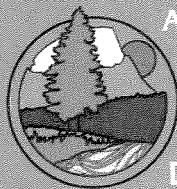


STATE OF ALASKA



Alaska Department of
**NATURAL
RESOURCES**
DIVISION OF OIL & GAS

Final Best Interest Finding and Determination for the Sale of Alaska North Slope Royalty Oil to Flint Hills Resources Alaska, LLC

25 March 2013

Final
Best Interest Finding and Determination
for the
Sale of Alaska North Slope Royalty Oil
to
Flint Hills Resources Alaska, LLC

Division of Oil and Gas
Alaska Department of Natural Resources
March 25, 2013

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| Exhibit 1: “Agreement for the Sale of Royalty Oil Between and Among the State of Alaska, Flint Hills Resources, LLC, A Delaware Limited Liability Company and Flint Hills Resources Alaska, LLC An Alaska Limited Liability Company” | | |
| Exhibit 2: “Report to the Alaska Legislature from the Alaska Royalty Oil and Gas Development Advisory Board, February 28, 2013” | | |
| Exhibit 3: “Alaska Royalty Oil and Gas Development Advisory Board, Resolution 13-1” | | |
| Exhibit 4: Public Comments on the “Preliminary Best Interest Finding and Determination for the Sale of Alaska North Slope Royalty Oil to Flint Hills Resources Alaska, LLC” dated February 20, 2013 | | |

I. Introduction

The Commissioner of the Department of Natural Resources (DNR), on behalf of the State of Alaska, has negotiated a long-term contract to sell the State's North Slope royalty oil to Flint Hills Resources Alaska, LLC (FHR) and Flint Hills Resources, Inc. (as guarantor), both of which are subsidiaries of Koch Industries, Inc. FHR has owned and operated a commercial refinery in North Pole, Alaska, since its purchase of the asset from Williams Alaska Petroleum Inc. in 2004. The North Pole, Alaska, refinery operated by FHR is the State's only current North Slope royalty in-kind customer and has continuously purchased North Slope royalty in-kind from the State since it began refining operations in 1979.

The State proposes this sale of royalty in-kind oil to meet in-state need for crude and facilitate continued operations of the North Pole refinery with the attendant benefits to Alaskans, particularly those Alaskans in the Interior. The negotiations that have resulted in the attached proposed contract have been carried out under the procedures for a non-competitive disposition of royalty oil set out in 11 AAC 03.030 – 11 AAC 03.070. Consistent with its obligations under 11 AAC 03.026(b), under the terms of this contract, the State will receive a price for its royalty oil that will be no less than the amount the State would have received, on average, if it elected to keep its royalty in-value.

This "Final Best Interest Finding and Determination for the Sale of North Slope Royalty Oil to Flint Hills Resources Alaska, LLC" (Final Finding and Determination) provides a summary of the State's royalty in-kind contract with FHR. After an in-depth consideration of the potential economic, environmental, and social impacts, and the various requirements for sale of the State's royalty oil, with a focus on the criteria specified under the terms of AS 38.05.183(e) and AS 38.06.070(a), the Commissioner finds that a negotiated long-term contract for the sale of the State's royalty oil to FHR is in the State's best interest.

II. Royalty in Kind Background

The State of Alaska owns the mineral estate, including oil and gas, under State-owned lands. To monetize the value of this estate, the State has entered into lease agreements with third parties who explore for, develop, and produce oil and gas from these lands. The State receives a royalty share of 12-1/2 to much as 33-1/3 percent of the oil and gas produced from these leased lands on the North Slope. The State may take its royalty either "in-kind" (RIK) or "in-value" (RIV). When the State takes its royalty as RIV, the lessees who produce the oil 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, it assumes ownership of the oil, and the commissioner disposes of it through sale procedures, either "competitive" or "non-competitive," under AS 38.05.183.

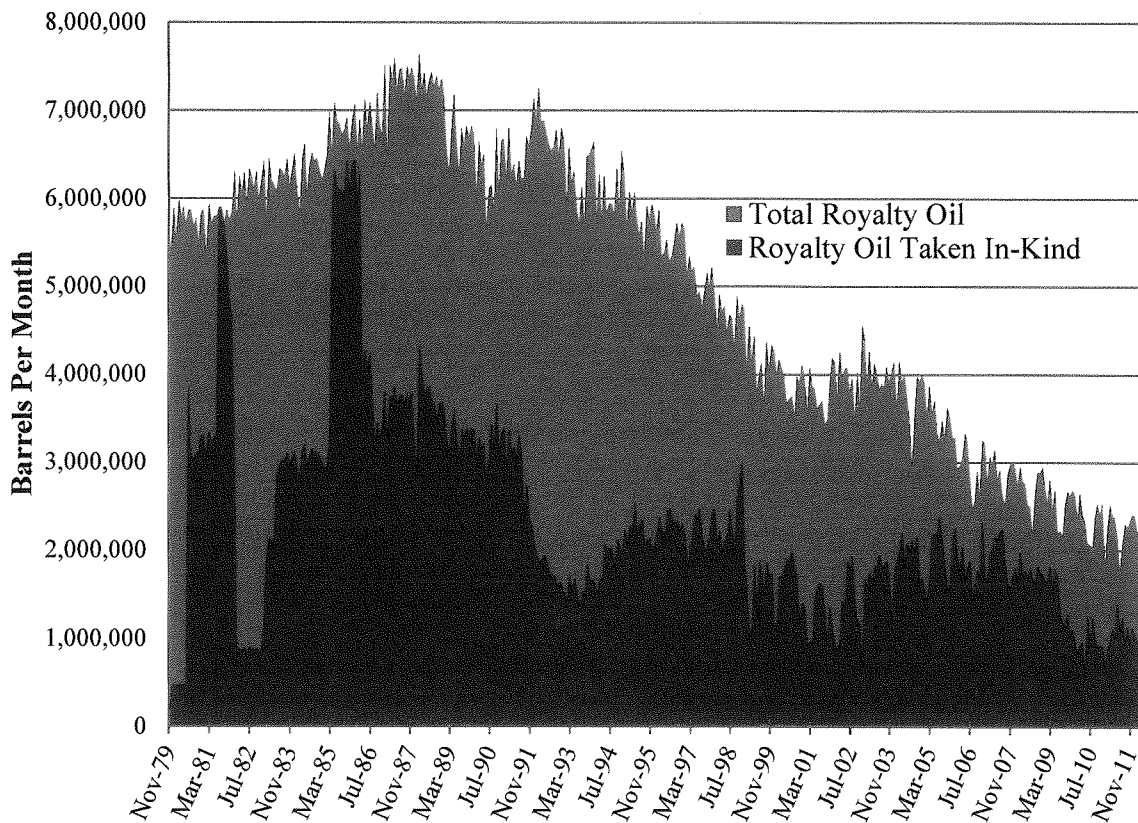
Between November 1979 and June 2012, the state disposed of 45.5 percent of its North Slope royalty oil through in-kind sales. Through the combination of both competitive and non-competitive RIK sales, the State has sold its North Slope royalty oil to in-state refineries, and occasionally has auctioned its North Slope royalty oil to customers in the Lower 48. Figure 1 summarizes the many North Slope RIK contracts since 1979 and Figure 2 illustrates the monthly volumes of royalty oil committed to these contracts during this period.

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 |
| 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 | | 46,418,344 |
| Kuparuk 12/86 - 12/91 | | 8,611,247 |
| Petrostar Purchases 12/86 - 12/91 | | 2,346,070 |
| Subtotal | | 67,841,239 |
| Plus: Tesoro Exchange Barrels | | 16,015,527 |
| Total Chevron | | 83,856,766 |
| Flint Hills Resources 4/04-12/2004 | | 153,697,898 |
| | | 153,697,898 |
| Golden Valley Electric Association | | |
| GVEA 1 8/81 - 5/84 | | 3,182,282 |
| GVEA 2 6/84 - 9/85 | | 2,511,064 |
| GVEA 3 10/85 - 12/91 | | 12,281,452 |
| Total GVEA | | 17,974,808 |
| MAPCO (Williams) | | |
| Mapco 1 (Williams) 11/79 - 12/2003 | | 279,786,163 |
| Mapco 2 12/97 - 11/98 | | 4,917,167 |
| Mapco 3 (Williams) 12/98-12/2003 | | 26,147,483 |
| Williams 4 (Intertek) 1/2004-3/2004 | | 5,582,298 |
| Williams 5 (Intertek) | 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 | | -2,346,070 |
| 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 | | 2,560,000 |
| Tesoro 3 12/81 - 1/82 | | 838,299 |
| Tesoro 4 1/83 - 12/94 | | 179,763,385 |
| Tesoro 5 11 months 10/85 - 8/90 | Reservation Fee | 47,364,835 |
| Tesoro 5 Reservation Fee 10/85 - 8/90 | | -38,707,561 |
| Tesoro 6 1/85 - 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 | | 838,804 |
| Shell 7/81 - 1/82 | | 4,191,436 |
| Sohio 8/81 - 1/82 | | 3,649,689 |
| Union 7/81 - 1/82 | | 4,328,866 |
| 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 | | 9,506,586 |
| 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 | | 715,780 |
| 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

Figure 2. North Slope Historic Total Royalty Volume and In-Kind Volumes (Oil and NGLs)



Source: State of Alaska Division of Oil and Gas

A. The Current Royalty In-Kind Contract with Flint Hills Resources

When the Prudhoe Bay field began production, the State entered into a 25-year contract to sell North Slope royalty oil to Earth Resources, Inc. who later assigned the contract to Mapco Alaska, Inc. who then built the refinery at North Pole, Alaska. Under this 25-year Earth Resources royalty oil contract supplied the North Pole refinery with an average of 35,000 barrels of royalty oil per day. In 1997, the State and Mapco Alaska, Inc. negotiated a one-year contract for approximately 13,000 barrels per day to augment the supply of royalty oil delivered under the 25-year contract. In 1998, the State and Mapco “extended” this one-year contract by negotiating a new five-year contract that was subsequently approved by the Legislature. This five-year contract provided an average of 22,800 barrels per day in addition to the 35,000 barrels per day delivered under the old 25-year contract. Later in 1998, Mapco sold its Alaskan assets and assigned both the 25-year contract and the 5-year contract to Williams. Under these contracts, the State was obliged to deliver only royalty oil produced from the Prudhoe Bay Unit. These two contracts expired on December 31, 2003.

Following the expiration of the 1978 and 1998 RIK contracts on December 31, 2003, the State continued to supply the North Pole refinery with royalty oil under a short-term contract between

the State and Williams which expired on March 31, 2004.¹ The State executed a second short-term RIK contract with Williams to provide the refinery with an uninterrupted supply of royalty oil through September 30, 2004² to enable continued operation of the refinery while Williams and FHR finalized the sale of the asset to FHR. Concurrent with the sale of the North Pole refinery to FHR, DNR and FHR concluded negotiations that ultimately resulted in the current RIK contract. The current ten-year contract with FHR³, scheduled to expire on March 31, 2014, is now the sole RIK contract for Alaska North Slope oil.

B. Royalty Oil Available For Taking In-kind

The volume of royalty oil the state receives depends on the volume of oil produced from State-owned lands. The continuing production decline observed on the North Slope is well-known and well-documented. As the volume of North Slope oil declines, the volume of North Slope royalty oil available for taking as RIK will also decline. The proposed contract obliges the State to deliver a maximum of 30,000 barrels per day to FHR between April 1, 2014 and March 31, 2019.⁴

In an environment of declining production, in order to meet this obligation an increasingly large share of royalty oil must be committed to RIK. In fact, one key concession secured by DNR during negotiation of the proposed contract was a five year contract term. FHR had sought a ten-year contract term that would have obligated the State to commit the vast majority of its royalty oil to a single party (i.e., FHR). Such a ten-year term would have greatly increased the State's volumetric risk, would have similarly increased the State's exposure to substantial loss in the event of non-performance on the part of FHR, and would have greatly circumscribed the State's ability to sell North Slope royalty oil to other potential RIK buyers.

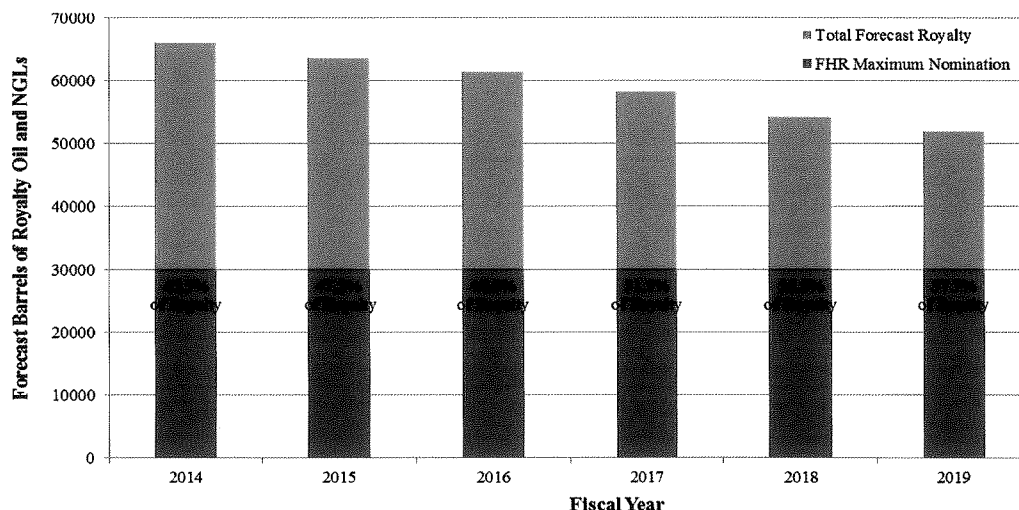
¹ See Alaska Department of Natural Resources. October 1, 2003. "Best Interest Finding and Determination for the Sale of Alaska North Slope Oil" for a copy of this short-term contract.

² See Alaska Department of Natural Resources. December 29, 2003. "Best Interest Finding and Determination for the Sale of Alaska North Slope Oil" for a copy of this second short-term contract.

³ See Alaska Department of Natural Resources. February 12, 2004. "Best Interest Finding and Determination for the Sale of Alaska North Slope Oil to Flint Hills Resources Alaska, LLC" for a copy of this ten-year contract.

⁴ The contract includes a proposed term extension that will, at the Commissioner's discretion and with legislative approval, allow the State to renegotiate a new contract with FHR.

Figure 3. Total Expected Royalty Oil and NGL Volume and Expected Share Committed to FHR



Source: State of Alaska Division of Oil and Gas

Figure 3 shows the expected royalty production for the North Slope from fiscal year 2014 to fiscal year 2019, as well as the maximum nomination volume under the proposed contract. This total royalty production forecast is derived from the Alaska Department of Revenue's recent production forecast and is the royalty share of an aggregation of three distinct forecasts: expected royalty production from wells that are currently producing, expected royalty production from projects that are under development, and expected royalty production from projects that are under evaluation.⁵ In fiscal year 2014, the State is expected to receive approximately 66,000 barrels per day of royalty oil and natural gas liquids (NGLs) from the North Slope.⁶ By fiscal year 2019, royalty oil and NGLs production is expected to decline to just under 52,000 barrels per day.⁷ If FHR purchases the maximum volume allowable under the proposed contract, the State will be required to provide FHR with 45.5 percent of its average daily forecast North Slope royalty in fiscal year 2014, growing to 57.7 percent by fiscal year 2019.

When considering the volume of royalty oil that will be available to the state for taking in kind, there are two additional key considerations. First, expected royalty oil production is based on a forecast. Even the best forecasts will undoubtedly be incorrect, with the magnitude of the error greatest in out-years. Historically, the State's production forecast from which the royalty forecast is derived has been quite optimistic, with realized production often falling well below forecasted levels.⁸ As can be gleaned from the above numbers, the State's royalty forecast would need to be seriously deficient during the term of the contract for the state to struggle to meet its volume obligation. However, it should be noted that the state has reserved the right to

⁵ See Department of Revenue, Revenue Sourcebook, Fall 2012, p. 41-42 for a discussion of the three distinct forecasts.

⁶ 60,000 barrels per day from wells that are currently producing, and 6,000 barrels per day from projects that are under development

⁷ Approximately 38,500 barrels per day from wells that are currently producing, 11,500 barrels per day from projects that are currently under development, and 2,000 barrels per day from projects that are currently under evaluation

⁸ The Department of Revenue, which develops the North Slope production forecast, has recently transitioned to a new, less optimistic forecasting approach.

nominate no more than 85 percent of its North Slope total royalty as RIK through the term of the proposed contract.

Second, royalty forecasts provide an expected daily production volume for the entire year. However, there is substantial seasonality in the observed level of production from the North Slope, with daily production peaking during winter months and declining to lowest levels during summer months. Between 2008 and 2011, typical summer production volumes were 17 percent lower than the yearly average. Based on this observed decline, if FHR nominates 30,000 bpd of royalty oil, the state will be committed to delivering nearly 55 percent of daily summer royalty production in fiscal year 2014. By fiscal year 2019, this grows to nearly 70 percent of summer royalty production.

C. Price and Consumption of Energy in Alaska

In 2010, on a per capita basis, Alaskans spent more on energy than residents of any other state, with average per person expenditures of \$8,807 on energy throughout the year.⁹ Of this \$8,807, nearly 16 percent¹⁰ would be spent purchasing the most expensive gasoline in the nation.¹¹ Not only is our gasoline the most expensive in the nation, but our diesel and home heating fuel are also among the most expensive in the nation. When compared to residents of other states in the union, Alaskans pay the second highest average price for distillate fuel oil¹², averaging \$23.39 per million BTUs.¹³

As seen in Table 1, just as the cost of refined petroleum is quite high in Alaska, so is the cost of non-petroleum energy. In 2010, retail electricity in Alaska cost \$43.29 per mmbtu (14.77 cents per kilowatt hour), the fifth highest cost of any state in the nation. From a price perspective, Alaskan natural gas is competitive with the rates borne by those Outside. At \$9.98 per mmbtu at the meter, consumers in nineteen states pay more for natural gas than Alaskans. While access to competitively priced, clean-burning natural gas is a boon for those Alaskans with access to natural gas infrastructure, outside of Southcentral Alaska, very few Alaskan consumers have access to this fuel.

⁹ <http://www.eia.gov/beta/state/?sid=US>

¹⁰ \$1,307 per capita

¹¹ Tied with Hawaii, http://www.eia.gov/beta/state/seds/data.cfm?incfile=sep_sum/html/rank_pr_mg.html

¹² Distillate fuel oil is a class of refined petroleum products consisting of No. 1, No. 2, and No. 4 fuel oil (i.e., home heating oil); and No. 1, No. 2, and No. 4 diesel.

¹³ BTU is an acronym for British Thermal Unit which is defined as the amount of energy required to raise the temperature of one pound of water at 60 degrees Fahrenheit and one atmosphere by one degree Fahrenheit.

Table 1. Alaska Total End-Use Price Estimates, 2010

| Fuel | Price | Rank |
|-------------------------|--------------|-------------|
| Coal | 3.43 | 21 of 44 |
| Distillate Fuel Oil | 23.29 | 2 of 51 |
| Gasoline | 27.17 | 1 of 51 |
| Kerosene-type Jet Fuel | 16.81 | 5 of 51 |
| Liquefied Petroleum Gas | 26.79 | 20 of 51 |
| Natural Gas | 9.98 | 20 of 51 |
| Other | 28.72 | 7 of 51 |
| Residual Fuel Oil | 13.69 | 4 of 47 |
| Retail Electricity | 43.29 | 5 of 51 |

Source: U.S. Energy Information Administration State Energy Data 2010: Prices and Expenditures

Notes: Prices are given in millions of BTUs.

Natural gas as it is consumed, including supplemental gaseous fuels that are commingled with natural gas.

Other category includes asphalt and road oil, aviation gasoline, kerosene, lubricants, and other petroleum products.

Rank is Alaska's position among the fifty states and the District of Columbia (or the number thereof utilizing the fuel), lower numbers indicate a higher position in the price distribution.

As noted, Alaskans spend more per person for energy than residents of any other state. This high rate of per capita expenditure on energy is driven not only by price, but also by volume consumed. Table 2 gives the statewide consumption of various forms of energy during the first decade of the twenty-first century. Table 3 then gives a further disaggregation of the consumption of distillate fuel in Alaska.^{14,15} Despite its rarity outside of Southcentral Alaska and portions of Fairbanks, on a per capita BTU basis, natural gas was the most common fuel used in the homes of Alaskans. In 2010, the typical Alaskan consumed an average of 26.4 million BTU of natural gas in their residence.

¹⁴ It should be noted that the data sources and estimation strategies for Table 2 and Table 3 differ. Stemming from these differences the volume of distillate fuel oil sales, particularly by sector, differ somewhat.

¹⁵ The values given in Tables 2 and 3 are point estimates, the associated standard errors are not shown. All comparisons are simple comparisons of the presented point estimates and do not consider the uncertainty associated with the estimate. Put differently, observed differences should not be interpreted as statistically significant.

Table 2. Alaska Energy Consumption Estimates

| | Physical Units | | | Billion British Thermal Units | | | Thousands of BTU Per Capita | | |
|---|----------------|---------|---------|-------------------------------|---------|---------|-----------------------------|---------|---------|
| | 2000 | 2005 | 2010 | 2000 | 2005 | 2010 | 2000 | 2005 | 2010 |
| Residential | | | | | | | | | |
| Coal | 58 | 40 | 61 | 898 | 631 | 934 | 1,432 | 946 | 1,315 |
| Electricity | 1,855 | 2,062 | 2,093 | 6,329 | 7,034 | 7,142 | 10,095 | 10,547 | 10,056 |
| Wood | 77 | 46 | 45 | 1,540 | 920 | 902 | 2,456 | 1,379 | 1,270 |
| Kerosene | 13 | 31 | 15 | 76 | 176 | 83 | 121 | 264 | 117 |
| Liquefied Petroleum Gases | 125 | 158 | 154 | 480 | 606 | 589 | 766 | 909 | 829 |
| Distillate Fuel Oil | 1,731 | 1,619 | 1,548 | 10,086 | 9,431 | 9,019 | 16,088 | 14,141 | 12,699 |
| Natural Gas | 15,987 | 18,029 | 18,714 | 16,418 | 18,098 | 18,806 | 26,188 | 27,136 | 26,479 |
| Commercial | | | | | | | | | |
| Coal | 466 | 465 | 494 | 7,262 | 7,252 | 7,553 | 11,583 | 10,873 | 10,635 |
| Distillate Fuel Oil | 1,155 | 1,006 | 1,980 | 6,729 | 5,857 | 11,535 | 10,733 | 8,782 | 16,241 |
| Fuel Ethanol | 1 | 6 | 18 | 2 | 19 | 61 | 3 | 28 | 86 |
| Electricity | 2,418 | 2,695 | 2,830 | 8,251 | 9,195 | 9,655 | 13,161 | 13,787 | 13,594 |
| Kerosene | 0 | 1 | 16 | 2 | 5 | 92 | 3 | 7 | 130 |
| Liquefied Petroleum Gases | 96 | 98 | 151 | 368 | 375 | 578 | 587 | 562 | 814 |
| Motor Gasoline | 64 | 168 | 158 | 332 | 877 | 822 | 530 | 1,315 | 1,157 |
| Natural Gas | 26,485 | 16,903 | 15,920 | 27,201 | 16,968 | 15,998 | 43,387 | 25,441 | 22,525 |
| Industrial | | | | | | | | | |
| Coal | 1 | 2 | 4 | 13 | 25 | 57 | 21 | 37 | 80 |
| Distillate Fuel Oil | 2,266 | 1,912 | 2,509 | 13,202 | 11,138 | 14,615 | 21,058 | 16,700 | 20,578 |
| Fuel Ethanol | 0 | 3 | 10 | 1 | 12 | 33 | 2 | 18 | 46 |
| Electricity | 1,037 | 1,156 | 1,324 | 3,537 | 3,944 | 4,518 | 5,642 | 5,914 | 6,361 |
| Liquefied Petroleum Gases | 0 | 6 | 53 | 1 | 22 | 183 | 2 | 33 | 258 |
| Natural Gas | 341,872 | 356,102 | 255,642 | 351,106 | 357,469 | 256,892 | 560,038 | 535,979 | 361,702 |
| Other Petroleum Products | 3,805 | 5,724 | 4,356 | 23,077 | 34,304 | 26,121 | 36,809 | 51,434 | 36,778 |
| Motor Gasoline | 25 | 102 | 85 | 129 | 533 | 442 | 206 | 799 | 622 |
| Residual Fuel Oil | 0 | 0 | 4 | 0 | 0 | 28 | 0 | 0 | 39 |
| Electrical Power Generation | | | | | | | | | |
| <i>Total Electricity Consumed</i> | 5,310 | 5,913 | 6,247 | 18,118 | 20,174 | 21,315 | 28,899 | 30,248 | 30,011 |
| <i>Fuel Consumed to Produce Electricity</i> | | | | | | | | | |
| Coal | 500 | 398 | 410 | 8,283 | 6,087 | 5,958 | 13,212 | 9,127 | 8,389 |
| Distillate Fuel Oil | 415 | 538 | 489 | 2,415 | 3,134 | 2,850 | 3,852 | 4,699 | 4,013 |
| Natural Gas | 35,570 | 39,284 | 39,732 | 35,672 | 39,506 | 39,963 | 56,899 | 59,234 | 56,268 |
| Residual Fuel Oil | 670 | 696 | 306 | 4,213 | 4,377 | 1,923 | 6,720 | 6,563 | 2,708 |
| Transportation | | | | | | | | | |
| <i>All Petroleum Products</i> | 37,801 | 46,407 | 36,904 | 212,243 | 261,179 | 207,307 | 338,542 | 391,604 | 291,887 |
| Distillate Fuel Oil | 5,308 | 7,509 | 7,234 | 30,917 | 43,741 | 42,138 | 49,315 | 65,584 | 59,330 |
| Jet Fuel | 25,872 | 31,940 | 22,726 | 146,698 | 181,100 | 128,857 | 233,993 | 271,536 | 181,430 |
| Liquefied Petroleum Gases | 0 | 4 | 1 | 0 | 14 | 3 | 0 | 21 | 4 |
| Lubricants | 98 | 83 | 77 | 596 | 503 | 469 | 951 | 754 | 660 |
| Motor Gasoline | 5,884 | 6,583 | 6,662 | 30,658 | 34,348 | 34,764 | 48,902 | 51,500 | 48,947 |
| Residual Fuel Oil | 118 | 12 | 40 | 742 | 74 | 255 | 1,184 | 111 | 359 |
| Aviation Gasoline | 521 | 277 | 163 | 2,632 | 1,399 | 822 | 4,198 | 2,098 | 1,157 |
| <i>Non-petroleum Products</i> | 7,425 | 2,874 | 4,057 | 7,743 | 3,426 | 5,918 | 12,351 | 5,137 | 8,333 |
| Fuel Ethanol | 49 | 219 | 748 | 168 | 761 | 2,593 | 268 | 1,141 | 3,651 |
| Natural Gas | 7,376 | 2,655 | 3,309 | 7,575 | 2,665 | 3,325 | 12,083 | 3,996 | 4,682 |

Source: Energy data from Energy Information Administration, State Energy Data System: 1960-2012

Population data from U.S. Census Bureau, Population Division

Notes: Other Petroleum Products include asphalt and road oil, kerosene, lubricants, aviation gasoline blending components, crude oil, petrochemical feedstock, motor gasoline blending components, miscellaneous petroleum products, natural gasoline, petroleum coke, plant condensate, pentanes plus, still gas, unfinished oils, unfractionated stream, and waxes.

Physical units are reported in the following units: coal is measured in thousands of short tons, natural gas in millions of cubic feet, electricity in millions of kilowatt hours, and petroleum products in thousands of barrels.

Fuel Ethanol includes denaturant in the physical units analysis, but excludes denaturant in the BTU analysis.

Table 3. Alaska Distillate Fuel Consumption Estimates

| | 2000 | 2005 | 2010 | 2011 |
|---|---------|---------|---------|---------|
| Residential | | | | |
| No 1 Distillate | 36,307 | 36,205 | 36,914 | 32,421 |
| No 2 Distillate | 39,832 | 31,746 | 23,930 | 23,407 |
| <i>Residential Total Distillate</i> | 76,139 | 67,951 | 60,843 | 55,829 |
| Commercial | | | | |
| No 1 Distillate | 16,120 | 17,677 | 39,693 | 38,473 |
| No 2 Fuel Oil | 19,526 | 5,729 | 8,511 | 8,846 |
| No 2 Ultra-Low Sulfur Diesel (0-15ppm) | 0 | 0 | 15,436 | 22,203 |
| No 2 Low Sulfur Diesel (15-500ppm) | 6,167 | 3,087 | 11,585 | 208 |
| No 2 High Sulfur (501+ ppm) | 8,953 | 15,709 | 2,587 | 123 |
| Other Distillate | 31 | 0 | 3 | 0 |
| <i>Commercial Total Distillate</i> | 50,796 | 42,201 | 77,815 | 69,853 |
| Industrial | | | | |
| No 1 Distillate | 16,120 | 13,427 | 11,017 | 28,169 |
| No 2 Fuel Oil | 6,250 | 210 | 1,605 | 958 |
| No 2 Ultra-Low and Low Sulfur Diesel | 30 | 4,295 | 17,057 | 36,439 |
| No 2 High Sulfur | 15,301 | 26,919 | 6,480 | 138 |
| <i>Industrial Total Distillate</i> | 37,701 | 44,850 | 36,159 | 65,704 |
| Electrical Power Generation | | | | |
| <i>Electrical Generation Total Distillate</i> | 46,232 | 57,455 | 37,048 | 30,127 |
| Off-Highway | | | | |
| No 2 Diesel -- Construction | 10,815 | 14,050 | 11,654 | 8,239 |
| No 2 Diesel -- Other Use | 10,266 | 3,800 | 2,363 | 1,888 |
| <i>Off-Highway Total No 2 Diesel</i> | 21,080 | 17,850 | 14,017 | 10,126 |
| On-Highway | | | | |
| <i>Total On-Highway No 2 Diesel</i> | 90,999 | 172,595 | 166,599 | 169,158 |
| Military | | | | |
| No 2 Diesel | 9,451 | 14,233 | 6,369 | 7,234 |
| <i>Total Military Distillate</i> | 9,524 | 14,401 | 11,691 | 12,409 |
| Oil Company | | | | |
| <i>Total Oil Company Distillate</i> | 40,834 | 17,515 | 48,241 | 56,554 |
| Total Distillate Sales | 506,230 | 563,020 | 558,559 | 594,620 |

Source: Energy Information Administration, Distillate Fuel Oil and Kerosene Sales by End Use

As was the case with the use of energy in the residential sector, on a per capita BTU basis, natural gas was the most common fuel used in the Alaskan commercial and industrial sector. In 2010, the Alaskan commercial sector consumed approximately 22.25 million BTUs of natural gas for every resident. Based on point estimates alone, this was a 48 percent reduction in the per

capita consumption of natural gas since 2000. Like the residential and commercial sectors, the industrial sector relied very heavily on energy supplied by natural gas. However, consumption by the industrial sector exceeded that of either the residential or commercial sectors by more than an order of magnitude. In 2010, on a per capita BTU basis, the Alaskan industrial sector consumed 361.7 million BTUs of natural gas for every Alaskan resident. While quite large, this actually represented a 35.4 percent decrease in per capita natural gas consumption by the industrial sector since 2000.

While statewide energy consumption patterns are of interest in their own right, the proposed contract will have little impact on either the consumption of, or the price of, non-crude based energy products such as natural gas. If the proposed contract is to have any impact on price or consumption pattern in the state, it will most prominently impact price and availability of gasoline, jet fuel, and perhaps home heating oil.¹⁶ While natural gas was the most common fuel used by Alaskans in their residence in 2010, the next most common fuel was distillate fuel oil in the form of heating oil, with a per capita average consumption of 12.7 million BTUs per year.

Similarly, in the commercial sector, the second most common fuel was distillate fuel oil, in the form of both diesel and heating oil. Overall, the Alaska commercial sector consumed over 11.5 trillion BTUs of distillate fuel oil in 2010. In the same year, the commercial sector in Alaska consumed 822 billion BTUs of gasoline.

Although energy in the industrial sector was dominated by natural gas (84.8 percent of BTUs consumed by the industrial sector), the next two most common fuels on a BTU basis were petroleum products (i.e., other petroleum products and distillate fuel oil). While the residential, commercial, and industrial sectors all rely on petroleum products, the utilization of refined petroleum products is greatest in the transportation sector. In 2010, Alaskans (and those in Alaska) consumed over 207 trillion BTUs of petroleum-based energy to facilitate their travels. Of these 207 trillion BTUs, 62.2 percent would be consumed in the form of jet fuel, 20.3 percent would be consumed as distillate fuel oil, and 16.8 percent would be consumed as gasoline.

D. Commercial Refining In Alaska

Alaska currently has six in-state refineries, operated by five organizations: BP, ConocoPhillips, Flint Hills Resources Alaska, Petro Star, and Tesoro. Of these six refineries, four produce refined petroleum products for the consumer market.¹⁷ The four in-state refineries producing refined petroleum products for the consumer market are FHR's North Pole refinery, Tesoro's Kenai refinery, and Petro Star's North Pole and Valdez refineries. All four of these refineries refine Alaskan crude and supply the Alaska retail market with refined petroleum products.

FHR's North Pole refinery is strategically located on the Trans-Alaska Pipeline System (TAPS) and relies on the pipeline for all feedstock refined in the facility. At present, FHR's North Pole refinery draws approximately 82,000-84,000 barrels of Alaska North Slope crude oil (ANS) from TAPS per day. From these 82,000-84,000 barrels, the refinery will produce approximately 22,000-25,000 barrels of refined product. All crude and constituents that are not transformed

¹⁶ As was previously discussed, the prices in Alaska for all three of these products are among the expensive in the country.

¹⁷ BP and ConocoPhillips currently operate small topping plants on the North Slope that primarily support oil industry operations.

into refined product are injected back into TAPS.¹⁸ At present throughput volumes, the FHR North Pole refinery 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, and 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.

All of this nearly one million gallons per day of refined petroleum products produced at FHR's North Pole refinery will remain in the Alaska market. Currently, FHR ships approximately 680,000 gallons of refined product per day from the Interior to Anchorage on the Alaska Railroad, with the vast majority of the southbound product being jet fuel destined for Ted Stevens Anchorage International Airport. In addition to the southward movement of refined product, FHR also rails roughly 230,000 gallons of ultra-low sulfur diesel and gasoline blendstock north into the Interior each day. In addition to its production and movement of refined product, FHR also owns 30.7 million gallons of product storage capacity in Anchorage and 19.3 million gallons of product storage in Fairbanks.

Like FHR's North Pole refinery, Petro Star's North Pole and Valdez refineries both exclusively refine ANS drawn from TAPS. The total nameplate throughput of Petro Star's refineries is substantially less than that of FHR's North Pole refinery. Petro Star's North Pole refinery has a maximum throughput capacity of 22,000 barrels per day, while the Valdez refinery has a maximum throughput of 60,000 barrels per day. Each of these refineries will refine between 25 and 30 percent of the crude drawn from TAPS into refined product. The remaining 70 to 75 percent of the volume drawn from TAPS will be re-injected into the pipeline.

In a typical year, roughly one-third of the refined product produced by Petro Star will be ultra-low and low sulfur diesel, nearly fifty percent will be jet fuel, and the remainder will consist primarily of home heating fuel. The majority of the refined product produced by Petro Star will remain in Alaska. Petro Star supplies jet fuel to both military and civilian customers, with the majority of the civilian jet fuel being consumed at Ted Stevens Anchorage International Airport. Petro Star also supplies between fifty and sixty percent of the home heating fuel that is sold in the Interior.

The final commercial refinery operating in Alaska is Tesoro's Kenai refinery in Nikiski. Unlike the other three commercial refineries in Alaska, Tesoro's Kenai refinery is not tied to TAPS. Being located off of TAPS impacts operations in two central ways. First, rather than drawing feedstock directly from TAPS, feedstock at the Kenai refinery arrives over water. The ability to accept waterborne cargos means that, unlike the other three commercial refineries in the state, the Kenai refinery has the ability to source crude from the world market. While importation of non-Alaskan crude is possible at the Kenai refinery, it is a relatively rare event. Over 90 percent of the crude refined in the Kenai facility is Alaskan crude, both Alaska North Slope and Cook Inlet crudes. Fewer than three cargos of foreign crude were imported in the past year.

¹⁸ The "middle" of a barrel of crude is the most valuable portion of a barrel, particularly for refineries possessing the technological sophistication of Alaska's TAPS-dependent refineries. The TAPS-dependent refineries transform the middle of a barrel into refined product and return the light- and heavy-ends to TAPS. The refiner then pays a fee to the other shippers on TAPS for degrading the value of the TAPS stream.

The second key impact that being located away from TAPS has on operations at the Kenai refinery is its inability to re-inject unprocessed portions of a barrel of crude back into the pipeline. The Kenai refinery, like all commercial refineries in Alaska, does not possess the technological sophistication to transform every portion of a barrel into refined product. The portion of a barrel not refined into saleable product, the so-called “heavy ends,” must be loaded onto a ship and transported to another Tesoro facility on the United States West Coast for further processing.

Tesoro’s Kenai refinery has a nameplate throughput capacity of 72,000 barrels per day, but actual throughput is highly seasonal and well below the nameplate capacity. During the summer months, when demand for refined product is at its peak, the Kenai refinery processes approximately 65,000 barrels per day of crude, declining to approximately 45,000 barrels per day during the winter months. Overall, about one-quarter (24 percent) of the product refined at the Kenai refinery is gasoline, another 35 percent is jet fuel, 11 percent is ultra-low and low sulfur diesel fuel, and 30 percent are “heavy ends.”

The majority of the end-use products refined at the Kenai facility will be consumed by the Alaska market. Nearly all of the jet fuel produced at the Kenai refinery will be transported via pipeline to Anchorage, with the majority of Anchorage-bound jet fuel consumed by Ted Stevens Anchorage International Airport. Tesoro will supply ultra-low sulfur diesel and gasoline to both Southcentral and Interior markets, with product transported to the Interior via the road system. Although the Kenai refinery supplies ultra-low sulfur diesel and gasoline to the Interior market, none of the heating oil consumed in the Interior is refined by Tesoro. Stemming from its access to waterborne transportation, although rare in occurrence, Tesoro also retains the ability to ship refined product out of Alaska.

E. RIK’s Role in Alaskan Commercial Refining

The State of Alaska’s RIK has played a critical role in the development and continued operation of the Alaskan refining sector. All four commercial refineries currently operating in the state have, at various points in time, had a RIK contract. Three of these four refineries refined royalty oil, while a royalty contract backstopped financing for the fourth.

As was discussed, the State has supplied FHR’s North Pole refinery with royalty oil for the past 33 consecutive years. Between November 1979 and June 2012, the State sold over 472 million barrels of Alaska North Slope crude to the North Pole refinery currently operated by FHR. The current ten-year contract with FHR has generated mutual benefits for both FHR and the people of Alaska. Under the terms of FHR’s current ten-year royalty oil contract, FHR has the option to purchase no oil from the State if the economic provisions of the contract departed from those available from other crude oil suppliers in the Alaska market. However, FHR has continued its contractual relationship with the state, albeit at lower volumes than it had first anticipated, suggesting that the current ten-year contract offers attractive economic terms unavailable from private North Slope crude oil suppliers. On the other hand, the people of Alaska have enjoyed the economic, social, and labor market benefits of petroleum products refined from Alaskan

crude by Alaskans in Alaska.¹⁹

As with FHR's North Pole refinery, the state has a long history selling its North Slope RIK to the Tesoro refinery in Nikiski. The state supplied the Kenai refinery with ANS crude between July 1980 and January 1982 and again between January 1983 and December 1998.²⁰ In total, the Kenai refinery purchased 230 million barrels of Alaska North Slope royalty oil under seven separate RIK contracts. The state is currently negotiating a new RIK contract to renew North Slope RIK sales to the Kenai refinery and expects to once again begin supplying the Kenai refinery in 2014.

The historical relationship between the sale of RIK and Petro Star's North Pole refinery is similar to the role played by royalty oil in FHR's North Pole refinery and Tesoro's Kenai refinery. The State sold North Slope royalty oil to Petro Star's North Pole refinery from December 1986 through December 1991. In total, the state supplied Petro Star's North Pole refinery with just over 3 million barrels of North Slope royalty oil under this 5 year contract.

Perhaps the most interesting role played by a royalty oil contract was the 1992 contract with Petro Star Valdez Joint Venture. In mid-1991, Petro Star and its joint venture partners contacted DNR in order to secure a royalty oil contract for a proposed refinery in Valdez. DNR ultimately negotiated a ten-year contract with Petro Star and its joint venture partners to supply the proposed Valdez refinery with up to 30,000 barrels per day of royalty oil. With this contract in hand, the joint venture secured the needed financing and constructed the Valdez refinery. The royalty contract helped the joint venture secure financing by demonstrating guaranteed access to an on-going supply of feedstock. Ultimately, Petro Star Valdez Joint Ventures never took possession of a single barrel of royalty crude under the ten-year contract, preferring, rather, to secure its feedstock from the private market.

F. Alaska's Fiscal Condition is Wedded to Oil and Gas

Both the economic and the fiscal health of Alaska are wedded to oil and gas. In 2011, the total market value of all goods and services produced in Alaska totaled \$51.4 billion. Approximately, one out of every five of those dollars was generated by oil and gas.²¹ Oil and gas account for an even larger share of revenues received by the State of Alaska. In fiscal year 2012, 93 percent of the state's general fund unrestricted revenue came from oil and gas.²² In the same fiscal year, Alaska generated \$2.95 billion from oil and gas royalties.²³

¹⁹ See Alaska Department of Natural Resources. February 12, 2004. "Best Interest Finding and Determination for the Sale of Alaska North Slope Oil to Flint Hills Resources Alaska, LLC" for a full discussion of the benefits derived from the current contract. Later sections more fully develop the benefits associated with the proposed contract

²⁰ The State also supplied Tesoro's Kenai refinery with 22.1 million barrels of Cook Inlet royalty crude between January 1979 and September 1985.

²¹ Gross State Product data from the United States Department of Commerce, Bureau of Economic Analysis (accessed on 8/23/2012, at <http://www.bea.gov/iTable/iTable.cfm?ReqID=70&step=1&isuri=1&acrdn=1>). In 2011, oil and gas GSP was not disaggregated from mining sector GSP. Between 2000 and 2010, oil and gas accounted for an average of 80.1% of mining GDP. If 2011 follows decennial averages, oil and gas generated \$10.1b. If oil and gas fell at a decennial low (71.5%) as a proportion of mining industry GSP, oil and gas generated \$9.0b in 2011.

²² Alaska Department of Revenue – Tax Division, Fall 2012 Forecast, p. 13

²³ <http://dog.dnr.alaska.gov/index.htm>

Just as our current economic and fiscal health is deeply tied to oil and gas, so is our future. The Department of Revenue forecasts that at least 87 percent of the state's general purpose unrestricted revenue will be derived from oil and gas revenue through 2021. They also forecast that the West Coast delivered value of the state's royalty share of North Slope oil will be worth \$2.7 billion in FY2013, falling to \$2.0 billion in FY2021.²⁴

The importance of this substantial revenue source is underscored by recent Office of Management and Budget projections of Alaska's fiscal health. Under the scenarios presented in the FY 2014 10-year Plan, the state is expected to experience a budget shortfall during fiscal year 2013. Although the results depend on the assumptions used to generate the projections, three of the four scenarios presented by the Office of Management and Budget forecast budget shortfalls to persist from fiscal year 2015 through fiscal year 2023.²⁵

G. RIK Oil Sale Procedure and Schedule

Before executing a contract for the disposition of RIK, the commissioner must find that the disposition is in the best interests of the State (11 AAC 03.010). The commissioner establishes the terms, conditions, and methods of disposition of the State's RIK oil (11 AAC 03.010). There exists a statutory presumption that taking RIK (AS 38.05.182(a)) with sale to in-state customers (AS 38.05.183(d)) accomplished through competitive means (AS 38.05.183(a)) is in the state's best interest. That being said, the state has many competing interests and the state's best interest may be served through a non-competitive disposition of the state's royalty in kind.

Given the statutory presumption that the state's best interest is served through a competitive disposition of royalty oil to in-state customers, DNR first sought to determine the level of interest on the part of in-state producers and refiners in the purchase of the State's RIK. To gauge the level of interest in the market, DNR distributed an informal solicitation of interest in RIK oil in mid-August 2012. Beyond simply gauging the market's interest in RIK oil, this solicitation outlined the state's desire to obtain "special commitments" that would meaningfully address the high cost of energy in Alaska. This informal solicitation of interest was directly transmitted to six organizations: BP, ConocoPhillips, ExxonMobil, Petro Star, FHR, and Tesoro. Of these six, three possess commercial in-state refining capabilities. Beyond directly transmitting the informal solicitation of interest to these six organizations, the state also informed the market of its intent to sell RIK through announcements in both industry-specific and general media.²⁶

The informal solicitation generated four responses affirming interest in purchasing the State's RIK. These affirmative responses were from BP, ConocoPhillips, FHR, and Tesoro. DNR received no indications of interest outside of these four parties; notably, Petro Star as owner of

²⁴ Based on Department of Revenue, Revenue Sourcebook, Fall 2012, forecast production and price estimates during FY2013 and FY2021 and Division of Oil and Gas North Slope Royalty Forecast. It should be noted that even if market price and production forecasts are perfect, the state will not realize this full value. Royalty agreements allow for deductions of costs associated with moving the state's royalty share from the point of production to the U.S. West Coast.

²⁵ FY 2014 10-Year Plan, State of Alaska, Governor's Office of Management and Budget. All four projected scenarios indicate a budget shortfall in FY2013. The balance of the State's total reserves is projected to remain positive through FY2022 in all four projected scenarios.

²⁶ Anchorage Daily News, Aug 19, 2012. Accessed at <http://www.adn.com/2012/08/19/2593940/state-gauging-interest-in-royal.html>.

Petroleum News, Aug 19, 2012. Accessed at <http://www.petroleumnews.com/pnads/773411753.shtml>

two commercial refineries in Alaska chose not to respond. Subsequent discussions with the interested parties that did reply revealed that BP and ConocoPhillips would both require the ability to export RIK oil from the state. In order to permit the export of RIK crude, under 11 AAC 03.010, the commissioner would be required to “determine in writing that the oil, gas, or associated substances subject to export are surplus to present and projected intrastate domestic and industrial needs.”²⁷ Such a determination would be inconsistent with the informal solicitation of interest distributed by DNR which outlines that the State is interested in special commitments meant to “mitigate the high cost of consumer petroleum products in Alaska and **address the need for a greater supply of crude oil for use in the state**” (emphasis added).

Thus, in response to its solicitation of interest, DNR received only two affirmative responses that could potentially satisfy the criteria set out by DNR in its informal solicitation of interest. Further discussion with the two parties, Tesoro and FHR, who expressed interest consistent with the State’s goals indicated that competitive bidding would be very unlikely to yield special commitments that served the State’s best interest.²⁸ Specifically, discussions with the parties revealed that the scheme likely to be used by the parties to trade-off between price per barrel and “special commitments” would be expected to generate proposals that would not, in DNR’s view, yield the greatest total benefit for Alaska. Moreover, with only two interested parties, there exists a risk that bids received from a competitive process would yield substantially less total value for the State than could be achieved by independently negotiating with each interested party. In light of the very small number of interested parties and the low probability that competitive bidding would maximize total State value, the commissioner determined that seeking a non-competitive, negotiated agreement was in the State’s best interest, and therefore, waived competitive bidding.

Consistent with his obligations under AS 38.05.183(a), AS 38.06.050(a), and 11 AAC 03.040, the commissioner submitted the Preliminary Best Interest Finding and Determination for the Sale of Alaska North Slope Royalty Oil to Flint Hills Resources Alaska, LLC., dated February 20, 2013, to the Alaska Royalty Oil and Gas Development Advisory Board (“Board”) for review. The Preliminary Finding and Determination represented the commissioner’s formal notification to the Board of his intent to waive competitive bidding.

Notice of the publication of the Preliminary Finding and Determination and an invitation for public comment appeared in several newspapers including the Fairbanks News-Miner, the Anchorage Daily News, the Juneau Empire, and the Kenai Peninsula Clarion. A copy of the proposed RIK contract was made available from the State by contacting:

Division of Oil and Gas
Attn: Kevin Banks
550 W. 7th Ave, Suite 1100
Anchorage, Alaska 99501
Phone: (907) 269-8781
E-mail: kevin.banks@alaska.gov

²⁷ AS 38.05.183(d) place a similar requirement on the commissioner.

²⁸ As noted above, DNR is currently in negotiations to supply RIK to Tesoro. DNR expects to renew RIK sales to Tesoro sometime in 2014, or possibly earlier.

and it was also published on the Division of Oil and Gas website at:

<http://dog.dnr.alaska.gov/>

Formal written notice of the State's intent to sell royalty oil to FHR and informing the recipients of the publication of the Preliminary Finding and Determination, was given directly to the parties listed in Table 4. Included among those listed below are North Slope lessees, local public officials, and the other in-state refineries. Members of the Alaska Legislature were also notified.

Table 4. Parties Receiving Formal Written Notices

| | | |
|--|--|---|
| Anadarko Petroleum Corporation ATTN: AK Land Supervisor PO Box 1330 Houston, TX 77251 | ASRC Exploration, LLC 3900 C Street, STE 801 Anchorage, AK 99503 | BP Exploration (Alaska) Inc. ATTN: Land Manager - Alaska PO Box 196612 Anchorage, AK 99519 |
| Chevron USA, Inc. 3800 Centerpoint Drive, STE 100 Anchorage, AK 99503 | ConocoPhillips Alaska, Inc. ATTN: Land Manager PO Box 100360 Anchorage, AK 99510 | Doyon, Limited ATTN: SR VP Lands & Natural Resource 1 Doyon Place, STE 300 Fairbanks, AK 99701 |
| Eni Petroleum US, LLC 1201 Louisiana, STE 3500 Houston, TX 77002 | Eni US Operating Co., Inc. 1201 Louisiana, STE 3500 Houston, TX 77002 | ExxonMobil Alaska Production, Inc. ATTN: Land Resources Manager PO Box 2180 Houston, TX 77252 |
| ExxonMobil Alaska Production, Inc. ATTN: Land Resources Manager PO Box 196601 Anchorage, AK 99519 | ExxonMobil Alaska Production, Inc. ATTN: Land Resources Manager PO Box 2024 Houston, TX 77525 | Murphy Exploration (Alaska), Inc. 550 Westlake Park Blvd., STE 1000 Houston, TX 77079 |
| Murphy Exploration (Alaska), Inc. 16290 Katy Frwy., STE 600 Houston, TX 77094 | Nana Regional Corporation, Inc. ATTN: Vice President Minerals 1001 E. Benson Blvd Anchorage, AK 99508 | Petro-Hunt, LLC 1601 Elm Street, STE 3900 Dallas, TX 75201 |

Pioneer Natural Resources
Alaska, Inc.
700 G Street, STE 600
Anchorage, AK 99501

Savant Alaska, LLC
7501 Village Square Drive,
STE 102
Castle Rock, CO 80108

Mayor Luke Hopkins
Fairbanks North Star Borough
809 Pioneer Rd,
Fairbanks, AK 99701

Mayor Dan Sullivan
Municipality of Anchorage
632 W 6th Avenue, Suite 840,
Anchorage, AK 99501

Mayor Bryce Ward
City of North Pole
125 Snowman Lane
North Pole, AK 99705

Mayor Jerry Cleworth
Fairbanks City Hall
800 Cushman Street
Fairbanks, AK 99701

Mayor Pat Porter
City of Kenai
210 Fidalgo Avenue
Kenai, Alaska 99611

North Slope Borough
Mayor Charlotte E. Brower
P.O. Box 69
Barrow, AK 99723

Doug Chapados,
President/CEO
Petro Star Inc.
3900 C Street, STE 802
Anchorage, AK 99503

In making his determination, the commissioner considered the criteria listed in AS 38.05.183(e) and AS 38.06.070(a). The commissioner's analysis of these criteria is discussed in detail in following sections. As outlined in 11 AAC 03.060(a), the RIK contract must be awarded to the prospective buyer whose proposal offers maximum benefit to the citizens of the State. A copy of the proposed RIK oil sale contract is attached as Exhibit 1 to this Final Finding and Determination. The Board's report is attached as Exhibit 2, the Board's resolution to the Legislature is attached as Exhibit 3, and the public comments received by DNR concerning the proposed contract are attached as Exhibit 4.

III. Discussion of Contract Terms

A. Price

The pricing strategy in the proposed sale is meant to arrive at an equitable value for state's royalty oil at the point where ownership is transferred to FHR. In order to determine the monetary consideration the State receives for its royalty oil, the proposed sale uses a netback valuation strategy. The netback value in the proposed sale is meant to represent the value of ANS sold on the United States West Coast (USWC) as it enters the Trans-Alaskan Pipeline System (TAPS) or the regulated pipeline network upstream of TAPS Pump Station No. 1.

Each element of the netback value is discussed in greater detail below, but succinctly, there are five key elements to the netback value. The netback value begins by determining the value of royalty oil where the overwhelming majority of ANS is sold—the USWC. In order to account for the difference in value associated with transactions on the USWC versus Valdez, a location differential is subtracted (netted) out. Next, to account for the pipeline tariffs to ship royalty oil between the point of delivery on the North Slope and the North Pole refinery, pipeline tariffs are deducted. Fourth, an adjustment is made for the quality difference between the royalty oil and the value of the TAPS common stream received by the buyer. Finally, an adjustment is made to

account for the value impact caused by the difference in the metered volume of oil put into the pipeline at TAPS Pump Station No. 1 and the metered volume of oil delivered to Valdez Marine Terminal. The per-barrel monetary consideration received by the state is represented formulaically as:

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

1. ANS Spot Price

“ANS Spot Price” is defined as the monthly average of the daily high and low assessments for the month for ANS traded at the USWC as reported by Platts Oilgram Price Report, Telerate online data reporting service, and Reuters online data reporting service.²⁹ The three separate price reporting agencies relied upon in the determination of the ANS spot price are three of the four most common markers for ANS value and are each widely used by industry to assess the prevailing market value of ANS. PTR determines the ANS spot price in the existing RIK sales contract and the prevailing value calculation used by Alaska’s Department of Revenue (15 AAC 55.171 (m)). Given its common use by both the private and public sectors, PTR provides a credible and reliable estimate of the current market value of ANS.

If DNR or FHR determines that the true market value of ANS is no longer accurately reflected by PTR, then a good faith effort will be made to arrive at a mutually agreeable alternative source to establish the ANS Spot Price. If such a mutually agreeable alternative source cannot be identified, “the State will select the alternative source that most reliably represents the price for ANS.” The ANS Spot Price calculation does not include days in which all three reporting agencies do not assess the value of ANS on the USWC.

2. \$2.15 (“RIK Differential”)

The \$2.15 term in the price structure serves a dual role. First, the term is meant to capture the difference in the value of ANS sold on the USWC and at the Valdez terminal. The per-barrel price of ANS is lower in Valdez than the USWC because of both competitive and mechanical forces. Mechanically, a barrel destined for the USWC transacts at a lower price in Valdez because the owner foregoes the cost of transportation to the USWC. Competitively, there are only four entities that have the capacity to lift oil from the Valdez terminal. These firms may have the ability to exercise what economists call market power to negotiate contracts with a Valdez differential that is greater than the marginal cost of transportation.

The second purpose of the \$2.15 term is the preservation of DNR’s statutory and regulatory obligation to secure a price for its RIK that is at least equal to the volume weighted average price of RIV. While simple in statement, achieving this standard is challenging due to the way lessees report the RIV price. The RIV valuation methodology, i.e., the final value of the State’s RIV, is defined by the lease contract provisions and the many royalty settlement agreements that further refined these provisions. In some cases, the price received by the State for RIV is not known until the lessees’ royalty filing is audited several years after the initial filing and when the lessees refile their royalty reports. Thus, in order to satisfy its mandate, the State must choose a price

²⁹ Hereafter, simply PTR.

term when selling its RIK that either directly references the volume-weighted average price of RIV subject to retroactive adjustment when the lessees refile, or anticipate the monthly difference between the reported and final price of RIV

During the negotiations that resulted in the proposed contract, DNR and FHR wrestled with the problem posed by potential retroactive adjustments long after DNR had delivered its royalty oil to FHR. Indeed, the use of a price structure that does not directly reference RIV evolved from FHR's distinct aversion to retroactive adjustment. With the notable exception of the current FHR ten-year sales contract, most past RIK sale agreements contained price provisions that allowed DNR to retroactively adjust the price of royalty oil when the lessees filed their final RIV value. Such retroactive adjustments greatly complicated FHR's ability to price its refined product. To overcome this, FHR has sought contract provisions that, to the extent possible, circumscribe the ability of DNR to adjust prices for oil already delivered. This contract, like the current ten-year contract, includes a RIK Differential that the DNR and FHR mutually agreed would mitigate such retroactivity and satisfy the State's legal obligation. Put differently, the use of a price provision that does not directly reference RIV was not a unilateral imposition by DNR, but rather was FHR's preference.

The \$2.15 RIK Differential will be adjusted one time after the second year of the contract. The readjusted amount will be calculated using the following method. First, for each month between January 2013 and December 2015, DNR will calculate the volume-weighted average value of its RIV as reported by BP, CPAI, and ExxonMobil at Valdez. DNR will then subtract the volume-weighted average value of its RIV at Valdez from PTR minus \$2.15. Conceptually, this calculation measures how the RIK value at Valdez differs from the volume weighted average RIV value at Valdez. The thirty six resulting values will then be averaged to yield a single value measuring the average difference between RIK and volume weighted RIV at Valdez. The RIK Differential for deliveries on and after April 1, 2016 will be \$2.15 plus the average difference between RIK and volume weighted RIV at Valdez, subject to the constraint that the RIK Differential will be no less than \$2.00 but no more than \$2.30.

3. Tariff Allowance

The Tariff Allowance provides an additional deduction from the ANS Spot Price equal to sum of the ownership-weighted average minimum interstate TAPS tariff filed with the Federal Energy Regulatory Commission (FERC), plus any tariffs paid by FHR for shipment of royalty oil on pipelines on the North Slope upstream of Pump Station No. 1. Under the proposed contract, DNR has the option of providing royalty oil from any ANS production unit, and the additional allowance for tariffs paid on pipelines upstream of TAPS Pump Station No.1 is intended to match a similar deduction taken by the lessees on RIV from those production units. Because FHR is reimbursed for the cost incurred to ship oil from the production units upstream of TAPS Pump Station No.1, DNR has the freedom to maximize value by judiciously nominating royalty oil from different combinations of North Slope production units.³⁰

The Tariff Allowance is one of the elements of the price term in the proposed contract that is

³⁰ This capability provides further assurance that DNR will achieve its statutory and regulatory obligation to secure a price for RIK that is at least equal to the volume weighted average of RIV. See also Section III.C. below.

subject to retroactive adjustments. The Tariff Allowance may be adjusted if the tariff used in the calculation of the Tariff Allowance is changed (or subject to a refund order) by FERC at a later date.

4. Quality Bank Adjustment

The Quality Bank Adjustment is a positive or negative number that reflects the value of different streams of crude oil that are shipped in TAPS. The Quality Bank is administered by the owners of TAPS and regulated by the FERC. Oil tendered for shipment at TAPS Pump Station No. 1 is produced from several different production units and the shippers of oil of lesser value must reimburse the shippers of oil of greater value for the degradation of value of the comingled stream—the value that the shippers receive when they sell the oil. Similarly, the refineries in North Pole and Valdez also take oil out of TAPS, extract the valuable components of the oil in manufacturing petroleum products, and re-inject into the pipeline a mixture of lower valued components. The return streams from the refineries bear a quality bank payment to each of the owners of the passing TAPS stream.

The Quality Bank Adjustment in the proposed contract is calculated as the difference of the value of royalty oil where it is tendered at the point of sale—either at TAPS Pump Station No. 1 or at the entry into a pipeline upstream of TAPS Pump Station No. 1—and the value of the oil in TAPS downstream of the Petro Star Valdez refinery. The proposed contract provides an example for how the Quality Bank Allowance is calculated for RIK oil produced at Lisburne. The Quality Bank Allowance is another element of the price term in the proposed contract that is subject to retroactive adjustments. DNR may readjust the Quality Bank Allowance if the Quality Bank administrator recalculates any of the values used in the calculation of the Quality Bank Allowance.

5. Line Loss

Line loss is a per barrel amount that is calculated as

$$0.009 \times (\text{ANS Spot Price} - \$2.15 - \text{Tariff Allowance} \pm \text{Quality Bank Adjustment})$$

The line loss provision accommodates the impact on value caused by the small difference between the metered volume delivered into TAPS at Pump Station No. 1 and the metered volume delivered to the Valdez Marine Terminal.

B. Quantity

DNR seeks to sell a maximum of 30,000 barrels per day of royalty oil through the proposed sale. As discussed above, the maximum volume of oil sold under the proposed sale is set such that it is highly likely the State will be able to fulfill its quantity obligations even during periods of summer production decline. If FHR nominates the maximum under the proposed contract, this sale will account for between 45 percent and 57.7 percent of the State's total forecast volume of North Slope royalty oil during the period of the contract. However, DNR reserves the right, at

the commissioner's discretion, to limit the quantity of oil sold in the proposed sale to not more than 85 percent of the total monthly North Slope royalty oil, or not more than 95 percent of the monthly royalty oil from any single unit.³¹

The number of barrels per day outlined above represents an upper bound on the actual amount of royalty oil delivered daily under the proposed contract. On the supply side, the number of barrels of royalty oil disposed of under this contract is limited by the State's agreements with its lessees – the State's ability to nominate royalty oil is bound by production – and the commissioner's discretion to nominate no more than 85 percent of total monthly North Slope royalty oil or no more than 95 percent from any single unit. Put differently, the proposed contract permits the State to retain at least 15 percent of its royalty oil for either taking in-value or for sale to other qualified buyers.

On the demand side, the delivered volume of royalty oil may be reduced through two separate quantity adjustment provisions. First, the proposed contract allows FHR to nominate a volume of oil that falls inside of an agreed upon nomination range, initially set at a minimum of 18,000 barrels per day and a maximum of 30,000 barrels per day. This allows FHR to adjust its royalty purchase on a monthly basis in a fashion that will allow FHR to purchase a volume of royalty oil that is consistent with its expectations about future demand for refined product.

The second quantity adjustment provision in the proposed contract allows FHR to reduce the maximum quantity of royalty oil purchased from the State after the first twelve months of the contract, conditional on the approval of the commissioner and a six month notification period before the reduction. FHR may further reduce the maximum quantity after twelve months have elapsed since the last reduction, again conditional on the approval of the commissioner and a six month notification period before the reduction. After a reduction in the volume of royalty oil supplied to FHR under this provision, FHR may subsequently request to increase the volume of RIK, not to exceed 30,000 barrels per day, once again conditional on the approval of the commissioner.

In addition to the flexible quantity provision contained in the proposed contract, the buyer also retains the ability to manage for planned refinery turnarounds—extensive and routine maintenance projects that could temporarily shut-in production—and provide an additional mechanism to terminate the contract. If FHR fails to nominate or nominates zero barrels for three consecutive months, then the contract terminates. Thus, FHR can use this mechanism to terminate the contract and pursue alternative crude supply agreements.

While the buyer retained valuable quantity adjustment terms, the State secured a five year term that will mitigate volumetric concerns in the out-years of the contract. Beyond reducing the State's risk of having insufficient volumes to fulfill FHR's nomination, the shortened term will allow the State to supply other potential customers (e.g., other in-state refiners) with RIK. For example, the State is currently negotiating an RIK contract with Tesoro to supply feedstock to the Kenai refinery. The five year term in the proposed contract allows DNR greater flexibility in

³¹ Unit is a term defined in regulation (11 AAC 83.395) as “a group of leases covering all or part of one or more potential hydrocarbon accumulations, or all or part of one or more adjacent or vertically separate oil or gas reservoirs, which are subject to a unit agreement.” In vernacular usage, the term “unit” may sometimes be equated to the term “field.”

negotiating this potential RIK contract.

C. General Discussion of Price and Quantity Terms

On the whole, the price and quantity terms in the proposed contract offer attractive terms for FHR while also protecting the State's interests. With respect to the State's interests, as discussed above, DNR has a statutory and regulatory duty to ensure that RIK generates revenue at least as great as what would have been realized for the average barrel of RIV. As discussed in detail in Section IV. A. below, DNR's analysis indicates that the proposed contract will meet this standard.

The proposed contract also allows the realization of additional revenues by preserving DNR's ability to arbitrage its royalty take. While for the purposes of exposition this document has treated all RIV barrels as fully substitutable, this is not absolutely correct. Stemming from variation in the calculation of royalty value across producers, the RIV price that would have been realized from a barrel of royalty oil varies across producers. The per-barrel pricing structure outlined in this section aims to generate a price that is, in expectation, at least equal to the volume-weighted average RIV price. However, under the proposed contract, DNR may choose to nominate RIK barrels from areas that would have yielded the lowest RIV price, which will necessarily be less than the volume-weighted average value. The difference between the RIK and RIV amount is additional revenue to the state that is preserved under the proposed contract.

Finally, it is also worth noting that while it is the state's expectation that each barrel of RIK oil will be sold for slightly more than its RIV amount, the price may not necessarily match its market value. As has been discussed, under the terms of the proposed contract the state offers FHR very flexible quantity terms, as well as supply and price certainty, that would be available from a private supplier only at a higher price. The willingness on the part FHR to enter into the proposed contract is prima facie evidence that the terms offered by the state are no more onerous than those the buyer could have negotiated in the marketplace. Moreover, given that the contract may be terminated by simply failing to nominate crude oil, FHR's continued nomination of RIK is further evidence that conditions imposed under the proposed sale are no worse than those that could have been secured had the buyer transacted with any other party.

D. Special Commitments

As was noted above, DNR's solicitation of interest generated four responses affirming interest in the State's RIK. None of these four respondents indicated a willingness to provide comprehensive special commitments. However, during the course of negotiation, DNR was able secure two special commitments from FHR. The first special commitment rewards substantial investment with a contract extension, and the other preserves a status-quo commitment from the current ten-year contract to maintain gasoline price parity between Fairbanks and Anchorage.

1. Contract Extension

If FHR undertakes a large capital project at the refinery or enters into a binding agreement to support a solution to bring natural gas from the North Slope into the Interior, FHR may request

that the contract be amended and extended for an additional five years. Perhaps most valuable from the State's perspective, a binding commitment to support a natural gas transportation system would monetize the State's North Slope natural gas, offer Interior citizens the ability to substitute away from high cost heating fuel, and improve the Fairbanks North Star Borough's ongoing air quality problem.

2. Post Truck Rack Price Parity

The second special commitment contained in the contract constrains the difference between FHR's posted gasoline truck rack prices between Anchorage and Fairbanks. This commitment has been in effect for the past ten years, and will have about the same prospective impact on the wholesale price of gasoline. FHR agrees that, for the volume of gasoline it produces at its North Pole refinery, the annual average difference between its posted truck rack price in Fairbanks and its posted truck rack price in Anchorage will not exceed one cent per gallon. This price parity provision applies only to the gasoline produced at the refinery. The substantial volume of gasoline exchanged with Tesoro and transported into the Interior for FHR, would not be subject to this provision. It should also be noted that this provision affects only the wholesale posted price of gasoline and may not translate to retail price parity between Anchorage and Fairbanks.

E. Other Contract Terms of Interest

1. Force Majeure

DNR will, to the best of its abilities under its agreements with its lessees, accommodate a temporary reduction in the volume of RIK oil delivered to FHR if the reduction is necessitated by a Force Majeure event. The volume of royalty oil will be reduced by an amount equal to the reduction in FHR's requirements that is a direct result of the Force Majeure event. FHR will, however, accept delivery of all royalty oil nominated by the state under the proposed contract. Importantly, changes in commercial or financial markets impacting the price of crude or refined petroleum do not constitute Force Majeure events. Thus, volumes cannot be altered, and performance of other contract provisions cannot be suspended, due to changes in market conditions.

2. Retroactivity

The only terms in the proposed contract subject to retroactive adjustments are the tariff allowance and the quality bank adjustment. If a tariff which has been used in the calculation of a Tariff Allowance is changed or subject to a refund order by the FERC, the Tariff Allowance will be recalculated using the changed FERC-ordered tariff, and the royalty oil price will be retroactively readjusted accordingly. Similarly, if the stream values used in the calculation of the Quality Bank Adjustment is recalculated by the Quality Bank administrator, the Quality Bank Adjustment will be recalculated and royalty oil price will be retroactively readjusted accordingly. Although FHR desired to eliminate all retroactive adjustment in the proposed contract, DNR was able to retain these two retroactive adjustments to help ensure that RIK-RIV price parity was achieved.

3. Security

When the State enters into a sale of RIK oil, the State is exposed to the risk that the buyer will default on its obligations to pay for the royalty oil delivered to, and nominated on the behalf of, FHR. There are two key elements of the “default risk” to which the state is exposed in an RIK sale. The first element is the total loss from royalty oil already delivered to FHR, the second is the so-called “denomination” risk. Under the proposed contract, DNR would be unaware of the buyer’s inability, or unwillingness, to pay for oil already delivered for up to 26 calendar days after the final delivery of the month. An immediate move on DNR’s part to declare the contract in default would likely require up to another 7 calendar days. Thus, the State could deliver up to 65 calendar days of royalty oil before it could declare the buyer in default (31 days of delivery, 20 calendar days to bill, 6 calendar days for payment, and 7 calendar days to declare default). The revenue from these 65 days of royalty oil would, in the absence of a security or litigation, be a total loss.

In addition to this total loss, the State is also exposed to the losses that would likely stem from a distressed sale of previously nominated royalty oil – the “denomination risk.” In order to fulfill its obligations under the proposed contract, the DNR must alert upstream producers of its intent to take RIK at least ninety days ahead of the date of delivery (i.e., it must nominate oil at least ninety days in advance). Thus, should the buyer default, DNR will have nominated an additional 90 days of RIK oil consistent with its obligations under the sale contract. This additional 90 days of royalty oil must be disposed of by the State, likely at distressed prices.

In order to help insulate the State from the default risk that an RIK disposition generates, the State requires that either a letter of opinion from a financial analyst approved by the State is submitted to the State each year, or FHR provides an annually renewed, continuously maintained stand-by letter of credit equal in value to ninety days of royalty oil. In order to waive the requirement for a ninety day letter of credit, the buyer, or guarantor, must submit to a full review of the financial health of the buyer, or guarantor. If the financial analyst finds that the buyer’s, or guarantor’s, long term (and short term, if available) credit rating is likely to fall to, or below, Standard and Poor’s BBB+ or Moody’s Baa1 at any time during the next twelve months, then the state will immediately require a one-year irrevocable stand-by letter of credit. It should also be noted that the performance of Flint Hills Resources Alaska, LLC, is guaranteed by its parent Flint Hill Resources, LLC. At present, the parent has a Moody’s A1 long-term obligation and P-1 short-term obligation rating, as well as an S&P A+ long-term obligation and A-1+ short-term obligation rating.³²

4. In-State Processing – AS 38.06.070(b)

Under the proposed contract, FHR is compelled to use “commercially reasonable efforts” to manufacture refined petroleum products from the State’s RIK oil in Alaska. While the spirit of this provision is attractive from the State’s perspective, it is unlikely to materially impact the behavior of FHR. FHR has little alternative to in-state processing of the state’s RIK oil. That

³² A Moody’s A-1 long-term obligation rating indicates low credit risk, P-1 is the highest grade short-term obligation rating. Similarly, S&P’s A+ long-term obligation rating indicates a strong ability to meet long-term obligations, and A-1+ is the highest grade short-term obligation rating.

being said, if processing the State's RIK oil in Alaska is the most economic approach, then FHR will process the State's RIK oil in Alaska independent of any in-state processing provision. However, if processing the State's RIK oil in Alaska is not the most economical alternative, FHR will make a "commercially reasonable" decision to process the oil outside of Alaska.

5. Employment of Alaskans and Use of Alaska Companies

The buyer agrees to employ Alaska residents and Alaska companies to the extent they are available, willing, and at least as qualified as other candidates for work performed in Alaska in connection with the proposed sale.

6. Dispute Resolution

In the event that a dispute arises, both parties may avail themselves of the dispute resolution mechanism contained in the proposed contract. The dispute resolution mechanism can be triggered by either the State or FHR by giving notice of the dispute to the other party. Within 60 days of providing notice of the dispute, both parties shall submit their arguments and evidence to the commissioner. After having received the arguments and evidence concerning the dispute from the parties, the commissioner shall adjudicate the dispute. Both the State and FHR agree to abide by the findings of the commissioner provided that the decision is "supported by substantial evidence in light of the whole record."

7. Proration

Under the terms of the proposed contract, the State reserves the right to prorate royalty oil that has been nominated for taking RIK. DNR has reserved 15 percent of its royalty oil for taking RIV or for sale to other RIK purchasers. DNR has, similarly, reserved a minimum of 24,000 barrels per day of RIK for FHR. However, in the event that DNR is unable to supply the total volume of oil nominated by its RIK purchasers, DNR has reserved the right to prorate those volumes not specifically guaranteed to either FHR or other RIK purchasers.

IV. Analysis of State Benefits

A. The Cash Value Offered – AS 38.05.183(e)(1)

Under the terms of the proposed RIK contract, the State will receive a price for its RIK oil that is at least equal to the price it would have received if it elected to keep its royalty oil in-value. Such a cash value is consistent with the State's obligations as mandated in 11 AAC 03.026. The State has continually supplied the FHR North Pole refinery with feedstock for the last 33 consecutive years. Under the expiring ten-year royalty sale agreement with FHR, the State supplied the North Pole refinery with between 17,500 barrels per day and 77,000 barrels per day of Alaska North Slope royalty crude. Under the proposed contract, the State would supply the North Pole refinery with a maximum of 30,000 barrels per day of North Slope royalty crude oil. Based on Department of Revenue's ANS price, TAPS tariff, and up-stream deduction forecasts, this is forecasted to yield between \$3.5 billion and \$5.9 billion in state revenue.³³

³³ Alaska Department of Revenue, Revenue Sources Book Fall 2012

As has been mentioned, the State is obliged to receive monetary consideration for its RIK that is at least equal to the volume weighted average monetary consideration received for its RIV. Given that the allowances upstream of Valdez are quite similar for RIK and RIV, this is tantamount to requiring that the difference between the RIK USWC destination value and the RIK differential be greater than the difference between the volume-weighted RIV USWC destination value and volume-weighted RIV marine allowance. Guaranteeing this standard, however, requires knowledge of future events that are unknowable. For this contract, the State has relied on both retrospective examination and reasonable expectations about future economic conditions to develop contractual elements such that RIK and RIV parity is reasonably expected to be realized. Based on the analyses outlined below, DNR expects the price term contained in the proposed contract will achieve RIK-RIV parity.

To estimate the difference between the expected value of the RIK sold under the proposed contract and the expected value of RIV during the proposed contract term, DNR analyzed how the proposed RIK value would have compared with the realized value of RIV over the last four years. In particular, for the period between 2008 and 2011, DNR examined the difference between the RIV value for royalty oil taken from Prudhoe Bay and the value that would have been realized for the RIK taken from the same unit had the proposed contract been in effect. DNR also simultaneously undertook a complementary approach to determining whether the State is likely to achieve RIK-RIV parity by developing reasonable expectations concerning future changes to destination value and marine transportation allowances. These reasonable expectations can then be combined with the retrospective analysis to determine whether it seems likely that the State will achieve RIK-RIV parity.

The retrospective analysis revealed that if the proposed contract had been in effect during the 2008 to 2011 period, RIV would have exceeded RIK by just less than five cents per barrel (a difference of less than 0.1 percent of the RIK price). But, the value of DNR's retrospective analysis hinges critically on the whether the historical period used in the retrospective analysis is representative of the future. The dramatic disruptions in world economic conditions between 2008 and 2011 were virtually unprecedented. The ANS USWC delivered value illustrates just how dramatic these economic changes affected world oil markets. The monthly average value for a barrel of ANS delivered to the USWC began 2008 at \$91.12, rose to \$134.12 by June 2008, and then fell precipitously through the last half of the year to finish 2008 at \$40.03. After hitting this bottom, the value of ANS saw a steady upward march through 2011, crossing the \$100 per barrel threshold in March 2011.³⁴ DNR's expectation is that the economic conditions that gave rise to the large swings in oil prices are very unlikely to reoccur during the term of the proposed contract. Given this, relying solely on historical analysis will not fully inform expectations concerning the future performance of the proposed contract.

As a part of its historical analysis, DNR analyzed the difference between the RIV USWC destination value and the RIV differential along with the corresponding elements embedded in the RIK price formula. With respect to destination value, it should be noted that most of the State's North Slope RIV oil has a destination value defined by provisions in the various RSAs between the State and BP, ExxonMobil, and ConocoPhillips. Each of the RSAs specifies

³⁴ Prices reported in Platts Oilgram.

different destination values. Presently, BP uses only the ANS USWC spot price reported in Platts. ConocoPhillips uses an average of the ANS USWC spot price reported by Platts and Reuters. ExxonMobil uses a market basket of crude values—including ANS, WTI, Isthmus (a Mexican crude), and Line 63 (a California crude)—as reported by Platts. The ExxonMobil market basket is constrained to be no greater than Platts reported ANS USWC value plus fifty cents and no less than Platts reported ANS USWC value minus fifty cents. Put succinctly, the RIV volume weighted average destination value is driven more strongly by Platts than the PTR destination value in the proposed RIK contract.

To see the import of this, one must look no further than the divergence between the RIV destination value and the RIK destination value attributable in part to the sudden shift in market conditions. The USWC delivered market value of ANS as reported by Platts Oilgram became decoupled from the market price reported by Telerate and Reuters. On a monthly average basis, between January 2005 and December 2007, the difference between the USWC value of ANS reported by Platts and the average USWC value of ANS reported by Telerate and Reuters was \$-0.12, meaning that the average of the values reported by Telerate and Reuters exceeded the Platts value by nearly twelve cents. However, during the period used in the historical analysis, January 2008 to December 2011, this changes. During this period, on a monthly average basis, Platts reported ANS USWC value exceeded the average of the value reported by Telerate and Reuters by \$0.72. In 2012, this disparity began to ease, with Platts reporting values that exceeded the average of the values reported by Telerate and Reuters by \$0.41. Put differently, if the pattern observed in price reporting data during 2008 to 2011 had been consistent with more recent (and more distant) historical patterns, the State's retrospective analysis would have indicated that the proposed contract fulfilled the state's RIV-RIK parity obligation.

The other key term impacting the difference between RIK and RIV is the marine transportation allowances permitted under the RSAs. The producers deduct either their actual and reasonable costs or a formula-calculated proxy of their costs of transporting the State's RIV to the USWC. Many of the allowable costs associated with the transportation of RIV to the USWC are fixed costs that do not depend on the volume of oil transported. For example, the expense associated with fleet depreciation, return on capital, minimum staffing requirements, some operating costs, and overhead are affected very little by the marginal barrel of crude oil. The small cost savings associated with shipping one fewer barrel of oil is more than offset by spreading total costs across a smaller number of barrels. As the volume of North Slope oil production continues to decline over the contract period, the State can expect that the marine transportation allowance claimed by RIV shippers will trend higher, on a per barrel basis.³⁵ Such an interpretation is further buttressed by the increasing trend observed for the variable costs for operating vessels in the ANS trade. As an example, new rules governing the use of more expensive low-sulfur fuel were imposed on the fleet in 2012.

The data can be used to infer such a phenomenon. DNR estimates the volume-weighted average marine transportation allowance was \$2.65 in 2008.³⁶ Estimates indicate that the marine

³⁵ This is very dependent on the number of vessels in the ANS fleet and how well the fleet capacity matches ANS production. ExxonMobil is presently preparing to increase its number of vessels in its ANS fleet.

³⁶ The reported volume-weighted average marine transportation allowances reported here were inferred from the lessee's royalty fillings to ensure that data confidentiality was preserved.

transportation allowance declined in 2009 to \$2.23, but then rose in 2010 to \$2.62 and rose once again in 2011 to \$3.15. Current DNR estimates indicate that the marine transportation allowance in 2012 will rise again to between \$3.19 and \$3.24. Consistent with the view of increasing average transportation costs, the Department of Revenue forecasts that average allowable marine transportation claimed by producers for tax purposes will rise from \$3.67 in fiscal year 2014 to \$3.88 in fiscal year 2019. If the upward trend observed in marine transportation allowance continues, then the growth in marine transportation allowances will more than offset the five cent deficiency observed in the state's retrospective analysis.

It should also be recalled that the RIK Differential will be adjusted after the second year of the contract, subject to the constraint that it will not be reduced below \$2.00 nor exceed \$2.30. The readjustment helps ensure that neither the State nor FHR is unreasonably disadvantaged throughout the life of the contract by assumptions which ultimately prove incorrect. For example, if DNR's forecast concerning increasing marine transportation allowances proves to be incorrect, and during the first two years of the contract RIK fails to achieve parity with RIV, the readjustment mechanism will allow the State to mitigate this in the last three years of the contract. On the other hand, if the value agreed to by FHR ultimately results in RIK outperforming RIV in the first two years of the contract, the adjustment mechanism will increase the RIK Differential with the goal of closing the difference between RIK and RIV for the remaining three years of the contract.

B. The Projected Effects of the Sale on the Economy of the State – AS 38.05.183(e)(2)

The proposed sale will provide the State an estimated \$3.5 billion to \$5.9 in revenue during the course of the sale. The sale will also help facilitate the continued operation of the North Pole refinery with the economic benefits that accompany such operations. Beyond the refinery's continued production of nearly one million gallons per day of refined petroleum products for the Alaskan economy, the North Pole refinery currently operated by FHR employs over 129 full-time-equivalent positions, with 110 of these positions located in North Pole, Alaska, inside the Fairbanks North Star Borough (FNSB).³⁷ The Fairbanks Economic Development Corporation estimates that each of these 110 refinery positions provide an estimated \$166,000 per year in income and support another eleven positions in the FNSB.³⁸ The refining sector, including both the FHR and Petro Star North Pole refineries, generate approximately \$140 million in gross regional product in the FNSB.³⁹

During the period of the proposed contract, another hidden economic benefit of the continued operation of the FHR North Pole refinery will become salient. As TAPS throughput declines, the oil in the pipeline cools more rapidly and jeopardizes the pipeline's ability to safely operate. FHR's North Pole refinery adds heat to the TAPS stream and helps mitigate TAPS low-flow issues.

The North Pole refinery draws its crude from TAPS. The refinery then fractionalizes the crude by applying heat. The resulting fractions are cooled and further processed to yield refined

³⁷ Private communication with FHR

³⁸ Fairbanks Economic Development Corporation. "FNSB Economy in 2009: Model Overviews"

³⁹ *ibid*

petroleum products. However, some portions of the heated crude cannot be processed in FHR's North Pole refinery and is reinjected into TAPS. The net effect of this reinjection is to warm the comingled stream that flows south through TAPS. A 2010 BP analysis of low TAPS throughput indicated that "for current [2010] Flint Hills Refinery operations in Fairbanks the minimum wintertime throughput is 640,000 barrels per day...[i]f Flint Hills Refinery is shut down, or if the heat currently supplied by the refinery operation is eliminated, the minimum wintertime throughput is 780,000 barrels per day."⁴⁰ It should be noted that at the time this report was in preparation, FHR was operating three crude towers. Today it operates a single crude tower, and the refinery has installed a new heat exchanger meant to capture heat from the residual crude constituents before re-injection into TAPS. Thus, FHR's role in low-flow mitigation is much less pronounced today than in 2010, but any aid in extending the longevity of Alaska's economic lifeblood is important to the State's economy.

**C. The Projected Benefits of Refining or Processing the Oil in the State
– AS 38.05.183(e)(3)**

The proposed sale of royalty oil will help ensure continued in-state processing with its attendant price and labor market benefits. As discussed in Sections IIC and IID, products from in-state refiners supply a substantial proportion of the state's needs for refined petroleum products. Given the small and isolated nature of the Alaska market, it is probable that in the absence of in-state refining capacity, Alaskans would observe higher wholesale prices for refined petroleum products. Not only could this manifest as higher retail prices for Alaska residents who already expend more on a per capita basis for energy than residents of any other state, but the ubiquity of refined petroleum in the production and distribution of goods means such a price increase could affect the Alaska economy through smaller profit margins, higher consumer costs for non-petroleum goods, and a degraded competitive position for Alaskan goods sold Outside. The magnitude of these effects is unknown and quite hard to empirically isolate, but it is clear that it will be directly related to the size of the change in the underlying cost of refined petroleum.

The absence of the in-state refining capacity provided by FHR would also have direct, indirect, and induced labor market impacts in Alaska. FHR currently employs 129 Alaskans in high paying positions, positions that would not exist without the presence of the refinery. In-state refining also has substantial indirect effect on the Alaska labor market. For example, at its peak, FHR transported over 117 rail cars per day of petroleum products between Anchorage and the Interior on the Alaska Railroad. In spite of diminishing production, FHR's North Pole refinery today still ships 30 rail cars per day of petroleum products between Anchorage and the Interior.⁴¹ This change in the utilization of the Alaska Railroad illustrates FHR's impact on indirect employment: the Alaska Railroad Corporation eliminated 52 positions when it reduced rail service between Fairbanks and Anchorage.⁴²

⁴⁰ Trans Alaska Pipeline System Very Low Throughput Mitigation Analysis, August 16, 2010, p. 7

⁴¹ Private communication with FHR.

⁴² Alaska Railroad Announces Layoffs, Blames Global Recession. June 19, 2012. [Alaskapublic.org](http://www.alaskapublic.org). Accessed at <http://www.alaskapublic.org/2012/06/19/alaska-railroad-announces-layoffs-blames-global-recession/> on 08/24/2012.

D. The Ability of 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 – AS 38.05.183(e)(4)

FHR's North Pole refinery began producing refined petroleum products in 1977. The North Pole refinery continues to operate to this day, producing over 330 million gallons of refined product per year. Of this 330 million gallons of refined product produced by FHR per year, between sixty-four and seventy-three percent will be jet fuel. A substantial volume of this jet fuel will support operations at Ted Stevens Anchorage International Airport, the fourth busiest cargo airport in the world⁴³ and the economic engine that supports one out of every ten jobs⁴⁴ in Anchorage. Since 1979, the State has continually supplied the North Pole refinery with Alaska North Slope royalty oil, supplying nearly 154 million barrels⁴⁵ under the current RIK contract. There is little question that FHR's North Pole refinery can supply refined products to Alaskans.

E. The Revenue Needs and Projected Fiscal Condition of the State – AS 38.06.070(a)(1)

The current and projected fiscal condition of the State has been discussed in greater detail above, see Section IID. In short, the State's fiscal condition has been strong in recent years, but recent Office of Management and Budget projections indicate that the State could experience a budget shortfall in FY2013. Based on these same projections, ongoing budget shortfalls are likely from FY2015 through FY 2023. The sale of royalty oil under the proposed contract is projected to generate between \$3.5 billion and \$5.9 billion in State revenue. The proposed contract is expected to yield revenues that are at least as great as what would have realized had the State's royalty been left in value. The proposed sale may even offer a small incremental improvement to the State's fiscal picture by generating increased revenue through arbitrage. While the incremental revenue generated through the proposed sale will not offset the deficits that are projected by the less optimistic scenarios outlined by the Governor's Office of Management and Budget, the proposed sale will do no harm to the State's revenue picture.

F. 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 – AS 38.06.070(a)(2)

As was noted at the outset, on a per capita basis, Alaskans spend more on energy than residents of any other state. This high expenditure rate is driven in large part by the very high per unit cost paid by Alaskans for energy. Most pertinent for current purposes, Alaskans pay the highest rates in the country for gasoline, and the second highest rates in the nation for distillate fuels including diesel and home heating fuel. It is not likely that the proposed sale will materially reduce the price paid by Alaskan consumers for refined petroleum products. However, the absence of a sale would, at least in the short term, require the importation of refined petroleum products. Such importation would not decrease the price of energy.

⁴³ Where busiest is measured by cargo throughput. Alaska Department of Transportation & Public Facilities, Access at <http://dot.alaska.gov/anc/> on 02/19/13.

⁴⁴ Alaska Department of Transportation & Public Facilities, Access at <http://dot.alaska.gov/anc/> on 02/19/13.

⁴⁵ As of June 2012

Overall, based on EIA estimates presented in Section IIC, in 2010 Alaska consumed just over 290 million gallons of gasoline and 954 million gallons of jet fuel. Assuming these numbers are representative of current consumption, FHR supplies roughly 18 percent of the gasoline consumed by Alaskans and 26 percent of the jet fuel consumed by Alaskans (or those in Alaska). Clearly, the loss of this volume of gasoline and jet fuel could generate substantial regional and state-wide need for refined petroleum products.

G. The Desirability of Localized Capital Investment, Increased Payroll, Secondary Development and Other Possible Effects of the Sale – AS 38.06.070(a)(3)

The proposed sale of RIK 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 negotiations, FHR indicated that the North Slope royalty oil transacted under the proposed sale will be used in a status-quo fashion. Royalty oil will continue to be used as the primary source of feedstock to run the single crude tower still in operation at the North Pole refinery. If the State's RIK is used in such a fashion, there will be little incremental capital investment, payroll, secondary development, or other effects.

However, the proposed contract provides for the possibility of a contract extension if FHR commits to a large capital project or provides binding support for a system to transport North Slope natural gas into the Interior. Obviously, a large capital project (e.g., desulfurization facilities) would require substantial capital investment and would spur hiring, at least temporarily. Similarly, if FHR's commitment to a natural gas transportation system encouraged the construction of such a system, there would be substantial local capital investment, increased labor market demand, positive environmental spillover effects, and decreased energy costs.

H. The Projected Social Impacts of the Transaction – AS 38.06.070(a)(4)

Beyond the direct revenue impact and the possible construction of a natural gas transportation system, the proposed sale is unlikely to have any incremental social impact. However, the absence of the proposed sale could have serious social impact. For example, if the North Pole refinery ceased operations, just over 1,300 jobs would be lost in the FNSB.⁴⁶ Such a change would result, at least temporarily, in increased utilization of the social safety net. Moreover, depending on how the market responded to the loss of supply from the FHR refinery, there could be infrastructure impacts. For example, if the market fills the demand left unmet by a cessation of operations at the North Pole refinery by trucking refined product into the Interior, Interior roadways would experience increased usage.

⁴⁶ Fairbanks Economic Development Corporation. "FNSB Economy in 2009: Model Overviews"

I. The Projected Additional Costs and Responsibilities Which Could Be Imposed Upon the State and Affected Political Subdivisions by Development Related to the Transaction – AS 38.06.070(a)(5)

The proposed sale of RIK, in and of itself, is expected to generate negligible additional cost or responsibilities for the State or the FNSB. While it is possible that the sale of RIK may cause a restart of one or both of the idled refining towers in the North Pole refinery, it is expected that such a move would generate fewer than 40 new, full-time positions.⁴⁷ Such a modest change in steady state employment is unlikely to significantly affect the utilization of public services, meaningfully affect the size or distribution of population, or result in large indirect or secondary labor market effects.

However, the absence of a sale could impose substantial costs on government resources. As was noted, if FHR ceased operations, there would likely be an increase in reliance on government assistance with an accompanying increase in state and federal expenditures. From a local perspective, the labor market impact of the closing of the North Pole refinery could foreseeably result in a long run redistribution of population, likely with a net population loss in the FNSB. Such a population contraction would reduce the burden placed on local educational systems, but would also likely result in a loss of local property tax revenues.

J. The Existence of Specific Local or Regional Labor or Consumption Markets or Both Which Should Be Met by the Transaction – AS 38.06.070(a)(6)

While the proposed contract is unlikely to induce substantial new hiring, it will facilitate the continued operation of the North Pole refinery with the attendant labor market impacts. As was discussed above, the North Pole refinery employs 129 full-time-equivalent positions, 110 in North Pole and 19 in Anchorage. In 2009, the Fairbanks Economic Development Corporation estimated that a typical position in one of the refinery in the FNSB provided an average \$166,011 per year per position in income, more than 2.5 times the average income in the borough.⁴⁸ Beyond direct employment effects, the cascading economic effect of each FNSB refining job is estimated to generate 11.1 additional positions typically providing \$66,365 per year per position in income. Put differently, the FHR North Pole refinery and the economic activity derived from it is estimated to support 1,331 jobs in the FNSB with an expected total income very near \$100 million per year (\$99.3 million). The loss of the positions at the FHR refinery and the indirect and induced labor market effects could have a material impact on the economic health of the FNSB. Although the proposed contract cannot guarantee the continued operation of the FHR refinery, it will guarantee an ongoing supply of crude to the FHR refinery at North Pole.

K. The Projected Positive and Negative Environmental Effects Related to the Transaction – AS 38.06.070(a)(7)

The sale of RIK oil will, in and of itself, have no negative environmental effects and will not affect the volume of oil shipped in Alaska. If RIK oil simply replaces oil that would have been

⁴⁷ The idling of towers #1 and #3 resulted in the loss of 38 full-time positions.

⁴⁸ Fairbanks Economic Development Corporation. "FNSB Economy in 2009: Model Overviews"

purchased from the private market on a one-to-one basis, then there is no environmental impact. In such a situation, the North Pole refinery processes the same volume of feedstock to refine the same volume of product.

However, the absence of a sale may induce changes in consumption behavior that generates environmental risk. For example, if in the absence of a sale, FHR was to cease operations at the North Pole refinery, Alaskans might observe an increase in the cost of home heating oil. Such an increase could lead some Alaskans to substitute energy generated from wood for energy generated from heating oil. Such a substitution would degrade air quality. Such degradation could be particularly problematic for residents of areas with pre-existing air quality concerns, such as the Fairbanks-North Pole area.⁴⁹ On the whole, since the proposed contract is expected to maintain status quo refining behavior, it is unlikely that there will be a large net change in the state's exposure to environmental risk due to the proposed sale of royalty oil.

It should also be noted that the State transfers title and risk for RIK crude to the buyer at the point of delivery.⁵⁰ This legal construction does not change the volume of oil flowing through TAPS on a given day and does not impact environmental risk. However, it does insulate the State from the financial risk associated with an adverse environmental outcome.

L. The Projected Effects of the Proposed Transaction upon Existing Private Commercial Enterprise and Patterns of Investments – AS 38.06.070(a)(8)

The proposed contract will help facilitate the continued operation of the North Pole refinery by guaranteeing an ongoing supply of crude. The continued operation of the North Pole refinery will allow FHR to continue to supply its customers, including Ted Steven International Airport, Fairbanks International Airport, and the regional wholesale market. The continued operation of the North Pole refinery will sustain the demand that FHR generates among its vendors and servicers including, perhaps most notably, the Alaska Railroad. As was noted previously, it is possible, but certainly not probable, that the proposed sale will result in modest new investment.

The largest potential impact on existing private commercial enterprise and patterns of investments occur in the absence of a RIK sale to FHR. FHR indicates that the North Pole refinery has experienced on-going financial pressures and that refinery operations might cease in the absence of a new RIK contract. This would result in the loss of approximately 18 percent of the gasoline consumed in Alaska and 26 percent of the jet fuel consumed in Alaska. Such a loss could result in market changes that directly impact existing private commercial enterprise.

V. Public Comment

Under 11 AAC 03.020(c)(2), before the publication of a final finding and determination, the commissioner must engage in a public comment period lasting not less than least 30 days. The public comment period on the proposed RIK sale began February 20, 2013 with the public notice, publication, and dissemination of the Preliminary Finding and Determination. The public

⁴⁹ See, for example, http://www.dec.state.ak.us/air/anpms/comm/fbks1_pm.htm

⁵⁰ Put differently, the state instantaneously passes the title and risk of royalty oil from the producer to the buyer at the point of delivery.

comment period closed on March 22, 2013. During this comment period, DNR received six public comments from five different entities. Four of these six comments were received in the written form, the remaining two comments were provided orally during the February 26, 2013, Alaska Royalty Oil and Gas Development Advisory Board meeting in the Noel Wien Library in Fairbanks, Alaska. A copy or transcription of each comment is attached in Exhibit 4. All comments received expressed support for the proposed contract.

VI. Finding and Determination

A. Disposal of Royalty Oil In-kind is in the State's Best Interest

In accordance with AS 38.05.182(a), 11 AAC 03.010(b) and (d), and 11 AAC 03.060, DNR has published this Final Finding and Determination. The commissioner has determined that it is in the best interest of the State to take its royalty oil in-kind in order to supply the FHR refinery at North Pole with feedstock.

B. Competitive Bidding is Waived

Consistent with the results of the solicitation described in Section II.G. above and DNR's assessment of the potential benefits of negotiated RIK contracts, the commissioner has determined, in accordance with AS 38.05.183(a) and 11 AAC 03.030, that the best interests of the State will be served through the sale of its RIK to FHR under non-competitive procedures.

The proposed contract will protect the State's interest by earning revenue that is at least equal to the volume weighted average revenue earned by the State's royalty in-value and by facilitating continued operations at FHR's North Pole refinery. In making this Final Finding and Determination the commissioner considered that without a royalty contract there was a chance that the North Pole refinery could cease operations with the resulting negative consequences for Alaska. The commissioner also considered the State's expectation that it will to have sufficient royalty oil to supply other in-state refiners interested in the purchase of RIK. The commissioner further considered that DNR has negotiated a contract that will permit a transparent and equitable allocation of the State's royalty oil across all RIK buyers should the State's volumetric expectations be incorrect.

A copy of the Preliminary Finding and Determination was delivered to the Royalty Board as notification under AS 38.05.183(a) and 11 AAC 03.010(g)

C. The Proposed RIK Oil Sale Offers Maximum Benefits to the State

When RIK is sold through a process other than competitive bid, the commissioner shall award the disposal to the prospective buyer whose proposal offers the maximum benefits to the citizens of the State of Alaska. In making the award the commissioner must consider the criteria set out in AS 38.05.183(e) and in AS 38.06.070(a). The commissioner's in-depth review and consideration of all of the required statutory criteria is set out above in Section IV of the Final Finding and Determination. The commissioner finds that the proposed sale of North Slope royalty oil to FHR, under the terms and conditions of the attached proposed contract, offers the

maximum benefit to the state.

D. Alaska Royalty Oil and Gas Development Board

The Preliminary Finding and Determination and a copy of the proposed contract was submitted to the Alaska Royalty Oil and Gas Development Board in compliance with AS 38.05.183(c), 11 AAC 03.024, and 11 AAC 03.040, which require the commissioner to give written notice to the board of intent to waive competitive bidding in an RIK sale.

E. Legislative Approval


Under AS 38.05.183 and AS 38.06.055, legislative approval is required for RIK oil disposition with a term of more than one year. Legislation approving the sale has been prepared and submitted to the Legislature.

G. Applicable Criteria and Weights

For the purposes of the proposed contract, as was outline in Section IV, the commissioner considered all criteria outlined in AS38.05.183(e). The commissioner finds that the proposed sale will positively impact, or affect no harm on, all of the criteria in AS38.05.183(e). In his analysis of the proposed sale, the commissioner most heavily weighted the cash value offered, the projected effect of the sale on the economy of the state, and the ability of FHR to supply refined product to Alaskans. While all criteria in AS38.05.183(e) received non-zero weight, the other criteria discussed in Section IV received less weight.

VII. Conclusion

On careful consideration of the circumstances of the proposed sale, material information and legal requirements, the commissioner determines, in accordance with AS 38.05.183, that the best interest of the State does not require this royalty in-kind sale be made by competitive bid, and the that the proposed contract with FHR offers maximum benefits to it citizens.



Daniel S. Sullivan
Commissioner

March 25, 2013

Date

**AGREEMENT FOR THE SALE OF
ROYALTY OIL
BETWEEN AND AMONG
THE STATE OF ALASKA,
FLINT HILLS RESOURCES, LLC, A DELAWARE LIMITED LIABILITY COMPANY
AND
FLINT HILLS RESOURCES ALASKA, LLC, AN ALASKA LIMITED LIABILITY
COMPANY
EFFECTIVE _____, 2013**
