changing tax laws came a growing concern about declining Alaska oil production and the need to encourage new oil development. In addition, major concerns in 2010 about potential utility gas shortages from the Cook Inlet basin led to legislative tax action to encourage new exploration and development in that region. Then, in 2012, came a drive to encourage exploration and development in the so-called "Middle Earth" basins, potential petroleum basins in Interior Alaska.

But with the collapse in oil prices and state revenues in 2014, a focus on state cost cutting led to the passage of House Bill 247, or HB 247, this year, a bill that trimmed back some tax credit provisions.

Ken Alper, director of the Alaska Department of Revenue's Tax Division, has explained to Petroleum News the system of state tax credits that has evolved against this background of changing taxes and state priorities.

Exploration credit

The earliest of the credits introduced by Gov. Frank Murkowski in 2003 prior to the enactment of PPT addressed concerns about declining oil production by encouraging the drilling of new exploration wells. Essentially, a company drilling an exploration well more than specified distances from an existing unit or well could claim a credit against taxes of 20 percent of the cost of the new well. Although originally used as a credit against current or future taxes, this credit could later be taken as a tradable and cashable tax credit certificate. The credit changed over the years, eventually becoming a 30 to 40 percent credit, depending on the distance from the existing unit or well, Alper explained.

In general, this exploration credit only applied to drilling conducted prior to July 1, although the state is still processing claims relating to drilling prior to that date. However, under the SB 21 legislation, state lawmakers extended the credit until 2022 for basins in Middle Earth, Alper explained. HB 247 made no changes to this credit, Alper said.

Alper also commented that the sunsetting of this credit this year probably accelerated the start of some exploration projects such as the project at Smith Bay, off the northwestern North Slope.

Qualified capital expenditure

A separate set of credits addressed the encouragement of new investment in oilfield development. For example, the so-called qualified capital expenditure credit, introduced as part of PPT and sometimes called the 20/20 plan, provided a tax credit of 20 percent of the cost of specified types of exploration and development capital expenditure in a tax system that used a base tax rate of 20 percent of production profits. Major oil producers could discount this credit against their tax liabilities, while companies in the process of field development, with no taxable oil production, could obtain a tax credit certificate that could be traded, applied against a future tax liability, or redeemed for cash from the state.

Under SB 21 the qualified capital expenditure credit ceased to apply to the North Slope after Dec. 31, 2013, but continued to operate elsewhere in the state. In Cook Inlet, where the ACES legislation had capped production taxes at levels similar to those prior to PPT, producers ended up paying zero or near zero taxes but remained eligible for substantial qualified capital expenditure credits, Alper commented.

HB 247 reduces the credit in Cook Inlet to 10 percent in 2017, and phases the credit out completely at the end of that year. However, the credit will remain at 10 percent in Middle Earth.

Per-barrel credit

The SB 21 legislation, in part to replace the capital expenditure credit that it eliminated, brought in a new per-barrel credit for oil produced on the North Slope. The tax credit allows a $5-per-barrel credit for the production of new oil. For oil from legacy oil pools, the credit works on

see TAX CREDITS page 14

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● GOVERNMENT

Saddler: Many unanswered AKLNG questions

Eagle River Republican, House Finance vice chair says turnover, lack of clarity driving AKLNG doubt in some legislative camps

By STEVE QUINN
For Petroleum News

Not long after he won his primary race and with that a clear path to another term in office, House Rep. Dan Saddler went right back to work. Even though he's not on House Resources or the Resources finance subcommittee, he pays rapt attention to resource development issues. Most recently he sat at the table during a joint House-Senate Resources committees hearing on the AKLNG project, which featured updates from BP, Exxon, ConocoPhillips, plus analyses from consultants Nikos Tsafos of Enalytica and David Barrowman of Wood MacKenzie, plus Alaska Gasline Development Corp. President Keith Meyer.

Saddler, an Eagle River Republican, shared his views in an interview with Petroleum News.

Petroleum News: What was your take from these last two hearings and where do you think we are heading?


REP. DAN SADDLER

Saddler: My take is the governor's administration is trying hard to bend the curve of the process we have in place — and the governor initially said he supported — and trying to turn it into something that the governor wants but so far is unwilling to clearly delineate. It's clear we all agree the natural gas pipeline is very important for the state's economy and the producers' bottom lines and all the attendant benefits: economic activity; jobs; low-cost energy for the state. But how we get there is the big problem. We have been pursuing a process we thought would work. Now we find out, kind of to our surprise, an entirely new concept is being interposed on top of that old prospect and we are not exactly sure why. The answers to the questions are not very compelling — yet.

Petroleum News: The ability to get the answers you're looking for seems to have been eluding the Legislature since the administration took over. Is that a fair observation?

Saddler: That's a fair assessment. Certainly Bill Walker ran for governor in 2010 on a platform of advancing a natural gas pipeline. That's the whole reason he ran. After winning office in 2014 on largely that same platform, it's clearly been his priority, and I respect that. We've tried to ask questions of him as to what his intent is. It's hardly ever clear what he wants to do. He came into office saying that he was not going to change the schedule and change the process he inherited laid out in SB 138, and the HOA (heads of agreement) joint venture agreement.

But almost immediately he began changing it, changing personnel — Dan Fauske and other members of the AGDC board and staff, the quick change on the attorney general. We've heard a lot of potential ways this project could go but not with a lot of clarity of which way the governor wants to go. So we tried to ask questions and get answers.

Sometimes we are faced with the attorney general claiming attorney-client privilege and saying nothing. Sometimes we are told to submit our questions and we'll get our answers later. Sometimes we ask questions of the governor and he responds with double-talk if you will that may technically fill the answer but it doesn't give us any clarity over what it means, so it's frustrating to not know what the view and the path forward are.

Petroleum News: At what point do you feel the Legislature is going to need some firm answers?

Saddler: I think pretty dang quickly. The governor is going to come to us for a budget for AGDC under his new scenario of state leadership, and it's a state-owned corporation. It's got a separate identity but we are the guys expected to write the checks for increasing the operation to basically replace TransCanada and ExxonMobil as the team leaders of this project. So he's going to ask us for money and I think we have an obligation to the people of Alaska to find out what he intends to do with that money. That's where I think the rubber will meet the road.

Petroleum News: Do you foresee new legislation needed?

Saddler: I think a lot of folks were surprised by the extent to which this governor has taken the broad powers of AGDC to empower the structure of joint power between the state and three producers and he's turned that into a structure that has subverted the original intent. I don't know if we need to have new legislation to restructure AGDC. During the joint Resources hearing the question was raised about whether the state can easily use tax-exempt financing. The attorneys gave us some information that indicated some changes in the state statute regarding AGDC might be more beneficial to making that tax-exempt status more clear. You know we did try with Mia Costello's bill — SB 125 — to improve communication by putting members of the Legislature on the AGDC board as non-voting members, which, to my mind, would have been a good gesture. It passed the House and Senate and the governor vetoed it, which to my mind is a bit of evidence of a desire to not have cooperation and mutual understanding. That's troublesome.

Petroleum News: Did you get a sense of misalignment among the four partners?

Saddler: Well, yes I do, pretty clearly. We can clearly identify alignment under SB 138 with the three producers, the state and TransCanada. And the advantages are pretty well established. But when the governor threw his curve ball of state leadership or ownership that brought some obvious misalignment we heard that Exxon and Conoco maintained their preference for the current structure of the AKLNG project.

But BP indicated they were willing to consider state ownership. Another evidence of misalignment is that Exxon and BP helped fund the Wood MacKenzie study with the state but ConocoPhillips did not, so I'm just wondering what that's about.

We've seen the governor continue to claim the producers want to shelve the project, but Bill McMahon of Exxon made the point rather firmly, he called out the governor for repeated misrepresentation of Exxon's position, so there is evidence of misalignment or at the very least miscommunication.

The original project included TransCanada and they were eliminated from the equation entirely because the administration froze them out of the project. I'm just afraid we are seeing the producers are being frozen out too on the pretext that they don't want to meet the governor's timeline. I'm afraid that could lead to the governor saying, "well there is nobody else standing with the AKLNG project so the state has to go at it alone." It's kind of like the child who is on trial for killing his parents, but throws himself at the mercy of the court because he's an orphan.

Petroleum News: Speaking of the Wood-Mac study, what was your takeaway from it?

Saddler: That the current economics don't make the project economic. The right answer is not to enter the next stage of the project is what the producers said. We had a meeting with Dave Bannerman. He said even the most favorable oil price projections of about $70 a barrel, that AKLNG is marginally economic and still relatively disadvantaged compared to the peer projects. Alaska's supply of gas is known and that's a low cost, but our transportation cost is tremendously higher relative to peer projects. So even if the price goes up and down the delivery cost is a huge factor.

The other takeaway from the Wood MacKenzie presentation is even if the tax exempt financing is a possibility even that doesn't really get us there and it's not a sure thing anyway. So I think the proper conclusion there is not full speed ahead but caution, yellow lights ahead.

Petroleum News: Do you see any advantage to slowing down the project so when the market conditions become more favorable, then you can ramp up easier.

Saddler: I do. Again we signed onto a process where we agreed to spend money to get clear answers based on real facts, not just rhetoric and pie in the sky stuff. In each stage in the process, we examine the facts developed and make a considered decision to move to the next stage or not. We followed that process through pre-FEED, which Steve Butt says is 97 percent complete. So the indication from the producer is we should not proceed to that next step of FEED at this point. Their recommendation is we should go slow, keep carving down the price, continue with the FERC regulatory process and see if prices improve and see if market conditions change. I don't see a compelling reason why that is not the right thing to do here.

Petroleum News: Earlier you touched on taxes. There

see **SADDLER Q&A** page 17

● PIPELINES & DOWNSTREAM

Settlement talks continue on Swanson rate

Hilcorp acquired Swanson River Pipeline from Tesoro subsidiary Kenai Pipeline; current proposed tariff is 40 cents per barrel

By KRISTEN NELSON
Petroleum News

In March the Regulatory Commission of Alaska accepted a stipulation allowing Swanson River Oil Pipeline LLC, a Hilcorp subsidiary, to charge a temporary and refundable rate of 40 cents per barrel for transportation on the Swanson River Oil Pipeline.

In an Aug. 26 order RCA said the parties, Swanson River Oil Pipeline, Tesoro Alaska Co., Kenai Pipeline Co. and the Alaska Attorney General, filed a request Aug. 19 that the docket be held in abeyance until the end of the year so they may continue settlement negotiations. The parties noted in the Aug. 19 request that they had submitted a stipulation to the commission in February, resolving some but not all of the issues in the docket, and allowing SROP to charge a temporary and refundable rate of 40 cents per barrel effective March 1. That rate was to become permanent unless there was a protest from the state or the parties filed an agreement containing a different rate by Aug. 31.

The parties said Aug. 19 that they tried to resolve the matter prior to Aug. 31, but "are still exchanging information in furtherance of a long-term settlement."

They told the commission they believe they can settle the matter by mid-October, and set Oct. 18 as the date the 40 cents per barrel rate would become permanent and not subject to refund unless one of the parties files a protest by Oct. 17 or the parties file an agreement containing a provision to adjust the 40 cents per barrel rate.

Docket dates from 2015

SROP applied to RCA in 2015 to operate under a simplified pipeline tariff rate of 68 cents per barrel, an increase from the 8.9 cents per barrel established in 1992. Hilcorp acquired the pipeline from Kenai Pipe Line in 2013 and a certificate of public convenience and necessity was transferred from Hilcorp to SROP in 2015.

In its Oct. 26 order the commission also said the parties have requested that the commission hold in abeyance a decision on SROP's petition to have the pipeline declared a designated pipeline facility eligible to operate under a simplified pipeline tariff until Oct. 18, at which time SROP would notify the commission whether it still requests that designation.

The commission also said the parties request that the docket be held in abeyance until Dec. 30 to allow them time to complete negotiations on a settlement agreement.

The commission said it was extending to Dec. 30 the date at which the tariff would automatically go into effect absent further action by the commission and said it would determine any further action to be taken related to the proposed tariff and related petition no later than Dec. 30.

The 68 cents

Following the Oct. 1, 2015, filing, Tesoro and Kenai Pipeline Co. protested the proposed 68 cents per barrel tariff, citing depreciation issues, the rate and a procedure to negotiate long-term resolution of rates.

The parties noted in their Feb. 26 stipulation that the pipeline is one of the oldest oil pipelines in Alaska. In 1995, they said, Kenai Pipeline Co., which then owned SROP and other assets, was sold to Tesoro. Hilcorp acquired the Swanson River Pipeline in 2013 and it was transferred to SROP, an affiliate of Hilcorp Alaska, on Feb. 15, 2016.

The parties said Hilcorp Alaska sought depreciated plant information about the pipeline from Kenai Pipeline Co., "but was unable to obtain the information that it sought," and then "relied in part on the KPL Annual Operating Reports to the Commission." That report, however, did not provide separate property balance and depreciation figures for the pipeline which Hilcorp had acquired.

"In reality, as of the date that KPL sold the Pipeline to Hilcorp Alaska, the property balances related to the Pipeline were fully depreciated," the parties said, adding that since Hilcorp filed the tariff, "KPL has provided Hilcorp Alaska with sufficient explanation regarding its carrier property accounts to demonstrate such full depreciation."

"Hilcorp Alaska asserts that if it had known that the Pipeline had no undepreciated plant as of its purchase in 2013, it would have pursued a different strategy in connection with its rate filing," the parties said, adding that Hilcorp is "seeking enough in rates to cover its actual expenses of operating" the SROP.

In their February stipulation the parties said they had reached agreement with respect to settlement of issues raised by Tesoro and Kenai Pipeline, setting an interim and refundable rate and a procedure to negotiate possible long-term resolution of tariff issues.

Zero value

The parties said in February that when Kenai Pipeline sold the Swanson River Pipeline to Hilcorp, its net plant value, cost less accumulated depreciation, was zero, "resulting in a starting rate base of zero at the time of acquisition by Hilcorp Alaska."

The parties said they had agreed to an interim and refundable rate of 40 cents per barrel and said Hilcorp would provide cost support data for that rate to the other parties.

They also said SROP and the Office of the Attorney General, Regulatory Affairs and Public Advocacy Section, "agree to work toward reaching a long-term tariff settlement agreement."

Kenai Pipeline also agreed to file with RCA before May 31 an explanation of adjustments in its 2008 annual operating report and any amendments or supplements warranted in the light of such explanation, as well as amendments to its 2013 and 2014 operating reports to reflect the transfer of Swanson River Pipeline to Hilcorp.

In its March order accepting the parties' February stipulation RCA said it was unclear how the 40 cents per barrel rate was calculated, and said supporting information must be filed with a revised rate.

In a May filing Kenai Pipeline said the Swanson River Pipeline was acquired in 1995 as part of the acquisition of KPL from Chevron, and by 2002 the portion of the acquired assets related to the Swanson River Pipeline was fully depreciated. KPL said the sale price when the asset was sold to Hilcorp Alaska was $150,000. ●

Contact Kristen Nelson at knelson@petroleumnews.com

GOVERNMENT

BLM seeks nominations to advisory council

The federal Bureau of Land Management said Aug. 26 that it continues to seek nominations for five positions on BLM's Alaska Resource Advisory Council. The council advises BLM on public land issues.

BLM said it would accept nominations for 45 days, ending Oct. 10. There was a first call for nominations and individuals who applied in the first call do not need to reapply; nominations from the first and second calls will be considered together.

The council has 15 members with interest or expertise in public land management. Individuals may nominate themselves for the council, and must be residents of Alaska. BLM said they will be evaluated based on training, education and knowledge of Alaska.

"Nominees should also demonstrate a commitment to consensus building and collaborative decision-making," the agency said. A completed application is required, along with letters of reference from any represented interest or organization.

The council has 15 members with interest or expertise in public land management. Individuals may nominate themselves for the council, and must be residents of Alaska. BLM said they will be evaluated based on training, education and knowledge of Alaska.

Five positions are open:

•Two positions in category one, public land ranchers and representatives of organizations associated with energy and mineral development, the timber industry, transportation or rights of way, off-highway vehicle use and commercial recreation.

•Two positions in category two, nationally or regionally recognized environmental organizations, archaeological and historical organizations, dispersed recreation activities and wild horse and burro organizations.

•One position in category three, state, county or local elected officials, representatives and employees of a state agency responsible for management of natural resources, representatives of Indian Tribes, representatives and employees of academic institutions involved in natural sciences and the public at large.

Information and applications are available online at www.blm.gov/ak/rac or by contacting RAC Coordinator June Lowery at jlowery@blm.gov or at 907-271-3130.

—PETROLEUM NEWS

● ENVIRONMENT & SAFETY

Drift River: oil in 20-inch line removed

By KRISTEN NELSON

Petroleum News

Cleanup continues at the Drift River Terminal Facility on the west side of Cook Inlet following two spills discovered in July.

The Alaska Department of Environmental Conservation's Division of Spill Prevention and Response said in an Aug. 25 update that crude oil in the 20-inch fill line was removed Aug. 16, following arrival Aug. 15 of a marine tanker.

The division said in earlier reports that the first spill was discovered July 2 when a Cook Inlet Pipeline Co. operator was doing a facility inspection; the second was found July 28 when pipeline staff inspected areas above the buried 20-inch fill line.

The spill occurred because the 20-inch fill line was over pressurized when two tanks were being emptied in preparation for internal inspection.

Total spill volume unknown

The spill discovered July 2 involved 14 gallons of crude oil inside a valve box, with 1 gallon on the ground.

The spill found July 28 was a crude oil stain at the surface of one of the buried 20-inch fill line blind flanges. CIPL reported a surface stain area with a triangular dimension 24 feet by 24 feet by 30 feet.

On Aug. 10, free product was discovered when workers were excavating a buried flange. The division said the total spill volume is unknown, but CIPL will submit a spill volume estimate based on waste generated as part of its final report.

CIPL and DEC "will discuss the future of the 20-inch fill line system and testing required for the system," the division said.

The division said grid line delineations have been completed at dig site 2, where the oil stain was discovered July 28, and at dig site 1, where free product was discovered Aug. 10.

Dig site 1 is some 12 feet by 20 feet and dig site 2 is some 60 by 60 feet.

Five dig sites identified

The division said five dig sites have been identified to delineate potentially impacted area.

Sheet pilings are required to protect workers at the dig sites and the sheet pilings arrived Aug. 22. The division said CIPL expected to complete staging materials at dig sites 1 and 2 the week ending Aug. 26.

CIPL will continue delineation and contaminated soil excavation once the sheet piling is in place and will submit a soil sampling plan and a waste management plan for DEC approval.

CIPL and DEC "will discuss the future of the 20-inch fill line system and testing required for the system," the division said. ●

NORTH OF 60 MINING news

page 10 Seabridge CEO Rudi Fronk: Deep Kerr may improve KSM economics

www.MiningNewsNorth.com | *The weekly mining newspaper for Alaska and Canada's North* | **Week of September 4, 2016**

NEWS NUGGETS

Compiled by Shane Lasley

SHANE LASLEY

This high-grade skarn mineralization was encountered during the 2012 drilling at the Peak zone. Today, similar mineralization is being traced in the North Peak-Connector zones, an area that shows the potential to significantly increase the gold resource at Tetlin.

Filling the gap; added drill results reinforce Peak zones connection

Contango Ore Inc. Aug. 25 reported second-quarter financial results along with assays from seven additional holes drilled at its Tetlin gold project in eastern Alaska. The company reported a net loss of US$1.2 million, or US31 cents per share, for the year ended June 30, compared with a loss of US$3.6 million, or US94 cents per share, for the same period last year. This substantial reduction in net loss is due to all exploration expenses this year being incurred by Peak Gold LLC, a joint venture under which Royal Alaska, LLC, a wholly-owned subsidiary of Royal Gold Inc., up to a 40 percent interest in Tetlin by investing up to US$30 million in the project by October 2018. This earn-in spending is being invested into the exploration and development of the Peak deposit as well as other new gold-bearing areas across the Tetlin properties, near the crossroads community of Tok. TET16210, the last hole of the 2016 phase 1 winter drill program at Tetlin, tested an idea that the North Peak zone and Peak deposit may be two parts of a continuous band of skarn mineralization. Drilled about 200 meters southeast of North Peak and 200 meters northeast of Peak, TET16210 cut two mineralized intercepts, including 43.96 meters averaging 3.28 grams per metric ton gold, 30.6 g/t silver and 0.402 percent copper. During the summer program by Peak Gold,

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BONNIE BROMAN, COURTESY OF NOVACOPPER INC.

NovaCopper will soon be known as Trilogy Metals, a name that better reflects the copper, zinc and precious metals found at Arctic, a high-grade volcanogenic massive sulfide deposit that lies under the mountain across this valley.

EXPLORATION

Enter Trilogy Metals

NovaCopper rebrands to better reflect diversity of metals in Ambler district

By SHANE LASLEY

Mining News

What does a name say about a company? Management of NovaCopper Inc. feels that its corporate moniker does not say enough about the diversity of metals present in the high-grade deposits encompassed by its Upper Kobuk Minerals Projects in the Ambler mining district of Northwest Alaska.

Arctic, the most advanced UKMP deposit, actually hosts more zinc than it does copper. And, while copper remains the dominant metal in terms of value, zinc supply shortages are closing the price gap between these two metals. Additionally, strong gold and silver prices have increased precious metals contributions to Arctic's value this year.

"The Ambler district is more than just copper – it is copper; it's zinc; (and) it's precious metals," NovaCopper President and CEO Rick Van Nieuwenhuyse explained in a recent interview.

As such, when markets open in Toronto and New York Sept. 8, NovaCopper Inc. will be no more. In its place, Trilogy Metals Inc., trading under the symbol TMQ, will grace the boards of the Toronto Stock

see **TRILOGY METALS** *page 10*

NORTHERN NEIGHBORS

Compiled by Shane Lasley


SEABRIDGE GOLD INC.

The first two holes drilled at Deep Kerr this year have successfully expanded the breadth of this important copper-gold deposit at KSM. To efficiently continue to test this deep deposit, the company will wedge off these two holes to target new areas of the Deep Kerr expansion area.

Drilling expands Deep Kerr deposit at KSM

Seabridge Gold Inc. Aug. 30 said results from the first two core holes drilled this year into the Deep Kerr deposit indicate an increase in the potential mining rate from the proposed underground block cave shapes for the copper-gold deposit at the KSM project in northwestern British Columbia. In March, Seabridge published an updated resource estimate for Deep Kerr of 1.01 billion metric tons of inferred resource grading 0.53 percent (11.8 billion pounds) copper and 0.35 g/t (11.3 million ounces) gold. The first two holes drilled this year have confirmed continuity of mineralization in Deep Kerr over considerable distances south of the deposit. K-16-51, located about 125 meters south of the current resource limits, cut multiple zones including 119 meters averaging 0.44 g/t gold and 0.45 percent copper and 187 meters averaging 0.33 g/t gold and 0.46 percent copper. K-16-52 cut 231 meters grading 0.31 g/t gold and 0.47 percent copper about 500 meters to the south of K-16-51. With grades consistent with the inferred resource, these holes are expected to expand the known resource in the shape and orientation required to optimize the proposed Deep Kerr mine plan at a higher throughput. "This year's drill program has been carefully designed to expand and optimize the prospective mine plan at Deep Kerr and thereby improve the KSM project's potential economics," said Seabridge Chairman and CEO Rudi Fronk. "Overall, Deep Kerr is once again demonstrating that it has very few equals for size and grade." K-16-51 and K-16-52 have been re-entered for so-called daughter holes which use the upper part of the original hole before being wedged into new intercepts of the target zone. The daughter holes are targeted to fill in the gaps along strike from the original drill holes.

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NEWS NUGGETS

drilling has encountered high-grade gold mineralization between the southern end of North Peak and TET16210. All seven holes reported by Contango Ore on Aug. 25 encountered significant width of gold mineralization in this North Peak-Connector zone at Tetlin. TET16242, drilled adjacent to TET16210, cut five gold mineralized intercepts, including 26.35 meters averaging 5.55 g/t gold from a depth of 37.58 meters. TET16244, drilled 100 meters northwest of the Connector zone discovery hole, cut three gold mineralized intercepts, including 26.35 meters averaging 5.55 g/t gold from a depth of 11.74 meters. TET16248, drilled 25 meters northeast of TET16244, cut six gold mineralized intercepts: 1.37 meters of 9.29 g/t gold from a depth of 9.38 meters; 9.06 meters of 5.02 g/t gold from 11.74 meters; 5.78 meters of 1.79 g/t gold from 30.78 meters; 2.74 meters of 10.62 g/t gold from 43.22 meters; 4.98 meters of 5.53 g/t gold from 52.75 meters; and 10.79 meters of 4.05 g/t gold from 61.23 meters. Assays from the summer program at Tetlin are expected to continue to roll in during the coming weeks. Contango Ore President and CEO Brad Juneau is scheduled to speak at the Denver Gold Forum on Sept. 19.

More funds for Caribou Dome

Coventry Resources Ltd. Aug. 29 reported binding agreements with investors who have subscribed for 56.47 million shares at AU3.2 cents per share, to raise a total of AU$1.8 million. The company's two largest institutional shareholders, Lowell Resources Fund and Ruffer Gold Fund, have agreed to participate in the financing. Coventry said both continue to be very supportive of the company's exploration activities at the high-grade Caribou Dome copper project in Alaska. The proceeds will be used to continue exploration at Caribou Dome. Coventry said preliminary data from a recently completed induced polarization survey, covering 4.4 miles (seven kilometers) of the prospective horizon that hosts a previously identified high-grade copper deposit at Caribou Dome has identified a number of high priority exploration targets. One of two rigs operating on the property is testing some of these new targets, with a view to rapidly expanding the resource base. The other rig is focusing on the thick, shallow high-grade mineralization at the Caribou Dome deposit itself, with extensional and infill drilling to be undertaken in the coming weeks to continue to improve confidence in developing a potential high-grade starter open pit. ●

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TRILOGY METALS

Exchange and NYSE-MKT.

NovaCopper shares under the previous symbol, NCQ, will seamlessly transition to Trilogy Metals shares, requiring no action for current shareholders.

Transition to Trilogy

Spun out of Novagold Resources Ltd. in 2012 to continue the exploration of Arctic and Bornite, two of the highest grade unmined copper deposits in the world, NovaCopper was a natural choice for the Ambler mining district focused exploration company.

In the months leading up to the formation of NovaCopper, Van Nieuwenhuyse, who was then president and CEO of Novagold, forged a partnership with NANA Regional Corp. that brought together a large package of Novagold-owned mining claims blanketing a 70-mile- (110 kilometer) long belt of high-grade copper-lead-zinc-gold-silver deposits with an adjacent package of NANA-owned lands known for hosting exceptionally high-grade copper.

The alliance provides the Inupiat-owned Alaska Native regional corporation with the opportunity to benefit from the exploration and eventual development of the world-class Arctic deposit and other similar volcanogenic massive sulfide prospects across the Ambler belt. In return, NovaCopper was given the opportunity to investigate Bornite, a copper-rich deposit situated about 16 miles (26 kilometers) southwest of Arctic, and explore other mineral prospects across a large highly prospective swath of NANA lands in the Upper Kobuk region.

Over the ensuing four years, the partnership and the mineral endowment found on the 353,000 acres of UKMP lands has grown.

Today, the Arctic and Bornite deposits together are believed to host roughly 8.4 billion pounds of copper; 2.6 billion lbs. of zinc; 610,000 oz. of gold; 45.3 million oz. of silver; as well as significant quantities of lead and cobalt.

It is the natural diversity this broad range of metals – especially the zinc and precious metals components of Arctic, the UKMP deposit nearest to a production decision – that prompted the transition to the new name of Trilogy Metals.

Arctic focus

Over the past two years, the rebranded company has focused its field work on gathering the last bits of information needed to complete a pre-feasibility study that will

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Petroleum news

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NORTHERN NEIGHBORS

Millrock buys operations base for exploring Golden Triangle

Millrock Resources Inc. Aug. 30 reported the purchase of an exploration operations facility in the town of Stewart, B. C. from J. Calder Resources Inc. and Geofine Exploration Consultants. The facility, which consists of a house-office, a large storage garage, and core-cutting facility, is situated on eight real estate lots. The facility sits on a large gravel pad and the lot is securely fenced for safe storage of drill core and equipment. An array of exploration equipment also was included in the purchase. Millrock President and CEO Gregory Beischer said, “This facility will make an excellent base of operations for continued exploration of Millrock’s existing projects in the Golden Triangle, and for those we generate in the future.” In exchange for the facility, Millrock will pay C$300,000 over two years and issue 50,000 Millrock shares.

Silver Range to sell Uptown Gold

Silver Range Resources Ltd. Aug. 30 said it has signed a letter of intent to option the Up Town gold project located about five kilometers (three miles) northwest of Yellowknife to Rover Metals Corp. The property covers eight gold showings, collectively defining two corridors of structurally hosted high-grade gold mineralization sub-parallel to the shear zone hosting the historical 8.1-million-ounce gold deposit that supported the Giant Mine. The Fox South shear at Uptown is 1,100 meters west of the Brock shaft at Giant and consists of a 10- to 70-meter-wide reverse shear zone mapped over a strike length of 400 meters. Grab samples from this zone have assayed up to 30.3 grams per metric ton gold and sawn channel sample results have returned up to 1.1 meter of 2.20 g/t gold. Two holes have been drilled into this zone, returning 4.14 meters of 2.62 g/t gold and 2.13 meters of 4.67 g/t gold. Farther west, seven showings define a 4,500-meter-long corridor of structurally hosted gold occurrences. Rover Metals Corp. is a private gold exploration and small-scale gold production company focused on assets in Canada and Colombia. Under the terms of the agreement, Rover has the option to purchase a 75 percent interest in Uptown Gold over a three-year term in return for C$300,000 in cash; 7.5 percent of Rover’s outstanding shares upon signing; and a work commitment of C$1.6 million. Once vested, Rover has the option to purchase the remaining 25 percent of the property by issuing Silver Range 4.9 percent of its shares outstanding at the time thereof. If Rover acquires full ownership of Uptown, Silver Range will retain a 2 percent net smelter return, half of which may be purchased for C$1 million. Advance royalty payments of C$50,000 per annum would be due to Silver Range on the fifth anniversary of a definitive agreement.

Comstock returns to drill QV

Comstock Metals Ltd. Aug. 30 said a 2,500-meter rotary air blast drill program is now underway at its QV gold project in the White Gold district, Yukon Territory. This program will test for extensions of the VG Zone, where 3,400 meters of diamond drilling in 17 holes formed the basis for a maiden inferred mineral resource of 4.4 million metric tons averaging 1.65 grams per metric ton (230,000 ounces) gold. Initial testing of strong gold-in-soil anomalies with coincident resistivity at the Stewart and Shadow targets also will be carried out.


KENNADY DIAMONDS INC.

Select diamonds from a bulk sample collected from the Kelvin kimberlite at Kennady North. These, along with diamonds collected from a 620-metric-ton sample currently being processed will provide information for a preliminary economic assessment expected by year’s end.

Validating Faraday kimberlites

Kennady Diamonds Inc. Aug. 30 provided an update on the summer drilling program on the Kennady North diamond project in Nunavut. Exploration and delineation drilling is being conducted from two land-based setups. One rig is focused on the Faraday 1 and Faraday 3 kimberlite complex, and the second rig is targeting Faraday 2. One hole at Faraday 2 cut 30.3 meters of continuous kimberlite, with Faraday 3 producing three separate intersects of 18.3, 20.7and 28.7 meters. Kennady Diamonds President and CEO Rory Moore said, “Our exploration model continues to be validated at Kennady North, with eight of the nine latest drill holes intersecting kimberlite.” It is anticipated that more than 8,000 meters of core drilling will be completed on the Faraday kimberlites by the end of the summer program, with the results incorporated into defining a diamond resource along the Kelvin-Faraday corridor. Additionally, the company said the results from the processing of a 620-metric-ton bulk sample collected from the Kelvin kimberlite at Kennady North is expected in September.

Locals call for Back River review

Sabina Gold & Silver Corp. Aug. 30 provided a permitting update on its Back River gold project in Nunavut. A June report by the Nunavut Impact Review Board recommended to the Minister of Indigenous and Northern Affairs Canada not to advance the Back River project to the next phase of permitting at this time. Sabina submitted an extensive response to the NIRB Report to the minister and requested that the minister either reject the report or send it back to NIRB for further review. Kitikmeot Inuit Association, which is the designated Inuit organization responsible for the lands and the people of the Kitikmeot Region where Back River is located, and the Government of Nunavut have both requested that the project be returned to NIRB for further review. “KIA agrees that Sabina has proposed to conduct careful and comprehensive caribou monitoring and mitigation programs based in a Wildlife Mitigation and Monitoring Plan and a Wildlife Effects Monitoring Plan. While KIA said it is satisfied with these plans, the organization also noted that the plans were only finalized during the hearing and these final details were the subject of a joint submission by Sabina, KIA and the Government of Nunavut on the final day of the hearing. “Unfortunately, that meant the [NIRB] Board did not have the benefit of a full airing of these revised plans,” KIA President Stanley Anablak penned in a letter to the minister. In its letter to the federal minister, the Nunavut government said sending the report “back to the NIRB for further review and public hearings may be the most responsible and expeditious way forward, and the one that provides the best opportunity to advance responsible development to provide economic opportunities for Nunavut’s communities while respecting Inuit societal values and protecting the integrity of our land, water and wildlife.” Sabina said its extensive engagement in the Kitikmeot region have resulted in continued broad support for Back River as evidenced by the many letters to the minister in favor of the project.

Two Hope Bay milestones reached

TMAC Resources Inc. Aug. 29 reported the safe delivery of the processing plant to its Hope Bay gold mine project in Nunavut. “We remain on track to advance the Hope Bay Project towards commercial production in early 2017,” said TMAC CEO Catharine Farrow. “As of this week, the mill building is nearing full completion with the steel erected, the wall paneling and roofing installed and only some civil work remaining. We have initiated the movement of the recently off-loaded processing plant components into the mill building.” The processing plant was fabricated at Gekko Systems’ facilities in Australia and shipped to Hope Bay in northern Nunavut. The motor control components for the plant were shipped to Vancouver, trucked to Yellowknife and then flown to Hope Bay. This allowed for early arrival and installation of these components, which will expedite installation and commissioning of the processing plant. Other vital plant components, including thickeners, select conveyors and filter presses, arrived at site in an east coast freighter that offloaded at Hope Bay earlier in August. “With this critical portion of the 2016 sealift behind us we are now totally focused on assembling and commissioning the processing plant as planned. Additionally, the underground mining continues to advance smoothly. We remain on plan and budget and are making excellent progress toward building the first gold mine in what we believe to be Canada’s next gold mining district,” Farrow added.

Additionally, TMAC reported that Caroline Bennett, minister, Indigenous and Northern Affairs Canada, has accepted the Nunavut Impact Review Board recommendation to allow TMAC’s proposed amendments to the Doris North gold project to proceed. TMAC is currently permitted to deposit 458,000 metric tons of tailings – about 1.5 years of currently planned production – into an already permitted tailings impoundment area. The requested amendment increases the tailings that may be

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TRILOGY METALS

outline plans to develop an open pit mine at Arctic.

A roughly 3,000-meter drill program at Arctic was the biggest ticket item of this year's field program.

Prior to a similar infill drill program completed last year, Arctic hosted 23.85 million metric tons of indicated resource averaging 3.26 percent (1.71 billion lbs.) copper, 4.45 percent (2.34 billion lbs.) zinc, 0.76 percent (400 million lbs.) lead, 0.71 grams per metric ton (550,000 oz.) gold, and 53.2 g/t (40.8 million oz.) silver.

This VMS deposit also contains an estimated 3.63 million metric tons of inferred resource averaging 3.22 percent (239 million lbs.) copper, 3.84 percent (285 million lbs.) zinc, 0.58 percent (43.2 million lbs.) lead and 0.59 g/t (60,000 oz.) gold.

"What is so spectacular about Arctic is it hosts really fantastic grades," said Van Nieuwenhuyse.

Drilling over the past two seasons has focused on upgrading much of the inferred resources to the higher confidence measured and indicated categories; some pit expansion drilling; and holes targeted to collect pit slope stability, hydrology and metallurgical information.

Thanks in part to great weather at Arctic this year, the 2016 program came in under the US$5.5 million budgeted for the field work.

Trilogy Metals is expected to release results from this drilling and the other field work in October.

Advancing Ambler

When Trilogy Metals returns to the Ambler district in 2017, the company plans to complete the geotechnical work needed to further refine locations for a power plant, mill, waste rock pile, stockpiles and tailings facilities for the Arctic mine plan to be detailed in the prefeasibility study.

The renamed company also would like to resume drilling at Bornite, a copper-rich carbonate replacement deposit that is reminiscent of those found in the African Copper Belt of southern Africa and the Mt. Isa district of Queensland, Australia.

Using a 0.50 percent copper cutoff grade, Bornite now hosts an estimated 40.5 million metric tons of in-pit indicated resources averaging 1.02 percent (913 million pounds) copper; and 84.1 million metric tons of inferred resources averaging 0.95 percent (1.8 billion lbs.) copper.

Additionally, at a 1.50 percent copper cutoff grade, Bornite is estimated to contain 57.8 million metric tons of below-pit inferred resources averaging 2.89 percent (3.7 billion lbs.) copper.

While already world-class in terms of both size and grade, the various zones of Bornite are open to expansion in several directions. The most compelling area is a 1,000-meter-wide stretch of continuing high grades along the northern front.

Hole RC13-0220, the most northeasterly hole drilled at Bornite cut three very high-grade intervals from 877 to 923 meters (at a 2.0 percent cutoff): 5.9 meters of 6.66 percent copper; 9.9 meters of 2.48 percent copper; and 19.7 meters of 2.24 percent copper.

Hole RC13-0224, drilled about 800 meters west of hole 220, cut five high-grade intercepts from 579 meters to 755 meters along this northern front: 19.5 meters of 3.02 percent copper; 16.8 meters of 2.36 percent copper; 39.5 meters of 2.37 percent copper; 8.6 meters of 3.26 percent copper; and 6.5 meters of 7.7 percent copper.

Trilogy believes that continued expansion in this direction could put the grades and size of its Ambler deposits on par with Mount Isa, where more than 400 million metric tons of ore grading 2.12 percent copper has been mined over the past 75 years.

Financial footing

An innovative financing completed last year puts Trilogy Metals in a good position to finish the pre-feasibility work at Arctic and continue exploration at Bornite.

In mid-2015, the company closed the buyout of Sunward Resources Ltd., a fellow exploration company with roughly US$20 million in the bank but a market cap hovering around US$13 million.

In exchange for the cash and Sunward's Titiribi gold-copper project in Columbia, NovaCopper issued 43.1 million shares to Sunward shareholders.

When Trilogy Metals lights up the boards of the TSX and NYSE-MKT exchanges, it will have nearly US$10 million of this cash remaining in its treasury.

Adding to this strong financial footing, the company cut a deal in mid-August to sell the Titiribi property to Brazil Resources Inc., an exploration company with a growing portfolio of gold and copper properties in South America and Alaska.

In exchange for the Columbia gold-copper property, Trilogy will hold 5 million Brazil Resources shares. With a 50-day moving average of C$2.60 per share, these shares are currently worth about C$13 million.

"While we believe the Titiribi property has excellent exploration potential and a strong local team, the sale allows NovaCopper (Trilogy) to focus on its high-grade copper, zinc and precious metals projects located in Northwest Alaska," said Van Nieuwenhuyse. ●

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NORTHERN NEIGHBORS

deposited into the facility to 2.5 million metric tons, sufficient for the current life of mine production plan at Doris. With the minister approval, NIRB can now finalize the amended project certificate. It also allows the Nunavut Water Board to proceed with consideration of an amended water license. The public hearing on the new water license for Doris is scheduled for mid-September.

Northern Empire vends Kiyuk Lake

Northern Empire Resources Corp. Aug. 29 reported a definitive agreement to sell its Kiyuk Lake gold property in Nunavut to Montego Resources Inc., a Vancouver B.C.-based junior exploration company incorporated in 2012. Under the terms of the agreement, Northern Empire will transfer its 100 percent interest in Kiyuk Lake (subject to a 2 percent net smelter return royalty to the original property vendor) in exchange for 6.68 million Montego shares, or 19.99 percent of that company's issued and outstanding shares. After the vending of Kiyuk Lake, Northern Empire's portfolio includes Richardson and Hilltop, adjacent gold properties about 70 miles southeast of Fairbanks, Alaska. ●

● ENVIRONMENT & SAFETY

Flint v. Williams remanded to Superior Court

Supreme Court reverses statute of limitations for off-property sulfolane contamination, upholds on-property, equitable conclusions

By KRISTEN NELSON
Petroleum News

The Alaska Supreme Court has partially reversed and partially affirmed Superior Court rulings in the case Flint Hills Resources brought against Williams Alaska Petroleum and The Williams Companies over sulfolane contamination at the Flint Hills North Pole refinery and on adjacent property.

Flint Hills acquired the refinery from Williams in 2004.

In its decision, issued Aug. 26, the Supreme Court said that Williams Alaska Petroleum, which owned the North Pole refinery until 2004, knew that the then-unregulated chemical sulfolane, a solvent, was present in groundwater on refinery property, but did not know that it had migrated off the property.

Almost immediately after Flint Hills purchased the refinery it was notified by the Alaska Department of Environmental Conservation that sulfolane was to be a regulated chemical and that Flint Hills needed to find the source of sulfolane in the refinery groundwater.

Flint Hills was also warned by its environmental contractor that sulfolane could be leaving the refinery property and that more work was needed to determine the extent of the problem, the court said.

Flint Hills drilled perimeter wells in 2008 and discovered that sulfolane was migrating beyond refinery property and contaminating drinking water in North Pole.

A resident sued Flint Hills and Williams and Flint Hills cross-claimed against Williams, the court said. The Superior Court dismissed Flint Hills' claims as time-barred and Flint Hills appealed.

The Supreme Court said it affirmed Superior Court rulings on the damages' cap provisions in the sales contract, and on Flint Hills' equitable claims, but found the Superior Court was in error on time barring part of its statutory claims.

Sulfolane found in 2001

The court said Williams discovered sulfolane in the refinery's groundwater in 2001, but at that time sulfolane, a solvent used to strip out parts of crude oil used to make gasoline, was not a regulated chemical.

When it purchased the refinery in 2004 Flint Hills agreed to assume responsibility for existing and known contaminants on refinery property, including sulfolane. At that time the parties believed sulfolane was only on refinery property.

Flint Hills requested a study on subsurface contamination from Shannon & Wilson in 2004 and in 2005 Shannon & Wilson proposed groundwater monitoring wells, which were installed. In 2006 Shannon & Wilson told Flint Hills it believed sulfolane likely to travel with groundwater and recommended sentry wells at the property boundary and in 2008 Flint Hills installed monitoring wells which confirmed that sulfolane had migrated beyond the refinery property.

A North Pole homeowner sued Flint Hills and Williams in 2010 over sulfolane contamination in his drinking water and Flint Hills filed a cross-claim against Williams for costs of remediation efforts.

Supreme Court ruling

The Supreme Court ruled that the Superior Court was in error when it ruled contractual indemnification claims were time-barred and concluded that a six-year statute of limitations applied for statutory claims arising from sulfolane leakage off the refinery property, but also found that a two-year statute of limitations applied for sulfolane on the Flint Hills refinery property.

The Supreme Court said there was no benefit to Flint Hills in waiting to seek indemnity from Williams and said in the context of a breach of contract, "the statute of limitations begins to run when the indemnifying party refuses the indemnified party's request for indemnification."

It said it agreed with the Superior Court that Flint Hills' statutory claim is time-barred for sulfolane contamination on the refinery property, but found that liability to owners of property outside the refinery boundaries is subject to a six-year statute of limitations for trespass claims.

The Superior Court said Flint Hills should have concluded long before May 2008 that sulfolane had migrated beyond sampling disclosed in its agreement with Williams, and barred the claim based on the two-year statute of limitations.

But, the Supreme Court said, Flint Hills' statutory claim for contamination on neighboring properties is subject to the six-year statute of limitations, and was timely because it was filed within the six-year period beginning in July 2004.

Flint Hills' claims for damages on its own property, however, are barred by the two-year statute of limitations.

The Supreme Court reversed the Superior Court's ruling that Flint Hills' contractual indemnity clause claim and its statutory claim for off-site damages are time-barred, while affirming other Superior Court rulings, and remands the case to Superior Court for further proceedings. ●

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GOVERNMENT

Interior publishes revised offshore regs

The U.S. Department of the Interior has published a final version of revised regulations for the safety of offshore oil and gas production, the agency said Aug. 26. The revisions bring the previous regulations up to date by incorporating new technologies while addressing issues such as production safety systems, subsurface safety devices, safety device testing and production processing systems. The regulations go into effect 60 days after publication in the Federal Register, although the compliance dates for some items within the regulations have been deferred.

The regulations incorporate industry standards and best practices for the use of offshore safety equipment and systems while also prescribing maintenance, testing and reporting requirements for specific production and subsurface safety devices, Interior says.

"The department has a responsibility to update its regulations to keep pace with advancing technology and ensure the safest possible offshore oil and gas operations," said Deputy Assistant Secretary for the Interior Amanda Leiter when announcing the revised regulations. "The regulations issued today reflect the industry's shift to deeper waters and adoption of more sophisticated technology."

"By updating the requirements for these critical safety systems, we are meeting our commitment to promote the highest level of protection for both offshore workers and the environment," said BSEE Director Brian Salerno. "The rulemaking process allowed us to develop the most effective and timely revisions by incorporating input from our partner federal agencies, industry and research organizations."

—ALAN BAILEY

The tax credit payment challenge

With the crash in state oil revenues and the subsequent vetoes by Gov. Walker of the immediate payout by the state for some money claimed against state tax credit certificates, the intricacies of the tax credit system have become a significant worry in the continuing economics of oil and gas exploration and development in Alaska.

While major oil producers in Alaska have used the credits to lower their tax bills, companies engaged solely in exploration or in new field development have been able to take some credits as tax credit certificates, usable to discount against future tax liabilities or exchangeable for cash from the state. A certificate can be sold to a third party, in which case the third party has to use the certificate as a tax discount and cannot cash the certificate in.

Ken Alper, director of the Alaska Department of Revenue's Tax Division, explained to Petroleum News that a 2013 law allows a company to assign a tax credit to another company at the time of applying for the credit — this type of assignment cannot be conducted retrospectively, after the application has been made. The company to which the certificate is assigned can cash in the certificate with the state at some time after the tax credit has been earned.

This tax credit assignment system, by enabling the guarantee of payments to lenders, has encouraged lenders rather than venture capitalists to invest in the Alaska oil and gas industry, Alper explained.

But the lack of state funds for redeeming the certificates has caused significant problems for tax credit certificate holders, with holders exploring the possibility of recouping at least some funds by selling the certificates to other companies. However, because companies buying the certificates can only redeem the certificates as an offset to Alaska oil production taxes, only Alaska oil producers have any interest in obtaining the certificates. And, with current low oil prices and corresponding low tax liabilities, the producers see relatively little incentive to buy the certificates, a phenomenon that reduces the certificates' market value, Alper explained.

Meanwhile, the governor's vetoes are spreading the state payments against the certificates over multiple years. A provision in House Bill 247, passed by the state Legislature this summer, elevates companies with the highest levels of Alaska hire in the priority for certificate payments. Another provision of the bill requires the state to report each April on companies that received tax credit certificate cash payments in the previous year, and the aggregate amount of those payments for each company.

—ALAN BAILEY

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TAX CREDITS

a sliding scale ranging from $1 to $8 per barrel at oil prices below $150 per barrel. The credit has to be taken against actual taxes, and cannot be cashed or carried forward to a subsequent year.

The per barrel credit sought to eliminate the regressive tax effect of stacking a fixed royalty rate on top of a fixed tax rate at low oil prices — the credit slightly reduces the effective tax rate at low oil prices while increasing the effective rate at oil prices above $100, Alper explained.

HB 247 includes a provision causing new oil to be reclassified as legacy oil after three to seven years, depending on the oil price.

Net operating loss credit

Another credit, called the carried-forward annual loss credit, also referred to as the net operating loss, or NOL, credit, was introduced in conjunction with the move to a profit based tax regime in PPT and ACES. Essentially, under the ACES tax system, with its 25 percent base tax rate, a company could take a tax credit of 25 percent of an operating loss, the idea being to create a level playing field, in which a company with development expenditure but little or no oil production could obtain a similar development tax benefit to a producing company that could offset its costs against its North Slope production revenues.

Thus, the credit percentage was adjusted in synchronization with changes in the tax laws, ending up as 35 percent, a figure that matches the 35 percent tax rate under SB 21.

The production tax and the associated NOL credits for a single company are aggregated for the entire North Slope, rather than being calculated separately for each field that a company is involved in, Alper said. Thus, through the credit, the state can end up, in effect, underwriting some percentage of a field development cost, even for a new field. This phenomenon became particularly heightened during the ACES era, when the tax credit could lower a company's tax rate under the ACES progressive tax formula, Alper commented.

Losses carry forward

A company producing fewer than 50,000 barrels of oil can take the NOL credit as cash from the state, while a major producer can only take the credit against its own tax liabilities. However, if a company operating at a loss earns a tax credit in excess of its tax liability for a year, the company can continue carrying forward the resulting credit year upon year until the entire credit is consumed. Moreover, under the profit-based tax system, if the company's total qualifying expenditures across the North Slope exceed its oil revenues over the course of a year, the excess expenditures carry forward against revenues in subsequent years.

These credit and expenditure carry-forward arrangements are causing a major problem for the state, given the sharp fall in companies' oil revenues as a result of recent low oil prices and the fact that the tax fence is Slope-wide rather than field-wide. Essentially, a company, especially if it is incurring major capital expenditure, can generate carry-forward credits that reduce its tax liability to zero, thus undermining the supposed tax floor set under SB 21, potentially over several years.

Despite a lengthy debate about making changes to the NOL credits to harden the tax floor, HB 247 did not make any changes to the NOL credit rules for the North Slope. However, the bill is phasing out the credit in Cook Inlet by the end of 2017, with the credit in Middle Earth dropping to 15 percent of losses, starting in 2017.

Small producer credit

PPT also brought in a small producer credit that allowed companies with oil production below a certain level to obtain a credit prorated up to $12 million per year, depending on the production level. The credit, once invoked, applied for up to nine years of continuous production. The expiry of this credit on May 1 probably encouraged BlueCrest to start production from the Cook Inlet Cosmopolitan field in April and caused Chugach Electric Association to push for completion of its purchase of a share of the Beluga River gas field before the beginning of May, Alper commented. The credits could only be applied against tax and were not transferable.

Another credit, called the traditional investment expenditure credit that came in conjunction with PPT, created some level of tax certainty during the dramatic changes to the tax regime at that time but was later repealed in conjunction with the ACES legislation.

Cook Inlet incentives

Concerns about declining gas production in the Cook Inlet basin triggered tax legislation in 2010, with a tax credit designed to encourage the development of a new gas storage facility on the Kenai Peninsula, to help utilities warehouse gas supplies for winter use. However, the legislation incorporated a number of incentives for gas exploration and development in Cook Inlet and resulted in what is referred to as the well lease expenditure credit. Working in parallel with the qualified capital expenditures credit, the credit, which applies to the Cook inlet and Middle Earth, consists of 40 percent of certain specified expenditures associated with exploration operations and drilling wells. The well lease expenditure and qualified capital expenditures credits are mutually exclusive, with a company typically splitting its credit claims between the two credits, using the higher rate of the well lease expenditure credit as much as possible.

But a company operating in Cook Inlet can also take an NOL credit, a factor that can result in the state picking up more than

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EXPLORATION & PRODUCTION

Alaska Oil and Gas Conservation Commission August summary

Prudhoe Bay injections

On Aug. 2, the Alaska Oil and Gas Conservation Commission granted (Area Injection Order No. 3B.002, Area Injection Order No. 3B.003 and Area Injection Order No. 4G.001), three requests from BP Exploration (Alaska) Inc. to continue injecting water into specific Prudhoe Bay unit wells. The company had reported a "potential Inner Annulus repressurization" at the PBU S-41A, PBU X-24A and PBU 09-25 wells, which triggered "diagnostics and monitoring." The tests convinced the commission that "the well's condition does not compromise overall well integrity so as to threaten human safety or the environment," although the commission did impose reporting requirements.

On Aug. 16, the commission rescinded and replaced (Area Injection Order No. 3B.004) Area Injection Order No. 3.026, which allowed water injections at the PBU W-42 well.

BP asked for permission in November 2015 to conduct a mechanical integrity test on the well at a pressure of 1,400 pounds per square inch. Shortly thereafter, though, the company decided that advanced corrosion made the well inoperable, which negated its initial request. After resolving some issues with surface equipment, BP resumed water injection and conducted the test at 1,400 psi in July 2016, according to the commission.

The original area injection order in 2009 required that any testing of the well occur at the maximum rate of pressure expected during actual injections, which would have been approximately 1,200 psi. But the existing regulations require any mechanical integrity test to be 1500 psi. The rescinded and replaced area injection order addresses the contradiction by requiring all future pressures tests to meet the regulatory standard.

Additionally, the commission found that "the well's deteriorating condition represents concern for continued injection" and "encouraged" BP to repair the well's tubing.

The current approval will expire at the end of 2018, or sooner "if pressure monitoring, tests or surveys show further deterioration of the well's mechanical integrity."

BlueCrest advancing Hansen

On Aug. 11, the commission granted (Conservation Order No. 728) a request from BlueCrest Alaska Operating LLC for a spacing exemption for the Hansen H-16 well.

The proposed oil well would be within 1,000 feet of an existing well, in the same governmental section, capable of producing from the same pool. The Hansen H-16 well would be a horizontal development well targeting the Hansen Undefined Oil Pool.

"The well path and bottom-hole location for Hansen H-16 were chosen — based on reservoir mapping and modeling results — to ensure greater ultimate recovery by maximizing the amount of wellbore open to the reservoirs, and extracting oil that cannot be efficiently produced by existing wells," the commission wrote in its decision.

Although the commission received two public comments on the application, and a request for a public hearing, no one attended the hearing and therefore the commission

see AOGCC SUMMARY page 17

LAND & LEASING

Call for info for spring Cook Inlet sale

The Alaska Department of Natural Resources, Division of Oil and Gas, has issued a call for substantial new information for Cook Inlet and Alaska Peninsula areawide oil and gas lease sales tentatively scheduled for spring 2017.

For its 2016 Cook Inlet and Alaska Peninsula sales, scheduled for May 4, the state received no bids, a frequent occurrence for Alaska Peninsula sales, but the first time a Cook Inlet areawide sale has failed to attract bidders.

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The division is requesting substantial new information which has become available over the past year. The division said it "generally considers 'substantial new' information to be published research, studies, or data directly relevant to the matters" listed in state statute which the director must address in a best interest finding. The most recent Cook Inlet areawide best interest finding was issued in 2009 and the most recent Alaska Peninsula BIF in 2014.

Information must be received by 5 p.m. Oct. 31.

More information is available on the state's online public notice website.

—KRISTEN NELSON

EXPLORATION & PRODUCTION

Ahtna confirms Saxon rig for Tolsona well

Ahtna Inc., the Native regional corporation for the Copper River region, has confirmed that it will be using the Saxon 147 drilling rig to drill the Tolsona No. 1 natural gas exploration well, about 11.5 miles west of the town of Glennallen. In an Aug. 29 email Ahtna Corporate Communications Director Shannon Blue told Petroleum News that the project team is still firming up the schedule for the drilling project but expects to start drilling about Sept. 20. Meanwhile, the team is beginning to mobilize equipment and materials to the drilling site, Blue said.

Ahtna has previously completed the construction of a new 4-acre gravel pad and access road for the drilling project

Ahtna has previously completed the construction of a new 4-acre gravel pad and access road for the drilling project. The well will target thick Nelchina sandstone intervals at depths between 4,000 and 5,000 feet. The idea is to establish a viable supply of gas in the Copper River region to alleviate the high cost of energy in the region. The drilling project is also creating a number of local jobs.

The region is known to be gas prone. A previous gas exploration well, the Ahtna 1-19 well, drilled about two miles east of the Tolsona well between 2005 and 2007, encountered gas but eventually had to be abandoned because of exceptionally high formation pressures and problems with water encroachment.

—ALAN BAILEY

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TAX CREDITS

50 percent of a company's costs. And all of these credits can be taken as tax credit certificates.

HB 247 is phasing out the well lease expenditure credit, cutting it in half in 2017 and eliminating it in 2018.

A bill introducing a jack-up rig credit for the Cook Inlet was also passed in 2010, to encourage offshore Cook Inlet exploration drilling. This credit expired on July 1 — it may have encouraged companies to bring jack-up rigs to the inlet but was never used, probably because it proved easier to claim the other regular credits.

Middle Earth

In 2012 the Legislature passed bills somewhat paralleling in Middle Earth basins the approach that had been taken to encourage exploration in Cook Inlet. There was a tax credit for the support of LNG storage facilities and a new tax credit of 80 percent of the cost of the first two wells drilled and 75 percent of the cost the first seismic program in each of six defined Interior basin regions. The credit expired on July 1. However, Ahtna Inc., the Native regional corporation planning to drill for gas near Glennallen this year, has obtained a one-year extension to the credit.

Another tax credit, the education tax credit, has been on the books for many years and enables companies to take credits for contributions to qualified educational and vocational programs. This credit does not specifically relate to oil production taxes and can be claimed by wide variety of businesses, not just in the oil industry, Alper said. ●

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The changing state tax credit payments

Data provided by the Alaska Department of Revenue on actual and forecast state tax credit payments provide insights into the workings of the oil and gas tax credit system and the potential impact of recent tax credit legislation.

For example, data for fiscal year 2015 (ended June 30, 2015), indicates $628 million in cash payouts by the state for refunded tax credits earned by companies operating in Alaska. Companies used another $664 million in credits as offsets against Alaska production tax liabilities, resulting in a total of $1.292 million in credits, paid either as cash or as tax liability reductions.

The bulk of the cash credits, $404 million, were paid from operations outside the North Slope, primarily in Cook Inlet. These Cook Inlet cash payments have ramped up steadily, beginning with a figure of just $4 million in 2010, as a result of tax credits introduced at that time to boost the exploration for and development of natural gas from the Cook Inlet basin to meet local utility needs. However, some of the Cook Inlet tax credits are claimed for oil exploration and development, rather than gas, Ken Alper, director of the Alaska Department of Revenue's Tax Division, has told Petroleum News. The bulk of the credits taken against tax liabilities originated from the North Slope, where major oil producers are able to discount a per-barrel oil production credit against their production taxes, assessed under current tax laws. Prior to 2014, major producers on the Slope used a 20 percent qualified capital expenditure credit to reduce their tax bills.

The credits taken as cash payments in fiscal year 2016 were limited to $500 million, because of Gov. Bill Walker's veto of about $200 million in tax credit payments in June 2015, Alper said. The deferred payments were pushed into fiscal year 2017, increasing the estimated FY17 demand to $775 million. Towards that demand, the Legislature appropriated $460 million in the FY17 budget that was passed this year. However, Walker's recent veto of $430 million of this funding limits the payout in FY17 to an estimated $30 million while increasing the FY18 payout to an estimated $1.170 million.

The recent passage of House Bill 247 also has a significant impact on future estimates of tax credit cash payment: The phasing out of Cook Inlet tax credits in this bill caused the estimated future payments to tail off significantly in the next few years.

The Department of Revenue thinks that the credits claimed against tax liabilities on the North Slope will already have dropped dramatically, from $664 million in fiscal year 2015 to an estimated $70 million in fiscal year 2016. This is largely a consequence of lower tax liabilities due to low oil prices. Alper said the department estimates that credits used against liability will likely increase gradually as oil prices recover, to about $300 million by 2020. The estimated demand for cash credits, once the current backlog is paid, is expected to decline to $285 million in fiscal year 2019, and to be below $200 million per year after that, Alper said.

—ALAN BAILEY

Oil Patch Bits

Crowley's Eric Evans promoted to VP of strategy


ERIC EVANS

Setting its sights on future growth opportunities, Crowley Maritime Corp. announced Aug. 15 that veteran company executive Eric Evans has been promoted to vice president of strategy, a newly created position that will focus on facilitating long-term growth through external business partnerships, including mergers and acquisitions.

Evans, who most recently served as vice president of finance and planning for several of the company's business units, will continue to be based in Crowley's Jacksonville, Florida, headquarters. He will report to Carl Fox, senior vice president of corporate services, and will have strong functional ties to John Calvin, senior vice president and controller, as well as the finance teams within each of the company's business units. The project management organization, which is focused on analysis and strategy execution, will report to Evans.

Evans joined Crowley in 1987 in Seattle as an accountant and manager of management reporting for 11 years, supporting the West Coast businesses and taking various short-term assignments in Saudi Arabia and Puerto Rico. In 1997, he took an assignment as administrative manager in Caracas, Venezuela, for Crowley's oilfield logistics company and was there for two years. Evans moved to Jacksonville to serve as the projects manager and finance director from 1999 to 2001 for Crowley's contract services and international operations, then moved to Seattle in a similar role. He was presented the Thomas Crowley Award, the company's highest honor, in 2004 and moved back to Jacksonville in 2009 to support Crowley's petroleum services, technical services, and petroleum distribution and marine services business units. He was promoted to his most recent position as vice president of finance and planning in 2010.

Evans graduated from the University of Pennsylvania's Wharton School in 1987 and is a Washington state CPA.

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SADDLER Q&A

is still no long-term agreement on taxes between the state and the producers. Administrations now and previously have disagreed on when is the right time to secure those. Is it a concern that this hasn't been complete yet?

Saddler: As you know the process called for a special session last fall for the Legislature to approve some of the decisions that had to be made. We were supposed to be presented with commercial terms, with marketing plans, the RIK/RIV decision was supposed to be made. I think we were supposed to have put the constitutional amendment on fiscal on the ballot at that special session. It would have come up in the 2016 general election. The governor slowed things down and stopped negotiations on some of those fronts, so we let the window of opportunity slip to 2018.

Steve Butt's report had a red light, a green light and a yellow light. And the red lights were lack of commercial agreements and lack of tax certainty. Those are not just my concerns that they aren't done yet; those are the producers as well. Exxon, BP and Conoco have made it clear for years and years and years: fiscal certainty was sine qua non (essential action) — without that this project cannot go forward.

I remember the Murkowski administration squaring that circle saying we would do it by contractual basis and we never ever tested that. The current administration seems to think a constitutional amendment is the way to do it, but that's a convenient way to push it off two years and the governor had insisted on a timeline, making a FEED decision.

Petroleum News: Would you like to see efforts move forward?

Saddler: I would have liked to see them happen on the schedule we laid out. I think the people of Alaska need to have the conversation among themselves and see what that means. Maybe having two years of seeing what the next iteration of the plan forward is before that vote happens is a good thing. I'm looking for a good thing. I want a gas pipeline project to go through if it makes economic sense. I don't want it to go through at any cost. I know fiscal certainty on taxes is a critical, essential element. If that requires changing the constitution, it's not my opinion, the state of Alaska and its citizens need to make that decision if the benefits, as I understand them, are worth that long-term commitment.

Petroleum News: Do you view this situation as the state taking over an uneconomic project?

Saddler: I will echo what Nikos Tsafos said, if it's not an economic project and the state takes it over, you've still got a state-owned uneconomic project. Again, the process we laid out seems to show there is a lot of caution and this is not the time to go to FEED but the time to go slow and bring down the cost. I'm concerned that the governor's focus on getting a gas line, on his terms, under Alaska ownership will cloud his judgment as to whether it's the best deal for the state. So I'm concerned the governor will lead us toward a decision to participate or lead an uneconomic project with the hope that it will be better in the future but without any evidence toward that end.

Petroleum News: So what do you need to hear from the governor or Mr. Meyer say between now and when session begins in January?

Saddler: I do have a lot of questions. I need to see if the state can actually qualify for tax-exempt financing and frankly whether income would be tax-exempt or not. I need to know what provisions are being made for payment in lieu of taxes for the communities affected by the pipeline construction. That's a big issue the work the municipal group has done but that's since been suspended. I guess I'd like to know if the governor envisions going it alone to the point that he's willing to pledge the Permanent Fund to back up the state ownership of this project. I guess I'd like to know if there is going to be clear sailing for the FERC permitting. We need to make sure we can get the regulatory permission. The last thing I'd like to know is if the governor will pursue a private letter of ruling on tax-exempt status. If so and the timeline is about a year, why not just continue with the current project design that we have and use that year to continue to carve down the cost and finish the FERC process. I just don't see the governor's compulsion for changing the project structure the next couple of months.

Petroleum News: One constant that's going to be missing soon is project manager Steve Butt. Even those on different sides of various resource development arguments seem to come together in appreciating Steve Butt. He seemed to command people's attention with his thoughts and respect. What does that mean to you?

Saddler: I met with Steve shortly after he was named as the leader of this project a couple of years ago. He's been the face of the AKLNG project every time we've had an important briefing. That continuity, that trust has been a valuable element of this project to me as a legislator. I never had a sense he was representing just Exxon's interest. He was representing the entire working group's interest including TransCanada, BP, ConocoPhillips as well as Exxon. We are going to lose that trust.

I do understand one of the ways that kept the costs down was rotating human resources off the project once the work was done so I can't fault the team for taking him off the job once his work is done. There is no need to keep him on payroll twiddling his thumbs for a year. I would be concerned at who would be the next person leading that effort. Until I know who that person is I really can't denigrate them. There will be some loss of trust, some loss of comfort and one more data point of the project we thought was moving forward has to pause for a while.

Petroleum News: Nikos Tsafos touched on that. When he was meeting with people he felt like he was meeting with someone different every time from the administration.

Saddler: That is problematic to me as well. The working group leaders were always consistent and we had some kind of relationship. Seeing an ever changing parade of people — consultants, commissioners and deputy commissioners — cycle through this project I think is one reason why some people in the Legislature have some discomfort with the governor's direction. It's not clear exactly what direction it is. We've had to make guesses — informed guesses, but still guesses — as to what the ultimate goal is and what the ultimate strategy for getting there was. Even Keith Meyer said at his first meeting was one of the problems he saw was a lack of trust by the Legislature of the administration. I think that changing parade of characters is an important part of that.

Petroleum News: It seems like it's going to fall on him to regain that trust. Where are you with him on that?

Saddler: He's got a way to go. I'll just leave it there.

Petroleum News: Do you feel like AGDC is starting over?

Saddler: Yes, I do. As I said before the legal structure is pretty permissive. It gives pretty broad powers to AGDC to do a lot of things, to create a gas line, to create subsidiaries, the power of eminent domain, a right to certain public resources, so it's a very powerful organization. The staff, executive leadership and the board have almost been entirely flushed by the current administration. The people appointed in their place seem to have an orientation toward a different kind of project.

So yes, I think AGDC has become a new organization with new people and according to my best evaluation with a new mission. That's particularly troubling because the governor came into office promising to maintain the structure and the momentum we had in the system designed by SB 138, and I guess we presumed that meant the executive leadership of AGDC.

Petroleum News: Let's go back to your concern over the tax-exempt status. Did you get any clarity on it or is it being researched?

Saddler: The clear answer is it's pretty murky. It sounds like it's a lot more difficult than it might appear. The clear advice was to ask for a private-letter ruling from the IRS about the tax-exempt status of the financing bonds for the AKLNG project. It sounds like it requires the application be supported by the clear facts of the plan, not hypotheticals, not provisional plans that can be amended later.

I think I heard there are questions that even if tax-exempt status were obtained for the state then it would apply to sections of the project the state actually owns. If the state were to sell off portions of the project, those elements would lose tax-exempt status. It's not entirely clear if the producers as private entities would be able to obtain benefit from this project. I guess the state ownership might obviate that but these are a lot of issues that need to be nailed down. ●

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AOGCC SUMMARY

made its decision based upon the information contained within the original application.

Middle Ground Shoal changes

As initially reported in the Aug. 28 issue of Petroleum News, Hilcorp Alaska LLC proposed a series of changes to Conservation Order No. 44, governing operations for oil and gas production at the offshore Middle Ground Shoal field in the Cook Inlet basin.

The proposed changes come as the company is asking state officials to expand the field to include the North Middle Ground Shoal field and the South Middle Ground Shoal unit.

The commission tentatively scheduled a public hearing on the request for Sept. 20.

—ERIC LIDJI

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POWER POOL

The commission has asked the utilities to pursue voluntary efforts to achieve economic dispatch across the Alaska Railbelt transmission grid, which stretches from the southern Kenai Peninsula to Fairbanks in the Interior. As reported in the Aug. 28 issue of Petroleum News, the utilities propose using a stepwise approach, starting with the Anchorage pool and then progressively expanding this pool to incorporate other utilities.

New power plants

Chugach Electric and ML&P are especially anxious to achieve cost savings through maximum use their new high-efficiency, gas-fired, combined-cycle power plants: the jointly owned Southcentral Power Project and ML&P's Plant 2A. The new Plant 2A has yet to go on line — full implementation of the Anchorage pool is contingent on this plant being in operation. When Matanuska Electric joins the pool, its new power plant at Eklutna, north of Anchorage, will join the economic dispatch power mix. The Eklutna plant has 10 modern internal combustion engines that can be switched in and out, to meet a varying power load.

The Southcentral utilities have been discussing their pooling arrangements with the utilities farther afield on the grid and have said that the pooling method can be expanded across the entire grid. Lee Thibert, CEO of Chugach Electric Association, told the commission that it would likely be possible to bring utilities on the Kenai Peninsula and Fairbanks into the pooling system within a year or two.

Single transmission lines

Apparently one complication in expanding the pool beyond the Anchorage and Matanuska and Susitna valleys area is the fact there are just single transmission lines linking this area to the Kenai Peninsula and Fairbanks. These single lines form single points of failure in the transmission system, requiring adequate power generation capability in each of the regions to ensure continuity of power supplies should one of the single lines break.

Thibert commented to the commissioners that the need for must-run generation units at the far ends of the single transmission ties causes some complications but that these complications can be worked out.

Mark Fouts, Chugach Electric executive manager of fuel and corporate planning, said that the procedures that have been developed in conjunction with the upcoming Anchorage power pool take into account the single transmission tie issue, but that it is essential to ensure that the system works for the other utilities. It may be necessary to operate a looser pool arrangement for the utilities connected to Southcentral via single transmission ties — the prize to be gained is a Railbelt pool that is as optimal as possible, Fouts commented.

Grid upgrades?

There have been discussions over the years about upgrading the transmission grid, including the construction of additional intertie lines, to eliminate the single point of failure problem. And the utilities are moving towards the formation of a single transmission company to operate the grid and hence make investment in grid upgrades more practical.

Tony Izzo, general manager of Matanuska Electric, expressed concern that the benefits to be gained from forming a transmission company must outweigh the associated costs. Izzo commented that, given the current economic challenges that the state faces, there are questions over how much should be spent on grid upgrades. In 2013 the Alaska Energy Authority issued a report suggesting upgrades, including duplication of the interties to the Kenai Peninsula and Fairbanks, at a total cost of more than $900 million. Izzo said he could not envisage coming remotely close to being able to justify that level of expenditure in the current economic climate.

Full use of new power plants

In response to commissioner questions about possible ratepayer concerns that, under economic dispatch, utilities would not make full use of some of the new generation capacity built in recent years at considerable cost, Fouts said that all of the new generation capacity would be required. The various units would all be running, although different units might run more than others, depending on their relative efficiencies.

Mark Johnston, general manager of ML&P, commented that the investments in the generation units continues to be needed and that the selling point for the new pooling arrangement is that electricity consumers will end up saving money. ●

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QUALITY BANK

receives at Valdez. Crude is valued according to the quality of components or "cuts."

The court said Petro Star argued the methodology used by the Quality Bank undervalues Resid, one of the cuts, in an unjust and unreasonable manner. FERC rejected Petro Star's argument.

The court said FERC "failed to respond meaningfully to evidence presented by Petro Star, rendering its decision arbitrary and capricious, and that Petro Star's purported failure to provide a viable methodology does not provide an independent ground for the Commission's decision."

The court granted the petition for review and remanded the case to FERC "to reconsider the methodology used to value Resid or to provide a more reasoned explanation for its approach."

The Resid issue

The court said that six of the nine cuts the Quality Bank uses to value crude have published market prices and can be sold following distillation and without further processing.

But three cuts — Light Distillate, Heavy Distillate and Resid — require additional processing following distillation and thus have no published market prices.

The Quality Bank methodology requires FERC to set a value for these pre-market cuts, which requires starting with published market prices for finished products that could be developed from the pre-market cuts and then deducting additional processing costs required to produce finished products, which requires, the court said, "estimating the costs associated with operating a hypothetical refinery," with the cost deduction for Resid including a 20 percent capital recovery factor, accounting for the capital investment required to build a hypothetical refinery capable of processing pre-market cut into a marketable product, coke.

The case is a challenge to the Quality Bank's valuation formula for Resid, adopted in 2004, the court said.

Original complaint from Flint Hills

In August 2013 Flint Hills, which then operated a refinery in North Pole, brought a complaint to FERC questioning whether the Quality Bank method was just and reasonable and suggesting that "as a result of the capital recovery factor included in Resid's processing cost adjustment, the Quality Bank undervalued Resid relative to the other cuts."

FERC dismissed the complaint on timeliness grounds, but initiated its own investigation into Quality Bank methodology.

Petro Star, also a refiner along the trans-Alaska oil pipeline, intervened to support Flint Hills' position. Both argued that the 20 percent capital investment allowance should be removed from the Resid formula.

The matter was heard by an administrative law judge who rejected the argument for two reasons, saying the companies failed to propose an alternative and also failed to demonstrate that it was unjust and unreasonable to include a capital investment allowance in the processing cost adjustment for Resid.

Petro Star filed exceptions.

FERC affirmed the administrative law judge's decision in its entirety; Petro Star petitioned for review. Flint Hills had by then terminated operations at its North Pole refinery and did not join the appeal.

Petro Star claims

The court said Petro Star's argument on the capital recovery factor "is rooted in theoretical economic principles." The company said that published market prices for the six marketable cuts are "short-run, spot-market prices that do not reflect long-run considerations such as capital investment returns, which are regarded as sunk costs."

But in valuing Resid, the Quality Bank calculation is based on a capital investment allowance assuming a long-term 20 percent return on capital, making the Resid valuation "incommensurate with the valuation of the six marketable cuts, infringing the essential requirement that the Quality Bank 'assign accurate relative values' to the cuts."

The court said Petro Star established a case that new evidence warranted re-examination of the Resid formula.

FERC might find on remand that the existing formula is just and reasonable, the court said, but it must either answer Petro Star's objection or change the formula.

The court also disagreed with FERC's contention that Petro Star was required to propose a just and reasonable alternative methodology, and said that basis was not independent of FERC's rejection of Petro Star's argument that inclusion of the capital recovery factor in the Resid calculation is just and unreasonable. FERC must, the court said, "provide a meaningful response to the new evidence presented by Petro Star." ●

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LNG PLAN

tests for tax-exempt status. "The entity must be classed as a 'political subdivision,' with sovereign (governmental) powers. The (AGDC) project could possibly qualify under this," he said.

However, last February the IRS issued revised rules that added further qualifications, the most important being that the project is under "government control" and "government ownership," Schuetze told the legislators.

This means Walker's plan to bring in new partners would likely cause the project to fail the "government ownership" test, because some of the benefits would flow to private investors, Schuetze said.

Hurdles even for railroad bonding

Eric Wohlforth, a veteran Alaska bond attorney with decades of experience, said flatly that it will not be possible to secure tax-exempt status on bonds issued by AGDC for the project after changes in federal tax law in the federal Tax Reform Act of 1986, and that while it might be possible to get tax-exempt status on bonds issued by the state-owned Alaska Railroad Corp. for the project, there are hurdles even there.

"In my opinion there is no possibility that interest on state of Alaska or Alaska Gasline Development Corp. bonds to finance the project would be exempt from federal income taxation under federal tax law generally applicable to state and local government financing," Wohlforth wrote in a memorandum to legislators.

The Alaska Railroad does has unique and special authority to issue tax-exempt bonds granted by Congress and among its powers the railroad corporation has authority to build pipelines, Wohlforth told legislator at the Aug. 25 hearing.

However, the benefits of the financing have to accrue to the railroad under the federal law that transferred the railroad to the state, he said.

Third-party problems

Meanwhile, a consultant to the Legislature, Nikos Tsafos, with enalytica, a consulting firm, pointed out flaws in the notion that third parties investing in a utility-type project might result in lower costs.

He particularly warned legislators to steer clear any proposal that the state itself buy gas from producers and sell it on world markets, a so-called "merchant" model for the project.

There are huge risks for the state in this idea, Tsafos warned, to the point that financial markets will would be so leery that the state will be unable to get outside funding for gas purchases. "If they (the producers) offer you gas, don't buy it," Tsafos warned legislators.

Producers praise creativity

Despite the uphill fight the governor's plan faces, the three North Slope producers, who are partners with the state in the current Alaska LNG Project pre-feasibility engineering work, praise the creativity of Walker's ideas.

They are ready to turn over the keys to the project to the governor at the end of the year, all three companies said.

Dave Van Tuyl, BP's Alaska manager, recognizes big challenges Alaska LNG faces in its current joint-venture organization but told the committee, "BP is not giving up on the project. Instead we need to change gears and figure out how we can reduce the cost of supply so that the project can be competitive."

"We believe the best way to make that happen is with a state-led project and we support the state's efforts. We are determined to find a way to lower the cost of supply and make Alaska competitive in the global marketplace," Van Tuyl said.

He cited major conclusions of a presentation made a day earlier to the legislators, on Aug. 24, that Alaska LNG's current joint-venture configuration is uneconomic and that a third-party investor, in combination with possible exemption from federal tax, would reduce the cost of supply for Alaska LNG to ranges where it might compete with other LNG.

Van Tuyl said the concept of a third-party investor with a utility-type toll, "would represent a major step-change in the cost of supply. That step alone, converting the up-front capital (invested by producers) into a toll over time, could allow the project to compete globally," Van Tuyl said.

However, "the details matter and there are many that still many that remain to be worked out," he cautioned.

In principle, however, "the state should be able to access lower-cost financing than a taxable entity like BP if the project was financed as a utility, and through the use of things like tax-exempt financing," if those tools are available, he said.

Comments at the hearing by ExxonMobil and ConocoPhillips, two other producers who are partners in Alaska LNG, were similar to those by BP.

Critique of tolling model

Tsafos was quite direct in his critique of the governor's plan, however.

"By itself, a (third party investor) 'tolling' model doesn't reduce the cost of supply," he said. The only way to reduce the cost is to accept a lower return on capital invested to build the project. The concept laid out in the Wood Mackenzie presentation was a third-party investor accepting an 8 percent return on investment compared with 12 percent the North Slope producers would likely require.

Wood Mackenzie also assumed that a state-led project would not pay taxes like the state property tax and state corporate income tax.

Tsafos told legislators that a key weakness in this is that any gain from an increase in LNG market prices would go to the gas owners (of which the state is one, through its royalty gas) and not to the third-party investors in the project who bear all the risk of constructing the project.

Tsafos also questioned whether investors could be brought in at the front end, before the project is built, and agree to an 8 percent return. There are examples, he said, where investors including entities like pension funds buy oil and gas infrastructure, Norway being one example, but this is always done after the project is built and there is no more construction risk, he said.

Even then equity investors may want more than 8 percent, he said. The Permanent Fund itself has a target for a 5 percent total return (not including inflation) but since a good portion of the Fund is invested in low-yield government bonds the Fund's other investments, including in infrastructure, must have higher returns to achieve an average 5 percent total return.

Plausible elements

However, there are plausible elements to the state's plan, Tsafos acknowledged.

In Indonesia, for example, the government owns infrastructure including LNG plants, but construction and operations are managed by companies that supply gas. "They want to make sure things are done right," Tsafos told the legislators.

Tsafos also said it isn't clear what the governor is achieving by switching to a state-led project now. It certainly isn't an acceleration of schedule, to move to the project's next step of Front-End Engineering and Design, or FEED.

The state's AGDC has said its target for initiating the FEED is late 2018, which is actually later than the target for the current Alaska LNG joint-venture.

He also said the Legislature should know what was proposed by the Alaska LNG joint-venture for a 2017 budget. "What's in that (proposed) budget? It would be interesting to know what we're tossing out," by moving to a project led by the state, he said. ●

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EXPLORATION & PRODUCTION

US drilling rig count down 2 to 489

The number of rigs drilling for oil and natural gas in the U.S. decreased by two the week ending Aug. 26 to 489.

A year ago, 877 rigs were active. Depressed energy prices have sharply curtailed oil and gas exploration.

Houston oilfield services company Baker Hughes Inc. said 406 rigs sought oil, unchanged from the previous week, and 81 were drilling for natural gas, down two. Two rigs were listed as miscellaneous.

Canada had 146 rigs active, up 25 from the previous week; a year ago 196 rigs were active in Canada.

Among major oil- and gas-producing states, Pennsylvania gained two rigs and Wyoming was up one. Colorado, Louisiana, Ohio, Texas and West Virginia each declined by one. Alaska, Arkansas, California, Kansas, New Mexico, North Dakota, Oklahoma and Utah were unchanged.

The U.S. rig count peaked at 4,530 in 1981. It bottomed out in May at 404.

—ASSOCIATED PRESS

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COLVILLE UNIT

rying forward the continued development of the expansion acreage, provide the Division the basis to support approval of the requested expansion."

Later this year and early next year, ConocoPhillips plans to drill two Nanuq-Kuparuk wells from the new CD-5 pad into the expansion acreage, according to recent plans. The expansion includes leases AA 094165, AA 094167 and AA 092675, which makes the Colville River unit contiguous with the Greater Mooses Tooth unit in the federally managed National Petroleum Reserve-Alaska. ConocoPhillips is in the early stages of its first development in the Greater Mooses Tooth unit and plans to connect the development back to its existing infrastructure at the Colville River unit. Having the two units "touching" will make it easier to arrange transportation and other logistics in the future.

The decision is effective retroactive to July 1.

—ERIC LIDJI

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ARCTIC FOCUS

Obama's visit

Meanwhile, President Obama's three-day visit to Alaska last summer had made the Arctic a top priority for the president and has since made the Arctic a significant issue in Washington, D.C., Papp said. The president has taken several Arctic related actions, including funding for new icebreakers, $4 million to promote innovative energy opportunities for remote Alaska villages, and a pledge to bolster efforts to implement improved navigational tools in the Bering, Chukchi and Beaufort seas.

In September the White House is sponsoring a first ever meeting of science ministers from 20 countries, to discuss scientific challenges and coordination in the Arctic, Papp said.

Arctic Council progress

Under U.S. chairmanship, the Arctic Council has been making significant progress in implementing council agreements on search and rescue, and on oil spill prevention and response. The White House meeting in September will play into a third binding agreement being negotiated, an agreement for international Arctic science cooperation and access. And under U.S. leadership, the Arctic Council has released first-of-a-kind procedures for the safe operation of unmanned aircraft in the Arctic. An initiative called the Rising Sun is addressing the high rate of suicides among the indigenous peoples of the north. The U.S. chairmanship of the council has also seen the launch of the offshore Arctic regulators forum, a group of petroleum experts dedicated to improving Arctic offshore safety regulations, Papp said

> *The U.S. chairmanship of the council has also seen the launch of the offshore Arctic regulators forum, a group of petroleum experts dedicated to improving Arctic offshore safety regulations, Papp said*

Mapping and communications

Another initiative involves working with universities and government agencies to develop more detailed maps and imaging of the Arctic region, including the production of the first ever digital surface map of the circumpolar north. Next year will see the completion of an assessment that will lead to recommendations on how Arctic states can move forward with improved telecommunications, an essential requirement for meeting growing communications needs, including the support of emergency operations. Another Arctic Council initiative is focusing on implementing renewable energy projects in remote Arctic regions.

On the education front, under the Arctic Fulbright Scholarship initiative, the United States is sponsoring 17 scholars from across the Arctic to participate in an 18-month program for research into energy, water, health and infrastructures, with the University of Alaska Fairbanks playing a pivotal role. And the Arctic Youth Ambassadors Program is providing 22 young Alaskans with a platform for sharing their experiences with the world.

Climate change

Papp said that he has become particularly concerned about the impacts of climate change in the Arctic. Commenting on the effects of the shrinking sea ice on both marine mammals and the people of the north, Papp stressed the urgency of becoming less dependent on carbon based energy before it becomes too late to deal with the situation. With the signs of climate change all around, it is necessary to start moving forward, Papp said, adding that preparing the Arctic's future will require careful strategic planning and a shared commitment to international cooperation.

—ALAN BAILEY

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PIPELINES & DOWNSTREAM

Responders to get notice of oil shipments

Emergency responders in communities along oil train routes in Washington state will start receiving advance notice of the shipments this fall.

The Spokesman-Review reports (http://goo.gl/i7M9Ui) that terminals, refineries and other facilities that receive crude oil by rail must begin notifying the state Department of Ecology in advance of shipments under a new rule adopted the week of Aug. 22. The state will relay the information to local emergency responders.

Gov. Jay Insless says that following recent oil train disasters, the state is trying to improve public safety and protect the environment.

Typically, two or three oil trains per day transport volatile crude from the Bakken oil fields through Spokane and Spokane Valley en route to Western Washington. A consultant warned state officials in August that a derailment or fire in downtown Spokane would pose severe challenges for responders, including the possibility of train cars falling from elevated tracks onto buildings.

The rule is Washington's first reporting requirement for oil shipments.

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