Royalty In-Kind Sale to Flint Hills Resources

April 8, 2013

Division of Oil and Gas
Alaska Department of Natural Resources

Royalty in-Value versus Royalty in-Kind

The state has a choice to take its royalty in-value (RIV) or in-kind (RIK).

- When the State takes its royalty as RIV, the lessees who produce the oil also market the State's share along with their own production and pay the State the value of its royalty share.
- When the State takes its royalty share as RIK, the State assumes ownership of the oil, and the commissioner disposes of it through the sale procedures prescribed by AS 38.05.183.

Non-Competitive RIK Sale Process

- Statute presumes State's Best Interest is met by
  - Taking royalty in-kind—AS 38.05.182(a)
  - With sale to in-state buyer—AS 38.05.183(d)
  - Accomplished through a competitive process—AS 30.05.183(a)
- August 13, 2012 Informal Solicitation of Interest sent to:
  - North Slope Producers
  - In-state Refiners
  - Industry specific & general media

RIK Contract Terms

- Proposed 2013 contract is similar to 2004 contract
- Proposed 2013 contract, like 2004 contract, **does not** directly reference RIV valuation in RIK price calculations
- Key Contract provisions
  - Price
  - Quantity
  - Term
  - Special Commitments
  - In-State Processing and Local Hire

RIK Contract Price

ANS Spot Price – $2.15 – Tariff Allowance ± Quality Bank Adjustment – Line Loss

- ANS Spot Price = Average US West Coast Price for Alaska North Slope oil.
  - Reported by industry trade publications: Platts, Telerate, Reuters
- $2.15 = RIK Differential
  - Destination Value - Marine Costs so RIK ≥ RIV.
  - Subject to a one-time adjustment of no more than ± $0.15 per barrel.
  - This amount = $1.65 per barrel in the current 2004 contract.
- Tariff Allowance = TAPS and Pipelines Upstream of PS-1.
- Quality Bank Adjustment = as reported by the TAPS Quality Bank Administrator
- Line Loss = 0.0009 times the netback price

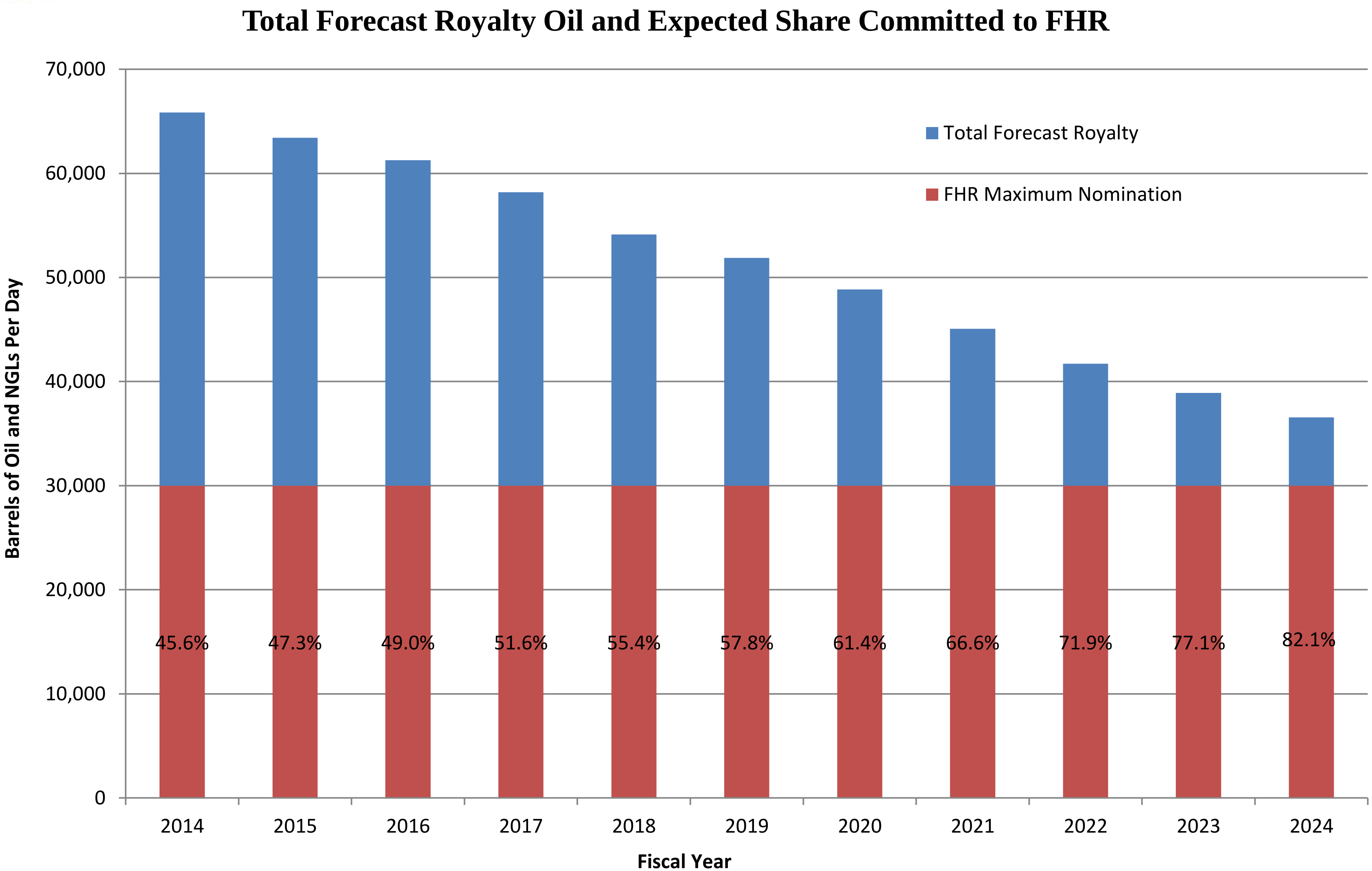
RIK Contract Quantity

- Initial Quantity Range
  - 18,000 – 30,000 barrels per day
  - May be adjusted after 12 months, with Commissioner approval
- Termination of Contract
  - No or zero nomination for 3 months terminates contract
  - Contract terms comparable to the private market
- Refinery Turnaround
  - Contract allows FHR the flexibility to cease royalty oil purchases during maintenance
- Guarantees, reserves and proration clauses included
  - 24,000 barrels per day with 15 percent reserves for other RIV or RIK interests

2013 RIK Contract Term

- FHR initially sought a ten-year contract
  - Creates supply and price risk
  - Increases counterparty risk
  - Limits the State's ability to supply other RIK buyers
- DNR negotiated a five year term
  - April 1, 2014 to March 31, 2019
  - Possible extension condition for:
    - Large capital improvement at the North Pole Refinery
    - Binding support for a North Slope natural gas transportation system

2013 RIK Contract Quantity



Commissioner's Decision Criteria

AS 38.05.183(e) states that the commissioner must sell the State's royalty oil to the buyer who offers "maximum benefits to the citizens of the state." In making this determination the commissioner must consider:

1) The cash value offered
2) The projected effects of the sale on the economy of the state
3) The projected benefits of refining or processing the oil in state
4) The ability of the prospective buyer to provide refined products for distribution and sale in the state with price or supply benefits to the citizens of the state
5) The eight criteria listed in AS38.06.070(a), as reviewed by the Royalty Board

Royalty Board's Decision Criteria

AS 38.06.070(a) states that the Alaska Royalty Oil and Gas Development Advisory Board must consider:

1) The revenue needs and projected fiscal condition of the state
2) The existence and extent of present and projected local and regional needs for oil and gas products
3) The desirability of localized capital investment, increased payroll, secondary development and other possible effect of the sale
4) The projected social impacts of the transaction
5) The projected additional costs and responsibilities which could be imposed upon the state and affected political subdivisions by development related to the transactions

Royalty Board's Decision Criteria

AS 38.06.070(a) states that the Alaska Royalty Oil and Gas Development Advisory Board must consider:

6) The existence of specific local or regional labor or consumption markets or both which should be met by the transaction
7) The projected positive or negative environmental effects related to the transactions
8) The projected effects of the proposed transaction upon existing private commercial enterprise and patterns of investment

Figure 1. Royalty In-Kind Sales History

Purchaser / Contract	Period	Total RIK Volumes (barrels through Jun 2012)	
Negotiated In-Kind Sales			
Alpetco			
Alpetco	7/80-1/81	7,390,392	
Alpetco	7/80-1/82	31,576,151	38,966,543
Chevron			
Chevron 1	7/80 - 6/81	1,742,342	
Chevron 2	5/83 - 5/84	6,721,236	
Chevron 3	5/84 - 7/91	48,418,344	
Kuparuk	12/86 - 12/91	8,611,247	
Petrostar Purchases	12/86 - 12/91	2,348,070	
Subtotal		67,841,239	
Plus: Tesoro Exchange Barrels		16,015,527	
Total Chevron			83,856,765
Flint Hills Resources	4/04-12/2004	153,697,898	153,697,898
Golden Valley Electric Association			
GVEA 1	6/81 - 5/84	3,182,282	
GVEA 2	6/84 - 9/85	2,511,064	
GVEA 3	10/85 - 12/91	12,281,462	
Total GVEA			17,974,808
MAPCO (Williams)			
Mapco 1 (Williams)	11/79 - 12/2003	279,766,163	
Mapco 2	12/97 - 11/98	4,917,167	
Mapco 3 (Williams)	12/98-12/2003	28,147,483	
William 4 (Interim)	1/2004-3/2004	5,582,298	
Williams 5 (Interim)	Replaced by FHR.	0	
Total Mapco			318,413,111
Petrostar			
Petro Star	12/86 - 12/91	5,378,079	
Less: Chevron Purchases	12/86 - 12/91	-2,348,070	
Petro Star JV	3/92 - 12/93 — Contract terminated because Petro Star failed to take oil	0	
Total Petrostar			3,030,009
Tesoro			
Tesoro 1	7/80 - 6/81	1,737,316	
Tesoro 2	7/80	2,550,000	
Tesoro 3	12/81 - 1/82	838,299	
Tesoro 4	1/83 - 12/94	179,783,385	
Tesoro 5 11 months	10/85 - 8/90	47,364,935	
Tesoro 5 Reservation Fee	10/85 - 8/90 — Reservation Fee	-38,707,561	
Tesoro 6	1/95 - 12/95	13,703,946	
Tesoro 7	1/96-12/98	38,865,223	
Subtotal		246,135,543	
Less: Chevron Exchange Barrels		-16,015,501	
Total Tesoro			230,120,042
Competitive In-Kind Sales			
First Competitive RIK Sale			
Alaska Petroleum Co.	Jul-81	622,698	
ARCO Products Co.	7/81 - 12/81	1,847,668	
Oasis Petroleum Co.	7/81 - 1/82	838,604	
Shell	7/81 - 1/82	4,191,436	
Sohio	8/81 - 1/82	3,649,689	
Union	7/81 - 1/82	4,328,966	
Total			15,479,061
Second Competitive RIK Sale			
Chevron 4	4/85 - 3/86	5,703,996	
Chevron 5, 6, 7	4/85 - 9/85	3,226,724	
Sohio	4/85 - 12/85	955,688	
Texaco 1	4/85 - 12/85	2,867,172	
Texaco 2	4/85 - 3/86	9,506,588	
Union 2	4/85 - 9/85	1,135,522	
US Oil & Refining - B	4/85 - 3/86	3,802,521	
Total			27,198,211
Quasi-Competitive RIK Sale			
Chevron 8	10/85 - 3/86	954,349	
Union 3	10/85 - 3/86	715,760	
US Oil & Refining - 1,2	10/85 - 3/86	1,908,696	
Total			3,578,805
Total North Slope RIK Oil (Including estimated future deliveries)			892,315,253

Source: Alaska Department of Natural Resources, Division of Oil and Gas

Source: Final Best Interest Finding and Determination for the Sale of Alaska North Slope Royalty Oil to Flint Hills Resources Alaska, LLC (DNR 2013)

Best Interest of the State Served by the RIK Contract with Flint Hills Resources (FHR)

- Cash Value Offered with Contract
  - Cash value of $3.5-5.9 Billion over 5 years
    - Analyzed for Consistent value between RIK and RIV
    - Volume weighted average of current reported netback price (11 AAC 03.026(b))
  - Anticipated increases in marine transportation allowance will favor RIK contract
- Positive effect on the State
  - Maintain stability in in-state refining and distribution of refined products.
  - Support jobs and economy of Fairbanks North Star Borough

FHR’s North Pole Refinery

- Strategically located on TAPS
- Current throughput of 82,000-84,000 barrels per day of ANS crude
- Producing approximately 22,000-25,000 barrels of refined product
- All crude and constituents that are not transformed into refined product are injected back into TAPS (with a penalty paid)

FHR's North Pole Refinery

- FHR produces approximately
  - 672,000 gallons of jet fuel per day
  - 143,000 gallons of gasoline per day
  - 41,000 gallons of home heating fuel per day
  - 68,000 to 194,000 gallons per day of product consisting of HAGO, LAGO, naphtha, asphalt, refining fuel, and a small volume of high-sulfur diesel
- 680,000 gallons per day shipped to Anchorage via the Alaska Railroad
- 230,000 gallons of ultra-low sulfur diesel and gasoline on the backhaul to Fairbanks
- FHR owns 50 million gallons of storage facilities
  - 30.7 million in Anchorage and 19.3 million in Fairbanks

Proposed Contract Benefits

- Proposed contract is expected to:
  - Maintain status quo of in-state refining behavior
  - Produce **330 million gallons** of refined product or **18% of gasoline** and **26% of jet fuel** consumed in Alaska
  - Provide approximately **$140 million** per year in gross regional product sales for the Fairbanks North Star Borough (FNSB)
  - Support **1,300 direct and indirect jobs** in the FNSB
  - Sustain **$100 million** in annual earnings in FNSB
  - Provide socio-economic stability against energy costs

Projected Impacts if not Approved

- If FHR stops refining, anticipated effects include:
  - Loss of approximately 1,300 direct and indirect jobs in the Fairbanks North Star Borough
  - State could experience increased utilization of the social safety net
  - Possibility of population redistribution
  - Increased and decreased infrastructure utilization and maintenance with population shift
  - Impact to the fuel supply for the Fairbanks and Anchorage airports, affecting trade and tourism and the Alaska Railroad
  - Loss of heat source for warming low flow in TAPS

Questions?