

HCR

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Summary and Background for Sale and
Purchase of State Royalty Gas to Alaska
Pipeline Company and for related
Agreement with Phillips Petroleum Company

This contract entitled "Gas Purchase Contract", dated April 11, 1977, between Alaska Pipeline Company (Buyer) and the State of Alaska (Seller) is regarding the sale and purchase of State royalty gas. To accomodate delivery of gas under the above contract it was necessary to enter into an agreement dated April 11, 1977 between Phillips Petroleum Company (Lessee) and the State of Alaska. The above contracts will supercede the contract entitled "Gas Purchase Contract", dated June 4, 1976 between Alaska Pipeline Company and the State of Alaska and was approved by the legislature. The new agreements are necessary because certain of the provisions of the old agreement have proven unworkable.

The following exhibits are submitted in support of these agreements:

1. Gas Purchase Contract dated June 4, 1976 between APC and the State.
2. North Cook Inlet Field Royalty Gas, Commissioner's Proposal in Concept.
3. House Concurrent Resolution No. 142, introduced May 4, 1976.
4. Letter dated April 30, 1976 to the Speaker of the House from the Governor.
5. Findings and Conclusions for Non-Competive Sale.

The reasons that the Contract entered into last year could not become operational are as follows:

1. Article 2.1 of that agreement required that Buyer was to purchase all royalty gas available at the point of delivery (wellhead). Buyer does not have adequate demand to take all of the gas all of the time. Buyer agreed that all gas purchased under the contract will be used to meet the requirements of its customers within the State of Alaska. One solution to Buyer's inability to use all of the royalty gas might have been for Buyer to sell its surplus gas back to Phillips Petroleum. Had Buyer done that it may have been in breach of last years contract because Buyer agreed to use the gas for its customers and the sale was for in-state use. Phillips, however, sells the gas out-of-state.

2. The point of delivery of the gas was at the wellhead on the Lessee's offshore platform in the North Cook Inlet Field. Buyer was required, at its own expense, to arrange to accept the gas at the point of delivery. However, Buyer has been unable to do so because it is not economically feasible to construct a pipeline to the point of delivery and because Buyer has been unable to reach agreement with the Lessee to use Lessee's existing pipeline to deliver the gas to a point on the North Kenai Road where Buyer could receive the gas. Lessee has been unwilling to transport the gas for Buyer

because to do so would place Lessee under the jurisdiction of the Alaska Public Utilities Commission and Lessee does not wish to become a public utility.

Current agreements provide for several provisions which deserve special consideration. They are as follows:

Quantity

The Buyer presently does not have markets for all royalty gas produced nor does the Lessee have the production capacity to produce enough gas to maintain required production at his LNG plant, in addition to producing all royalty gas. The Buyer and Lessee have therefore agreed that they will both use their "best reasonable efforts" to accommodate the other and that Lessee will produce and Buyer will sell that gas which is available.

If this agreement is not completed, the Buyer's market will have to be satisfied from reserves in the Kenai gas field which would be unnecessarily depleted, and royalty gas produced from Lessee's field would be delivered to his market outside the State of Alaska.

The Lessee will be installing compressors to maintain current production rates and to accommodate production of royalty gas. However, as the field well pressure continues to decline, the ability to produce the total required gas will correspondingly decline. Since the Lessee is required to maintain production for the LNG plant, the Buyer has agreed to allow any production shortfall to be taken from that quantity of gas dedicated to Buyer.

However, it is also reasonable to expect that productivity in the field will be sufficient to accomodate the needs of the Buyer for most of the life of these agreements.

Delivery - Compression

The Lessee has agreed to deliver the gas purchased by Buyer, by utilizing Lessee's pipeline facilities, to a point near the North Kenai road. The compression facilities necessary to increase field production will be installed by Lessee to accomodate this increased demand.

The Buyer previously agreed with Lessee that the cost of delivery shall be 10¢ per MCF and that the cost of compression shall be an additional 10¢ per MCF. These costs are paid directly from Buyer to Lessee for the account of the State. Should additional compressors be required during the life of these agreements the new charges must be agreed to or the contracts will terminate. It is further understood that Buyer's alternative source of gas would cost the same as royalty gas delivered to the same point.

Price

The State will at all times during the life of the agreements receive at least as much and perhaps more for its royalty gas as it would have received if it had taken its royalty in-value.

Public Utilities Commission/Alaska Pipeline Commission

A major reason the previous agreement failed was because Lessee would be subject to the jurisdiction of the above

mentioned regulatory agencies. The current agreements have been designed to avoid this problem as the only way that the producer would agree to transport the gas. The legal opinions relating to this matter were requested from the Attorney General and are enclosed to support these agreements.

The regulatory agencies would normally audit such costs as the delivery and compression charges to be paid by the Buyer to Lessee. However, in this case the Buyer and Lessee had agreed to these charges prior to the development of the current agreements. It is evident that had the previous agreement become operational, these same charges would have been applied to this gas.

E X H I B I T

1.

Gas Purchase Contract
dated June 4, 1976 between
Alaska Pipeline Company
and
State of Alaska

Gas Purchase Contract

This Contract, made and entered into this 4th day of June 1976, by and between the Alaska Pipeline Company ("APC") herein referred to as "Buyer" and the State of Alaska, hereinafter referred to as "Seller" :

WITNESSED

WHEREAS, Buyer owns and operates a natural gas pipeline system in areas of Alaska for the delivery of natural gas for ultimate consumption within the State of Alaska, and

WHEREAS, Seller has the right under each of the leases identified at Exhibit "A" attached hereto to be paid by the lessee thereunder a royalty of twelve and one-half percent in kind or in value of the natural gas produced and saved and used off of the lands covered by each such lease, and

WHEREAS, Seller is authorized by AS 38.05.183 to sell royalty gas; and

WHEREAS, Buyer represents to Seller that all gas purchased under this contract will be used to meet the requirements of its customers within the State of Alaska;

NOW, THEREFORE, in consideration of the representations, covenants, and conditions herein contained, Buyer and Seller hereby agree as follows:

ARTICLE I

Seller's Royalty Gas

1.1 Seller hereby agrees that within 30 days after the execution and approval of this agreement as required by the laws of the State of Alaska, Seller shall notify the lessee under the leases set forth at Exhibit "A" of this agreement of Seller's election to take its royalty gas in kind. Said notice will provide that the lessee shall commence the delivery of said royalty gas to Seller (or to Seller's designee) upon a receipt of notice from Seller that all facilities necessary to enable Buyer to receive and market said gas are ready; provided, however, in no event shall lessee be required to commence the delivery of royalty gas to Seller (or its designee) prior to six (6) months following lessee's receipt of notice of Seller's election to take its royalty gas in kind.

1.2 In order that Seller can give its lessee as much advance notice as possible of the date it will start receiving its royalty gas in kind, Buyer shall notify Seller, and Seller shall notify its lessee, at least 60 days prior to the date Buyer will receive gas from Seller pursuant to this contract.

ARTICLE II

Quantity

2.1 It is understood and agreed by the parties that the volume of gas available to Seller from the leases covered by this contract depends upon the production from the leases over which Seller has no control. Buyer hereby agrees to purchase on each day commencing with the date of first delivery

hereunder and continuing during the term of this contract all of Seller's royalty gas available at the point of delivery described in Article III hereof.

ARTICLE III

Delivery Point and Delivery Pressure

3.1 The point of delivery of all gas delivered hereunder shall be at the same point of delivery that Seller receives delivery of its royalty gas from its lessee in the North Cook Inlet Field.

3.2 Buyer, at its own expense, shall arrange to accept Seller's gas at the point of delivery.

3.3 Seller will deliver gas received by Seller from lessee at the pressure at which the gas is received by Seller from its lessee.

ARTICLE IV

Quality

4.1 The gas to be delivered by Seller to Buyer at the delivery point shall be gas of the same quality as is delivered to Seller by the lessee at the point of delivery.

ARTICLE V

Price and Billing

5.1 The price to be paid by Buyer to Seller for gas delivered shall be as follows:

- a. Commencing on the date of first deliveries hereunder, assuming that this date occurs prior to July 1, 1977 and continuing until the first day of July 1977, the price shall be 55.5 cents per MCF.
- b. Commencing on the first day of July 1977 and continuing until the first day of July 1978 the price shall be the higher of (i) 60.36 cents per MCF, (ii) the price Seller would have received from Phillips Petroleum Company had it not elected to receive its royalty gas in kind, (iii) the highest price paid by any purchaser in the upper Cook Inlet area for gas of similar quality and similar conditions of delivery; with due regard to appropriate factors including, but not limited to, difference of BTU content, delivery pressure, term of the contract and connection charges.
- c. For each succeeding 12 month period commencing July 1, 1978 the price shall be increased to the higher of (i) the previous year's price plus 2 cents per MCF, (ii) the price Seller would have received had it not elected to take its

royalty in kind, (iii) the highest price paid by any purchaser in the upper Cook Inlet area for gas of similar quality and conditions of delivery; with due regard to appropriate factors including, but not limited to, difference of BTU content, delivery pressure, term of the contract and connection charges.

5.2 Thirty days prior to the date of each annual price change, Seller, at its option, may determine the price which it would have received from its lessee had it not elected to take its royalty gas in kind and the highest price being paid for gas of similar quality and similar conditions of delivery; with due regard to appropriate factors including, but not limited to, difference of BTU content, delivery pressure, term of the contract and connection charges in the upper Cook Inlet area and submit the same to Buyer along with suitable supporting evidence as to such prices. Buyer shall have the right to submit other evidence within the 30 day period.

5.3 After the delivery of gas has commenced Buyer shall, on or before the 20th day following the end of each month, render to Seller a statement showing the quantity of gas delivered during that month and shall therewith pay Seller the amount due for all such gas.

5.4 Each party hereto shall have, at its expense, the right to examine the books and records of the other party to the extent necessary to verify the accuracy of any statement, charge, computation, or demand made under or pursuant to this

contract. Any statement shall be final as to both parties unless questioned in writing within two (2) years after payment thereof has been made.

5.5 The terms "upper Cook Inlet area" as used here in shall mean the area encompassed in a radius of 100 kilometers from the Phillips Petroleum North Cook Inlet platform.

ARTICLE VI

Term

6.1 This contract shall become effective upon the execution hereof and the approval of the Alaska Royalty Oil and Gas Development Advisory Board and the State Legislature and shall continue and remain in effect until July 1, 1984, unless terminated prior to such date by mutual agreement of the parties, or pursuant to Article VII.

ARTICLE VII

Conditions Precedent

7.1 Buyer shall have the right to terminate this contract upon 30 days written notice to Seller if Buyer is unable to make satisfactory arrangements to take delivery of the gas. Buyer shall exercise this right to terminate on or before January 31, 1978, thereafter Buyer may not exercise this right to terminate.

ARTICLE VIII

Notices

8.1 Notices required to be given under this contract shall be deemed sufficiently given and served when and if

deposited in the United States mail postage prepaid and certified
or registered addressed to Seller at:

Commissioner

Department of Natural Resources

Pouch M, Juneau, Alaska 99811

or to Buyer at:

Alaska Pipeline Company

P. O. Box 6288

Anchorage, Alaska 99502

IN WITNESS WHEREOF, the parties hereto have caused
this Agreement to be executed in four (4) original counterparts
on this day and year first above written.

"BUYER"

Harold E. Schmidt

STATE OF ALASKA

Greg R. Martin

ATTEST:

Richard F. Barnes

ATTEST:

William J. Gabel

E X H I B I T

2.

North Cook Inlet Field Royalty Gas
Commissioner's Proposal in Concept

The Commissioner of Natural Resources has recognized that the increasing growth of the Cook Inlet area of Alaska with its resultant increase in the use of natural gas requires that additional natural gas reserves be allocated for that purpose from State of Alaska royalty gas. From the standpoint of size of uncommitted gas reserves, geographical location and possible pipeline access, the North Cook Inlet field royalty gas appears the best available supply at this time. Pursuant to AS 38.05.182 the Commissioner proposes that it is in the best interest of the State to take in kind the State's royalty share of the gas production from the North Cook Inlet gas field and requests the consent of the Alaska Royalty Oil and Gas Development Advisory Board for this change.

The Commissioner further proposes to dispose of the North Cook Inlet field royalty gas to Alaska Pipeline Company and its subsidiaries through a negotiated contract. The proposed contract will contain the following provisions:

1. Purchaser agrees to take 1/8 of daily production from the North Cook Inlet gas field on an if and as deliverable basis for the contract period. The State will report to the Purchaser each month the amount of royalty gas produced by Phillips during the prior months.

The approximate average daily royalty gas share of the production from Phillips' North Cook Inlet field platform is 17,000 MCF. Gas production from the platform varies as LNG plant needs dictate therefore no daily amount can be specified.

2. Point of delivery will be the wellhead.
3. Purchaser is responsible for measurement costs, and any compression or dehydration costs if or when necessary.
4. The contract expires on June 1, 1984, unless extended by mutual agreement for a period not to exceed one year.
5. The price of the gas will be equal to the price the State otherwise would have received from Phillips for its royalty gas for export as LNG to Japan; but not less than the highest price paid by any purchaser in the Cook Inlet area for a similar sale of gas of similar quality. The price will be adjusted yearly on the anniversary date of the contract.

6. The contract shall not be effective until

-all necessary permits and authorizations by
governing bodies are obtained

-all transportation or exchange arrangements have
been completed to the satisfaction of the parties
involved.

-six month's notice required under lease

The Commissioner request approval of the above proposed concep-
tual plan by the Alaska Royalty Oil and Gas Development Advisory
Board.

E X H I B I T

3.

RECEIVED
MAY 05 1976

ALASKA ROYALTY
OIL & GAS BOARD

Introduced: 5/4/76
Referred: Resources and
Finance

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

1 IN THE HOUSE

2 HOUSE CONCURRENT RESOLUTION NO. 142

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 NINTH LEGISLATURE - SECOND SESSION

5 Relating to the taking of
6 state-owned royalty oil or gas
7 in-kind and its disposal by sale.

8 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 WHEREAS the legislature by enactment of the Alaska Royalty Oil and Gas
10 Development Board statute, AS 38.06. et seq., has established a clear policy
11 of favoring the taking of state-owned royalty oil or gas in-kind and making
12 that royalty available for in-state uses; and

13 WHEREAS the State of Alaska presently receives a one-eighth royalty on
14 gas produced from the North Cook Inlet Gas Field in value, but has the
15 right to receive this royalty in-kind; and

16 WHEREAS the commissioner of natural resources has entered into a
17 contract for the sale and purchase of state-owned royalty gas from the
18 North Cook Inlet Gas Field with Alaska Pipeline Company, an Alaskan corpora-
19 tion which sells natural gas in the Anchorage and North Kenai Road areas; and

20 WHEREAS the contract between the State of Alaska and Alaska Pipeline
21 Company requires as a condition precedent to its becoming effective appro-
22 val by a majority of each house of the Legislature;

23 BE IT RESOLVED by the Alaska State Legislature that approval of
24 Alaska Royalty Gas Sale No. 76-1, the contract for the sale of state
25 royalty gas from the North Cook Inlet Gas Field to Alaska Pipeline Company,
26 is hereby approved.

E X H I B I T

4.

April 30, 1976

The Honorable Mike Bradner
Speaker of the House
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Transmittal of Proposed
Alaska Royalty Gas Sale No. 76-1

Dear Mr. Speaker:

Attached is Alaska Royalty Gas Sale Contract No. 76-1 providing for a sale of State royalty gas from the North Cook Inlet Gas Field to Alaska Pipeline Company pursuant to AS 38.06 et seq., AS 38.05.182-183, and 11AC26.905-.900. Also attached are all necessary waivers or consents related to this action and required under the law. The contract and all necessary related actions have been approved by the Alaska Royalty Oil and Gas Development Advisory Board pursuant to the above statutes and regulations. Other information pertinent to the proposed sale is also attached, with the intention of supplying you with an adequate record on this matter.

Alaska Pipeline Company, and its subsidiary Alaska Gas and Service Company, supply natural gas to the Anchorage area and a portion of the North Kenai peninsula known as the North Kenai road area. Increased use of natural gas due to growth in both areas is diminishing the gas reserves dedicated to Alaska Pipeline Company faster than anticipated. The company estimates that the contract amount for the North Kenai road area will be exhausted by May of this year and has executed a one year contract with their present supplier to extend their service.

Natural gas from the North Cook Inlet Gas Field, operated by Phillips Petroleum Company, is transported from the offshore platform to the LNG plant in the Nikiski area served by the North Kenai road and liquified for export to Japan.

AGO 935921

The proposed contract provides that the State of Alaska will take its royalty share of the North Cook Inlet Gas Field production in kind rather than in value, and sell this gas to Alaska Pipeline Company at the same price that the State would otherwise receive from Phillips Petroleum Company. The amount of gas sold would average 15 to 16 million cubic feet per day and total about 41 billion cubic feet over the term of the royalty sales contract, which would expire June 1, 1984, coincidentally with the expiration of the present Phillips contract for export to Japan. Transportation or exchange provisions will be arranged by Alaska Pipeline Company, as will all necessary regulatory clearances.

The present peak gas demands along the North Kenai road can be as high as 10 million cubic feet per day. Gas excess to these needs can be used to augment the gas supply to Anchorage and extend the life of those reserves.

The total contract amount represents about one and one-half year's supply of gas at Anchorage's present rate of use, and about one year's production of the North Cook Inlet Gas Field.

The Commissioner of Natural Resources and the Alaska Royalty Oil and Gas Development Advisory Board recognize that the proposed sale of royalty gas will somewhat shorten the productive life of the North Cook Inlet Gas Field by approximately one year. Since the LNG contract requires delivery of a specified amount each year it will be necessary to increase the daily production of the field by the amount of the royalty gas withdrawn from the LNG plant. On balance, however, the sale of this royalty gas to supply the North Kenai road area and Anchorage is deemed to be in the best interest of the State, as it returns State royalty gas from foreign export to Alaska consumers at a price which assures all Alaskans a fair return for their resources.

I have, at various times, expressed the belief that section 55 of the Royalty Board Statute (which requires legislative approval by concurrent resolution of any sale of surplus royalty gas) is unconstitutional. The Administration believes that this requirement raises a substantial constitutional question and has concluded that in the future appropriate action will be necessary either by the Legislature to amend the Royalty Board Statute or by the courts to decide the constitutionality of

section 55. Notwithstanding such doubts concerning the constitutionality of this provision, the contract is being submitted to the Legislature for approval. Two reasons support this submission. First, early in this session, the Commissioner of Natural Resources advised the Legislature of his intent as a policy matter to carry out all the requirements of the Royalty Board Statute. I believe it would be less than forthright to pursue any other course for a sale during the closing days of the legislative session. Second, although this sale involves a relatively small quantity of gas, I am anxious to see it consummated at the earliest possible time as it will directly and immediately benefit gas consumers in the Anchorage and North Kenai areas. For that reason, it is undesirable that this contract become entangled in litigation which might extend over a lengthy period of time.

To avoid the choice of either appearing to acquiesce in the requirement of legislative approval or undertaking a perhaps unnecessary confrontation, a term has been included within the contract which provides that the contract will not become effective until approved by concurrent resolution passed by a majority of each house of the Legislature. The Administration always has the right to seek the advice and counsel of the Legislature and I have in this contract sought to make legislative approval a condition precedent to the contract becoming effective. I am submitting this contract to you for your approval pursuant to that term. However, in doing so, I wish to make clear beyond peradventure that my action should not be construed as either approval of or acquiescence in section 55 of the Royalty Board Statute and that I do not feel personally or legally obligated to submit future contracts for the sale of royalty oil or gas to the Legislature for approval by concurrent resolution.

You are aware that this is the first royalty sale contract prepared under the existing Statute, and of the first of its kind in the Nation. The Commissioner of Natural Resources, who is the official responsible for the agreement, is prepared to supply all necessary additional information to assist you in your consideration of this sale contract. Thank you for your consideration.

Sincerely,

Jay S. Hammond
Governor

Attachment

Natural Resources/WCF/ck/tdg



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

April 22, 1977

ACR
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The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

Under authority of art. III, sec. 18 of the Alaska Constitution, and in accordance with AS 24.30.060(b) and the Uniform Rules of the Alaska State Legislature, I am transmitting a resolution giving legislative approval to a sale of royalty natural gas from the North Cook Inlet Field to Alaska Pipeline Company. AS 38.06.055(a) provides that no sale of state-owned royalty oil may be made unless approved by concurrent resolution of the legislature.

The Alaska Royalty Oil and Gas Development Advisory Board reviewed the contract and granted its approval on April 6, 1977. The Board's declarations and findings are included in the material submitted to each legislator today. I would be pleased to assist you with any additional information which you request.

Last year the State of Alaska and the Alaska Pipeline Company entered into a contract for the sale of the same royalty gas to Alaska Pipeline Company. That contract was approved by the legislature last session. However, certain difficulties with volume flexibility and arranging for the transportation of the gas from the offshore platform to shore prevented Alaska Pipeline Company from receiving the gas under that contract. The current agreement has been executed to solve these problems and allow royalty gas to be delivered to Alaska Pipeline Company.

The problems with the previous agreement were:

1. Alaska Pipeline Company was unable to use all of the royalty gas at all times (as required in the contract) due to lack of an adequate market; and yet, because of limitations also included in the contract, is unable to sell the excess gas back to Phillips Petroleum Company for export from the State.

2. Alaska Pipeline Company was unable to enter into an agreement with Phillips Petroleum Company for transporting of the gas to shore from the production platform due to understandable reluctance of Phillips to expose themselves to the jurisdiction of the Public Utilities Commission or the Pipeline Commission. The new agreement I am submitting to the legislature today remedies these problems.

This new agreement with Alaska Pipeline necessitated that the State itself also enter into an agreement with Phillips Petroleum Company for delivery of the royalty gas from the platform to shore. This agreement requires that the State pay the cost of gathering and compressing the royalty gas to the point of delivery; however, Alaska Pipeline Company in turn agrees to pay these costs to Phillips for the account of the State. The Royalty Board has neither responsibility nor authority to judge the appropriateness of the level of these charges, and has not done so.

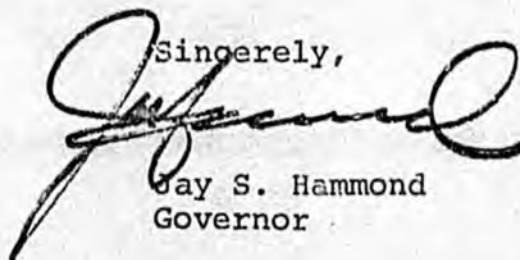
Phillips Petroleum Company has operational problems affecting their ability to deliver guaranteed volumes of royalty gas to shore, as does Alaska Pipeline Company affecting their ability to market the gas available. These companies, together with the State, have agreed to use their "best reasonable efforts" to accommodate the needs of one another to produce and market royalty gas.

The contract between the State and Phillips does not strictly require legislative approval since it does not involve a sale of royalty gas. Nevertheless, I have included it in the materials submitted to the legislature because it is an integral part of the sale of royalty gas to Alaska Pipeline Company.

I believe your careful review of the enclosed materials will reveal many questions regarding this approach to resolving the many problems associated with the acquiring and delivery of this royalty gas. However, I also believe that these agreements are the best possible solution at this time, are in the best interest of the State, and are important to the long-term interest of Anchorage utility customers.

Thank you for your consideration.

Sincerely,



Jay S. Hammond
Governor

Materials for Legislature
Alaska Pipeline Company

List of materials submitted to each legislator.

1. Gas Purchase Contract dated April 11, 1977 between Alaska Pipeline Company and the State of Alaska.
2. Agreement dated April 11, 1977 between Phillips Petroleum Company and the State of Alaska.
3. Reasons for Sale and Purchase of State Royalty Gas to Alaska Pipeline Company and for Agreement with Phillips Petroleum Company.
4. Findings and Conclusions of the Commissioner Pursuant to Alaska Statute 38.01.113(c) (determination not to use competitive bid procedures.)
5. Approvals relating to above by Alaska Royalty Oil and Gas Development Advisory Board dated April 6, 1977.
6. Attorney General's opinions relating to jurisdiction of Public Utilities Commission and Pipeline Commission.
7. Memos relating to gathering and compression charges.

1 The "Gas Purchase Contract" dated April 11, 1977,
2 between Alaska Pipeline Company and the State of Alaska is
3 hereby amended by adding this page 1(a) between pages 1 and
4 2.

5 ARTICLE I
6 DEFINITIONS

7 The following terms when used in this contract
8 shall have the following meanings:

9 1.1 The term "day" shall mean a period of twenty-
10 four (24) consecutive hours beginning and ending at 7:00
11 o'clock A.M. The reference date for any day shall be the
12 date of the beginning of such day.

13 1.2 The term "month" shall mean a period begin-
14 ning at 7:00 o'clock A.M. on the first day of a calendar
15 month and ending at 7:00 o'clock A.M. on the first day of
16 the next succeeding calendar month.

17 1.3 The term "Mcf" shall mean one thousand (1,000)
18 cubic feet of natural gas measured as hereinafter provided.
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21 Alaska Pipeline Company

State of Alaska

22 Neil Sur
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Theresche
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25 Date: 4-20-77

Date: 4-19-77
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PK 4-19-77
Rec'd Jul 4-20-77

~~DEFINITIONS~~

Seller's Royalty Gas

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2.1 Seller hereby agrees that within 30 days after the execution and approval of this agreement as required by the laws of the State of Alaska, Seller shall notify the Lessee under the leases set forth at Exhibit "A" of Seller's election to take its royalty gas in-kind. Said notice will provide that the Lessee shall commence the delivery of said royalty gas to Seller or to Seller's designee upon a receipt of notice from Seller that all facilities necessary to enable Buyer to receive and market said gas are ready; provided, however, in no event shall Lessee be required to commence the delivery of royalty gas to Seller or its designee prior to six (6) months following Lessee's receipt of notice of Seller's election to take its royalty gas in-kind.

2.2 In order that Seller can give its Lessee as much advance notice as possible of the date it will start receiving its royalty gas in-kind, Buyer shall notify Seller, and Seller shall notify its Lessee, that all facilities necessary to receive and market said gas are ready, at least 60 days prior to the date Buyer will receive gas from Seller pursuant to this Contract.

2.3 Buyer agrees that Seller's royalty gas which is purchased and received by Buyer will be used or resold for use

1 within the State of Alaska.

2
3 ARTICLE III

4 Quantity

5 3.1 It is understood and agreed by the parties that the
6 volume of gas available to Seller from the leases covered by
7 this Contract depends upon the production from the leases over
8 which Seller has no control, and further depends upon the Lessee's
9 gathering capacity installed and available, over which Seller
10 likewise has no control. Buyer hereby agrees to purchase on
11 each day commencing with the date of first delivery hereunder
12 and continuing during the term of this contract up to all of
13 Seller's royalty gas available at the point of delivery described
14 in Section 5.1 hereof, it being understood that Buyer's require-
15 ments for its markets may not allow Buyer to purchase the entire
16 amount of Seller's royalty gas on each day it is available;
17 and it being further understood that Buyer will take not less
18 than the amount for which Buyer has demand and delivery facili-
19 ties available. Buyer shall use its best reasonable efforts
20 to take not less than three (3) billion cubic feet per year of
21 royalty gas at the point of delivery.

22
23 3.2 It is recognized that it is impossible to deliver to Buyer
24 each day the exact amount of royalty gas produced from the leases
25 listed in Exhibit "A". Seller agrees that Seller or Lessee
26 will carry an over and short account with respect to the receipts
27 of royalty gas and the delivery of same to Buyer; provided,
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1 however, that the account shall never be required to carry
2 more than a total of 60,000 Mcf over or underdelivery. In
3 the event the takes by Buyer on a cumulative basis shall ever
4 be more than 60,000 Mcf less than the amount of royalty gas
5 available to Buyer at the point of delivery, Buyer shall not
6 be allowed to make up for any such underdelivery and Seller
7 may sell the undelivered quantity of royalty gas to Lessee.

8
9 ARTICLE IV

10 Quality, Pressure, and Odorization

11 4.1 The gas to be delivered by Seller to Buyer at the
12 delivery point shall be gas of the same quality and pressure
13 as delivered to Seller by the Lessee at the point of delivery.
14 Seller shall have no obligation to improve the quality or
15 pressure of gas beyond that quality and pressure at which
16 Lessee delivers the gas to seller.

17
18 4.2 Gas delivered hereunder will not be odorized and
19 if Buyer so utilizes the gas delivered hereunder for purposes
20 which require odorization of such gas, the full responsibility
21 for such use is Buyer's and Buyer agrees to comply with all
22 laws and regulations respecting the odorization of such gas
23 and hereby indemnifies and holds Seller harmless from any
24 and all claims, injuries, expenses, penalties and damages
25 arising out of or connected with Buyer's failure to observe
26 strictly and comply with all laws, rules and regulations with
27 respect hereto.

1 ARTICLE V

2 Point of Delivery, Point of Measurement,
3 Ownership, and Measurement

4 5.1 Buyer shall install, maintain, and operate a connec-
5 tion into the Lessee's pipeline system at or near Lessee's
6 pipeline tap presently being used to deliver gas from Lessee's
7 pipeline to the Tesoro refinery located in the general vicinity
8 of the Kenai LNG plant on the North Kenai Road, (hereinafter
9 called "the point of delivery"). The point of delivery of
10 all gas delivered hereunder shall be at the same point of
11 delivery that Seller receives its royalty gas from the Lessee.
12

13 5.2 Buyer agrees to install, maintain, and operate all
14 pipeline, pressure regulators, and related facilities necessary
15 to receive gas hereunder at and from the point of delivery
16 above specified, to Buyer's metering station(s) also located
17 in the general vicinity of the Kenai LNG plant on the North
18 Kenai Road (hereinafter called "the point of measurement").
19

20 5.3 Buyer shall be deemed to be in control and possession
21 of the gas delivered hereunder at and from the point of delivery
22 and responsible for any damage or injury caused thereby.
23 Buyer shall be responsible for any gas lost between the point
24 of delivery and the point of measurement. Buyer shall indemnify
25 and hold Seller harmless as to any injury or damage arising
26 out of the delivery of gas to Buyer and its measurement hereunder.
27

28 5.4 Standards of Measurements and Tests
29
30
31

1 5.4.1 Except for the determination and computation
2 of total heating value, the unit of volume of gas delivered here-
3 under shall be one (1) cubic foot at an absolute pressure of
4 fourteen and sixty-five hundredths (14.65) pounds per square
5 inch and at a base temperature of sixty (60) degrees Fahrenheit.
6

7 5.4.2 The volumes of gas delivered hereunder shall be
8 measured and computed by Buyer in accordance with the methods
9 prescribed in Gas Measurement Committee Report No. 3, Natural
10 Gas Department, American Gas Association, including the Appendix
11 thereto, dated April, 1955, except that the atmospheric pressure
12 shall be assumed to be fourteen and seven-tenths (14.7) pounds
13 per square inch. The method used for correcting such volumes
14 for deviation from the Ideal Gas Laws shall be the procedure
15 recommended in the most current Report of the American Gas Asso-
16 ciation or by any other method mutually agreeable to the parties
17 hereto.
18

19 5.4.3 The specific gravity of the gas delivered hereunder
20 shall be determined by Lessee utilizing the method prescribed
21 in American Petroleum Institute Code No. 50-A at the beginning
22 of delivery hereunder and once during each month thereafter. The
23 results of each such determination shall be used in computing the
24 volume of gas delivered hereunder until the effective date of
25 the next succeeding test.
26

27 5.4.4 The flowing temperature of the gas delivered here-
28 under shall be determined by means of a continuous recording
29 thermometer installed by Buyer so that it will properly record
30
31

1 the temperature of the gas flowing through the meter. The
2 arithmetical average of the hourly temperatures recorded each day
3 shall be used in computing the volumes of gas delivered during
4 such day.

5
6 5.4.5 If the gas delivered hereunder is solely from the
7 16-inch pipeline serving the North Cook Inlet Field, the total
8 heating value of the gas shall be the average of that recorded on
9 the recording calorimeter for Lessee's gas at the inlet to
10 Kenai LNG Plant during the billing period corrected to thirty
11 (30) inches of Mercury and sixty (60) degrees Fahrenheit dry.

12
13 5.5 Measurement

14
15 5.5.1 Seller or Lessee may at their option and expense,
16 install check meters upstream or downstream of Buyer's meter
17 station provided that such check meters will be installed so
18 as not to interfere with the operation of Buyer's facilities.
19 The calibrating and adjusting of meters and the changing of
20 charts and the reading of charts on meters shall be done by the
21 party who installed the meters.

22
23 5.5.2 Buyer, Lessee, and Seller shall have access at all
24 times to Buyer's metering equipment including all other instru-
25 ments used by Buyer in determining the measurement and quality
26 of the gas delivered hereunder, but the reading, calibrating
27 and adjusting thereof, and the changing of charts shall be done
28 only by the employees, agents, or representatives of Buyer. Upon
29
30
31
32

1 request of Lessee or Seller, Buyer shall submit to Lessee or
2 Seller records and charts from such equipment subject to return
3 by Lessee or Seller within thirty (30) days after receipt thereof
4 Buyer hereby agrees to assure Seller and Lessee ingress and egress
5 at the point of measurement and between the point of delivery and
6 the point of measurement without charge for all purposes necessary
7 hereto.

8
9 5.5.3 At least once a month Buyer shall test its above
10 mentioned metering equipment or cause the same to be tested and
11 shall give Lessee or ~~his~~^{its} representative reasonable prior notice
12 of the time all such tests are to be made so that Lessee may,
13 if desired, have its representative present to observe such tests
14 and any adjustments made upon such metering equipment. Following
15 any test, any of Buyer's metering equipment found to be inac-
16 curate to any degree shall be adjusted immediately to measure
17 accurately. If upon any test such metering equipment is found
18 to be inaccurate by two percent (2%) or more, registration from
19 said metering equipment and any payments based upon such regis-
20 trations shall be corrected at the rate of such inaccuracy for
21 any period of inaccuracy which is definitely known or agreed
22 upon, but in case the period is not definitely known or agreed
23 upon, then for a period extending back one-half of the time
24 elapsed since the last previous test, not exceeding however,
25 fifteen (15) days.

26
27 5.5.4 If for any reason Buyer's meter is out of service or
28 is found registering inaccurately and the error is not determin-
29 able by ordinary test such that the volume of gas delivered
30
31
32

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1 through such meter cannot be ascertained or computed from the
2 readings thereof, the volume of gas so delivered during the
3 period the meter is out of service or registering inaccurately
4 shall be estimated and agreed upon by the parties hereto upon the
5 basis of the best available data, using the first of the follow-
6 ing methods which is feasible:

7 (a) By correcting the error if the percentage of
8 error is ascertainable by calibration, special test,
9 or mathematical calculation;

10 (b) By using the registration of any check measuring
11 equipment of Lessee if installed and registering
12 accurately;

13 (c) By estimating the volume by comparing it with
14 deliveries during preceding periods under similar
15 conditions when the meter was registering accurately.

16
17 ARTICLE VI

18 Price and Billing

19 6.1 The price to be paid by Buyer to Seller for gas deliver-
20 ies shall be as follows:

21 (a) Commencing on the date of first deliveries here-
22 under assuming that this date occurs prior to July 1,
23 1978 and continuing until the first day of July, 1978,
24 the price shall be 64.65 cents per MCF.

25
26 (b) Commencing on the first day of July, 1978 and
27 continuing until the first day of July, 1979 the
28 price shall be the higher of (i) 66.65 cents per
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1 MCF, (ii) the price Seller would have received from
2 Lessee had it not elected to receive its royalty gas
3 in kind, (iii) the highest price paid by any purchaser
4 in the upper Cook Inlet area for gas of similar quality
5 and similar conditions of delivery; with due regard
6 to appropriate factors including, but not limited to,
7 difference of BTU content, delivery pressure, term of
8 the contract and connection charges.

9
10 (c) For each succeeding 12 month period commencing
11 July 1, 1979 the price shall be increased to the higher
12 of (i) the previous year's price plus 2 cents per Mcf,
13 (ii) the price Seller would have received had it not
14 elected to take its royalty in-kind, (iii) the highest
15 price paid by any purchaser in the upper Cook Inlet
16 area for gas of similar quality and conditions of delivery;
17 with due regard to appropriate factors including, but
18 not limited to, difference of BTU content, delivery
19 pressure, term of contract and connection charges.

20
21 (d) In addition to the price otherwise payable herein-
22 above, for gas delivered to Buyer at the delivery point
23 Buyer shall pay to Lessee, for the account of Seller,
24 a gathering charge of ten cents (10.0¢) per Mcf from the
25 date of first delivery hereunder. The above stated
26 charge shall increase six percent (6%) compounded annually
27 on each anniversary of the date of this contract.

28
29 (e) It is recognized by the parties hereto that it will
30 be necessary for Lessee to install compression facilities
31

1 during the term of this Agreement. At the time the
2 first compressor unit is installed and first used, Buyer
3 shall pay to Lessee, for the account of Seller, in addition
4 to the price and gathering charge otherwise payable
5 hereinabove, a compression charge of ten cents (10.0¢)
6 per Mcf for all gas delivered to Buyer at the delivery
7 point. Such charge shall increase by six percent (6%)
8 per year compounded annually, commencing on the
9 first anniversary of the date such compression facilities
10 are installed and ready for operation. Nothing
11 herein shall be construed by either party as an
12 obligation on Lessee to install any compression
13 facilities whatever or to operate any compression
14 facilities already installed.

15
16 (f) In addition to the price provisions stated herein,
17 Buyer hereby agrees to pay Seller as part of the total
18 purchase price of the royalty gas any costs not other-
19 wise stated herein incurred by Seller in transporting
20 that gas to the point of delivery specified in section 5
21 of this agreement including but not limited to any ⁵ *RL 4-19-77*
22 amount which Seller is obligated to reimburse Lessee _{A#1}
23 for a proportion of new or increased fees, imposts, *See*
24 duties, charges, ^{excises} or taxes. *4-20-77*

25
26 6.2 Thirty days prior to the date of each annual price change,
27 Seller, at its option, may determine the price which it would have
28 received from its Lessee had it not elected to take its royalty
29
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1 gas in-kind and the highest price being paid for gas of similar
2 quality and similar conditions of delivery; with due regard
3 to appropriate factors including, but not limited to, difference
4 of BTU content, delivery pressure, term of the contract and
5 connection charges in the upper Cook Inlet area and submit
6 the same to Buyer along with suitable supporting evidence
7 as to such prices. Buyer shall have the right to submit other
8 evidence within the 30 day period.

9
10 6.3 On or before the 15th day of each month after the
11 delivery of gas hereunder has commenced Buyer shall furnish
12 Seller and Lessee with a full and complete statement reflecting
13 the quantity of gas delivered at the delivery point during
14 the preceding month and the total amounts due hereunder.
15 Payment under sections 6.1(d), 6.1(e) and 6.1(f) of this Contract
16 shall be made to Lessee on account of Seller at Lessee's office
17 in Bartlesville, Oklahoma within ten (10) days after delivery
18 of each such statement. Payment under sections 6.1(a), 6.1(b)
19 and 6.1(c) of this Contract shall be made to Seller on the
20 day of delivery of each such statement by direct wire transfer
21 of federal reserve funds through the Federal Reserve Bank
22 wire transfer system to the following address:

23 BANK OF AMERICA, NA + SA
24 San Francisco, California
25 Securities Department 3255

26 Credit to: State of Alaska Investment Account
27 or to such other address as the Commissioner of Revenue may designate.

28
29 6.4 Each party hereto shall have, at its expense, the right
30 to examine the books and records of the other party to the extent
31

1 necessary to verify the accuracy of any statement, charge, com-
2 putation, or demand made under or pursuant to this contract. Any
3 statement shall be final as to both parties unless questioned in
4 writing within two (2) years after payment thereof has been made.

5
6 6.5 The terms "upper Cook Inlet area" as used herein
7 shall mean the area encompassed in a radius of 100 kilometers
8 from the Lessee's North Cook Inlet platform.
9

10 ARTICLE VII

11 Termination

12 7.1 This contract shall become effective upon the execution
13 hereof and the approval of the Alaska Royalty Oil and Gas Devel-
14 opment Advisory Board and the State Legislature and shall continue
15 and remain in effect until June 1, 1984 unless terminated or
16 extended prior to such date by mutual agreement of the parties, or
17 pursuant to this Article or Article VIII.
18

19 7.2 Seller's obligations hereunder are contingent upon
20 Seller arranging with Lessee for satisfactory transportation of
21 royalty gas sold hereunder to the point of delivery specified in
22 section ⁵ 4.1 of this agreement. If, after exercising Seller's
23 best efforts, Seller is unable to arrange such transportation on
24 terms satisfactory to Seller, Seller shall give notice to Buyer
25 and this agreement shall terminate 30 days after said notice.
26

27 7.3 The parties hereby agree that in the event that any
28 governmental agency declares that Lessee's activities hereunder
29 subject Lessee to regulation as a utility, then either party shall
30 have the option to give notice to the other and this agreement shall
31 terminate 30 days after said notice.
32

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1 7.4 In the event of default by Buyer in making the payments
2 required by this Contract, Seller shall give notice to Buyer
3 and if the default continues for a period of 30 days after such
4 notice, Seller shall have the option of terminating this Contract.
5

6 7.5 In the event that Lessee installs or causes to be
7 installed compression facilities in addition to the first
8 compressor unit mentioned in section 6.1(e) of this contract,
9 Seller shall give Buyer written notice at least six (6) months
10 prior to the time Lessee anticipates placing such additional
11 facilities in operation to maintain capacity in its gathering
12 system. Such notice shall also terminate this agreement at the
13 end of the six (6) month period unless within ninety (90) days
14 of the date of such notice a new compression charge is agreed
15 upon by the two parties to be applicable when the additional
16 facilities go into operation. If a new compression charge
17 is agreed upon, this agreement shall not terminate but shall
18 continue in full force and effect as amended to include the
19 new compression charge.
20

21 7.6 If the agreement between Seller and Lessee attached
22 hereto as Exhibit "B" is terminated for any reason, this
23 agreement may be terminated by either party upon thirty (30)
24 days notice.
25

26 7.7 If deliveries to Buyer hereunder have not commenced
27 on or before June 30, 1978, then this Contract shall immediately
28 terminate.
29
30
31
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1 ARTICLE VIII

2 Representation, Condition Precedent and Force Majeure

3 8.1 It is expressly recognized and agreed that the gas gather-
4 ing system utilized for deliveries hereunder is operated and main-
5 tained by Lessee for its own purpose and that Lessee will not de-
6 dicate any facilities or otherwise undertake to render any service
7 to or for the public. This Agreement is being undertaken solely
8 to effectuate the delivery of royalty gas which Buyer is purchasing
9 from the State of Alaska, and the parties hereto make the material
10 representation that neither this Agreement nor Buyer's use or dis-
11 position of the gas delivered hereunder will subject Lessee to reg-
12 ulation by the Federal Power Commission or the Alaska Public Util-
13 ities Commission or the Alaska Pipeline Commission.

14
15 8.2 Force Majeure

16
17 8.2.1 No liability shall result to either party from
18 delay in performance or non-performance of any obligation hereunder
19 (except Buyer's obligation to make payment hereunder) caused by
20 circumstances reasonably beyond the control of the party affected,
21 including, but not limited to, acts of God, fire, flood, storm, war
22 (declared or undeclared), repair of facilities, breakage or
23 accident to machinery or lines of pipe, repair, redrilling
24 or reworking of wells, governmental regulation, requisition
25 or direction, labor strikes or lockouts or breach of contract
26 by Lessee.

27
28 8.2.2 The party claiming relief under this Article VIII
29 shall advise the other party with reasonable promptness in writing
30
31
32

1 giving full particulars of the cause or causes relied upon
2 and shall also give prompt notice in writing of the cessation
3 of any such cause or causes. The party claiming force majeure
4 shall exercise due diligence in undertaking to remedy and
5 overcome the cause of delay hereunder, but neither party shall
6 be required to agree to any demand of labor to settle any
7 strike or labor dispute except in the sole discretion of the
8 party subject to such strike or labor dispute.

9
10 ARTICLE IX

11 Miscellaneous

12 9.1 The terms and provisions of this Agreement shall
13 extend to and be binding upon the parties hereto, their assigns
14 and successors in interest. It is understood, however, that
15 Buyer may not assign its rights and interest in this Agreement
16 without the written consent of Seller, except as may be necessary
17 to Buyer to conform with its various financing documents or
18 as may be desirable to Buyer as to its commonly owned affiliate
19 or subsidiary. No assignment shall relieve any assignor of
20 this Agreement of its obligations hereunder without the written
21 consent of Seller.

22
23 9.2 In the event Buyer does not receive or purchase
24 all of said royalty gas which is available to Buyer, then
25 Seller may receive and dispose of that portion not taken by
26 Buyer provided Seller does not burden Buyer with any cost
27 therefor including Lessee's charges for gathering and compression
28 on the gas not taken by Buyer.

1 ARTICLE X

2 Notices

3 10.1 Except as herein otherwise provided, any notice,
4 request, demand, statement or bill provided for in this Contract,
5 or any notice which either party may desire to give to the
6 other, shall be in writing and shall be considered as duly
7 delivered when mailed by registered mail to either of the
8 parties hereto as the case may be at the following address:

9 Commissioner of Natural Resources
10 State of Alaska
11 Pouch M
12 Juneau, Alaska 99811

13 Alaska Pipeline Company
14 P. O. Box 6288
15 Anchorage, Alaska 99502

16 or at such other address as either party shall designate from
17 time to time by formal written notice. Routine communications,
18 including monthly statements and payments, shall be considered
19 as duly delivered when mailed by either registered or ordinary
20 mail except payments for royalty gas from Buyer to Seller
21 which must be made by wire transfer under section 6.3 of this
22 Contract.

23 IN WITNESS WHEREOF, the parties hereto have caused this
24 Contract to be executed in two (2) original counterparts on
25 this day and year first above written.

26 BUYER

[Handwritten signature]

STATE OF ALASKA

[Handwritten signature]

27 ATTEST:

28 *[Handwritten signature]*

ATTEST:

EXHIBIT "A"

Attached to and Made a Part of a Gas Purchase and Sales Agreement dated April 11, 1977, Between ALASKA PIPELINE COMPANY "Buyer" and the STATE OF ALASKA "Seller"

With Respect to Certain Royalty Gas Owned and Taken in Kind by SELLER

Under the Leases Described Herein Covering Lands in the State of Alaska.

Each of the Following described Leases reserves to the State of Alaska a one-eighth royalty interest.

<u>Lease Serial No.</u>	<u>Legal Description</u>	<u>Gross Acres</u>
ADL-17589 2/1/62	T.12N., R.9W., S.M. Sec. 31: All; Sec. 32: All. T.11N., R.9W., S.M. Sec. 5: All; Sec. 6: All; Sec. 7: All; Sec. 18: N 1/2.	4,375.50
ADL-17590 3/1/62	T.12N., R.9W., S.M. Sec. 21: W 1/2; Sec. 28: W 1/2.	640.00
ADL-18740 9/1/62	T.12N., R.10W., S.M. Sec. 35: SE 1/4. T.11N., R.10W., S.M. Sec. 2: E 1/2; Sec. 11: E 1/2.	800.00
ADL-18741 9/1/62	T.11N., R.9W., S.M. Sec. 9: N 1/2, SW 1/4. T.12N., R.9W., S.M. Sec. 33: NW 1/4.	640.00

ADL-37831
9/1/62

T.12N., R.9W., S.M.

3,326.00

Sec. 29: All;

Sec. 30: All;

Sec. 19: SE 1/4;

Sec. 20: NE 1/4, S 1/2.

T.12N., R.10W., S.M.

Sec. 36: All;

Sec. 25: SE 1/4.

T.11N., R.10W., S.M.

Sec. 1: All.

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AGREEMENT

This Contract, made and entered into this 11th day of April, 1977, by and between the State of Alaska, herein referred to as "State", and Phillips Petroleum Company, herein referred to as "Lessee",

W I T N E S S E T H

WHEREAS, Lessee is the holder of certain mineral leases from the State in the North Cook Inlet area of Alaska, said leases identified in Exhibit "A" to this Agreement; and

WHEREAS, the State has the right under the terms of said leases to receive in value or in kind a 1/8 (one-eighth) royalty share of natural gas produced from said leases; and

WHEREAS, the State desires to receive its in kind royalty share of natural gas at a point other than at Lessee's production platform; and

WHEREAS, Lessee operates a gas pipeline to gather natural gas from the said leases to the LNG facility at Kenai, Alaska (hereinafter referred to as Kenai LNG Plant), which Lessee operates; and

WHEREAS, Lessee is willing to deliver to the State its in kind royalty share of the natural gas from said leases at a point near the Kenai LNG Plant; and

WHEREAS, the State desires to receive its royalty share of the natural gas from said leases at such a point

1 and has agreed with Alaska Pipeline Company to sell such gas
2 to Alaska Pipeline Company (herein referred to as "APC") for
3 resale and use within the State of Alaska according to the
4 terms of that certain Gas Purchase Contract attached hereto
5 as Exhibit "B".

6 NOW, THEREFORE, premises considered, the State and
7 Lessee hereby mutually agree as follows:
8

9 ARTICLE I

10 DEFINITIONS

11 The following terms when used in this Agreement
12 shall have the following meanings:

13 1.1 The term "day" shall mean a period of twenty-
14 four (24) consecutive hours beginning and ending at 7:00
15 o'clock A.M. The reference date for any day shall be the
16 date of the beginning of such day.

17 1.2 The term "month" shall mean a period begin-
18 ning at 7:00 o'clock A.M. on the first day of a calendar
19 month and ending at 7:00 o'clock A.M. on the first day of
20 the next succeeding calendar month.

21 1.3 The term "Mcf" shall mean one thousand (1,000)
22 cubic feet of natural gas measured as hereinafter provided.
23

24 ARTICLE II

25 The State's Royalty Gas

26 2.1 Within 30 days after the execution and approval
27 of this Agreement as required by the laws of the State of
28 Alaska, the State shall notify the Lessee under the leases
29

1 set forth at Exhibit A, the State's election to take its
2 royalty gas in kind. Said notice will provide that the
3 Lessee shall commence the delivery of said royalty gas to
4 the State (or to the State's designee) upon a receipt of
5 notice from the State that all facilities necessary to
6 receive and market said gas are ready; provided, however, in
7 no event shall Lessee be required to commence the delivery
8 of royalty gas to the State (or its designee) prior to six
9 (6) months following Lessee's receipt of notice of the
10 State's election to take its royalty gas in kind.

11 2.2 In order that the State give Lessee as much
12 advance notice as possible of the date it will start receiv-
13 ing its royalty gas in kind, the State shall notify Lessee
14 that all facilities necessary to receive and market said gas
15 are ready, at least sixty (60) days prior to the date on which
16 Lessee shall be required to commence delivery pursuant to
17 this Agreement.

18 ARTICLE III
19 FACILITIES
20

21 3.1 Lessee is presently operating and maintaining
22 a natural gas gathering system between the North Cook Inlet
23 Field and the Kenai LNG Plant.

24 3.2 The State or its designee shall install,
25 maintain and operate all pipeline, pressure regulators, and
26 related facilities necessary to receive gas hereunder at the
27 point of delivery hereinafter specified. Said point of
28 delivery shall be at or near the existing pipeline tap being
29 presently used to deliver gas from Lessee's pipeline to the
30

1 Tesoro refinery located in the general vicinity of the Kenai
2 LNG Plant on the North Kenai Road.

3 3.3 The State or its designee shall install,
4 operate and maintain all necessary equipment at the point of
5 delivery and at the State's or its designee's measuring
6 station(s) (hereinafter called the "point of measurement")
7 to properly control, odorize, and measure the volumes of
8 gas delivered hereunder.

9 3.4 Lessee hereby grants the State or its designee
10 ingress and egress at the point of delivery without charge
11 for all purposes necessary hereto, and the State and its
12 designee hereby agree to assure Lessee ingress and egress at
13 the point of measurement and between the point of delivery
14 and the point of measurement without charge for all purposes
15 necessary hereto.

16 ARTICLE IV

17 QUANTITY OF GAS

18
19 4.1 Subject to the availability of capacity in
20 its facilities to handle volumes in excess of its own
21 needs and to the extent of such availability, and upon
22 proper written notice from the State under Article II
23 hereof, Lessee shall gather the royalty gas in the North
24 Cook Inlet Field and deliver same to the State at the point
25 of delivery specified herein. The State is entitled to
26 receive at the wellhead 1/8 (one-eighth) of the natural gas
27 produced from the leases listed in Exhibit "A", and to the
28 extent that Lessee gathers and delivers more or less than
29 the amount of royalty gas to which the State is entitled,
30

1 that difference shall be carried in the over and short
2 account described below or Lessee shall purchase same on the
3 basis provided in Section 4.3 below.

4 It is recognized that it is impossible to deliver
5 to the State or for the State or its designee to receive the
6 exact amount of royalty gas produced from the leases listed
7 in Exhibit "A". Lessee agrees that it will carry an over
8 and short account with respect to the receipts of royalty
9 gas and the delivery of same to the State, provided, however,
10 that Lessee shall never be required to carry more than a
11 total of 60,000 Mcf over or under delivery. In the event
12 the takes by the State on a cumulative basis shall ever be
13 more than 60,000 Mcf less than the amount of royalty gas
14 available at the point of delivery, the State shall not be
15 allowed to make up for any such underdelivery, and Lessee
16 shall purchase the excess undelivered quantities of royalty
17 gas over 60,000 Mcf from the State at the wellhead on the
18 basis provided in section 4.3 below.

19 4.2 Subject to (i) the availability of royalty
20 gas at the platform and (ii) to the State's or its designee's
21 requirements, and (iii) the State's or its designee's ability
22 to take such requirement, Lessee shall use its best reasonable
23 efforts to deliver to the State or its designee at the
24 delivery point specified herein on an annual basis not less
25 than three (3) billion cubic feet of royalty gas; provided,
26 however, that in using such best reasonable efforts, Lessee
27 shall not be required to install or operate any pipeline,
28 compression or other facilities which, when operating as a
29 reasonably prudent operator, it would not otherwise install
30

1 and/or operate.

2 4.3 The parties recognize that the State contem-
3 plates selling such royalty gas to Alaska Pipeline Company
4 and that such purchaser may be unable from time to time to
5 take and deliver to its customers the full volumes of gas
6 attributable to the State's royalty interest although it is
7 committed to purchase that volume from the State. In such
8 event, Lessee agrees to purchase from the State from time to
9 time those volumes which APC is unable to take. For such
10 volumes which it purchases from the State, Lessee will pay
11 the State a price equal to that amount which Lessee would
12 have otherwise paid to the State as royalty if the State had
13 not elected to receive its royalty gas in kind, and Lessee
14 will not charge the State for gathering or compressing such
15 volumes of gas or for other charges under this Agreement.

16 ARTICLE V

17 POINT OF DELIVERY AND OWNERSHIP

18
19 5.1 The point of delivery to the State for all gas
20 gathered and delivered hereunder by Lessee shall be at the
21 juncture of APC's facilities and Lessee's facilities located
22 near the pipeline tap serving the Tesoro refinery as mention-
23 ed in Section 3.2 of this Agreement.

24 5.2 Lessee shall be deemed to be in control and
25 possession of the gas deliverable hereunder and responsible
26 for any damage or injury caused thereby until said gas shall
27 have been delivered to the State or its designee at the
28 point of delivery, after which delivery State or its designee
29 shall be deemed to be in exclusive control and possession of

1 the gas and responsible for any injury or damage caused thereby.

2 5.3 Measurement of royalty gas shall be the responsi-
3 bility of the State or its designee subject to Lessee's right
4 to verify such measurement or to install and operate check
5 metering equipment, and shall be done at a metering station(s)
6 on the North Kenai Road, called the "point of measurement".
7 The State or its designee shall be responsible for any gas
8 lost between the point of delivery and the point of measurement.

9 ARTICLE VI

10 QUALITY, PRESSURE, AND ODORIZATION

11
12 6.1 Lessee shall deliver gas hereunder at the
13 pressure existing from time to time in its facilities at the
14 point of delivery.

15 6.2 Lessee agrees that the quality of gas, when
16 delivered at the point of delivery hereunder, shall be the
17 quality of gas existing in its gathering system from time to
18 time and the State agrees to accept such gas.

19 6.3 It is understood that the gas delivered
20 hereunder will not be odorized by Lessee, and if the State
21 or its purchaser so utilizes the gas delivered hereunder for
22 purposes which require odorization of such gas, the full
23 responsibility for such use is the State's. Lessee shall
24 have no responsibility for odorizing such gas irrespective
25 of the State's disposition of same.

26 ARTICLE VII

27 STANDARDS OF MEASUREMENT AND TESTS

28
29 7.1 Except for the determination and computation
30

1 of total heating value, the unit of volume of gas delivered
2 hereunder shall be one (1) cubic foot at an absolute pres-
3 sure of fourteen and sixty-five hundredths (14.65) pounds
4 per square inch and at a base temperature of sixty (60)
5 degrees Fahrenheit.

6 7.2 The volumes of gas delivered hereunder shall
7 be measured and computed by the State or its designee in
8 accordance with the methods prescribed in Gas Measurement
9 Committee Report No. 3, Natural Gas Department, American Gas
10 Association, including the Appendix thereto, dated April,
11 1965, except that the atmospheric pressure shall be assumed
12 to fourteen and seven-tenths (14.7) pounds per square inch.
13 The method used for correcting such volumes for deviation
14 from the Ideal Gas Laws shall be the procedure recommended
15 in the most current Report of the American Gas Association
16 or by any other method mutually agreeable to the parties
17 hereto.

18 7.3 The specific gravity of the gas delivered
19 hereunder shall be determined by Lessee's utilizing the
20 method prescribed in American Petroleum Institute Code No.
21 50-A at the beginning of delivery hereunder and once during
22 each month thereafter. The results of each such determina-
23 tion shall be used in computing the volume of gas delivered
24 hereunder until the effective date of the next succeeding test.

25 7.4 The flowing temperature of the gas delivered
26 hereunder shall be determined by means of a continuous
27 recording thermometer installed by the State or its designee
28 so that it will properly record the temperature of the gas
29 flowing through the meter. The arithmetical average of the
30

1 hourly temperatures recorded each day shall be used in
2 computing the volumes of gas delivered during such day.

3 7.5 If the gas delivered hereunder is solely from
4 the 16-inch pipeline serving the North Cook Inlet Field, the
5 total heating value of the gas shall be the average of that
6 recorded on the recording calorimeter for Lessee's gas at
7 the inlet to Kenai LNG Plant during the billing period
8 corrected to thirty (30) inches of Mercury and sixty (60)
9 degrees Fahrenheit dry.

10 ARTICLE VIII

11 MEASUREMENT

12
13 8.1 As agreed in Section 5.3 hereof, the State or
14 its designee shall be obligated to and be responsible for
15 all metering of gas hereunder.

16 8.2 The State or Lessee may, at their option and
17 expense, install check meters upstream or downstream of the
18 State's or its designee's meter station provided that such
19 check meters will be installed so as not to interfere with
20 the operation of the State's or its designee's facilities.
21 The calibrating and adjusting of meters and the changing of
22 charts and the reading of charts on meters shall be done by
23 the party who installed the meters.

24 8.3 The State and Lessee shall have access at all
25 times to the State's or its designee's metering equipment
26 including all other instruments used by the State or its
27 designee in determining the measurement and quality of the
28 gas delivered hereunder, but the reading, calibrating and
29 adjusting thereof, and the changing of charts shall be done
30

1 only by the employees, agents, or representatives of the
2 State or its designee. Upon request of Lessee, the State or
3 its designee shall submit to Lessee records and charts from
4 such equipment subject to return by Lessee within thirty
5 (30) days after receipt thereof.

6 8.4 At least once a month the State or its des-
7 ignee shall test its above-mentioned metering equipment or
8 cause the same to be tested and shall give Lessee or its
9 representative reasonable prior notice of the time all such
10 tests are to be made so that Lessee may, if desired, have its
11 representative present to observe such tests and any adjust-
12 ments made upon such metering equipment. Following any
13 test, any of the State's or its designee's metering equip-
14 ment found to be inaccurate to any degree shall be adjusted
15 immediately to measure accurately. If upon any test such
16 metering equipment is found to be inaccurate by two percent
17 (2%) or more, registration from said metering equipment and
18 any payments based upon such registrations shall be corrected
19 at the rate of such inaccuracy for any period of inaccuracy
20 which is definitely known or agreed upon, but in case the
21 period is not definitely known or agreed upon, then for a
22 period extending back one-half (1/2) of the time elapsed since
23 the last previous test, not exceeding, however, fifteen (15)
24 days.

25 8.5 If for any reason the State's or its designee's
26 meter is out of service or is found registering inaccurately
27 and the error is not determinable by ordinary test such that
28 the volume of gas delivered through such meter cannot be
29 ascertained or computed from the readings thereof, the
30

1 volume of gas so delivered during the period the meter is
2 out of service or registering inaccurately shall be estimated
3 and agreed upon by the parties hereto upon the basis of the
4 best available data, using the first of the following methods
5 which is feasible:

- 6
- 7 (a) by correcting the error if the percentage of error
8 is ascertainable by calibration, special test, or
9 mathematical calculation;
- 10 (b) By using the registration of any check measuring
11 equipment of Lessee if installed and registering
12 accurately;
- 13 (c) By estimating the volume by comparing it with de-
14 liveries during preceding periods under similar
15 conditions when the meter was registering accurately.
16

17 ARTICLE IX

18 GATHERING AND COMPRESSION CHARGES AND TAXES

19

20 9.1 For all gas delivered by Lessee to the State
21 at the delivery point, the State or its designee shall pay
22 to Lessee a gathering charge of ten cents (10.0¢) per Mcf
23 from the date of first delivery hereunder. The above-stated
24 charge shall increase by six percent (6%) compounded annually,
25 on each anniversary date of the date this Agreement.

26 9.2 It is recognized by the parties hereto that
27 it may be necessary for Lessee to install compression facil-
28 ities during the term of this Agreement. At the time the
29 first compressor unit is installed and first used, the State
30

1 or its designee shall pay Lessee in addition to the gathering
2 charge set forth in Section 9.1, a compression charge of ten
3 cents (10.0¢) per Mcf for all gas delivered by Lessee to the
4 State at the delivery point. Such charge shall increase by
5 six percent (6%) per year, compounded annually, commencing on
6 the first anniversary of the date such compression facilities
7 are installed and first used.

8 9.3 In the event that Lessee installs or causes
9 to be installed from time to time compression facilities
10 in addition to the first compressor unit mentioned in
11 Section 2, above, Lessee shall give the State and its desig-
12 nee written notice at least six (6) months prior to the time
13 Lessee anticipates placing any additional unit or units in
14 operation in order to maintain capacity in its gathering
15 system. Such notice shall also terminate this Agreement at
16 the end of such six (6) months period. If, within ninety (90)
17 days of the date of such notice the parties shall agree upon
18 a new compression charge to be applicable when such additional
19 compression facilities go into operation, then this Agreement
20 shall not terminate but shall continue in full force and effect
21 as amended to include the new compression charge.

22 9.4 Lessee shall pay all ad valorem taxes on its
23 pipelines and facilities employed in delivering gas here-
24 under. In addition to the price and payments hereinabove
25 provided, the State shall reimburse Lessee in the proportion
26 of deliveries made to the State by Lessee, an amount equal
27 to the aggregate total of any new or increased fee, impost,
28 duty, charge, excise or tax levied or imposed in addition to
29 the rates at which those, if any, are levied, assessed, or
30

1 fixed as of the date hereof, with respect to the gathering
2 of the royalty gas delivered hereunder (including compres-
3 sion) prior to its delivery to the State that Lessee may be
4 required to pay for directly or indirectly.

5 ARTICLE X

6 BILLING AND PAYMENTS

7
8 10.1 On or before the 15th day of each month
9 during the term hereof the State or its designee shall
10 furnish Lessee with a full and complete statement reflecting
11 all gas delivered by Lessee during the preceding month and
12 the total amount due hereunder pursuant to Article IX hereof.
13 Payment hereunder shall be made to Lessee at its office in
14 Bartlesville, Oklahoma within ten (10) days after delivery
15 of each such statement.

16 10.2 On or before the 30th day of each month
17 during the term hereof Lessee shall furnish to the State or
18 its designee a full and complete statement reflecting the
19 total amount of royalty gas produced by Lessee during the
20 preceding month. Deducing the quantity taken by the State
21 for such month, Lessee shall determine the amount of royalty
22 gas not taken by the State for such month and shall make
23 payment therefor to the State together with said statement.

24 10.3 Each party hereto shall have, at its expense,
25 the right to examine the books and records of the other
26 party to the extent necessary to verify the accuracy of any
27 statement or invoice made under or pursuant to this contract.
28 Any statement shall be final as to both parties unless
29 questioned in writing within two (2) years after payment
30

1 payments required by Articles IX and X hereof. Lessee
2 agrees to accept such payments by APC as satisfaction of the
3 State's obligations under Articles IX and X hereof. In the
4 event of default by APC in making such payments, Lessee
5 shall promptly notify the State and if such default continues
6 for a period of thirty (30) days after such notice, Lessee
7 shall have the option of terminating this Agreement in its
8 entirety.

9 12.2 Lessee agrees to accept the State's designa-
10 tion of APC as the State's designee hereunder for the perform-
11 ance of any other obligations which the provisions hereof
12 place on the State.

13 12.3 By its execution hereof APC ratifies all of
14 the terms, covenants, conditions, and representations hereof.

15 ARTICLE XIII

16 FORCE MAJEURE

17
18 13.1 No liability shall result to either party
19 from delay in performance or non-performance of any obliga-
20 tion hereunder (except the State's obligation to make payment
21 hereunder) caused by circumstances reasonably beyond the
22 control of the party affected, including, but not limited
23 to, acts of God, fire, flood, storm, war (declared or unde-
24 clared), repair of facilities, breakage or accident to
25 machinery or lines of pipe, repair, redrilling or reworking
26 of wells, governmental regulation, requisition or direction,
27 or labor strikes or lockouts.

28 13.2 The party claiming relief under this Article
29 XIII shall advise the other party with reasonable promptness
30

1 in writing giving full particulars of the cause or causes
2 relied upon and shall also give prompt notice in writing of
3 the cessation of any such cause or causes. The party claiming
4 force majeure shall exercise due diligence in undertaking to
5 remedy and overcome the cause of delay hereunder, but neither
6 party shall be required to agree to any demand of labor to
7 settle any strike or labor dispute except in the sole discre-
8 tion of the party subject to such strike or labor dispute.

9
10 ARTICLE XIV

11 TERM

12 14.1 This Agreement shall become effective upon
13 the execution hereof and the execution and approval of the
14 Alaska Royalty Oil and Gas Development Advisory Board and
15 the State Legislature of the Contract attached as Exhibit
16 "B" hereto and shall remain in effect until June 1, 1984,
17 unless terminated or extended prior to such date by mutual
18 agreement of the parties, or pursuant to this Article or
19 Article XI or XIII.

20 14.2 In the event that the Agreement attached
21 hereto as Exhibit "B" is terminated, this Agreement may be
22 terminated by either party upon thirty (30) days notice.

23 14.3 If deliveries to the State or its designee
24 hereunder have not commenced on or before June 30, 1978,
25 then this Agreement shall terminate immediately.

26 14.4 In the event of termination of this Agree-
27 ment or of deliveries of royalty gas hereunder, the parties
28 agree that such termination shall have the effect of re-
29 voking the State's election to receive its royalty gas in-kind

1 as of the date of termination and Lessee shall immediately
2 commence such royalty payment under the terms of the leases
3 listed in Exhibit "A" to assure the state of its full royalty
4 share on all gas produced from the leases.

5 ARTICLE XV

6 MISCELLANEOUS

7
8 15.1 Except as herein otherwise provided, any
9 notice, request, demand, statement or bill provided for in
10 this Agreement, or any notice which either party may desire
11 to give to the other, shall be in writing and shall be con-
12 sidered as duly delivered when mailed by registered mail to
13 either of the parties hereto as the case may be at the
14 following address:

15 Commissioner of Natural Resources
16 State of Alaska
17 Pouch M
18 Juneau, Alaska 99811

19 Phillips Petroleum Company
20 Attn: Gas and Gas Liquids Division
21 Bartlesville, Oklahoma 74004

22 Alaska Pipeline Company
23 P. O. Box 6288
24 Anchorage, Alaska 99502

25 or at such other address as either party shall designate
26 from time to time by formal written notice. Routine com-
27 munications, including monthly statements and payments,
28 shall be considered as duly delivered when mailed by either
29 registered or ordinary mail.

30 IN WITNESS WHEREOF, this Agreement is executed as
31 of the day and year first above written.

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STATE OF ALASKA

By *Robert E. [Signature]*

ATTEST:

Assistant Secretary

PHILLIPS PETROLEUM COMPANY

By *[Signature]*
Vice President
ATTORNEY IN FACT

ATTEST:

Lee P. Vahlwald
Assistant Secretary

ALASKA PIPELINE COMPANY

By *[Signature]*
President

ALASKA PIPELINE COMPANY

Contract to Purchase State Royalty Gas

Findings and Conclusions of the Commissioner
Pursuant to Alaska Statute 38.05.183(c)

Alaska Statute, AS 38.05.183(c), requires that the Commissioner of Natural Resources make public, in writing, the specific findings and conclusions upon which a determination not to use competitive bid procedures is based for a sale of Alaska royalty oil or gas. Publication is to follow approval of the determination by the Alaska Royalty Oil and Gas Development Advisory Board. On April 6, 1977, the Royalty Board did approve the Commissioner's determination to waive the competitive bidding requirement for sale of royalty gas to the Alaska Pipeline Company by approving the contract entitled "Gas Purchase Contract" for gas, dated April 11, 1977, between the State of Alaska and Alaska Pipeline Company. Accordingly, these written findings and conclusions are submitted in fulfillment of the requirements of AS 38.05.183(c).

The Contract entitled "Gas Purchase Contract" dated April 11, 1977, between the Alaska Pipeline Company and the State of Alaska, as well as the agreement between the Phillips Petroleum Company and the State of Alaska, have been entered into because the Contract entitled "Gas Purchase Contract" dated June 4, 1976 could not become implemented.

The Findings and Conclusions for Non-Competitive Sale for the previous Contract is appended to support the current Findings and Conclusions of the Commissioner not to use competitive bid procedures for these contracts.

The current agreements have been executed solely to solve these problems and allow royalty gas to be delivered to the Buyer.

The reasons for this determination not to use competitive bid are the same as the previous determination.

Findings and Conclusions for Non-Competitive Sale

Pursuant to AS.38.05.183 and AS.38.06 the findings and conclusions which form the basis for the decision that the sale of North Cook Inlet Gas Field royalty gas to Alaska Pipeline Company should be non-competitive sale are summarized.

1. Alaska Pipeline Company formerly Anchorage Natural Gas Company, is in need of additional natural gas supply. The present contract of 10 billion cubic feet to supply the North Kenai road area will be exhausted during the first half of 1976. Alaska Pipeline has executed an agreement recently with their supplier which enables them to use gas from the Anchorage contract reserves to supply the North Kenai area for one additional year. Projections of the present growth rate of Anchorage and use of natural gas indicate that the Anchorage contract dedicated gas supply could be exhausted several years before the contract termination at the end of 1992.
2. The proposed sale amount of royalty gas is sufficient to meet the needs of the North Kenai area for the term of the agreement. Present use of the North Kenai area is 10 million cubic feet per day. About 90% of this gas is used by the Bernice Lake electric generating plant of Chugach Electric Association. The difference between winter and summer loads is small. The North Cook Inlet Gas Field royalty gas share averages 15 to 16 million cubic feet per day. Gas in excess to the North Kenai area demand can be used to augment the Anchorage contract gas supply. The total volume of gas which would be sold under the proposed agreement is approximately 40 to 41 billion cubic feet.
3. North Cook Inlet Gas Field gas furnishes 70% of the gas supply of the Nikiski LNG plant, the remaining 30% is supplied by Marathon from the Kenai Gas Field. The LNG is shipped to Japan in cryogenic tankers and revaporized for use by Tokyo Gas and Tokyo Electric. At this time, the State is taking its royalty share in value and this gas brings the greatest return to the State of any royalty gas.
4. Proposed sale of this royalty gas will not diminish State revenue. Alaska Pipeline has agreed to pay the State the same price that the State otherwise would have received

from Phillips. Price terms in the proposed agreement are based on Phillips prices plus an agreement to pay a price equal to the highest price paid in Upper Cook Inlet for gas of similar quality and similar conditions of delivery.

5. The proposed action may reduce the productive life of the field equivalent to one year at the present rate of production. The total amount of gas sold under the agreement will be about 40 to 41 billion cubic feet per year. The present LNG contract dedicated reserves are 647,543 million cubic feet. Estimated original recoverable reserves were 1,500,000 million cubic feet. The estimated remaining gas reserves not committed to contract are about 834 billion cubic feet. The proposed sale involves about 5% of the remaining uncommitted reserves. Because the LNG sale contract requires delivery of 50,750 million cubic feet of gas per year to Tokyo, it will be necessary for Phillips to increase the field production by the amount withdrawn for royalty sale. While this increased production will shorten the producing life of the field, the amount of decrease is small and amounts to less than one year's production.
6. During the period of review of Alaska Pipeline Company's application for purchase of royalty gas applications were also made by Homer Electric Association, Pacific Alaska LNG and Phillips Petroleum.

Homer Electric wished to buy the Bernice Lake generating facility from Chugach Electric and wanted to use the North Cook Inlet Gas Field royalty gas to supply the generator. This would be the same use proposed by Alaska Pipeline. Homer Electric subsequently advised the Alaska Royalty Oil and Gas Development Board that HEA had made satisfactory arrangements with the City of Kenai for a gas supply in the event it would be needed.

Pacific Alaska LNG made a statement that they would be interested in bidding for the North Cook Inlet royalty gas if it were offered in a competitive bid sale.

Later, Pacific Alaska advised the Board both by mail and in person that they were not making application for the North Cook Inlet royalty gas but rather a general statement applicable to possible future sales of other royalty gas.

Phillips Petroleum made a firm offer to purchase the royalty gas with an increase in price of five cents per thousand cubic feet (MCF) the first year, a similar increase the second year, and an annual escalation of two cents per MCF thereafter for the life of the present contract.

The withdrawals of Homer Electric and Pacific Alaska LNG left Phillips Petroleum as the only viable alternate to Alaska Pipeline's application.

CONCLUSION:

The decision to hold a negotiated sale rather than a competitive sale was based on several factors: end use, price to consumers, and future gas supply for Alaska.

The export of LNG to Japan has created a substantial market for Alaska's natural gas converting a non-revenue producing resource into a valuable asset with substantial revenues to the State.

The exported LNG produces about 75% of the State revenue from natural gas. While there was a reluctance to alter the use of the royalty gas and possibly necessitate additional costs to the LNG project, the use of the gas by the Kenai and Anchorage consumers was deemed to be a higher and better use.

Alaska Pipeline agreed to pay the State the same price the State otherwise would have received for the gas thereby maintaining the same revenue from the gas. While a competitive sale might have resulted in more revenue for the State it would also result in the gas being exported from the State and not available for Alaskan use. Alternately, if an Alaskan company was the successful high bidder it likely would set a new high price to the Alaskan consumer.

The present sale represents a balance of public values regarding this series of issues. The proposed non-competitive sale of North Cook Inlet Gas Field royalty gas appears to be in the best interest of the State as a whole and of the Kenai and Anchorage area gas consumers more directly. There is no loss of revenue to the State; the gas sale will be the gas supply for the North Kenai road area and add to the Anchorage area gas reserves; the slight loss of productive life of the North Cook Inlet Gas Field is offset by the continued service to the Alaskan gas consumers.

APPROVAL OF THE AGREEMENT FOR THE PURCHASE
AND SALE OF STATE ROYALTY GAS FROM THE NORTH
COOK INLET FIELD BETWEEN THE STATE AND
ALASKA PIPELINE COMPANY

WHEREAS, Alaska Statutes 38.06.050(a) and 38.05.183 require that the Alaska Royalty Oil and Gas Development Advisory Board ("Board") grant to the Commissioner of Natural Resources ("Commissioner") written approval for the sale, exchange or other disposition of royalty oil or gas, and

WHEREAS, Alaska Statute 38.05.182 requires that the Board grant its consent to the taking of royalty oil or gas in-kind, and

WHEREAS, the Board has been advised by the Commissioner of the progress of negotiations and has heard testimony, both in public sessions and working sessions, from the purchaser, and

WHEREAS, the Commissioner has now concluded his negotiations with the purchaser and has presented to this Board for its approval an agreement for the sale of royalty gas from the North Cook Inlet field (which gas is identified more specifically in the Contract), and

WHEREAS, This Board has carefully reviewed the proposed agreement and has received public comment on the agreement, and

WHEREAS, This Board finds that the taking of royalty gas in-kind to meet the obligations under the agreement will serve an important public purpose and be of general benefit to the public interest,

NOW THEREFORE, the Alaska Royalty Oil and Gas Development Advisory Board hereby grants its approval of the "Gas Purchase Contract" between the State of Alaska and Alaska Pipeline Company and further approves the taking in-kind of the royalty gas dedicated to this agreement.

This approval relates to that certain agreement entitled "Gas Purchase Contract" between the Alaska Pipeline Company and the State of Alaska dated this day of April 11 1977.

Approve

Disapprove

Don M. Tripleton
Paul G. B.
K. Lesche

Wesley A. Wright

Date: April 6, 1977

APPROVAL OF REQUEST OF COMMISSIONER OF NATURAL RESOURCES
TO WAIVE REQUIREMENT OF COMPETITIVE BIDDING

WHEREAS, Alaska Statutes 38.06.050(c) and 38.05.183 (a) and (c) require the Alaska Royalty Oil and Gas Development Advisory Board ("Board") grant written approval to the Commissioner of Natural Resources ("Commissioner") to waive the requirement that royalty oil or gas be sold by competitive bid, and

WHEREAS, the Commissioner has submitted to this Board a request to waive the requirement of public bidding with respect to royalty gas from the North Cook Inlet Field, and

WHEREAS, the Board has considered the request of the Commissioner and finds the Commissioner's reasons sufficient to justify a waiver of the requirement for public bidding in the public interest;

NOW THEREFORE, the Alaska Royalty Oil and Gas Development Advisory Board hereby grants to the Commissioner of Natural Resources its approval of his request to waive public bidding.

This waiver relates to that certain agreement entitled "Gas Purchase Contract" between Alaska Pipeline Company and the State of Alaska dated this day of April 11 1977.

Approve

Disapprove

B. M. Templeton
[Signature]
[Signature]

[Signature]

Date: April 6, 1977

APPROVAL OF REQUEST OF COMMISSIONER
OF NATURAL RESOURCES
TO REJECT APPLICATIONS

WHEREAS, Alaska Statute 38.06.050(b) prohibits the rejection of applications for the purchase of royalty oil or gas by the Commissioner of Natural Resources ("Commissioner") without the approval of the Alaska Royalty Oil and Gas Development Advisory Board ("Board"), and

WHEREAS, the Commissioner in conjunction with his request for the sale of royalty gas to Alaska Pipeline Company requests that he be allowed to reject applications in conflict with the proposed sale, and

WHEREAS, this Board has reviewed all other applications for the purchase of royalty gas and heard public comment thereon,

NOW THEREFORE, this Board hereby grants its approval to reject applications to the extent such applications are rendered infeasible or impossible by the contracts for the sale of royalty gas approved by this Board on this date.

This approval relates to that certain agreement entitled "Gas Purchase Contract" between Alaska Pipeline Company and the State of Alaska dated this day of April 11 1977.

Approve

Disapprove

Lois M. Thompson
Barrett
P. Pasche

Vernon D. Wright

Date: April 6, 1977

APPROVAL OF THE AGREEMENT FOR THE TAKING
AND GATHERING OF STATE ROYALTY GAS BETWEEN
THE STATE OF ALASKA AND PHILLIPS PETROLEUM
COMPANY

WHEREAS, Alaska Statutes 38.06.050(a) and 38.05.183 require that the Alaska Royalty Oil and Gas Development Advisory Board ("Board") grant to the Commissioner of Natural Resources ("Commissioner") written approval for the sale, exchange or other disposition of royalty oil or gas, and

WHEREAS, Alaska Statute 38.05.182 requires that the Board grant its consent to the taking of royalty oil or gas in-kind, and

WHEREAS, the Board has been advised by the Commissioner of the progress of negotiations and has heard testimony, both in public sessions and working sessions, from the Lessee, and

WHEREAS, the Commissioner has now concluded his negotiations with the Lessee and has presented to this Board for its approval an Agreement for the sale of royalty gas from the North Cook Inlet (which gas is identified more specifically in the Agreement), and

WHEREAS, This Board has carefully reviewed the proposed agreement and has received public comment on the agreement, and

WHEREAS, This Board finds that the taking of royalty gas in-kind to meet the obligations under the agreement will serve an important public purpose and be of general benefit to the public interest,

NOW THEREFORE, the Alaska Royalty Oil and Gas Development Advisory Board hereby grants its approval of the Agreement between the State of Alaska and Phillips Petroleum Company and further approves the taking in-kind of the royalty gas dedicated to this agreement.

This approval relates to that certain "Agreement" to take in-kind royalty gas from the North Cook Inlet between the State of Alaska and Phillips Petroleum Company. Dated April 11, 1977.

Approve

Disapprove

Don M. Tophan
[Signature]
[Signature]

[Signature]

Date: April 6, 1977

TO:

DATE: March 7, 1977

Guy Martin, Commissioner
Dept. of Natural Resources

FILE NO:

TELEPHONE NO:

FROM:

Wilson Condon
Deputy Attorney General

SUBJECT:

Jurisdiction of the APUC
over Phillips Petroleum
Pipeline

This is in response to your memorandum of February 24, 1977, in which you ask if the Alaska Public Utilities Commission would have jurisdiction over a pipeline operated by Phillips Petroleum if State-owned royalty gas is transported over that pipeline to North Kenai Road, where it would be sold by the State to Alaska Pipeline Company, a wholly owned subsidiary of Alaska Gas and Service. My conclusion is that the APUC would not have jurisdiction over the Phillips Petroleum Company pipeline.

The Alaska Public Utilities Commission has jurisdiction over "public utilities" which are defined by AS 42.05.70(2) as follows:

"public utility" or "utility" includes every corporation (whether public, cooperative, or otherwise), company, individual, or association of individuals, their lessees, trustees, or receivers appointed by a court, that owns operates, manages or controls any plant, pipeline or system for

* * *

(D) furnishing by transmission or distribution of natural or manufactured gas to the Alaska public for compensation;

* * *

"Public" is defined by AS 42.05.701(5) as follows:

"public" or "general public" means

(A) any group of 10 or more customers that purchase the service or commodity furnished by a public utility as defined in (2) of this section; and

(B) any utility purchasing the product or service or paying for the transmission of electric energy, natural or manufactured gas, or petroleum products which are re-sold to a group included in (A) of this paragraph or which are used to produce the service or commodity sold to the public by the utility.

If Phillips delivers royalty natural gas to the State at the wellhead, and the State contracts with Phillips for transportation of that gas to North Kenai Road, Phillips will be rendering a utility-type service because it will be engaged in the transmission of natural gas. Phillips, however, will be neither a "utility" nor "public utility" within the meaning of the Public Utilities statute because it will not be furnishing transmission service to the "public" or the "Alaska public." Phillips would be furnishing transmission service to the State. This would make it a public utility if 1) the State is the 10th customer to purchase transmission service (our assumption is there are less than 10 purchasers of transmission service), or 2) if the State is a "utility. . . paying for the transmission of. . . natural. . . gas. . . which is resold to [any group of 10 or more customers that purchase the service or commodity furnished by a public utility. . .]". The State would not be a utility (because it does not fit within the definition of AS 42.05.701(2)), thus Phillips could not be a public utility subject to the jurisdiction of the APUC when it furnishes transmission service to the State.

WLC:FHB:bvd

cc: Frederick H. Boness
Assistant Attorney General

Robert E. Stoller
Assistant Attorney General

TO: [Don Wold
Executive Director
Alaska Royalty Oil and Gas
Development Advisory Board

DATE: March 29, 1977

FILE NO:

TELEPHONE NO:

FROM:

Wilson Condon
Deputy Attorney General

SUBJECT: Jurisdiction of the
Alaska Pipeline Commission
Over Phillips East Cook
Inlet Gas Line

This is in response to your memorandum of March 11, 1977 in which you ask if the Alaska Pipeline Commission (APC) would have jurisdiction over a pipeline operated by Phillips Petroleum if State-owned royalty gas is transported over that pipeline to North Kenai Road, where it would be sold by the State to Alaska Pipeline Company, a wholly owned subsidiary of Alaska Gas and Service. My conclusion is that the APC would not have jurisdiction over the Phillips Petroleum Company pipeline.

The Alaska Pipeline Commission has jurisdiction over "pipelines", "pipeline facilities" and "pipeline carriers". AS 42.06.630(10) defines "pipeline carrier" as:

. . . the owner, including corporations
. . ., of any pipeline, as the term is
defined in this section, or any interest
in it;

AS 42.06.630(9) defines "pipeline" or "pipeline facility" as:

. . . all the facilities of a total system
of pipe . . . in this state used by a
pipeline carrier for transportation, for
hire and as a common carrier, of oil or
gas for delivery, storage, or further
transportation, and including all
pipe, pump and compressor stations,
station equipment, and all other facilities
used or necessary for an integral line of
pipe to effectuate the transportation from
point to point, excluding, however, gas
processing plant, heaters and separators;

The salient portion of the above definition is written in the conjunctive, i.e., to be a "pipeline" or "pipeline facility" under the Alaska Pipeline Commission Act, AS 42.06 et seq., a pipeline facility must be used ". . . for transportation, for hire and as a common carrier . . ." (emphasis added).

Of course Phillips, in the arrangement described at the outset of this memorandum, will be using its pipeline for "transportation" of gas. However, since the subject pipeline is neither operated by Phillips "as a common carrier" nor is it subject to the "common carrier" covenant requirement of AS 38.35.120 due to the fact that the lease of state lands for the subject pipeline pre-dates the enactment of that statute, the subject pipeline would not fall within the jurisdiction of the APC were the proposed arrangement to be entered into by Phillips.

WLC:RMB:jec



ALASKA PIPELINE COMPANY

General Offices Located at 3000 Spenard Road
P.O. Box 6288 Anchorage, Alaska 99502 / Phone (907) 277-5551
Telex 25-187

April 15, 1977

Mr. Don Wold, Executive Director
Alaska Oil and Gas Development Advisory Board
Department of Natural Resources
State Office Building
Juneau, AK 99811

Dear Don:

In response to your requests this week, we are writing to summarize and describe the essence and the effect of the contract(s) executed by the State and Phillips and Alaska Pipeline Company (APC) regarding the taking in kind of the State's royalty gas (1/8th) from the North Cook Inlet Gas Field.

By way of background, APC's supply until now has come entirely from the Kenai gas field, which is owned by Union and Marathon. We have had two supply contracts: one for Anchorage, in which delivery to us is at the Kenai gas field; and one for the North Kenai Road ("Nikiski") area, in which delivery to us is at or near the Kenai LNG plant.

The "Anchorage" contract is for a total of 550 BCF (billions of cubic feet) to be taken (take or pay for) at 26 BCF/year (which is 72,000 MCFD--72,000 thousand cubic feet per day) by December 31, 1992, but with deliverability of 160,000 MCFD on any day through December 31, 1985. The basic price for this gas is 24¢ per MCF until January 1, 1981, then 27¢ until January 1, 1986, and then the defined "area price" for the remainder of the contract term. In addition to this basic price we pay 19.5¢ per MCF for the extra deliverability described above, and the



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19.5¢ is adjusted each January 1 by the ratio of the published Wholesale Price Index (WPI) of the preceding November to the WPI of November, 1974. At present, the total cost for gas under this "Anchorage" contract is 45.1¢ per MCF.

The "Nikiski" contract was for 10 BCF to be delivered from May 1, 1967 to April 30, 1977, with deliverability of 10,000 MCFD, no take or pay, and priced at 1.5¢ higher than the basic price for "Anchorage" reserves as described above. We used the last of the 10 BCF under this contract in August of 1976, and thereafter we began taking "Anchorage" reserves at Nikiski, priced at the total price of "Anchorage" reserves plus 1.5¢ per MCF, temporarily (one year was agreed) pending resolution of a longer term supply. We had expected to be using North Cook Inlet royalty gas as the replacement for "Anchorage" reserves at Nikiski, and still expect to be doing so upon the implementation of the royalty gas contracts as revised this year.

We selected North Cook Inlet royalty gas because we believed, and still believe, this gas will be available to us and our customers at a lower price than any other "new" reserves. This gas is under contract (as LNG) to June 1, 1984 for export to Tokyo and its cost to us is approximately 75¢ per Mcf immediately, rising to 85¢ when compressors are installed, with certain escalation as described in the revised contracts. In comparison, Pacific Alaska LNG is offering \$1.45 for similar gas from Cook Inlet (without the same deliverability of our "Anchorage" reserves), with escalations. We do not have proof of the \$1.45 pricing, but it can be verified by the State. Thus, we see the royalty gas to be available

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to us at less than half the going price of "new" gas in the Cook Inlet area, delivered on the North Kenai Road.

Our alternative to competing at the \$1.45 price level is to continue to utilize "Anchorage" reserves at Nikiski, as we are now doing, but to pay the same price we would have paid for royalty gas. We have verbal assurance that we can operate on this basis at Nikiski while we install the facilities necessary to shift to royalty gas, and we are proceeding with preparations to do so at the earliest possible date following legislative approval of the royalty contracts as revised. We hope to begin taking royalty gas as early as June, 1977.

Several questions arose over the two years it has taken to reach agreement of the several parties as to our use of royalty gas, and I will try to comment as information for those who review the actions taken. First, the royalty gas contract signed last year, and approved by the legislature, was contingent on APC working out an arrangement with Phillips to obtain delivery of the royalty gas through their pipeline from the platform to the Kenai LNG plant, and it required "take or pay" of 100% of the royalty gas. These elements led to problems which had to be resolved as has been done in the revised contracts which were executed last week. The differences are (1) that the delivery to shore will be made by Phillips for the State, with APC paying Phillips for the account of the State, at prices negotiated by APC with Phillips, and (2) that there will be no "take or pay": Phillips will make a best effort to deliver at least 3 BCF per year (roughly 55% of the total royalty), and APC will make a best effort to take all of the royalty which Phillips

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can deliver, but neither party will be obligated to make extra investment or incur unreasonable extra operating cost.

Without obligation, APC expects Phillips to deliver essentially all the royalty and expects to take all the royalty, but only experience will tell the outcome of this expectation. Phillips may install one or more units of compression, and APC may install a pipeline to connect the royalty gas into its pipeline to Anchorage. Various factors outside the respective control of Phillips and APC have made it necessary to develop a best-efforts arrangement rather than the original "take or pay" of 100% of the royalty.

APC's royalty pipeline, if built, would provide several advantages:

1. It would essentially assure APC's ability to take all of the available royalty, all of the time, and gain the maximum benefit from royalty gas.
2. It would provide "back-up" for APC's North Road customers while royalty gas may not be available due to downtime of the LNG plant, the platform, or the Phillips pipeline or compressors.
3. It would provide APC with access to other than royalty gas in the vicinity of the Kenai LNG plant, which is at the center of several streams of natural gas--supplies to Swanson River for repressurizing, ammonia/urea manufacture, Pacific Alaska LNG, etc. Thus, the pipeline could give APC additional options on "new" gas from various sources.

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4. It would provide an independent supply of gas to APC for emergency in the event of catastrophic failure of the Kenai gas field--well operations, dehydration, or compression--or of APC's pipeline from the field to Mile 16 of APC's pipeline to Anchorage.

Feasibility of the royalty pipeline depends on the possibility of exchanging royalty gas with Union-Marathon, final rate decisions of the Alaska Public Utilities Commission (APUC), final quantification of the amount of royalty gas to be delivered, flow through of the extra cost of royalty gas, and other factors including availability and cost of right of way. At present it appears that there is sufficient benefit from the royalty line to justify the investment by APC.

APC's experience with the APUC is such that royalty gas is particularly attractive: the flow through of its extra cost to end users has been authorized by the APUC, whereas no other purchase by APC can be made with flow through except by further hearings. This fact, plus the fact that it appears royalty gas will always be available (for the contract term) at less cost than any other likely "new" gas, make the royalty most advantageous to APC and its customers. Further, the precedent of this purchase of this royalty gas by APC should be helpful at a future date when other royalty gas may become available and feasible for purchase by APC.

It is clear that APC's action to purchase royalty gas is in the public interest. The price is the lowest available to APC and its



ALASKA PIPELINE COMPANY

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April 15, 1977

customers; the price is qualified to be not less than the State would have received by its continued export to Japan or by any comparable sale during the contract term within 100 kilometers of the Phillips platform; and a relatively modest investment is required by APC even including the royalty pipeline. Other "new" gas could involve meeting the currently competitive price of Cook Inlet gas (\$1.45) and could involve pipeline costs or take or pay costs many times that for royalty gas. The quantity of this royalty gas is rather ideal for APC's present requirements. In 1976, APC's total purchases were 28.6 BCF compared to the required take or pay quantity of 26 BCF per year at the Kenai gas field. As structured, the royalty gas contracts would allow APC (and Phillips) to match their investment to market developments and thus provide the optimum conditions for such investment.

Clearly, Phillips has been a reluctant party in these contracts but has acted responsibly and reasonably and consistent with the public interest. Phillips preference has always been to retain the royalty gas and increase its value by liquefaction for export to Japan. That contract was originally 52¢ FOB Tokyo, but now is \$1.95. Clearly the increase (\$1.43) contains a substantial increase of profit (which is shared by the State through its royalty price). Clearly the 20¢ revenue which Phillips will realize by bringing the royalty gas on shore does not compare with the revenue and income Phillips would realize by its export.



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The 20¢ delivery/compression charge is obviously the most Phillips could charge, because it is the most APC would pay. The State is realizing the most it can from the royalty gas, because APC will not pay more for this gas. To suggestions, if any, that APC should not have accepted the delivery charge as contracted, APC would respond that it would be no more logical to require Phillips to accept less than their required price than for the State to accept less than it deems to be necessary for this gas.

APC will not increase its income by purchasing this royalty gas--it will simply recover most (not all) of its costs, by flow through. APC's objective in making this purchase is to prolong the life of its gas reserves and thus the availability of its "old" gas at "old gas pricing" for its customers.

APC firmly believes that the merit of its purchase of royalty gas has been established already in various arenas.

1. The APUC considered the subject in extensive hearings in 1975 and its order clearly contemplates the purchase and in fact, deemed the matter to be of urgent importance.
2. The Royalty Board and the Commissioner of Natural Resources have reviewed this matter at great length and have approved and authorized its present form.
3. The Attorney General has reviewed jurisdictional aspects and agreed it is not contrary to the public interest or the laws of Alaska.



ALASKA PIPELINE COMPANY

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Mr. Wold

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April 15, 1977

4. The legislature, in its prior approval, has endorsed the concept and pricing of this purchase by APC.

Previously, support for this purchase by APC was given by the City of Anchorage, Chugach Electric Association, and Homer Electric Association. APC is not aware of any opposition to its purchase of this royalty gas (opposition by Pacific Alaska LNG was withdrawn in 1976, at the insistence of APC). When these various governmental and business approvals are considered, and when the alternative can only be that this gas would continue to be exported to Japan, APC believes that ample justification for the contracts has been made.

At present, APC has about 415 BCF of gas remaining under contract at the Kenai gas field. At 30 BCF per year, there would be 14 years of reserves now remaining. The royalty gas potentially available to June, 1984 is about 40 BCF, which is less than a 10% increase. APC is and has been attempting to reduce the growth rate of its gas sales through conservation measures such as waste heat recovery by power plants and by opposing and reducing the use of gas-generated electric heat. However, it is very likely that unavoidable growth will shorten APC's reserve life to 10 years or less. APC must look to the long term aspects of its gas supply in order to avoid future shortages and problems with the long-term (20 year) financing APC requires. Purchase of the royalty gas is a step, but only a step, in this direction. Royalty gas at 75¢ or 85¢ will be helpful to APC in its negotiations for additional "new" gas reserves, viewed in the context of competitive offerings at \$1.45 or possibly a price equivalent to oil in future years.



ALASKA PIPELINE COMPANY

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Mr. Wold

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April 15, 1977

Delays in obtaining royalty gas can only diminish its benefit to APC and its customers because of the quantity available as well as the timing and impact of the purchase.

Very truly yours,

Dale Teel
President

DT/pm

~~RECORDED~~
Phillips

February 25, 1977.

Mr. John Horn
Phillips Petroleum Company
Gas and Gas Liquids Division
Bartlesville, Oklahoma 74004

Dear Mr. Horn:

As you know, the State of Alaska entered into an agreement with the Alaska Pipeline Company on June 4, 1976 for the sale of the State's royalty gas produced from your company's North Cook Inlet Gas Field. The Alaska Pipeline Company and Phillips have been unable to work out a mutually satisfactory arrangement for delivery of the gas. The State of Alaska, through the Department of Natural Resources, is continuing to explore various ways this can be accomplished in the interest of all parties.

The Alaska Pipeline Company has proposed that the State enter into an agreement with your company to take delivery of royalty gas from your pipeline at a mutually agreeable point near the North Kenai Road. The State is presently exploring this possibility and your cooperation has been greatly appreciated. Several questions have been raised regarding this procedure. They are:

1. Will the Alaska Public Utilities Commission have jurisdiction over the Phillips pipeline if the State takes delivery at this point? The State's Attorney General has been asked for an opinion.
2. What charges would be made by Phillips for delivery of the gas to this point? What is the detailed justification of these charges?
3. We understand that as the field pressure declines, compressors will be installed to maintain production rate. What costs will be incurred by the State and what is the detailed justification of these costs?
4. What is your best forecast of the dates of installation of the first and future compressors and how will the cost to the State change with installation of additional compressors?

Page Two
Mr. John Horn
February 25, 1977

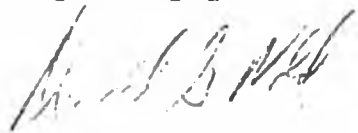
5. What is your best forecast of future production from this field? Will you share with the State your future production plans so that the State may plan accordingly to utilize its royalty gas?
6. The State understands your need to maintain production of your LNG plant and that your ability to deliver royalty gas to the State will change as the field pressure changes. Would you please explain this procedure and give us your best forecast of your ability to make delivery in the future?

Your response to the above would be greatly appreciated together with any further information that you may feel to be pertinent to the solution of this problem.

Would you please review the draft agreement prepared by Alaska Pipeline Company between Phillips and the State and recommend changes that may be of interest to your company?

Thank you for your cooperation. Your early response to the above will be greatly appreciated.

Very truly yours,



Donald G. Wold
Executive Director

DGW/jl



PHILLIPS PETROLEUM COMPANY

BARTLESVILLE, OKLAHOMA 74004

918 661 6600

NATURAL RESOURCES GROUP
Gas and Gas Liquids Division

March 3, 1977

Royalty Gas
North Cook Inlet Field

File: 1-Ho-115-77-G&GL

Mr. Donald G. Wold, Executive Director
Royalty Oil & Gas Development Advisory Board
Department of Natural Resources
Pouch M
Juneau, Alaska 99811

Dear Sir:

In your letter of February 25, 1977, you have requested certain information regarding whether Phillips could make the royalty gas from the North Cook Inlet Field available at an onshore location on the North Kenai Road, rather than in the field as provided in our lease with the State of Alaska. Information is listed by the numbers used in your letter:

2. Q. What charges would be made by Phillips for delivery of the gas to this point? What is the detailed justification of these charges?
 - A. Since we had previously negotiated a place differential of 10¢ per Mcf starting with the calendar year of 1977 and increasing 6% per year thereafter with Alaska Pipeline Co., Phillips would be willing to utilize this approach with the State. Although this is a negotiated figure, the data supporting same is shown on Table I.
3. Q. We understand that as the field pressure declines, compressors will be installed to maintain production rate. What cost will be incurred by the State and what is the detailed justification of these costs?
 - A. For the first compressor unit (approximately 3800hp) installed, compression charge would be 10¢ per Mcf increasing 6% per year from the year of installation. As later units are added, the compression charge will be agreed upon at that time. The above charge is the result of negotiations with Alaska Pipeline Company and is on the condition that Royalty gas would be handled only when there is surplus capacity in our gathering system and compressors. The above charge would be substantially higher if based on adding sufficient additional compressor capacity to assure the availability of capacity and would also entail a substantial minimum annual payment to cover these additional costs. Our calculations are attached as Table II.
4. Q. What is your best forecast of the dates of installation of the first and future compressors and how will the cost to the State change with installation of additional compressors?

March 3, 1977

4. Continued.

A. This is dependent on the amount of royalty gas taken by the State and also on other factors, such as, whether LNG in addition to current deliveries to Japan is sold to the south 48 states. Based on present information, we estimate that the first unit would be installed in 1978 or 1979.

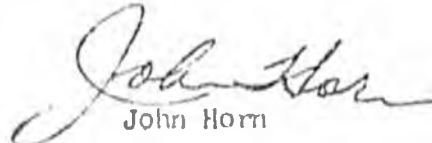
5. Q. What is your best forecast of future production from this field? Will you share with the State your future production plans so that the State may plan accordingly to utilize its royalty gas?

A. Production has averaged 43 to 45 Bcf annually over the last several years. We visualize that production could increase to 55 Bcf or more per year including royalty gas taken in kind.

6. Q. The State understands your need to maintain production of your LNG plant and that your ability to deliver royalty gas to the State will change as the field pressure changes. Would you please explain this procedure and give us your best forecast of your ability to make delivery in the future?

A. Without compression, the volume available from North Cook Inlet Field will decline rather rapidly commencing in 1979. Producing at the 43 to 45 Bcf per year rate and with the installation of compressors, these rates are estimated to continue until 1986, after which the volume declines approximately 10% per year. If the higher rate of 55 Bcf per year is maintained, the volume will commence declining in 1984 at the rate of approximately 10% per year.

You will appreciate that, due to the number of unknown factors, the information provided above is based on our best estimates of the situation as it now exists. New developments could change these estimates.


John Horn

JH:jaw

cc: R. I. Swetnam

T A B L E I .

PIPELINE

Estimated Present-Day Replacement Cost	at least	\$25,000,000
Estimated Present-Day Replacement Cost Depreciated to 1977		17,300,000

ESTIMATED COSTS

	<u>\$/Year</u>
Depreciation (20 Years)	\$1,100,000
Rate of Return 15% on Depreciated Investment	1,520,000
Income Tax @ 52.9% (State & Federal)	1,700,000
Operating Expense	2,750,000
 	<hr/>
TOTAL	<u>\$7,070,000</u>

Cost/Mcf @ 43 Bcf/Year = 16.4¢

Cost/Mcf @ 55 Bcf/Year = 12.9¢

TABLE II

COMPRESSORS
(FIRST UNIT)

To maintain capacity in the gathering system and compressors to handle the full 12.5% royalty gas volume, it will be necessary to install compressors at an earlier date. Also, it is estimated that to maintain this capacity it will be necessary to install an additional compressor unit over and above that required for maintaining deliveries without the State taking its royalty gas in kind. Estimated differential in compressor investment is \$5,000,000.

Cost of Compression

	<u>\$/Year</u>
Depreciation (10 Years)	\$ 500,000
Rate of Return 15% on Average Investment	375,000
Income Taxes @ 52.9% (State & Federal)	420,000
Operating Expense	715,000
	\$2,010,000

Minimum Annual Payment	= \$2,010,000
Royalty Gas Volume @ 43 Bcf/Year	= 5.4 Bcf
Royalty Gas Volume @ 55 Bcf/Year	= 6.9 Bcf
Cost/Mcf @ 5.4 Bcf	= 37.2¢
Cost/Mcf @ 6.9 Bcf	= 29.1¢

Phillips agreed with Alaska Pipeline Company's request to a compressor charge of 10¢/Mcf on a space-available basis and no minimum annual charge.

March 10, 1977

Memo to: File

Subject: Rationale for Accepting Gathering and Compression
Charges Proposed on North Cook Inlet Royalty Gas

By telephone March 10, 1977 Mr. Don Wold asked us to rationalize the acceptance of a 10¢/MCF charge for "gathering" and a 10¢/MCF charge for compressing royalty gas we have negotiated to purchase from the State of Alaska.

The State will escalate the price we pay for royalty gas to the highest price paid by other purchasers within 100 kilometers for similar quality and similar delivery conditions. We had offered to pay no more than the price the State would otherwise have received through the continued export of the royalty gas to Japan as LNG.

It thus is clear that the State places the State's interest above the interests of our ratepayers to the extent we have to pay more than would result from export of this gas. It does not follow that the Lessee who has made the investment required for production, gathering, and compression of royalty gas can be or should be held responsible to deliver the royalty gas at less cost than the Lessee determines to be necessary, fair, and reasonable. In fact, efforts by the State to do so will simply result in there being no agreement and no delivery of royalty gas by the Lessee.

The Lessee cannot be treated as a regulated operator under Alaska law, and the Lessee has the right to determine whether or not, and at what price, it is willing to share its facilities and install new facilities for the benefit of our ratepayers rather than for its shareholders. Clearly, the Lessee prefers not to share these facilities and will not do so if effort is made to assert that delivery of royalty gas onshore could have equal or greater priority than its contractual duty to delivery LNG to Tokyo, regardless of the revenue (price) received by Lessee.

The Lessee has provided (letter of 3-3-77) some cost estimates, reluctantly, to show the reasonableness of the prices accepted by us:

Table I: Pipeline (Gathering)

Annual cost is reported to be \$7,070,000. Assuming all this cost is carried by 43 BCF or 55 BCF, the average cost is 16.4¢ or 12.9¢. The selection of 10¢ as being appropriate for gathering



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royalty gas is less than these average costs, but clearly more than the incremental cost, as it must be. There is no way for a third party to impose a different price on the Lessee, and the price of 10¢ is far below any alternative available to us. In fact, there is no such alternative except not to take royalty gas, and we are not obliged to do so. We bear all the risk that the cost of this gas will remain competitive and will be recoverable through our revenues.

Table II: Compressors (first unit)

Annual cost is reported to be \$2,010,000. Assuming all this cost is carried by 43 BCF or 55 BCF, the average cost is 4.67¢ or 3.65¢. While the compression is not required except to deliver royalty gas (but all the gas must be compressed), the incremental cost here would be 37.2¢ or 29.1¢. However, the Lessee recognizes that during the contract term compression will be required even if royalty gas is not being delivered to us. The selection of 10¢ as being appropriate for the compression is less than the short term incremental cost but well more than the average cost. Again, there is no way for a third party to impose a different price on the Lessee, and we bear all risk that the cost of this gas will remain competitive and will be recoverable through our revenues.

If the two components are combined, the results are:

\$9,080,000 annual cost @ 43 bcfy

21.12¢ average cost

versus 20.00¢ price requested

The price requested is below the reported average cost. Assuming no incremental cost for gathering (pipeline) however, the price requested is well above the incremental cost. In fact, there is an incremental cost for gathering (as to dehydration), and other down-hole expenses which are a function of production rate. We are not equipped to quantify these costs and there is no reason to do so. The essence of this matter is that the Lessee has offered us a price below average cost and above incremental cost which is acceptable to us and that we are the only party at risk.

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There are only two beneficiaries of this contract. We do not benefit, since we will simply recover our added costs from our rate payers. We believe Phillips will not benefit since they are reluctant and clearly prefer to process and ship the gas to Japan. We believe their profits in processing and selling the royalty gas to Japan would be much greater than the amount of income from the proposed compression and transmission charges net of incremental expenses. The State takes no risks and may benefit from a higher wellhead price. Our ratepayers benefit from the increased life of our committed reserves. If the transaction is not consummated then, the losers are the State and our ratepayers, which (through power distribution) include more than half of the State's population, from Homer and Seward to Talkeetna.

There is no way to require the Lessee to deliver royalty gas (at any price) and no way to disagree with the price(s) now offered. Clearly the end objective -- obtaining of royalty gas -- is in the public interest, and the State should place that interest foremost.



dh

AGO 935997