Report to the Alaska Legislature from the Alaska Royalty Oil and Gas Development Advisory Board

April 8, 2025

According to Alaska Statute ("AS") 38.06.070(c), the Alaska Royalty Oil and Gas Development Advisory Board ("Royalty Board") "…shall make a full report to the legislature on each criterion specified in (a) or (b) of this section for any disposition of royalty oil or gas that requires legislative approval. The board's report shall be submitted for legislative review at the time a bill for legislative approval of a proposed disposition of royalty oil or gas is introduced in the legislature."

The Alaska Department of Natural Resources ("DNR") is proposing the sale of royalty in-kind ("RIK") oil to Marathon Petroleum Supply and Trading Company LLC ("Marathon") under a contract for an initial period of three years, and with optional annual extensions for an additional seven years, unless either party withdraws by November 1 of year three and each year of the extension period. Delivery of royalty oil during the initial period will start on August 1, 2025 and end on July 31, 2028.

Pursuant to AS 38.06.050 and 38.06.055, before entering into a contract for the sale of RIK oil, the DNR Commissioner must obtain both the review of the proposed sale by the Royalty Board and approval of the proposed sale by the legislature. Limited exceptions to this rule are set forth in AS 38.05.055(b), but do not apply in this instance. Upon the recommendation of the Royalty Board, DNR anticipates that the Governor will propose a bill to the legislature seeking approval for this contract. This document is the Royalty Board's report regarding the sale of North Slope royalty oil by DNR to Marathon under the proposed contract titled "Agreement for the Sale of Royalty Oil between and among the State of Alaska, and Marathon Petroleum Supply and Trading LLC, a Delaware Limited Liability Company and Marathon Petroleum Corporation, a Delaware Corporation" ("Proposed Contract").

The Royalty Board reviewed the Preliminary Best Interest Finding and Determination for the Sale of Alaska North Slope Oil to Marathon Petroleum Supply and Trading Company LLC ("Preliminary Finding and Determination") made available to the Royalty Board by the DNR via a link to the Division of Oil and Gas website and by email on March 4, 2025. Additionally, in accordance with 11 AAC 03.020(c)(2), DNR established a thirty-day public comment period that will end on April 11, 2025. The Royalty Board's review and recommendation and any public comments are inputs that DNR uses to convert the Preliminary Finding and Determination into the Final Best Interest Finding and Determination for the Sale of Alaska North Slope Oil to Marathon.

AS 38.06.070(a)-(b) lists the criteria that the Royalty Board must consider when making a recommendation to the legislature for the sale of royalty oil. Below, each criterion is listed in boldface type followed by the Royalty Board's findings. The data and information below draw from DNR's Preliminary Finding and Determination.

AS 38.06.070(a)(1): the revenue needs and projected fiscal condition of the state.

Royalties and taxes related to the oil and gas sector (i.e., petroleum revenue) have historically been an important source of revenue to the State of Alaska, deriving from its role as resource owner and taxing authority. The contribution of petroleum revenue to the total unrestricted general fund revenue has ranged between 24-50% during fiscal years 2020 through 2024.

The Fall 2024 Revenue Sources Book projects petroleum revenue to provide between 25% and 30% of the State's unrestricted revenue over the next ten fiscal years, years 2025 through 2034. DNR projects that the sale of North Slope royalty oil under the Proposed Contract will generate between \$1.3 million and \$6 million in revenue to the State each year of the contract, that is in addition to what would be obtained if these quantities of royalty oil were to be taken in-value.

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AS 38.06.070(a)(2): the existence and extent of present and projected local and regional needs for oil and gas products and by-products, the effect of state or federal commodity allocation requirements which might be applicable to those products and by-products, and the priorities among competing needs.

The proposed sale of royalty oil will help ensure the continued in-state processing of crude oil into refined products with its potential price and labor market benefits. Even though the declining crude oil production on the North Slope entails a reduction in the available royalty oil that could be taken in-kind, DNR attempts to satisfy the demand of all potential in-state RIK buyers. The in-state refineries in turn supply a substantial proportion of the State's needs for refined petroleum products. It should be noted that most of the end-use products refined at the Nikiski refinery, which is operated by Marathon, will be consumed by the Alaska market. The Nikiski refinery produces approximately 55,000 barrels per day ("bpd") of refined product. This amounts to approximately 20.1 million barrels per year. Of the 55,000 bpd of refined products, approximately 30% is typically jet fuel. Under typical refinery operations, nearly all this jet fuel will be transported to Anchorage via a Marathon-owned common-carrier pipeline to support operations at Ted Stevens Anchorage International Airport. This refinery also produces 15,000 bpd of gasoline, approximately 27% of the refinery's total production. Under typical refinery operations, the remaining refinery output is primarily a combination of LPG (propane), distillate, vacuum gas oil, fuel oil, and seasonal asphalt. Approximately 12,000-15,000 bpd of heavy oils (C6 naphtha, vacuum gas oil, and fuel oils) are produced and shipped from the Nikiski refinery, primarily to other Marathon refineries as blend stocks and feedstocks. Approximately 4,000-6,000 bpd of the 12,000 to 15,000 bpd volume of heavy oils may be marketed as finished light sulfur fuel oil product in the Pacific Northwest.

AS 38.06.070(a)(3): the desirability of localized capital investment, increased payroll, secondary development and other possible effects of the sale, exchange, or other disposition of oil and gas or both.

The Proposed Contract will, in and of itself, require no additional capital investment, induce no change in payroll, yield no secondary development, and have few other consequences. During the negotiations, Marathon indicated that the North Slope royalty oil to be delivered by the State under the Proposed Contract would be used in a status-quo fashion. Royalty oil will not cause significant changes to the current overall feedstock sourcing for Marathon's refinery operations: sixty percent coming from North Slope crude oil, twenty percent from Cook Inlet oil, and the remaining twenty percent from other U.S. or foreign sources.

AS 38.06.070(a)(4): the projected social impacts of the transaction.

Beyond the direct revenue impact, the Proposed Contract is unlikely to have any incremental social impact. The royalty oil sold under the Proposed Contract is unlikely to materially impact refinery operations via significant new hiring. As such, no long-run population redistribution, change in the utilization of social services, or other social impacts are expected.

AS 38.06.070(a)(5): the projected additional costs and responsibilities which could be imposed upon the state and affected political subdivisions by development related to the transaction.

The proposed sale, in and of itself, is expected to generate negligible additional costs or responsibilities for the State or the Kenai Peninsula Borough. The State's royalty oil is expected to simply displace crude that could have been secured from the private market. The proposed sale is unlikely to materially impact the operations of the Nikiski refinery. However, when the State sells its royalty oil in-kind, it faces counterparty risk. There exists a possibility that the RIK buyer could, for a host of reasons, fail to fulfill its obligations under the Proposed Contract. Such a failure could expose the State to financial loss. The Proposed Contract recognizes this risk and mitigates it through a security arrangement that requires Marathon to provide either: (1) a letter of opinion from a financial analyst approved by the State in conjunction with a parental guaranty, or (2) an annually renewed, continuously maintained stand-by letter of credit or surety bond equal to the expected value of ninety days of royalty oil.

AS 38.06.070(a)(6): the existence of specific local or regional labor or consumption markets or both which should be met by the transaction.

The Proposed Contract is unlikely to induce any substantial new hiring given that the royalty oil would likely be used as a substitute for private sources of North Slope oil to Marathon. Marathon currently employs more than 240 Alaskans. The Nikiski refinery also retains contracted service providers, 25 of which are Alaskan residents. With respect to consumption markets, it should be recognized that demand for refined products is quite seasonal. The proposed sale preserves a valuable volumetric option. By exercising this option, Marathon may align its crude inventory with seasonal fluctuations in demand for refined product. Such an alignment may be of use in meeting seasonal fluctuations in consumption demand in an economically optimal fashion.

AS 38.06.070(a)(7): the projected positive and negative environmental effects related to the transaction.

The projected environmental effects of the sale, insofar as the sale will maintain the status quo, will be zero since the RIK oil likely replaces oil that would have been purchased from producers in the North Slope. However, in the absence of the current locally produced refined products, there could be increased environmental impacts associated with the transportation of imported petroleum products if the crude oil would have been obtained from outside of Alaska.

AS 38.06.070(a)(8): the projected effects of the proposed transaction upon existing private commercial enterprise and patterns of investments.

The Proposed Contract is unlikely to demonstrably impact the operations at the Nikiski refinery. As has been mentioned before, the crude supplied under the proposed sale will likely simply displace crude from the private sources of Alaska North Slope ("ANS") crude. As such, the proposed agreements are expected to have very little impact on existing private commercial enterprise and patterns of investment. The continued operation of the Nikiski refinery will allow Marathon to continue to supply its customers, including the Ted Stevens International Airport and regional wholesale and retail markets. The continued operation of the Nikiski refinery will sustain the demand that Marathon has among its vendors and services.

Additional considerations.

A. AS 38.06.070(b)

In addition to the above criteria, the Royalty Board also considered that the intent of AS 38.06.070(b) had been achieved through the Proposed Contract. AS 38.06.070(b) provides:

When it is economically feasible and in the public interest, the board may recommend to the commissioner of natural resources, as a condition of the sale of oil or gas obtained by the state as royalty, that

(1) the oil or gas be refined or processed in the state;

Article IV, "In-State Processing," in the Proposed Contract has an explicit provision that "Buyer agrees to use commercially reasonable efforts to process the Sale Oil at its refineries in Nikiski, Alaska."

(2) the purchaser be a refiner who supplies products to the Alaska market with price or supply benefits to state citizens; or

The Nikiski refinery began operations in 1969 and has provided a slate of refined products for Alaska residential and commercial customers. Royalty oil has been an important supply of feedstock to the Nikiski refinery. The State sold North Slope royalty oil to the Nikiski refinery under various contracts since 1980. In total, the State supplied the Nikiski refinery with just over 276 million barrels of North Slope royalty oil under these contracts. The Proposed Contract will provide Marathon with royalty oil supplies for an initial three-year term from August 1, 2025 to July 31, 2028.

(3) the purchaser construct a processing or refining facility in the state

Since the delivery of North Slope royalty oil will likely replace private sources of ANS crude oil, the proposed sale is not conditioned on the requirement that the RIK buyer construct a processing or refining facility in the state.

Conclusion

For these reasons, the Royalty Board recommends that the Proposed Contract be approved.