Royalty In-Kind Sale
to
Tesoro Refining & Marketing LLC

March 2014

Division of Oil and Gas
Alaska Department of Natural Resources

Royalty in-Value versus Royalty in-Kind

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

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

Non-Competitive RIK Sale Process

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

RIK Contract Terms

- The proposed 2014 contract amendment merely extends Tesoro’s current one-year contract negotiated in October 2013 for another year
- RIK Deliveries under the current one-year contract will begin February 1, 2014.
- The current one-year contract, <u>**does not**</u> directly reference RIV valuation in RIK price calculations.

RIK Contract Price

ANS Spot Price – $1.95 – Tariff Allowance ± Quality Bank Adjustment – Line Loss

- ANS Spot Price = Average US West Coast Price for Alaska North Slope oil.
  - Reported by industry trade publications: Platts and Reuters
- $1.95 = RIK Differential
  - Destination Value minus Marine Costs so that RIK ≥ RIV.
  - FHR's RIK Differential = $2.15 subject to adjustment; FHR's contract also includes a "Special Commitments" clause
- Tariff Allowance = TAPS and Pipelines Upstream of PS-1.
- Quality Bank Adjustment = as reported by the TAPS Quality Bank Administrator
- Line Loss = 0.0009 times the netback price

RIK Contract Quantity

- Initial Quantity Range
  - 5,000 – 15,000 barrels per day
  - May be adjusted after 12 months, with Commissioner approval
- Termination of Contract
  - Zero nomination for 3 months terminates contract
  - Contract terms comparable to the private market
- Refinery Turnaround
  - Contract allows Tesoro the flexibility to cease royalty oil purchases during maintenance
- Guarantees, reserves and proration clauses included

Commissioner's Decision Criteria

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

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

Royalty Board's Decision Criteria

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

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

Royalty Board's Decision Criteria

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

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

Figure 1. Royalty In-Kind Sales History

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

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

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

Best Interest of the State Served by the RIK Contract with Tesoro

- Cash Value Offered with Contract
  - Total cash value of $193 to $580 million during the year of the extension.
  - Any anticipated increases in marine transportation allowance will favor RIK contract
- Positive effect on the State
  - Maintain stability in in-state refining and distribution of refined products.
  - Support jobs and economy of Kenai Peninsula Borough

Tesoro’s Nikiski Refinery

- Began operations in 1969
- Largest most complicated refinery in Alaska (manufacturer of ultra-low sulfur road diesel)
- Currently producing approximately 710 million gallons of refined product (Jet fuel = 35 percent)
- Tesoro supplies more than 60 percent of the gasoline and 28 percent of the jet fuel consumed in Alaska.
- Employs 200 Alaskans in high paying positions
- Operates 31 company owned Tesoro 2Go retail stores, 44 Tesoro-branded stations, and 4 USA Gasoline stations

Questions?