Senate Bill 176: Approve Marathon Petro Royalty Oil Sale

Senate Finance Committee

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Alaska Department of Natural Resources

April 28, 2025




What is "Royalty In-Kind"?

Oil and gas leases issued by the State reserve a "royalty share" to the State – a portion of production that the State receives as owner of the resource.

The State has the option to take its royalty oil and gas in-value (RIV) or in-kind (RIK).

- RIV: Lessees market the royalty oil or gas alongside their own production; the State receives the proceeds from the sale of its royalty oil, subject to fair market value
- RIK: Lessees provide royalty oil or gas of sales quality to the State; the State is responsible for marketing its royalty oil or gas

Department of Natural Resources (DNR) has statutory processes for receiving royalty:

- Alaska Statute (AS) 38.05.182 requires DNR to make best interest findings for RIV and RIK determinations, and requires the commissioner report annually to the Legislature about these elections
- AS 38.05.183 guides DNR in the sales of RIK and requires that contracts meet a number of statutory criteria and, in certain cases, receive legislative approval before being entered into
- AS 38.06 establishes the Alaska Royalty Oil and Gas Development Advisory Board, which reviews royalty-in-kind actions by DNR

Royalty – A Core Lease Term

Alaska Lease Language

Competitive Oil and Gas Lease
Form #DOG 200004

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES

Competitive Oil and Gas Lease **ADL No. 389770**

THIS LEASE is entered into JUL 1 2002, between the State of Alaska, "the state," and

Union Oil Company of California 100%

35. ROYALTY ON PRODUCTION. Except for oil, gas, and associated substances used on the leased area for development and production or unavoidably lost, the lessee shall pay to the state as a royalty 12.50 percent

37. ROYALTY IN VALUE. Except to the extent that the state elects to receive all or a portion of its royalty in kind as provided in Paragraph 38 below, the lessee shall pay to the state that value of all royalty oil, gas, and associated substances as determined under Paragraph 36 above. Royalty paid in value will be free and clear of all lease expenses (and any portion of those expenses that is incurred away from the leased area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering, saltwater disposal, and preparing the oil, gas, or associated substances for transportation off the leased area. All royalty that may become payable in money to the State of Alaska must be paid on or before the last federal banking day of the calendar month following the month in which the oil, gas, or associated substances are produced. The amount of all royalty in value payments which are not paid when due under this lease or the amount which is subsequently determined to be due to the state or the lessee as the result of a redetermination will bear interest from the last federal banking day of the calendar month following

38. ROYALTY IN KIND. (a) At the state's option, which may be exercised from time to time upon not less than 90 days' notice to the lessee, the lessee shall deliver all or a portion of the state's royalty oil, gas, or associated substances produced from the leased area in kind. Delivery will be on the leased area, unit area, or at a place mutually agreed to by the state and the lessee, and must be delivered to the State of Alaska or to any individual, firm, or corporation designated by the state.

(b) Royalty oil, gas, or associated substances delivered in kind must be delivered in good and merchantable condition, of pipeline quality, and free and clear of all lease expenses (and any portion of those expenses incurred away from the leased area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering, saltwater disposal, and preparing the oil, gas, or associated substances for transportation off the leased area.

Alaska Oil and Gas Unit Agreement

NIKAITCHUQ UNIT AGREEMENT

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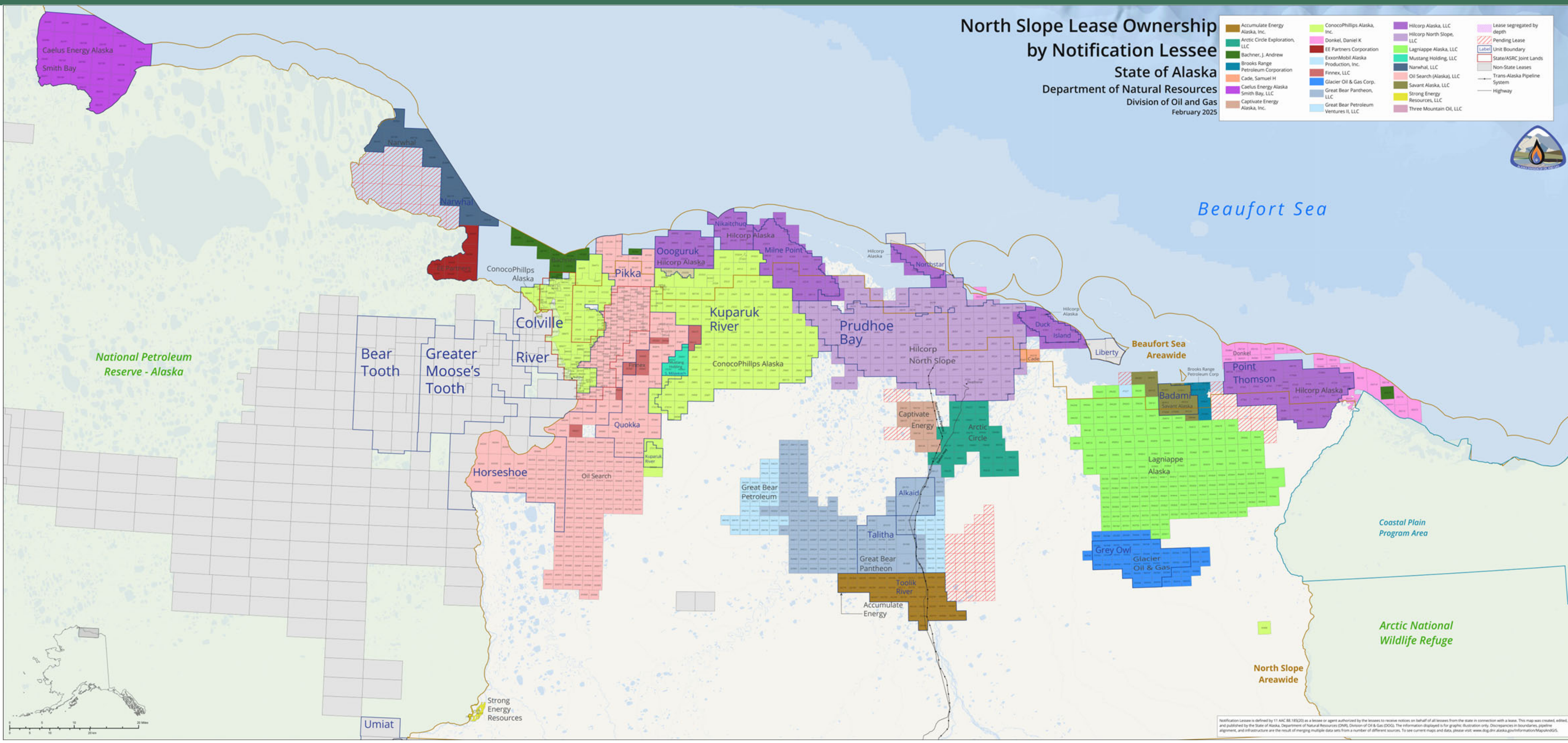
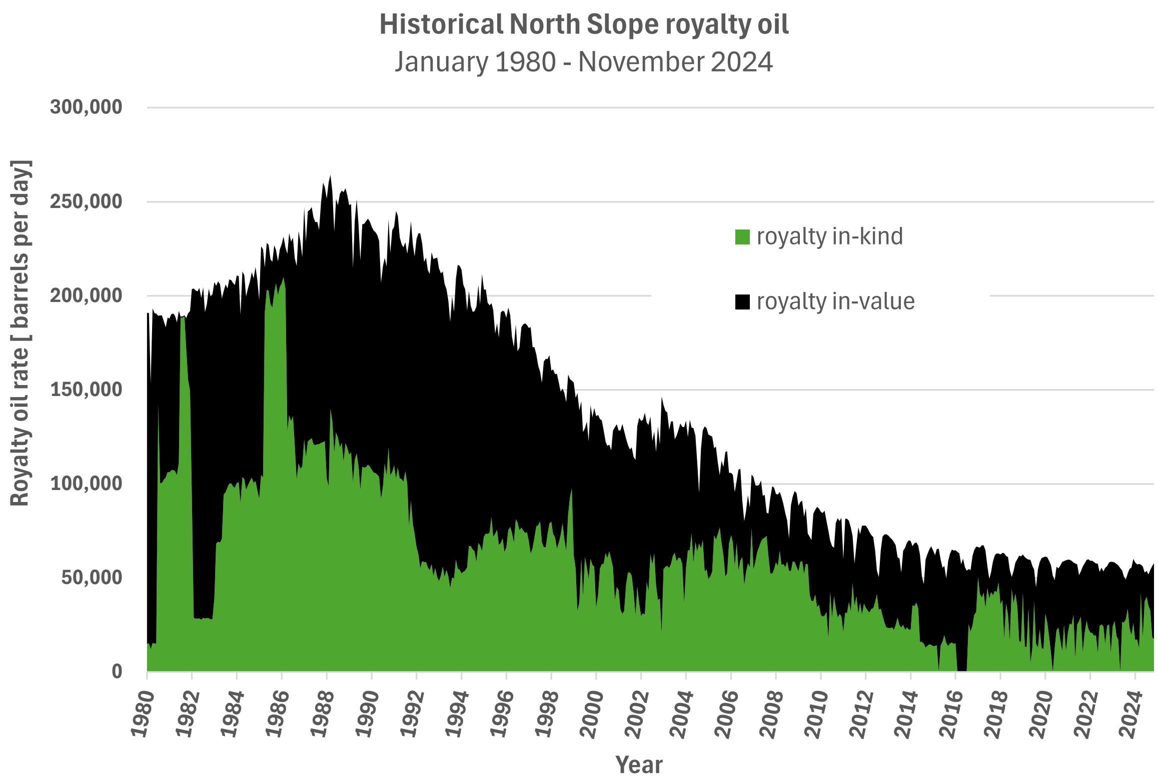
12.6. The Unit Operator shall give the Commissioner notice of the anticipated date for commencement of production at least six months before the commencement of Sustained Unit Production from a Participating Area. The Commissioner may take Unitized Substances in-kind in accordance with the following: **The Commissioner will give the Unit Operator 90 days written notice of the State's initial election to take Unitized Substances in-kind.** After taking has actually commenced, the Commissioner may increase or decrease the amount of Unitized Substances taken in-kind by not more than 10 percent, upon 30 days written notice to the Operator; and greater than 10 percent, upon 90 days written notice to the Operator.

Sources of North Slope Royalty



Royalty In-Kind Contract History

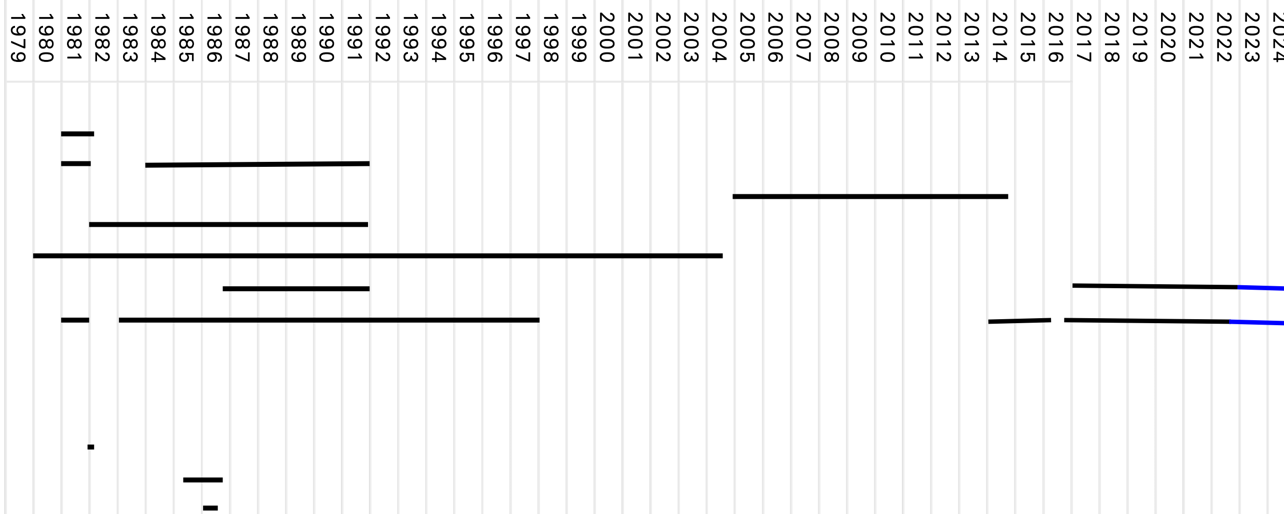
- The State has historically selected to receive royalty oil both in-kind and in-value
- About 97 percent of the State's royalty oil in-kind selections have been North Slope oil
- The amount of RIK oil that the State sells varies and depends many factors:
  - Alaska North Slope (ANS) oil production from state-owned lands
  - Royalty rates for State oil and gas leases
  - State's selection of the fields from which to choose RIK oil
  - Quantity of crude oil sought by in-state refineries or other potential buyers
  - Competitiveness of ANS royalty oil versus other sources of crude oil for in-state refineries or other potential buyers



Royalty In-Kind Contract History

- Almost all the nearly one billion barrels sold to date have been sold via non-competitive sales
- Less than 5 percent has been sold via competitive sales
- The large majority of RIK oil sold to date has been to in-state entities, with a few historical cases where RIK oil was sold for export outside of Alaska

North Slope RIK Contracts to In-State Purchasers Since 1979



Purchaser	Total RIK Volumes (through 11/2024)
Negotiated In-Kind Sales	
Alpetco	38,966,543
Chevron	83,856,765
Flint Hills Resources	171,496,610
Golden Valley Electric Association	17,974,808
MAPCO (Williams)	318,413,111
Petro Star	38,845,951
Tesoro/Marathon	276,734,558
Total Negotiated Sales	951,320,851
Competitive In-Kind Sales	
First Competitive RIK Sale	15,479,061
Second Competitive RIK Sale	27,198,211
Quasi-Competitive RIK Sale	3,578,805
Total Competitive	46,256,077
Total North Slope RIK Oil Sales	997,576,928

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

Processes and Legislative Approval

RIK contract development and execution involves several significant steps:

- DNR commissioner follows a statutory process to negotiate a proposed sale; then DNR publishes a proposed finding describing the terms and reasons for the sale
- DNR must brief the Alaska Royalty Oil and Gas Development Advisory Board (AS 38.06) on the proposed sale and receive the Board's review and approval
- After receiving public comment on the proposed findings, DNR publishes a final best interest finding
- AS 38.06.055 requires authorization by the Legislature before a contract can be executed

There are limited exceptions to this process, such contracts to relieve storage or market conditions with a duration of one year or less, and contracts for sales of 400 barrels per day or less. These exceptions do not apply to the Marathon contract now under consideration.

Royalty Board Review

AS 38.06.050 requires the Alaska Royalty Oil and Gas Development Advisory Board:

- To provide a written recommendation of the board on the proposed sale, submitted to the Legislature at the time a bill approving the proposed sale is introduced, and
- To provide a report on the criteria used to evaluate the proposed sale

The Alaska Royalty Oil and Gas Development Advisory Board

Resolution 2025-1

Whereas, on Monday, March 24, 2025 at 1:30 p.m., the Alaska Royalty Oil and Gas Development Advisory Board ("Royalty Board") conducted public hearings in the Kuparuk Conference Room of the Atwood State Office Building, 550 W. 7th Avenue, Suite 1100, Anchorage, Alaska, and via Microsoft Teams, to consider the proposed royalty in-kind oil supply 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").

Whereas, under the Proposed Contract, the Alaska Department of Natural Resources ("DNR") will sell North Slope royalty oil in-kind to Marathon Petroleum Supply and Trading LLC for a period of three years with possible annual extensions of one year each for seven additional years, unless either party withdraws by November 1 of year three and each year of the extended period. Delivery of royalty oil will range between 10,000 to 15,000 barrels per day (bpd). Pursuant to Alaska Statutes ("AS") 38.06.050 and 38.06.055, before entering into a contract for the sale of royalty oil, the DNR Commissioner must obtain both the review of the proposed sale by the Royalty Board and approval of the Alaska 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 Alaska Legislature seeking approval for the Proposed Contract.

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.

Royalty Board Review Criteria

Sec. 38.06.070. Criteria. (a) In the exercise of its powers under AS 38.06.040(a) and 38.06.050 the board shall 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 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;

(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;

(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 transaction;

(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 and negative environmental effects related to the transaction; and

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

(b) 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;

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

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

The 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**.

Recent RIK Contracts

Contract for sale of RIK Oil	Period	Royalty barrels for sale	Royalty Board review	Legislative approval
Tesoro (2016)	5 years (Aug 2016 – Jul 2021)	20,000 - 25,000 bpd	Support: Recommended Legislature Approval	Yes
Petro Star (2016)	1 year (Jan 2017 – Dec 2017) 4 years (Jan 2018 – Dec 2021)	2017: 18,800 – 23,500 bpd 2018: 16,400 – 20,500 bpd 2019: 13,200 – 16,500 bpd 2020: 10,800 – 13,500 bpd 2021: 8,400 – 10,500 bpd	Support: Recommended Legislature Approval	N/A (1-year contract) Yes (4-year contract)
Marathon (2021)	1 year (Aug 2021 – Jul 2022)	10,000 – 15,000 bpd	N/A	N/A (1-year contract)
Petro Star (2021)	1 year (Jan 2022 – Dec 2022)	10,000 bpd	N/A	N/A (1-year contract)
Marathon (2022)	3 years (Aug 2022 – Jul 2025)	10,000 – 15,000 bpd	Support: Recommended Legislature Approval	Yes
Petro Star (2022)	5 years (Jan 2023 – Dec 2027)	10,000 – 12,500 bpd	Support: Recommended Legislature Approval	Yes
Marathon (2025)	3 years firm + 7 years of optional annual extensions (Aug 2025 – Jul 2035)	10,000 – 15,000 bpd	Support: Recommended Legislature Approval	Pending

Competitive vs. Non-Competitive Sales

- AS 38.05.183 requires the sale of royalty oil be by competitive bid, unless determined that the best interest of the State does not require it or no competition exists
- A non-competitive sale requires a written finding by DNR; for the Marathon contract, a Final Best Interest Finding was published on April 14, 2025
- How does DNR decide between a competitive and non-competitive sale?
  - DNR publishes a “Solicitation of Interest” letter with the goal of gauging the interest of the market
  - In this letter, DNR establishes its preferred method of sale (*i.e.*, competitive disposition) with non-binding parameters for such sale
  - Interested parties are invited to comment on their willingness to buy RIK oil and their preferred terms
  - DNR analyzes those responses and makes a written determination of the method of sale that is in the best interest of the State

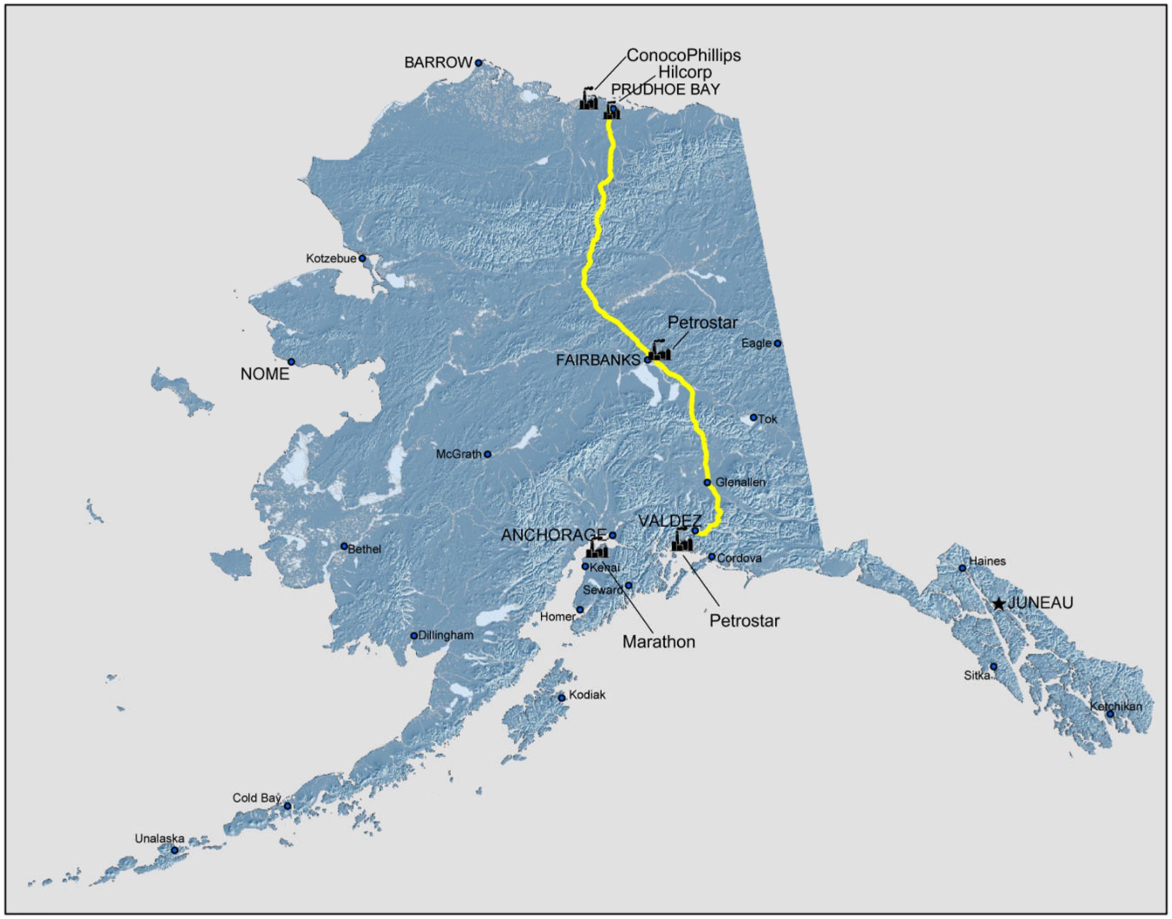
When awarding a royalty sale the commissioner shall consider:

- The cash value offered;
- The projected effects of the sale, exchange, or other disposal on the economy of the state;
- The projected benefits of refining or processing the oil or gas in the state;
- The ability of the prospective buyer to provide refined products or by-products for distribution and sale in the state with price or supply benefits to the citizens of the state; and
- The criteria listed in AS 38.06.070(a)

There have been very limited competitive sales in the past:

- Competitive sales of RIK oil only occurred in 1981, 1985, and 1986
- Less than 5 percent of RIK oil (46 million barrels of approximately one billion overall barrels) sold to date has been via competitive sales

Royalty-In-Kind In-State Priority

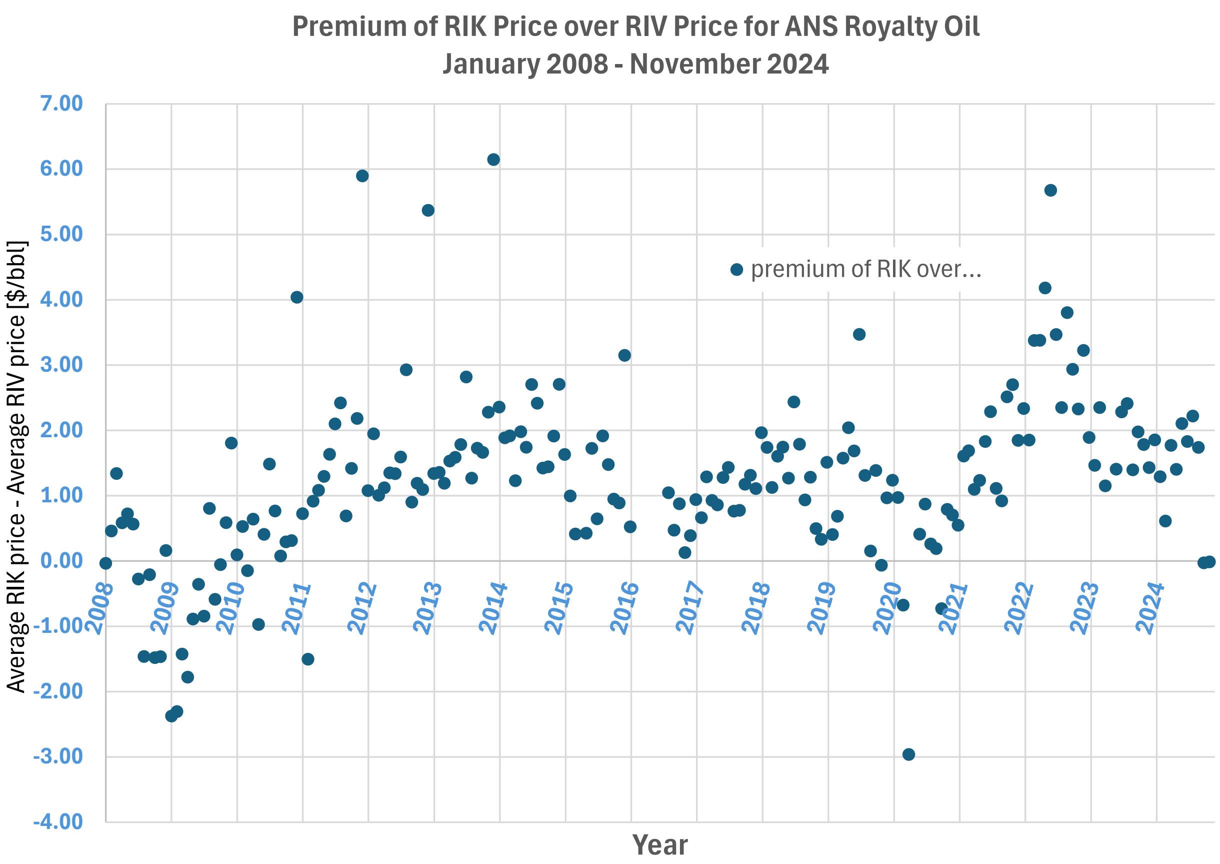


DNR is statutorily directed to give a priority to in-state RIK sales

Sec. 38.05.183. Sale of royalty.

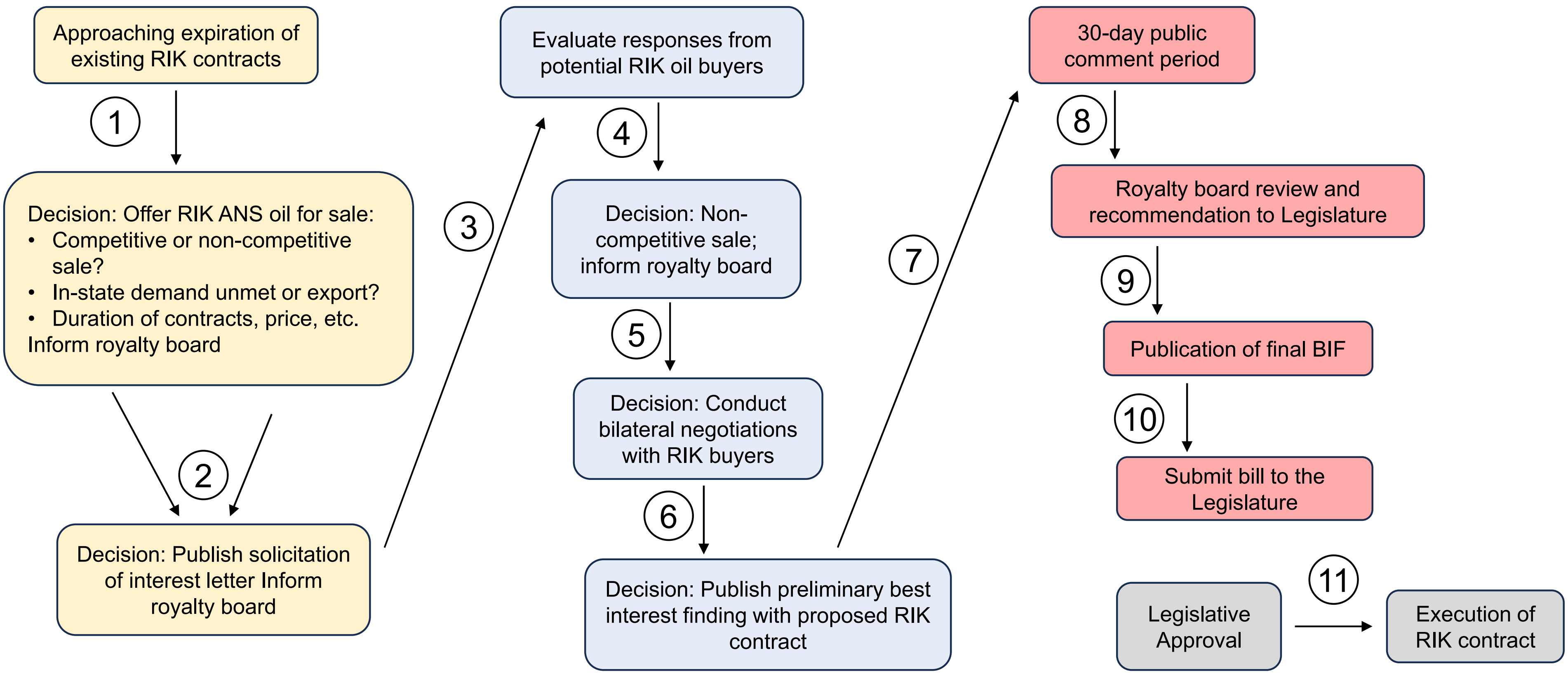
d) Oil or gas taken in kind by the state as its royalty share or gas delivered to the state under AS 43.55.014(b) may not be sold or otherwise disposed of for export from the state until the commissioner determines that the oil or gas is surplus to the present and projected intrastate domestic and industrial needs.

Historical Premium for RIK Sales



- 11 Alaska Administrative Code 03.026(b) states that the RIK price should be at least equal to the RIV price
- From 2008 - 2023 the average RIK price was $1.25/bbl higher than that RIV price
- The State sold over 173 million barrels of royalty oil during this period
- RIK sales proceeds were $12.99 billion
- The State made over $188 million in revenue compared to taking the royalty barrels in-value

RIK Process Overview



Recent RIK Contract Key Terms

<table>
<tr><th>Contract for sale of RIK Oil</th><th>Period</th><th>Royalty barrels for sale</th><th>Netback Pricing</th><th>RIK Differential</th></tr>
<tr><td>Tesoro (2016)</td><td>5 years
(Aug 2016 – Jul 2021)</td><td>20,000 - 25,000 bpd</td><td rowspan="7">DNR sells its royalty oil at the field or "well-head" and bases the price on market sales price indices with various costs backed out. Thus, the price of royalty oil is calculated by “netting back” the price of ANS oil from the U.S. West Coast to the field.

RIK price =

ANS price at the U.S. West Coast
- RIK Differential
- Pipeline transportation cost
+/- Quality bank adjustment
- Line loss</td><td>$1.95/bbl</td></tr>
<tr><td>Petro Star (2016)</td><td>1 year
(Jan 2017 – Dec 2017)
4 years
(Jan 2018 – Dec 2021)</td><td>2017: 18,800 – 23,500 bpd
2018: 16,400 – 20,500 bpd
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2020: 10,800 – 13,500 bpd
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(Aug 2025 – Jul 2035)</td><td>10,000 – 15,000 bpd</td><td>$2.426/bbl for 2025
(DOR Location Differential minus $0.24/bbl)</td></tr>
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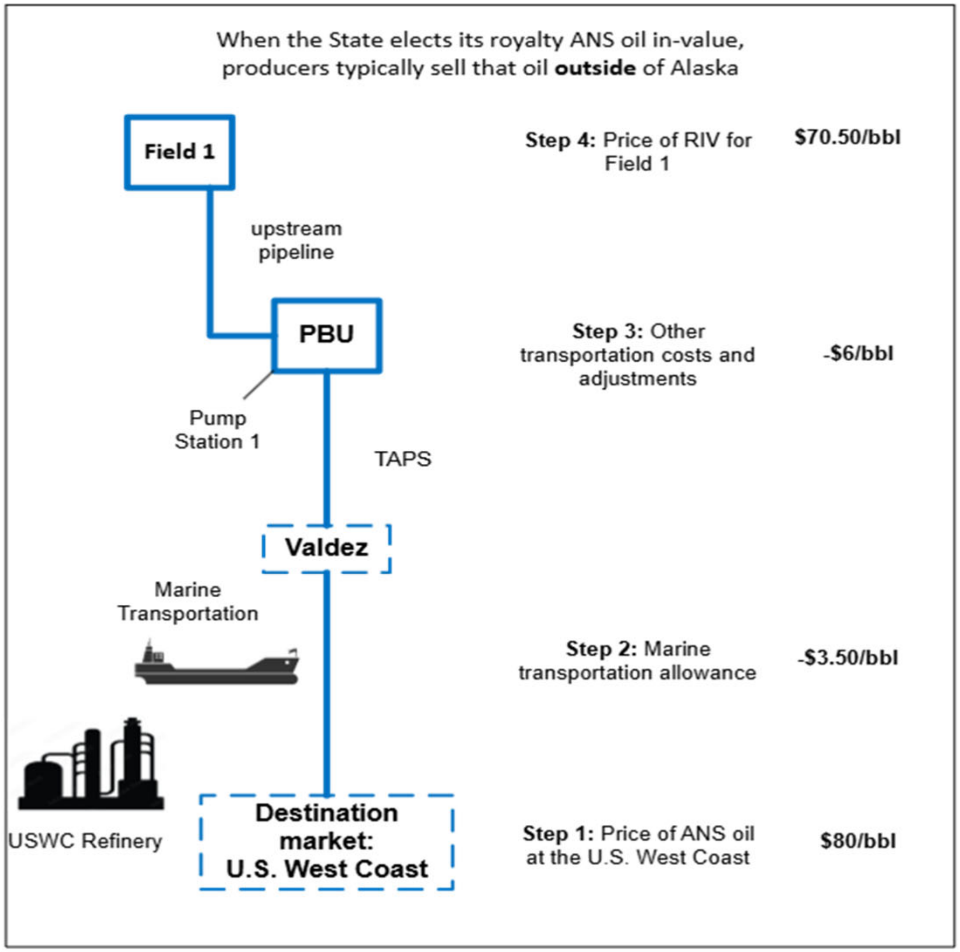
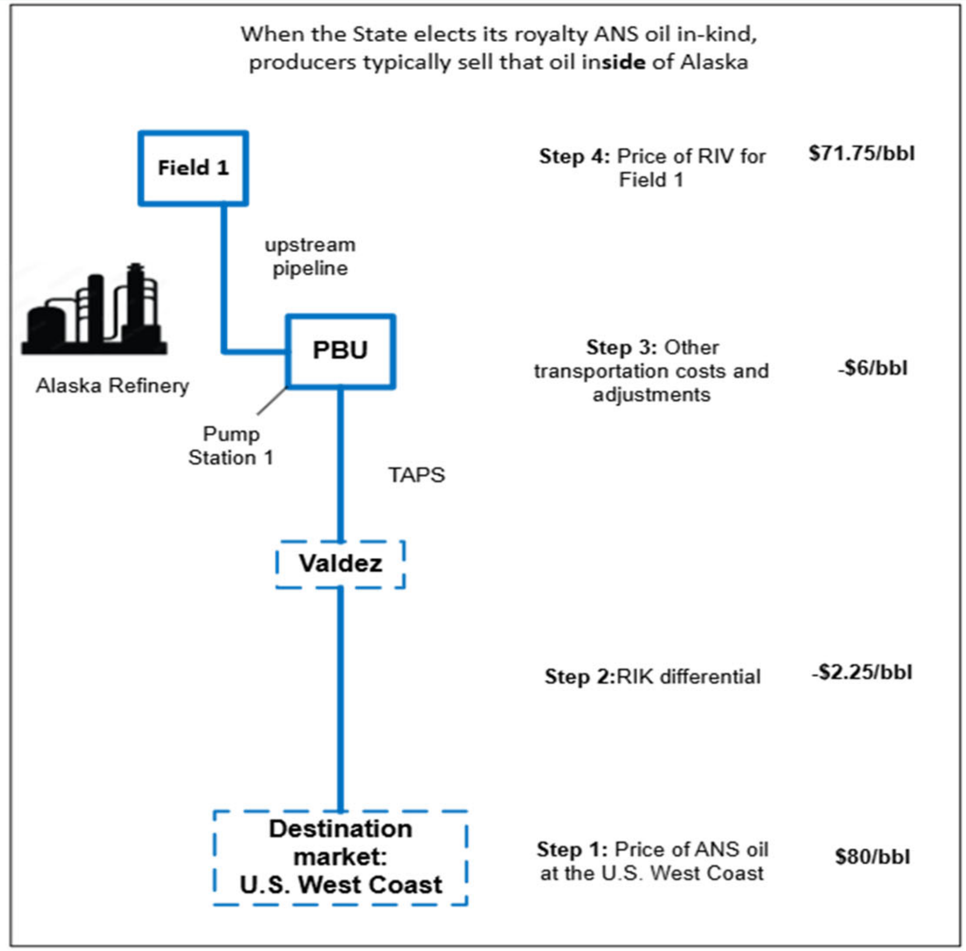
Why RIK?


When the State elects its royalty ANS oil in-value, producers typically sell that oil **outside** of Alaska
Field 1
upstream pipeline
PBU
Pump Station 1
TAPS
Valdez
Marine Transportation
USWC Refinery
Destination market: U.S. West Coast
Step 4: Price of RIV for Field 1
$70.50/bbl
Step 3: Other transportation costs and adjustments
-$6/bbl
Step 2: Marine transportation allowance
-$3.50/bbl
Step 1: Price of ANS oil at the U.S. West Coast
$80/bbl


When the State elects its royalty ANS oil in-kind, producers typically sell that oil in**side** of Alaska
Field 1
upstream pipeline
Alaska Refinery
PBU
Pump Station 1
TAPS
Valdez
Destination market: U.S. West Coast
Step 4: Price of RIV for Field 1
$71.75/bbl
Step 3: Other transportation costs and adjustments
-$6/bbl
Step 2:RIK differential
-$2.25/bbl
Step 1: Price of ANS oil at the U.S. West Coast
$80/bbl

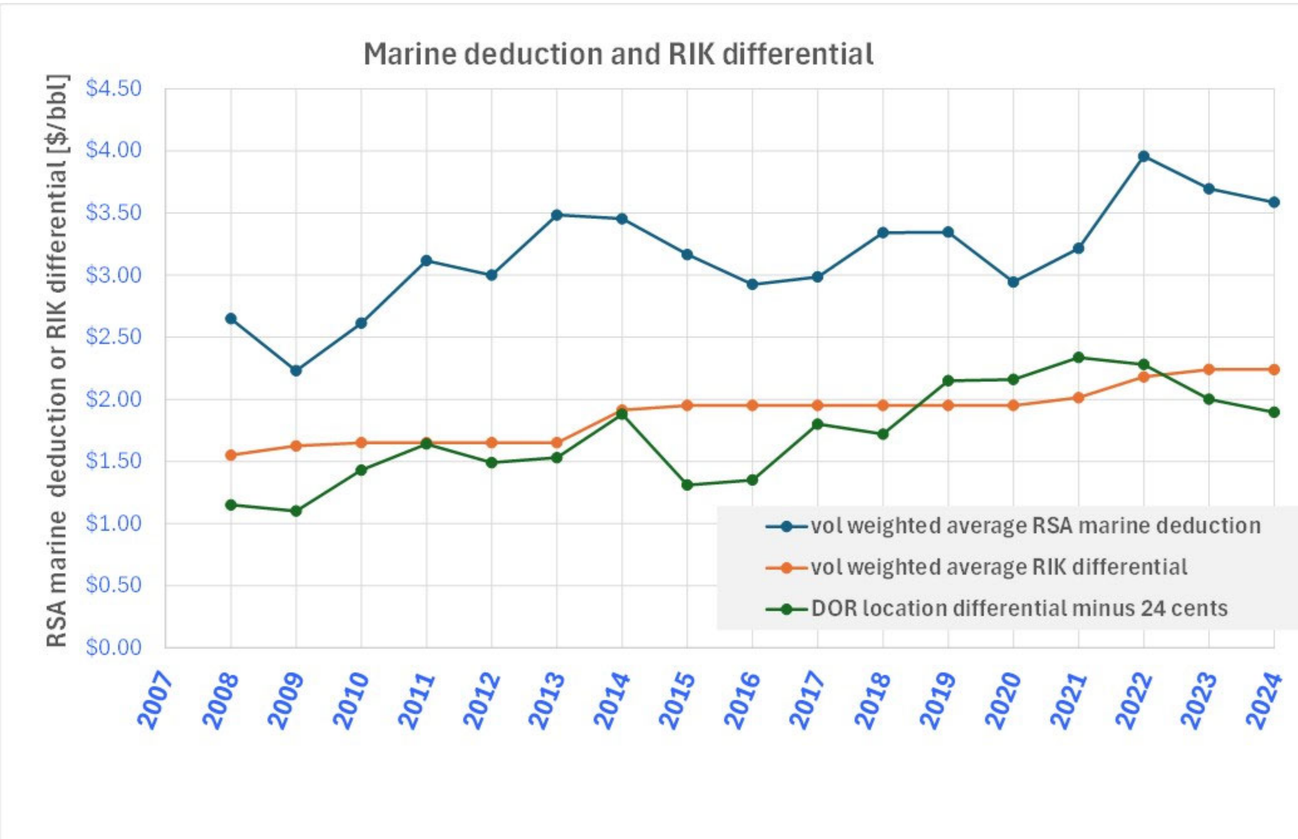
RIK Pricing Formula

ANS West Coast price	Monthly average of ANC USWC daily reported prices for Platts and Reuters
Minus (-)	
RIK differential (DOR location differential minus $0.24)	Publicly available number published by DOR Average location differential from arm's length transactions within the state
Minus (-)	
Tariff allowance	Actual TAPS and other pipeline tariffs from point of sale*
Plus or Minus (+/-)	
Quality bank adjustment	Reflects the value of the field specific oil stream in TAPS*
Minus (-)	
Line loss	Small variance in the metered volumes at Pump Station 1 and the Valdez Terminal
Equals (=)	
Royalty In-Kind price	

*Pipeline tariffs and quality bank adjustments are public and regulated by the Federal Energy Regulatory Commission
DOR: Department of Revenue
USWC: U.S. West Coast
TAPS: Trans-Alaska Pipeline System

Contract Terms for Marathon Using DOR Location Differential

Proposed RIK differential = DOR Location Differential minus 24 cents/bbl



- Difference between marine deduction and RIK differential largely drives RIK premium over RIV
- New methodology allows for dynamic RIK differential deduction over contract term
- DNR estimates $1.08/bbl RIK premium
- This would result in approximately $4.9 million incremental revenue per year of the contract over RIV if Marathon purchases an average of 12.5 thousand barrels of oil per day (mbopd)

RSA: Royalty Settlement Agreement

Maximum Benefit to Alaskans

As required by AS 38.05.183(e), the Marathon RIK contract maximizes the benefits to the State:

- The sale results in royalty premiums to the State compared to the average RIV values
  - Incremental increase in State revenue by $4 to $6 million per year
- In-state refining supports Alaskan jobs
  - Marathon provides 220 full-time positions at its Nikiski refinery, over 60 contracted positions and 40 positions at Anchorage and North Pole terminals
- Producing refined products in Alaska reduces the costs to Alaskans
- Fuel security is economic security
  - Marathon's Kenai refinery produces 55,000 barrels of refined product per day
    - 30 percent is jet fuel supplied to Ted Stevens Anchorage International Airport – nearly half the airport's demand
    - 27 percent is gasoline, which is consumed in state
    - 43 percent is a combination of liquid petroleum gas, fuel oil, asphalt and other products

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