

ECONOMIC RESULTS, SHUMAGIN-KODIAK SHELF PROVINCE

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INTRODUCTION

This section summarizes the results of economic modeling using the *PRESTO-5* (Probabilistic Resource *EST*imates-Offshore, version 5) computer program. The economic assessment results are influenced, to a large degree, by the undiscovered, conventionally recoverable oil and gas resources assessed using the *GRASP* (Geologic Resource *AS*essment Program) computer model. The conventionally recoverable results are discussed in separate .pdf files (*Summaries of Play Results, with Cumulative Probability and Ranked Pool Plots*).

Each province summary page includes three illustrations: (1) cumulative probability plots for risked, conventionally recoverable resource distributions (oil, gas, and BOE); (2) a table comparing risked, mean, conventionally recoverable resources with the risked, mean, economically recoverable resources at current commodity prices; and (3) a price-supply graph displaying economically recoverable resource curves.

The province summary page is followed by a table reporting play-specific, economically recoverable resource estimates for two representative price scenarios: a Base Price scenario (\$18/bbl-oil, \$2.11/MCF-gas) representing current market conditions; and a High Price scenario (\$30/bbl-oil, \$3.52/MCF-gas).

PROVINCE SUMMARY PAGE

Risked Cumulative Probability Distributions

The province summary page provides, at page top, cumulative probability distributions for risked, undiscovered endowments of conventionally recoverable oil, gas, and BOE, where resource quantities are plotted against “cumulative frequency greater than %.” A cumulative frequency represents the probability that the resource endowment is equal or greater than the volume associated with that frequency value along one of the curves. For example, a 95% probability represents a 19 in 20 chance that the resource will equal, or be higher than, the volume indicated. Cumulative frequency values typically decrease as resource quantities increase. An expanded description of cumulative probability plots is given in “*Summaries of Play Results, with Cumulative Probabilities and Ranked Pool Plots* ” provided as a

separate .pdf file.

Table of Risked Play Resources

The province summary page provides, at page center, a table comparing the total conventionally recoverable endowment and the smaller quantity of economically recoverable resources that could be profitably extracted under current economic and engineering conditions. Current prices are represented as \$18 per barrel of oil and \$2.11 per MCF of gas, where gas price is linked to oil price by energy equivalency and discount-value factors (5.62 MCF per barrel; 0.66 value discount). Conventional resource volumes correspond to points on the cumulative probability distributions (at page top). Economic resource volumes correspond to points along the mean price-supply curve (at page bottom). Resources listed as negligible (negl) have volumes lower than the significant figures shown. Not Available (N/A) means that these resources are unlikely to be produced in the foreseeable future because of reservoir conditions or the lack of a viable transportation infrastructure.

The ratio of economic to conventional resources indicates the proportion of the total undiscovered endowment that is profitable to produce under current commodity prices with proven engineering technology. However, for production to occur, commercial discoveries must be made, and the analysis does not imply discovery rates. Given the size and geologic complexity of the offshore provinces, exploration will require extensive drilling, and considering the relatively low chance of commercial success and the high cost of exploration wells, many of these frontier provinces are not likely to be thoroughly tested in the foreseeable future. The ratio of economic to conventional resources should be regarded as an opportunity indicator, rather than as a direct scaling factor for readily available hydrocarbon reserves.

Price-Supply Curves

The province summary page includes, at page bottom, a graph showing price-supply curves representing Low, Mean, and High resource production scenarios. Price-supply curves illustrate how volumes of economically recoverable resources increase as a function of commodity price. Characteristically, increases in commodity price result

in corresponding increases in economically recoverable resource volumes. The economic resource volumes represent oil and gas, as yet undiscovered, that could be recovered profitably given the modeled economic and engineering parameters. At very high prices, the mean curve approaches the mean total resource endowment estimated by *GRASP*. The price-supply curves do not imply that these resources will be discovered or produced within a specific time frame, only that the opportunity exists for commercial production at levels controlled by commodity prices.

The price-supply curves were generated by the *PRESTO-5* computer program, which simulates the exploration, development, production, and transportation of pooled hydrocarbons in geologic plays within a petroleum province. Economic viability depends on the interaction of many factors defining the size and location of the hydrocarbon pools, the reservoir engineering characteristics, and economic variables relating expenditures to income from future production streams. The economic simulation is quite complex, owing to the complexities in the state of nature, and requires a sophisticated analytical model.

The following is a brief overview of the *PRESTO-5* modeling process. Geologic parameters (for example, reservoir thickness, pool area, risk) used by the *GRASP* computer model to determine conventionally recoverable resources are transferred into the *PRESTO-5* model through an interface program. Economic viability is determined by performing a discounted cash flow analysis on the expenses and modeled production stream for each pool simulated in a given trial. A Monte Carlo (random sampling) process selects engineering parameters (for example, production rate profiles, well spacing, platform installation scheduling), and cost variables (for example, platforms, wells, pipelines) from ranged distributions. Each simulation trial models the expenses, scheduling, and production for pools “discovered” within a particular play. The sampling process is repeated for productive pools in all geologic plays, and the economic resources are aggregated to the province level. The development simulation process is repeated, typically for 1000 trials, at given set of prices (oil and gas prices are linked). After the specified number of trials are completed for the first set of oil and gas prices, a new set of prices is selected and another round of simulation trials is run. This process continues for approximately 30 iterations, yielding a range of economic resource volumes tied to commodity prices. The results for all runs are given as probability distributions, where selected probability levels can be displayed as continuous price-supply curves.

These analyses determine the resource

volumes that are commercially viable under a specific set of current economic and engineering assumptions. No attempt was made to upgrade engineering technology or development strategies that might be implemented in response to higher commodity prices.

The price-supply curves provided in this report are based on the most likely development scenario tailored for each particular province. All provinces were modeled on a stand-alone basis, with engineering assumptions designed for the primary hydrocarbon substance (oil or gas) identified by the *GRASP* analysis. Generally, the secondary hydrocarbon is less economically viable and places an extra burden on the primary hydrocarbon substance. For provinces without existing oil and gas infrastructure, the modeling scenarios were designed assuming that the primary substance would drive initial development in a particular province. Oil-prone provinces were modeled as “oil-only” production, with gas reinjected for reservoir pressure maintenance to maximize oil recovery. Gas-prone provinces were modeled with both gas and oil production because natural gas-liquids (or condensates) are not reinjected. Often the volume of condensates in gas-prone provinces exceeds any volume of non-associated crude oil. All hydrocarbon liquids are commingled in production and transportation systems.

This economic analysis assumes 1995 as the base year. Higher nominal commodity prices in the future (price increases only at the rate of inflation) do not result in higher estimated volumes of economically recoverable resources, whereas higher real commodity prices (increases above the rate of inflation) do increase the economically recoverable resources. The economic model assumes that commodity price and infrastructure costs were inflated equally at an assumed 3% annual inflation rate (flat real price and cost paths). The price-supply curves can be used to project economic resource volumes relative to future price if appropriate discounting back to the 1995 base year is made to account for real price and real costs changes in the intervening years.

The price-supply graph usually contains three curves, corresponding to Low, Mean, and High resource production levels. The Low resource case represents a 95% probability (19 in 20 chance) that the resources are equal to, or exceed, the volumes derived from the price-supply curves. The High resource case represents the 5% exceedance level (1 in 20 chance). The Mean resource case represents the average. In high-cost and high-risk provinces, where there are no economically recoverable resources at the 95% probability level, no “Low” curve is displayed. An apparent anomaly is observed in some cases where the lower tail of the “Mean” price-supply curve indicates

economic resources greater than the “High” (5% probability) curve. This situation occurs at low prices where the probability of economic success drops below 5%, and the Mean curve is obtained from the few productive trials occurring at probabilities below 5%.

A few additional observations concerning price-supply curves are noteworthy. Following established convention for price-supply curves, these graphs are rotated from the usual mathematical display of X-Y plots. Although shown along the vertical (Y) axis, price is the independent variable and resource is the dependent variable. In many of the gas-prone basins, price-supply curves will display an abrupt step below which no risked economically recoverable resources are modeled. This step corresponds to the minimum resource value required to overcome the cost of production and transportation infrastructure. Because of the distances to Asian markets, the assumed destination for Alaska gas production, natural gas must be converted to liquid form for transportation by ships. The infrastructure associated with conversion into liquefied natural gas (or LNG) does not lend itself to incremental additions for grassroots projects; therefore, an abrupt “cost-hurdle” created by large LNG and marine terminal installations must be overcome by significant resource volumes.

Finally, the reader must be aware that these price-supply curves are models of risked hydrocarbon resources. Both the geologic risk that the resources are pooled and recoverable as well as the economic risk that development is profitable under the assumed economic and technologic conditions are factored into the reported results. This means that although very low resource volumes are reported as “economically recoverable”, these low volumes, in fact, do not correspond to actual quantities of oil or gas. At low prices, risk is dominated by economic factors associated with engineering cost and reservoir performance variables. At high prices, risk is dominated by geologic factors related to volumetric variables. **Risked price-supply curves are most appropriately used to define the comparative potential of petroleum provinces under changing price and probability conditions.** They do not predict the timing of resource discovery or rate of conversion of undiscovered resources to future production. As previously stated, future production of the modeled economically recoverable resources will require extensive exploration programs. In the Alaska offshore, future leasing and exploration activities are likely to be driven by “high-side potential”, combining perceptions of greater rewards at higher risk, higher future commodity prices, and innovative technology to reduce costs.

TABLE FOR PLAY RESOURCE DISTRIBUTIONS

The risked mean contribution for each geologic play in the province is tabulated under two hypothetical price conditions. The Base Price (\$18 per barrel-oil; \$2.11 per MCF-gas) represents current economic conditions. The High Price (\$30 per barrel-oil; \$3.52 per MCF-gas) represents a situation where real price has increased significantly from current levels. Other economic parameters (for example, discount rate and corporate tax rate) were equal in both scenarios, as were engineering technology and cost assumptions. The play number, name, and *UAI* (*Unique Assessment Identifier* code) provide a link to the data presented in other sections of this report. Hydrocarbon substances are distinguished as oil (includes crude oil and gas-condensate liquids), gas (includes non-associated, associated, and dissolved gas), and BOE (gas volume is converted to barrel of oil equivalent and added to oil volume).

SHUMAGIN-KODIAK SHELF MODELING RESULTS

The Shumagin-Kodiak shelf province was modeled for the production of natural gas resources, with condensates recovered as a bi-product. The geologic model includes no crude oil resources, and liquid hydrocarbons occur only as condensates associated with gas pools. At present, there is no petroleum production or transportation infrastructure available in the western parts of the province (Shumagin shelf), although the eastern areas (Kodiak shelf) could utilize existing processing and transportation infrastructure in the Cook Inlet.

The development scenario assumes that gas produced from floating offshore production platforms would be transported by 215 mile subsea pipeline to a shorebase in the Kenai area of the Cook Inlet. Existing Cook Inlet facilities include: a liquefied natural gas (LNG) plant and marine export terminal, a urea plant, an oil refinery, and transmission gas pipelines to nearby population centers (Anchorage, Kenai Peninsula). It is assumed that gas production will be converted to LNG and exported by marine LNG carriers to markets in Japan (Yokohama). At present, approximately 50 BCFG of gas produced in the Cook Inlet is converted to LNG and shipped annually to Japan from the Phillips-Marathon LNG plant in Nikiski. Additional gas production from the Kodiak shelf would require an expansion of the Nikiski facility. Natural gas liquids, separated and stored on offshore production platforms, would be offloaded to small tankers (or barges) and transported to the marine terminal in Valdez, where it

would be commingled with North Slope crude oil and shipped to the West Coast (Los Angeles).

Under the Base Price condition (\$2.11 per MCFG), the Shumagin-Kodiak shelf province contains negligible volumes of economically recoverable gas and condensate, from an estimated mean conventionally recoverable gas endowment of 2.65 TCFG. At the High Price condition (\$3.52 per MCFG), this province has economic gas resources of 0.449 TCFG, or 17% of the mean gas endowment. The High Price condition is representative of the current price for LNG in Pacific Rim markets. A cost hurdle, imposed by development and transportation costs, is overcome at a price of approximately \$3.00 per MCFG, above which significant volumes of gas resources are recoverable in the High resource case. For example, at \$7.00 per MCFG (approximately twice the current overseas market price), the High resource case (1 in 20 chance) yields 6.7 TCFG of economically recoverable gas in the Shumagin-Kodiak shelf province. This undiscovered gas resource is comparable to the 7.4 TCFG of proven gas reserves in the Cook Inlet. This optimistic price and production scenario would require a substantial increase in real gas prices as well as an aggressive exploration program to discover these resources.

Gas resources in the Shumagin-Kodiak shelf are modeled in one geologic play, called the Neogene Structural Play. The Kodiak shelf province has been tested by 3 stratigraphic test wells and no exploration wells, whereas the Shumagin shelf has yet to be drilled. Information from the Kodiak shelf COST wells leads to the conclusion that this province is gas-prone. The Neogene Structural play is estimated to contain gas pools ranging in mean size up to 2.0 TCFG.

Gas production from the Shumagin-Kodiak shelf province is likely to utilize existing facilities in the Cook Inlet, as well as the marine terminal in Valdez, Alaska. The proximity to existing infrastructure and the high-side potential (which accepts high reward at high risk) are two primary incentives for exploration on the Shumagin-Kodiak Shelf.

Economic Results for Shumagin-Kodiak shelf assessment province.

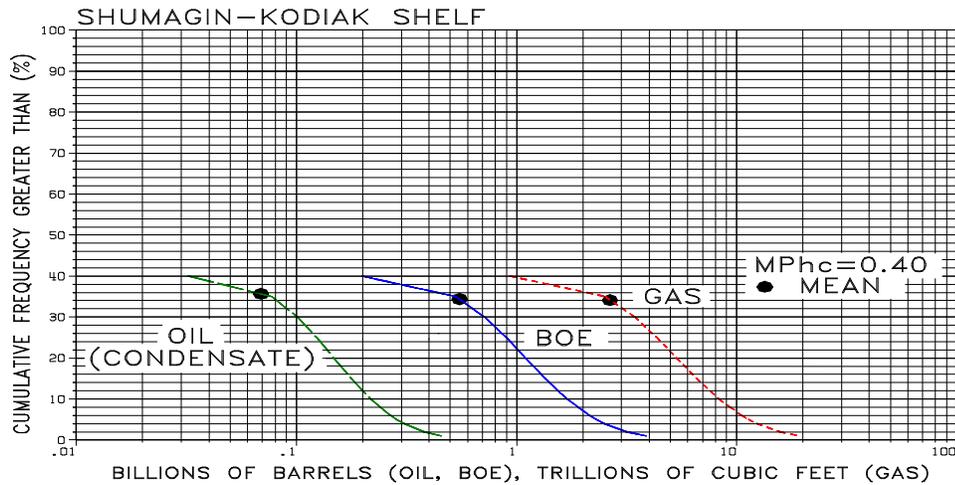
(A) Cumulative

frequency distributions for **risked, undiscovered conventionally recoverable resources** (B)

Table comparing results for conventionally and economically recoverable oil and gas; (C) Price-supply curves for **risked, economic gas** at mean and high (F05) resource cases.

BOE, total oil and gas in energy-equivalent barrels; MPhc, marginal probability for occurrence of pooled hydrocarbons in basin; BBO, billions of barrels; TCFG, trillions of cubic feet.

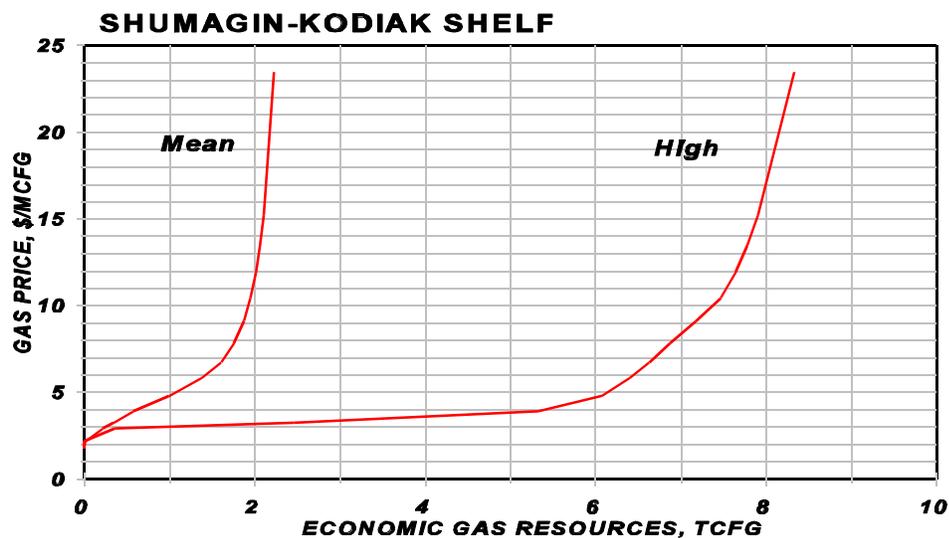
A.



B.

SHUMAGIN-KODIAK SHELF PROVINCE		
RESOURCE TYPE	MEAN OIL (BBO)	MEAN GAS (TCFG)
CONVENTIONALLY RECOVERABLE	0.07	2.65
ECONOMICALLY RECOVERABLE (\$18)	negl	negl
RATIO ECONOMIC/CONVENTIONAL	negl	negl

C.



OIL AND GAS RESOURCES OF SHUMAGIN-KODIAK SHELF PLAYS
Risked, Undiscovered, Economically Recoverable Oil and Gas

PLAY NO.	PLAY NAME (UAI* CODE)	BASE PRICE			HIGH PRICE		
		OIL	GAS	BOE	OIL	GAS	BOE
1.	Neogene Structural Play (UASH0100)	negl	0.004	0.001	0.013	0.449	0.093
	TOTAL	negl	0.004	0.001	0.013	0.449	0.093

* *Unique Assessment Identifier, code unique to play.*

OIL is in billions of barrels (BBO). **GAS** is in trillion cubic feet (TCF).

BOE is barrel of oil equivalent barrels, where 5,260 cubic feet of gas = 1 equivalent barrel-oil

For direct comparisons among provinces, two prices are selected from a continuum of possible price/resource relationships illustrated on price-supply curves. **BASE PRICE** is defined as \$18.00 per barrel for oil and \$2.11 per thousand cubic feet for gas. **HIGH PRICE** is defined as \$30.00 per barrel for oil and \$3.52 per thousand cubic feet for gas. Both economic scenarios assume a 1995 base year, flat real prices and development costs, 3% inflation, 12% discount rate, 35% Federal corporate tax, and 0.66 gas price discount.

Shaded columns indicate the most likely substances to be developed in this province. Economic viability is indicated on price-supply curves which aggregate the play resources in each province.