

MILLER PETROLEUM INC
Form 10-K
July 28, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

ii **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE
ACT OF 1934**
For the fiscal year ended: **April 30, 2010**
OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE
ACT OF 1934**
For the transition period from: _____ to _____

MILLER PETROLEUM, INC.

(Exact name of registrant as specified in its charter)

Tennessee
*(State or Other Jurisdiction
of Incorporation or Organization)*

001-34732
*(Commission
File Number)*

62-1028629
*(I.R.S. Employer
Identification No.)*

3651 Baker Highway, Huntsville, TN 37756

(Address of Principal Executive Office) (Zip Code)

(423) 663-9457

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.0001 per share	NASDAQ Global Market

Securities registered pursuant to Section 12(g) of the Act:

None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

 Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its Corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ü

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer	Accelerated filer	
Non-accelerated filer	Smaller reporting company	ü

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ü No

The aggregate market value of the outstanding common stock, other than shares held by persons who may be deemed affiliates of the registrant, computed by reference to the closing sales price for the registrant's common stock on October 30, 2009 (the last business day of the registrant's most recently completed second quarter), as reported on the OTC Bulletin Board, was approximately \$6,200,000. As of July 22, 2010, there were 33,389,383 shares of common stock of the registrant outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

List hereunder the following documents if incorporated by reference and the Part of the Form 10-K (e.g., Part I, Part II, etc.) into which the document is incorporated: (1) Any annual report to security holders; (2) Any proxy or information statement; and (3) Any prospectus filed pursuant to Rule 424(b) or (c) under the Securities Act of 1933. The listed documents should be clearly described for identification purposes (e.g., annual report to security holders for fiscal year ended December 24, 1980). None.

MILLER PETROLEUM, INC.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Various statements in this annual report contain or may contain forward-looking statements that are subject to known and unknown risks, uncertainties, and other factors which may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements were based on various factors and were derived from utilizing numerous assumptions and other factors that could cause our actual results to differ materially from those in the forward-looking statements. These factors include, but are not limited to the following:

- .
the capital intensive nature of oil and gas development and exploration operations and our ability to raise adequate capital to fully develop our operations and assets,
- .
our ability to perform under the terms of the Assignment Oversight Agreement with the Alaska DNR, including meeting the funding commitments of that agreement,
- .
fluctuating oil and gas prices and the impact on our results of operations,
- .
our ability to secure an extension of the Susitna Basin Exploration License,
- .
the impact of the global economic crisis on our business,
- .
the impact of natural disasters on our Cook Inlet Basin operations,
- .
the imprecise nature of our reserve estimates,
- .
our ability to recover proved undeveloped reserves and convert probable and possible reserves to proved reserves,
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the possibility that present value of future net cash flows will not be the same as the market value,
- .
the costs and impact associated federal and state regulations,

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changes in existing federal and state regulations,

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our dependence on third party transportation facilities,

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insufficient insurance coverage,

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conflicts of interest related to our dealings with MEI,

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cashless exercise provisions of outstanding warrants,

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market overhang related to restricted securities and outstanding options, warrants and convertible notes,

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adverse impacts on the market price of our common stock from sales by the selling security holders.

Most of these factors are difficult to predict accurately and are generally beyond our control. You should consider the areas of risk described in connection with any forward-looking statements that may be made herein. Readers are cautioned not to place undue reliance on these forward-looking statements, and readers should carefully review this annual report in its entirety, including the risks described in Item 1A. Risk Factors. Except for our ongoing obligations to disclose material information under the Federal securities laws, we undertake no obligation to release publicly any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events. These forward-looking statements speak only as of the date of this annual report, and you should not rely on these statements without also considering the risks and uncertainties associated with these statements and our business.

OTHER PERTINENT INFORMATION

We maintain our web site at www.millerenergyresources.com. Information on this web site is not a part of this prospectus.

Unless specifically set forth to the contrary, when used in this prospectus the terms "Miller," "we", "us", "our", and similar terms refer to Miller Petroleum, Inc., a Tennessee corporation doing business as Miller Energy Resources, and its subsidiaries.

PART I

ITEM 1.

BUSINESS.

Overview

We are an independent exploration and production company that utilizes seismic data and other technologies for geophysical exploration and development of oil and gas wells in the Appalachian region of eastern Tennessee and the Cook Inlet Basin in south central Alaska. In addition to our engineering and geological capabilities, we provide land drilling services on a contract basis to customers primarily engaged in natural gas exploration and production.

During 2010, we have significantly expanded our operations through the December 2009 acquisition of oil and gas assets from Pacific Energy Resources through a bankruptcy proceeding in which we acquired onshore and offshore production and processing facilities, the Osprey offshore energy platform, over 600,000 net lease acres of land with hundreds of miles of 2-D and 3-D geologic seismic data, miscellaneous roads, pads and facilities. Our current strategy focuses the majority of our efforts on growing our company, including the following:

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increasing our overall oil and gas production through maintenance and repairs of nonperforming or underperforming wells located in Alaska,

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organically growing production through drilling for our own benefit on existing leases and acreage in the exploration license with a view towards retaining the majority of working interest in the new wells, and

·
expanding our contract drilling and service capabilities and revenues, including drilling contracts with third parties.

Our exploration and production activities

Historically, we focused our exploration, development, and production efforts in the Appalachian region of eastern Tennessee. During 2010 we significantly increased our operations through the acquisitions of KTO and ETC in our Appalachian region and the assets in Alaska, which comprise our Cook Inlet operations. As of April 30, 2010, we had approximately 662,992 acres of gross oil and gas leases and exploration license rights (616,550 net acres), which includes 471,474 acres under the Susitna Basin Exploration License.

Cook Inlet Basin

We own approximately 131,190 gross acres of leasehold interests, the exploration license rights to an additional 471,474 acres and 10 crude oil and five natural gas wells in which we own an interest. Cook Inlet stretches 180 miles

from the Gulf of Alaska to Anchorage in south-central Alaska. The Cook Inlet Basin contains large oil and gas deposits including several offshore fields. There are also numerous oil and gas pipelines running around and under the Cook Inlet.

At the time the Alaskan assets were acquired by us, all of the operated wells were shut-in, a term used in the oil and gas industry which means the wells were closed off so that they could not produce oil, with the exception of the WF-2 natural gas well. As of June 30, 2010, four of the oil wells had been returned to production. In addition, Cook Inlet Energy owns a 30% working interest in two gas wells operated by Aurora Gas, Three Mile Creek 1 and Three Mile Creek 2, which have been operated continuously.

Oil wells drilled in this area range from 9,000 vertical feet to 10,000 vertical feet in depth while gas wells have a vertical depth of 8,000 feet to 9,000 feet. Wells that are deviated (continue on from the vertical depth either diagonally or horizontally) will have a longer measured depth of approximately 5,000 feet giving total measured depth of 14,000 feet to 15,000 feet. Well spacing is quite variable, as there are large parts of Cook Inlet which are completely undeveloped, and others, that are more mature. Our fields have approximately 60 to 80 acre spacing. The Cook Inlet basin contains a thick section of terrestrial Tertiary rocks which includes shales, sandstones, and coals. The primary targets in the area are crude oil reserves.

In January 2010 we entered into a Master Services Agreement with Fairweather E&P Services, Inc., a company based in Anchorage, Alaska which provides a wide range of support services for the oil and gas industries, whereby it acts as an independent contractor for us in the development and/or refurbishment of the wells in Cook Inlet Basin. The agreement it provides us with engineering, logistics, field and project management support for the

well and facility work in Cook Inlet Basin which are anticipated to be completed on or before December 31, 2012. We pay the contractor for all costs associated with these services, including any services that Fairweather E&P may subcontract to third party providers, at its cost plus 15%. Fairweather E&P is required to maintain certain minimum levels of insurance coverage and the agreement contains customary cross-indemnification provisions. We may terminate the agreement at any time without reason.

Susitna Basin Exploration License

Included in the Alaskan assets we acquired is a 100% interest in an Exploration License granted by the State of Alaska in October 2005 covering approximately 471,474 acres in the Susitna basin area north of Anchorage, Alaska. Under the terms of the Exploration License, the licensee was granted a five year exclusive license to explore for oil and gas on the specified lands, and upon fulfillment of the work commitment, the license for all or any part of the land could be converted into oil and gas leases. The original work commitment of approximately \$3.5 million was fulfilled, and we have the right at any time to convert the license for all or any portion of the acreage into oil and gas leases at any time. Once the exploration license is converted into oil and gas leases, we are required to pay a per acre fee to the state and commence drilling operations within specified timeframes. In an effort to control the timing of the development of this acreage, in April 2010 we requested a three year extension of the exploration license for a work commitment of \$750,000. While we reasonably believe the state will grant our request for extension, there are no assurances we are correct, or that if granted, that the terms and conditions of the extension will be satisfactory to us. If we are unable to negotiate an extension, it is likely we will convert the license for only a portion of the land into oil and gas leases.

Osprey Platform

Included in the assets acquired from Pacific Energy was the Osprey platform which is located in the Redoubt Unit approximately 1.8 miles southeast of the West Foreland in central Cook Inlet at a water depth of approximately 45 feet. The Osprey platform, which produces from the Redoubt Unit is connected to our Kustatan Production Facility by two eight-inch and one six-inch pipeline and one power cable. It relies on our Kustatan Production Facility, which is currently inactive, and our West McArthur River Unit Production Facility to provide all of its electricity and gas, and the Kustatan Production Facility to process all of Osprey's produced fluids. The platform has 21 slots, eight of which are currently used, and an attached 40 man camp. The platform is currently inactive.

The Osprey platform was placed on site during June 2000 and it initially conducted exploration drilling operations between January 2001 and July 2002. Eight wells were drilled, which in their present configuration consist of one water flood well, one Class I injection well, and six oil wells. The oil wells were equipped with electrical submersible pumps which were necessary to bring the oil to surface. In 2005, the third-party drilling rig was removed from the platform after a contract dispute. The removal of the rig crippled the ability to maintain and repair the platform's wells or to expand production. Shortly afterwards, a series of mechanical problems took much of the platform's production offline and these problems could not be corrected without a rig present. Reduced production was temporarily restored by deploying jet pumps, which can provide artificial lift, but do not require a rig; however, production continued to fall, and the Osprey platform was shut-in in the spring of 2009.

In order to restore production from the Redoubt Unit, it will be necessary to mobilize a drilling rig to the Osprey platform and repair six wells. We believe that past experience suggests that a rig should be permanently located on the platform. Two of these wells require only the replacement of the electrical submersible pumps, and the other four wells require re-drilling in sections. We estimated that the total cost of restoring production, including the purchase of a drill rig, is approximately \$35 million.

Assignment Oversight Agreement

On November 5, 2009, Cook Inlet Energy, LLC entered into an Assignment Oversight Agreement with the Alaska DNR which set out certain terms under which the Alaska DNR would approve the assignment of certain specified

state oil and gas leases from Pacific Energy Resources to Cook Inlet Energy. This agreement remains in place following our acquisition of Cook Inlet Energy in December 2009. Generally, the agreement requires Cook Inlet Energy to provide the Alaska DNR with additional information and oversight authority to ensure that Cook Inlet Energy is acting diligently to develop the oil and gas from Redoubt Shoal, West McArthur River Field and West Foreland Field. Under the terms of the agreement, until the Alaska DNR determines, in its sole discretion, that Cook Inlet Energy has completed its development and operation obligations under the assigned leases, Cook Inlet Energy agreed to the following:

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file a monthly summary of expenditures by oil and gas filed, tied to objectives in Cook Inlet Energy's business plan and plan of development previously presented to the Alaska DNR,

meet monthly with the Alaska DNR to provide an update on operations and progress towards meeting these objectives,

notify the Alaska DNR 10 days prior to commitment when Cook Inlet Energy is preparing to spend funds on a purchase, project or item of more than \$100,000 during the first 12 months, more than \$1 million during the second 12 months and more than \$5 million thereafter, and

submit a new plan of development and plan of operations for the Alaska DNR's approval on or before December 15, 2009 and submit a plan of development annually thereafter on or before February 1, 2010. Cook Inlet Energy timely met both of these deadlines.

The agreement required Cook Inlet Energy to obtain financing in the minimum amount of \$5,150,000 to provide funds to be used for expenditures approved by the Alaska DNR as part of Cook Inlet Energy's plan of development. The funds are to be used for workover and repair of the wells, repair of the physical infrastructure, construction of a grind and inject plant at the West McArthur River facility, normal operating expenses associated with the leases and infrastructure and other capital project which are to be pre-approved by the Alaska DNR. The agreement also required Cook Inlet Energy to demonstrate funding commitments to support restoration of the base production at the Redoubt Unit, including bringing a number of the shut-in wells back on line, which was estimated at \$31 million in the agreement but which we have internally increased to \$35 million to accommodate the purchase of a drilling right. These funding commitments necessary under the agreement were provided to us under the terms of the Vulcan Capital Corporation, LLC letter agreement described earlier in this annual report. We have subsequently provided these funds through for the West McArthur River facility using a portion of the proceeds of our capital raising efforts described elsewhere herein, and intend to seek alternative sources of funding for the balance of the necessary capital.

Cook Inlet Energy is prohibited from using any of the approximate \$36.15 million or any proceeds from the operations under the assigned leases of the funding commitments for non-core oil and gas activities under the assigned leases, or any activities outside the assigned leases, without the prior written approval of the Alaska DNR until the parties mutually agree that the full dismantlement obligation under the assigned leases is funded. The assigned leases will be subject to default and termination should Cook Inlet Energy fail to submit the information required under the agreement and expenditure of funds for items or activities do not support core oil and gas activities, as reasonably determined by the Alaska DNR.

Recent Developments

Cook Inlet Energy, LLC was one of nine successful bidders in State of Alaska's Division of Oil & Gas Cook Inlet Areawide 2010 Competitive Oil and Gas Lease Sale. There were 38 bids for 36 tracts covering an estimated 144,640 acres of State of Alaska oil and gas acreage. Cook Inlet Energy bid on seven tracts and was the successful high bidder on each of those tracts which cover an estimated 27,520 acres. Cook Inlet Energy's winning bid for these seven tracts was \$908,800. Cook Inlet Energy paid a deposit of \$181,767 at the time of the auction and the balance will be due once the title work is complete which we presently anticipate to be in January 2012. All of Cook Inlet Energy's bids completed acreage positions covering prospects acquired in its purchase of a portfolio of Pacific Energy Alaska assets late last year.

Membership in Cook Inlet Spill Prevention and Response, Inc.

Cook Inlet Energy is a Class G member of the Cook Inlet Spill Prevention and Response, Inc., which we refer to as CISPRI. CISPRI is a non-profit corporation formed in 1990 to provide oil spill prevention and response capabilities in Cook Inlet. CISPRI has been designated as a Class "E" Oil Spill Removal Organization by the U.S. Coast Guard, which is the highest level of designation based on spill containment and removal equipment requirements for offshore/ocean response. CISPRI's response zone includes the entire Cook Inlet Region, stretching from Palmer to the Barren Islands and out into the Gulf of Alaska. At each annual meeting of CISPRI members adopt a budget for the coming year which includes funds for day to day operational activities of CISPRI, investments in capital equipment and materials to be used in connection with the cleanup activities and research and development and training. The budget is funded through payment of dues by the members and the amount of dues is calculated in accordance with a participation formula. Class G members pay an annual fee of \$10,000 together with additional fees based upon the amount of oil we transport.

If a spill is identified as originating from facilities owned or operations conducted by one or more of the members, CISPRI will act to control and clean up the spill of crude oil/synthetic crude oil or refined petroleum products arising from those operations without any future action by the members. Any member that utilizes or receives the benefit of these activities must reimburse CISPRI for all expenses of control and clean up, including costs of equipment, materials and personnel. Each member is required to execute a response action contract providing terms and conditions under which response and cleanup activities will be undertaken. Cook Inlet Energy is a party to such an agreement which, in part, requires Cook Inlet Energy to maintain worker's compensation insurance, employers' liability insurance, comprehensive general and automotive liability insurance covering injury or death or persons and property damage of at least \$10 million. Cook Inlet Energy is in compliance with this insurance requirement. All members accept responsibility for spills which result from their operations or facilities and have indemnified CISPRI and all other members for all liabilities arising for a spill. This indemnification is not limited by the amount of insurance coverage.

Cook Inlet Energy may resign its membership in CISPRI upon 30 days written notice. At the effective date of the resignation, Cook Inlet Energy is obligated to pay all unpaid dues and assessments levied prior to the notice of resignation. Cook Inlet Energy's membership may be terminated by the Board of Directors of CISPRI upon 60 days notice if its determined Cook Inlet Energy is no longer eligible for membership. Cook Inlet Energy would not be entitled to a refund of any monies paid to CISPRI.

Appalachian Region

We own approximately 54,506 gross acres of leasehold interests with 185 producing oil wells and 334 producing gas wells in which we own an interest. Wells drilled in this area range from 1,800 to 4,200 feet in depth and the well spacing is generally from 20 to 40 acres per well and are predominately in Fort Payne formation.

The following table provides information on our reserves at April 30, 2010.

Reserves category	Net Reserves at April 30,					
	2010		2009		2008	
	Oil (MBbls)	Natural Gas (MMcf)	Oil (MBbls)	Natural Gas (MMcf)	Oil (MBbls)	Natural Gas (MMcf)
PROVED						
Developed producing						
Cook Inlet	1,695	1,085				
Appalachian region	108	619	43	563	63	511
Developed - non producing						
Cook Inlet	856					
Appalachian region	6	33	10	30	11	1,341
Undeveloped						
Cook Inlet	7,679	3,722				
Appalachian region				1,271		
Total Proved	10,344	5,459	53	1,864	74	1,852
PROBABLE						
Non-producing						
Cook Inlet		5,567				
Appalachian region						
Undeveloped						
Cook Inlet	6,173					

Appalachian region		3,695
Total Probable	6,173	9,262

POSSIBLE

Undeveloped		
Cook Inlet	1,078	5,203
Appalachian region	39	
Total Possible	1,117	5,203

When used in this table, MBbls means million barrels of oil and MMcf means million metric cubic feet. We also use a number of terms when describing our reserves. Proved reserves are the quantities of oil and gas that, by analysis of geosciences and engineering data, can be estimated with reasonable certainty to be economically producible. We provide information on two types of proved reserves - developed and undeveloped. Proved developed reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods and proved undeveloped reserves are reasonably certain reserves in drilling units immediately adjacent to the drilling unit containing a producing well as well as areas beyond one offsetting drilling unit from a producing well.

Under recent SEC rules we are now also permitted to provide information about probable and possible reserves. As set forth above, prior to 2010 our reserve reports did not contain any estimates on probable or possible reserves. Probable reserves are additional reserves that are less certain to be recovered than proved reserves but which, in sum with proved reserves, are as likely as not to be recovered. Possible reserves are additional reserves that are less certain to be recovered than probable reserves. The various reserve categories have different risks associated with them. Proved reserves are more likely to be produced than probable reserves and probable reserves are more likely to be produced than possible reserves. Because of these risks, the different reserve categories should not be considered to be directly additive.

Our reserve estimates for oil and natural gas at April 30, 2010 for our Cook Inlet assets were prepared by Ralph E. Davis Associates, Inc., an independent engineering firm, and our reserve estimates for oil and gas at April 30, 2010 for our Appalachian region assets were prepared by Lee Keeling and Associates, Inc., an independent engineering firm. Both of these reserve reports which are filed as exhibits to this annual report, were prepared in accordance with the generally accepted petroleum engineering and evaluation principles and most recent definitions and guidelines established by the SEC. All reserve definitions comply with the applicable definitions of the rules of the SEC. The reserves were estimated using engineering and geological methods widely accepted in our industry. The accuracy of the reserve estimates is dependent upon the quality of available data and upon independent geological and engineering interpretation of that data. For proved developed producing, the estimates considered to be definitive, using performance methods that utilize extrapolations of various historical data including oil, gas and water production and pressure history. For other than proved producing, proved undeveloped reserves and probable and possible reserve estimates were made using volumetric methods.

Our policies regarding internal controls over reserve estimates require reserves to be in compliance with the SEC definitions and guidance and for reserves to be prepared by an independent engineering firm under the supervision of our Chief Financial Officer. We provide the engineering firm with estimate preparation material such as property interests, production, current operation costs, current production prices and other information. This information is reviewed by our Chief Executive Officer and our Chief Financial Officer to ensure accuracy and completeness of the data prior to submission to our third party engineering firm. A letter which identifies the professional qualifications of each of the independent engineering firms who prepared the reserve reports are included in those reserve reports which are filed as exhibits to this annual report. There was no conversion of undeveloped reserves to proved reserves during the fiscal year ended April 30, 2010.

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Each of the engineering reports also projected future net income (FNI) from our net reserves and the present value, discounted at 10% per annum, of that future net income FNI @ 10% as summarized in the following table. Future net income is based upon gross income from future production, less direct operating expenses and taxes. Estimated future capital for development costs was also deducted from gross income at the time it will be expended. No allowance was made for depletion, depreciation, income taxes or administrative expense. In the following table, the price per barrel of oil was \$73.01 and the price per MMcf of natural gas was \$4.84 for the Cook Inlet reserves and \$71.85 per barrel of oil and \$5.15 per MMcf of natural gas for the Appalachian region reserves. In each instance these prices are computed in accordance with the SEC's rule and represent the average fiscal year prices.

	Producing	Non-Producing	Undeveloped	Expenses	Total
Proved - Cook Inlet					
FNI	\$ 108,169,312	\$ 45,505,746	\$ 422,335,438	\$ (94,233,000)	\$ 481,777,496
FNI @ 10%	\$ 75,596,359	\$ 26,222,301	\$ 267,256,594	\$ (57,103,397)	\$ 311,971,859
Probable - Cook Inlet					
FNI		\$ 24,160,285	\$ 313,927,312		\$ 338,087,597
FNI @ 10%		\$ 17,047,756	\$ 174,810,344		\$ 191,858,100
Possible - Cook Inlet					
FNI			\$ 71,892,688		\$ 71,892,688
FNI @ 10%			\$ 39,039,215		\$ 39,039,215
Proved - Appala					