Proposed Sale of the State's Royalty Oil to Petro Star: Senate Bill 30

House Resources Committee

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Royalty In-Kind versus Royalty In-Value

- The State has a choice to take its royalty in-kind (RIK) or in-value (RIV).
- 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 SOA takes its royalty share as RIK, the SOA assumes ownership of the oil, and the DNR Commissioner disposes of it through the sale procedures prescribed by AS 38.05.183.
- The SOA has regularly taken royalties of ANS oil as RIK (starting in 1979).
- The State will receive between **$29 to $37 million** in additional revenue over what the state would receive if the contracted volumes were taken RIV.
- Petro Star contract has been through public review and Royalty Board processes.

Non-Competitive RIK Sale Process

- Before taking RIK, the DNR Commissioner must find it is in the State's best interest.
- DNR must decide whether to sell RIK pursuant to a competitive auction or a non-competitive, negotiated sale.
- Solicitation of Interest issued January 2015 to prospective purchasers to gauge market interest.
- DNR determined that there was not competition allowing for a competitive sale, and proposed to enter into two negotiated contracts with Petro Star.
- The first contract, in effect for the period January – December 2017, did not need legislative approval under AS 38.06.055(a) and (b)(1), received recommendation of the Royalty Board and was entered into in August 2016.
- The second contract, effective for the period January 2018 – December 2021, received the recommendation of the Royalty Board, but requires Legislative approval.

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; and
5. The eight criteria listed in AS 38.06.070(a), as reviewed by the Royalty Board.

In considering these criteria, the commissioner will state which criteria apply to the proposed disposition and discuss the weight given to the applicable criteria in determining the maximum benefits to the state.

Approval Process for the RIK Sale

- DNR must make a Best Interest Finding (BIF) in support of the sale.
  - Preliminary BIF issued July 2016.
  - Final BIF issued in September 2016.
- DNR presented the proposed sale to the Royalty Board on August 31, 2016.
- The Board reviewed the Preliminary BIF and the proposed contracts, and unanimously voted to recommend the Legislature approve the sale of ANS royalty oil to Petro Star.
  - The Board issued a Report to the Alaska Legislature and Resolution 2016-2 stating that the proposed disposition of ANS royalty oil to Petro Star meets the requirements of AS 38.06.070.
- Prior to finalizing the RIK contract, the Legislature must pass a bill ratifying the contract with Petro Star (HB 70; SB 30).

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 effects 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;
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; and
8. The projected effects of the proposed transaction upon existing private commercial enterprise and patters of investment.

Petro Star RIK Contract Terms

- **Quantity**
  - 1-year contract: from 18,800 bpd to 23,500 bpd for Jan. 2017 – Dec. 2017
  - 4-year contract: from 16,400 bpd to 20,500 bpd for Jan. 2018 – Dec. 2018

    from 13,200 bpd to 16,500 bpd for Jan. 2019 – Dec. 2019

    from 10,800 bpd to 13,500 bpd for Jan. 2020 – Dec. 2020

    from 8,400 bpd to 10,500 bpd for Jan. 2021 – Dec. 2021
- **Price**: the contracts use a netback formula and provides higher revenue to State compared to RIV.
- **Quantity flexibility**
  - Petro Star may nominate zero barrels up to 3 consecutive months if "turnaround clause" is used, otherwise the contract terminates.
  - The State can cap its delivery amounts to 95% of the total ANS royalty oil if the nominations from all RIK buyers is greater than the 95% threshold.
  - Provided that the supply of ANS royalty oil exceeds demand from both RIK buyers, the State can sell Additional Sale Oil as long as the total deliveries are not greater than the 95% threshold.
- **Security**
  - Petro Star's guarantor (ASRC) shall provide a letter of opinion from a financial analyst or a stand-by letter of credit or surety bond equal in value to 50 days of delivery.
  - If guarantor's credit rating falls below investment grade level, then guarantor shall provide a stand-by letter of credit or surety bond described previously.
- **In-state processing**: Petro Star to use "commercially reasonable efforts" to manufacture refined products in-state from the ANS royalty oil.
- **Employment of Alaska residents**: no discrimination against AK companies and residents.

RIK Contract Price

ANS Spot Price - $1.95 – Tariff Allowance +/- Quality Bank Adjustments – Line Loss

- **ANS Spot Price** = Average US West Coast Price for Alaska North Slope oil (reported by industry trade publications Platts and Reuters)
- **$1.95 RIK Differential**
  - This is a deduction used to calculate the price of ANS oil sold in Alaska.
  - The deduction is applied to the price of ANS oil at its most common destination market (the U.S. West Coast).
  - It resembles the deduction used in sales of ANS oil in Alaska between North Slope producers and between North Slope producers and in-state refineries.
  - In contrast, for the ANS royalty oil that is sold outside of Alaska and that is taken in-value, producers use a deduction that approximates the marine transportation cost.
  - Since deduction that represents the marine transportation cost is generally higher than the value of the RIK differential, the State has the potential to obtain a higher price for its ANS royalty oil by taking it in-kind and selling it in Alaska.
- **Tariff Allowance** = Tariffs for TAPS and pipelines upstream of Pump Station 1 (PS-1).
- **Quality Bank Adjustments** = adjustments reported by TAPS Quality Bank Administrator.
- **Line Loss** = loss or mismeasurement of volume between PS-1 and the Valdez Marine Terminal (VMT). It is calculated as 0.09% of the amount resulting from the formula above, excluding “Line Loss.”

Contract is in the State's Best Interest

- The State will receive between **$29 to $37 million** in additional revenue over what the state would receive if the volume of ANS royalty oil the contracts is taken in-value.
  - 1-year contract (Jan. – Dec. 2017): from $7.6 to $9.5 million
  - 4-year contract (Jan. 2018 – Dec. 2021): from $22.3 to $27.9 million
- On average, producers selling ANS royalty oil outside Alaska for the 5-year period of the proposed RIK contracts with Petro Star are expected to deduct from $3.37 to $3.70 per barrel as a "marine transportation cost" in arriving at the price for RIV.
  - This is the deduction used to adjust the price of ANS oil from the U.S. West Coast to Alaska.
- The proposed contracts with Petro Star will deduct only $1.95 as a "location differential" from the west coast ANS value.
- The proposed sale provides crude to Petro Star's refineries at North Pole and Valdez with the associated economic and social benefits to Alaska's economy:
  - Petro Star employs approximately 44 people in its refining operations.
  - Maximum throughput capacity
    - North Pole refinery: 22,000 barrels per day (bpd). Valdez refinery: 60,000 bpd.
  - Of the throughput amounts, approximately 25%-30% will be refined products.
  - Petro Star refineries' estimated contribution to the local economy in 2014 was $25mm

Comparison of RIK Contracts

Period		Tesoro Minimum nomination (bpd)	Tesoro Maximum nomination (bpd)	Petro Star Minimum nomination (bpd)	Petro Star Maximum nomination (bpd)
Aug 01, 2016	Dec 31, 2016	20,000	25,000	NA	NA
Jan 01, 2017	Dec 31, 2017	20,000	25,000	18,800	23,500
Jan 01, 2018	Dec 31, 2018	20,000	25,000	16,400	20,500
Jan 01, 2019	Dec 31, 2019	20,000	25,000	13,200	16,500
Jan 01, 2020	Dec 31, 2020	20,000	25,000	10,800	13,500
Jan 01, 2021	Jul 31, 2021	20,000	25,000	8,400	10,500
Aug 01, 2021	Dec 31, 2021	NA	NA	8,400	10,500

		Tesoro	Petro Star
Price	Netback pricing	Destination value – **RIK Differential** – Tariff allowance – Quality bank adjustment – Line loss	
	Destination value	ANS price at the U.S. West Coast assessed by Platts and Reuters	
	RIK Differential	**$1.95**	
	Tariff allowance	Ownership-weighted average of the effective TAPS tariff filed with FERC for each carrier. If royalty oil comes from fields upstream of PS No 1, then RIK contracts consider tariffs filed with FERC for shipment of royalty oil upstream of PS No 1.	
	Quality bank adjustment	Adjustment representing the difference in quality between the oil produced from the **units on the North Slope** and the **co-mingled ANS TAPS stream value** at the Petro Star Valdez Refinery connection.	
	Line loss	**0.009%***(Destination value – $1.95 – Tariff allowance – Quality bank adjustment)	