COMMITTEE REPORT

HOUSE

(11)

4/7/82

FURTHER:

Date: 4/14/82

Mr. Speaker:

The Committee on FINANCE has had HB 888

"An Act relating to the sale of royalty oil by the State of Alaska to the Tesoro Alaska Petroleum Company; and providing for an effective date."

under consideration and reports it back as follows:

[✓] do pass   [ ] do not pass

[ ] do pass with attached amendments(s)

[ ] replace with CS for ______ [ ] same title [ ] new title

and recommends ______

[ ] AND attaches a "Letter of Intent"   [ ] New Fiscal Note

[ ] reports it back without recommendation

[ ] referred to the ______ Committee

MEMBERS SIGNING
DO PASS

MEMBERS HAVING
OTHER RECOMMENDATIONS:

CHAIRMAN

H 60 (Rev. 3/81)

Introduced: 3/29/82
Referred: Special Gas Pipeline
Committee and Finance

IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

HOUSE BILL NO. 888

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to the sale of royalty oil by the State of Alaska to the Tesoro Alaska Petroleum Company; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. The "Agreement for the Sale and Purchase of Royalty Oil between the State of Alaska and Tesoro Alaska Petroleum Company" (dated February 26, 1982) is hereby approved and ratified.

* Sec. 2. This Act takes effect immediately in accordance with AS 01.-10.070(c).

ALASKA ROYALTY OIL AND GAS DEVELOPMENT ADVISORY BOARD HB 888

Resolution 82-1

WHEREAS, the State of Alaska, through the Commissioner of the Alaska Department of Natural Resources, and the Tesoro Alaska Petroleum Company have entered into an "Agreement for the Sale and Purchase of Royalty Oil" dated the 26th day of February 1982; and

WHEREAS, in accordance with AS 38.06.055(a) ". . . the Commissioner of Natural Resources may not enter into a sale, exchange, or other disposition of oil or gas or of the rights or waiver of the rights to receive future production of royalty oil or gas under AS 38.05.183 without the prior approval of the Legislature. . ."; and

WHEREAS, according to AS 38.06.055(a), ". . . a sale, exchange encumbrance, or other disposition of oil or gas or of the rights or waiver of the rights to receive future production of royalty oil or gas may not be made by the commissioner of natural resources under AS 38.05.183 without prior review of the proposed sale, exchange, encumbrance or other disposition by the board. A written recommendation of the board on the proposed sale, exchange, encumbrance or other disposition of oil or gas or of the rights or waiver of the rights to receive future production of royalty oil or gas shall be submitted to the legislature at the time a resolution approving the proposed sale, exchange, encumbrance or other disposition is introduced in the legislature"; and

WHEREAS, in accordance with AS 38.06.040(a), the board shall (2) "hold public hearings on proposed sales, exchanges, or other disposals of royalty oil or gas to determine whether the proposals comply with AS 38.06.070;

(3) examine proposed sales, exchanges or other disposal of, and

recommend to the legislature that it approve or disapprove a proposed sale, exchange or other disposal of

(A) the oil or gas that is obtained by the state as royalty under AS 38.05.182; or

(B) the rights to receive future oil or gas production under state leases"; and

WHEREAS, the board did, on February 26, 1982, meet and receive from the commissioner of natural resources the above mentioned agreement with Tesoro as well as a document entitled "Review of Alaska Royalty Oil Policy and Findings on Proposed Disposal of State Royalty Oil" dated February 26, 1982 and the board did act and call public hearings, in accordance with the regulations outlined 3 AAC 56, in Anchorage on March 15, 1982 and Fairbanks on March 16, 1982 and received no public comment pertinent to this agreement; and

WHEREAS, in accordance with AS 38.06 and AS 38.05, the commissioner of natural resources is required to submit to the board, in writing, certain Findings or Determinations relating to the disposal of oil and gas royalty interests and the board has received the required Findings and Determinations; and

WHEREAS, the board members had the opportunity to review the agreement, related Findings and Determinations and Public Testimony during the period February 26, 1982 until March 25, 1982; and

WHEREAS, the board did, on March 25, 1982, meet to discuss the agreement, related Findings and Determination, and Public Testimony to insure that this disposal is in accordance with the statutory purpose and criteria set forth in AS 38.06 as well as

the board's "Basic Principles and Policies" as outlined in the board's development plan, and

THEREFORE, the board finds as follows:

1. that the commissioner of natural resources has followed the board policies and applicable statutes and regulations relating to the disposal of oil and gas royalty interests.

2. that the board agrees that the sale of the royalty oil interests to Tesoro-Alaska Petroleum Company as per the agreement is in the best interest of the state because
   (a) the oil is to be refined or processed or traded for other oil to be processed in the existing Tesoro refinery near Kenai, Alaska.
   (b) Tesoro-Alaska is an in-state refiner who supplies products to the Alaska market with price or supply benefits to state citizens.
   (c) the price the state will receive for this royalty interest appears to be substantially equivalent to or greater than the price the state would receive by taking this royalty in-value.
   (d) that Tesoro-Alaska is a highly qualified company who has been operating its refinery to produce products for the Alaska market for over 12 years.
   (e) that adequate security provisions have been included in the agreement.
   (f) that this agreement is consistent with the criteria outlined in AS 38.06.070.

AND THEREFORE BE IT RESOLVED THAT the Alaska Royalty Oil and Gas Development Advisory Board recommends to the Twelfth Alaska

Legislature that the "Agreement for the Sale and Purchase of Royalty Oil" between the State of Alaska and Tesoro Alaska Petroleum Company, dated February 26, 1982 be APPROVED.

Board Member CHARLES R. WEBBER moved the adoption of the Resolution. Board Member DON TEMPLEMAN seconded. The vote was as follows:

APPROVE	DISAPPROVE
[signature]	
[signature]	
[signature]	
[signature]	

Adopted this 25th day of March 1982.

[signature]

R.A. Lyon

Chairman

JAY S. HAMMOND
GOVERNOR

HB 888 + HB 889

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 29, 1982

The Honorable Joe L. Hayes
Speaker of the House
Alaska State Legislature
Pouch V
Juneau, AK 99811

Dear Mr. Speaker:

Under the authority of art. III, sec. 18 of the Alaska Constitution, I am transmitting two bills which provide legislative approval of royalty oil contracts. One bill covers the contract between the state and Tesoro Alaska Petroleum Company, and the other bill covers the contract between the state and Doyon, Ltd.

These contracts are described in great detail in the 238-page "Review of Alaska Royalty Oil Policy and Findings for Proposed Disposition of Royalty Oil," issued by the Department of Natural Resources on February 26, 1982. Copies of these findings and a 14-page summary of these findings have previously been made available to the legislature and individual legislators for review. The Doyon contract submitted for approval is a contract referred to in the findings as "Doyon I."

These contracts are being submitted for legislative approval for two reasons. First, although this administration has always taken the position that the statutory requirement of legislative approval of royalty oil contracts is unconstitutional (AS 38.06.055), as a matter of comity I have always respected the legislature's desire to have a direct voice in major disposals of royalty oil. Therefore, these contracts contain provisions requiring approval by the legislature before they become effective. Second, these bills would ratify the agreements for the sale of oil. This ratification would cure any procedural defect that may have occurred in the process of entering into these contracts.

Although we believe that all necessary steps have been taken, the statutes and regulations governing the disposal of royalty oil represent often conflicting desires and goals, both procedural and substantive. For example, even

if statutorily requiring legislative approval were constitutional, the present statutes provide, on the one hand, that the legislature is to approve the contract by enacting legislation (AS 38.06.055(a)), but, on the other hand, they also provide that a report of the Royalty Board "shall be submitted for legislative review at the time of (sic) resolution for legislative approval of a proposed disposition of royalty oil and gas is introduced in the legislature" (AS 38.06.070(c)). Since legislative approval is required anyway as a matter of contract, I believe it only prudent to present these contracts for legislative approval and ratification at this time.

Sincerely,

Jay S. Hammond
Governor

Introduced: 3/29/82
Referred: Special Gas Pipeline Committee and Finance

BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

IN THE HOUSE

HOUSE BILL NO. 888

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWELFTH LEGISLATURE - SECOND SESSION

A BILL

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HB 888
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Governor

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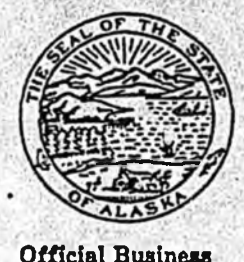

Alaska State Legislature

House of Representatives

Office of The Majority Leader

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811

April 7, 1982

MEMORANDUM

TO: Al Adams
Finance Committee Chairman

FROM: Rick Halford
House Special Gas Pipeline Committee Chairman

Rick Halford

SUBJECT: 0 Fiscal Note for HB 888

The House Special Gas Pipeline Committee has moved HB 888 "An Act relating to the sale of royalty oil by the state of Alaska to the Tesoro Alaska Petroleum Company: and providing for an effective date." - with a 0 Fiscal Note.

However, the Commissioner of Natural Resources has assured this Committee that he will forward to your Committee, an extensive detailed fiscal analysis to accompany the 0 Fiscal Note, for your review and consideration.

HB 888
HB 889

SUMMARY OF PROPOSED DISPOSITION
OF ROYALTY OIL

Department of Natural Resources
Commissioner's Office

March 15, 1982

I. Summary of Proposed Contracts

TESORO ALASKA PETROLEUM

The contract with Tesoro Alaska Petroleum is for the sale of 24.533% of the State's prudhoe Bay royalty oil (about 46,000 b/d) for a 12 year term at the in-value price. Tesoro is required to process the royalty oil in its Nikiski refinery and use its best efforts to market the products in-state. Exchanges of royalty oil for other crude (recognizing the limited ability of its refinery to run ANS crude) is permitted provided the exchanges are of equal value. Deducted from the 46,000 b/d is the amount of Cook Inlet royalty crude Tesoro receives at any time from its existing contract with the State. Tesoro agrees to continue to evaluate the possibility of expanding its refinery, including the construction of petroleum coking capacity. The State retains an option on all residual oil products (including any petroleum coke) produced from the Nikiski refinery. Tesoro may vary the volume taken at any time up to the maximum volume, but pays a reservation fee on the portion unused. The contract may be terminated on nine months' notice by Tesoro.

DOYON LTD

The State has executed two separate and mutually exclusive contracts with Doyon Ltd. Doyon contract #1 is for the sale of 10.677% of the State's Prudhoe Bay royalty production (approximately 19,000 b/d) for a 12 year term at the in-value price. Deliveries of any oil under this contract are contingent on the construction of a major new refinery at Fairbanks by December of 1983 and the marketing of products therefrom. If the refinery is not operating by that time, the contract automatically terminates. Doyon is required to process the royalty oil at the Fairbanks refinery and to use its best efforts to market the products in-state. The State retains an option on all residual products. Doyon may vary the volume taken up to the maximum volume, and may terminate the contract on nine months notice. The reservation fee system, a common feature of all the contracts, is deferred for four years as a concession to Doyon's status as a new refinery entering an existing market. The 10.677% figure represents the net barrels retained by Doyon from processing the maximum royalty oil which can be run through the facility (around 48,000 b/d), on the assumption that the State will take back the return oil and resell it to another Purchaser (Chevron). If the State does not take the return oil, the sale would be for 26.667% (the full refinery charge), and Doyon would be responsible for disposing of the return oil.

In the event Doyon acquires a controlling interest in the Mapco refinery prior to May 1, 1982, Doyon contract #1 goes out of existence and the Doyon contract #2 continues. If Doyon should acquire Mapco's plant at a later date, it must elect to either continue Doyon contract #1 or take the existing Mapco contract. However, Doyon may take the Mapco volume under the Doyon contract #1 (with the maximum volume not to exceed its total Fairbanks refining capacity) under limited circumstances, but it must still build a new Refinery.

Doyon contract #2 is for the sale of 9.067% of the State's Prudhoe Bay royalty production (about 17,000 b/d) for a 12 year term at the in-value price, on the assumption that Doyon acquires a controlling interest in the Mapco refinery and contract prior to May 1, 1982 (in which case the Doyon contract #1 expires). The volume sold under this contract, when combined with the volume committed under the existing Mapco contract, equals the gross refinery charge of the existing Fairbanks refinery. The concessions granted Doyon under contract #1 in recognition of their status as a new entrant are not included in contract #2 since they would be supplanting Mapco as the owner of the existing Fairbanks refinery. The State retains an option on all residual products, and has an opportunity to gain access to the return oil for resale to a downstream purchaser.

CHEVRON U.S.A.

A contract has not yet been consummated by the State with Chevron USA. However, the State has made a firm offer to Chevron for the sale of 20.267% of the State's Prudhoe Bay royalty oil (about 38,000 b/d) for 12 years at the in-value price. About 18,000 b/d would be processed at Chevron's Nikiski refinery, yielding a specified level of products (including asphalt) which Chevron must use its best efforts to market in-state. The other 20,000 b/d would be processed by Chevron in California and returned to Alaska as finished products in the form of a specified products slate (including aviation gasoline).

Chevron would be required to evaluate both expansion of its Nikiski refinery and its products handling and marketing facilities in Western Alaska. In the case of a West Coast crude shortage, Chevron would have to meet Alaska product requirements first. Chevron would also have to continue to supply at competitive prices all local Alaska markets in which it is the sole supplier. Further, Chevron would grant to the State an option to purchase up to 400,000 tons annually of petroleum coke. If the coke was unavailable because of existing contractual commitments, Chevron would be required to assist the State in locating other supplies. The option

would be assignable by the State to a bonafide exporter of Alaska coal.

Other provisions of the Chevron contract are similar to the Tesoro contract.

Still Under Consideration:

SUNEEL ALASKA

Suneel Alaska has requested up to 15,000 b/d of royalty oil for 10 years to be used to exchange for petroleum coke for blending with Alaska coal exported to Korea from the Usibelli Mine in Healy. The Department is determining whether a sale of royalty oil to Suneel is necessary and in the State's interest, or whether enhancement of Alaska coal exports can more practicably be served by the reservation of an option by the State on petroleum coke from another party (assignable to any Alaska coal exporter) or by other arrangements for procuring supplies.

PROVIDENT/KODIAK INDUSTRIES

Provident has requested up to 50,000 b/d for 20 years to be used in a refinery to be constructed in Arizona. No interim

taking is requested, and Provident has offered the in-value price plus a potential profit share to the State based on refinery profitability. In addition to assessing the likelihood of success of a sophisticated and expensive new refinery in a somewhat isolated market and the methods of financing the refinery, the Department is also reviewing the profit share mechanism. Since this is an export contract, it is not in the State's interest to make the sale absent a substantial premium. Futhermore, the State must assess the potential adverse market effects of a sale of this nature.

II. Solicitation and Royalty Oil Available

The initial solicitation for this disposal was issued on February 6, 1981, and was later amended on July 31, 1981. The solicitation requested proposals to purchase royalty oil for in-state processing, in-state supply of petroleum products, or other proposals in the best interests of the State. Twenty-seven companies responded prior to the September 1, 1981 deadline. The proposals generally fell into three categories: in-state processing, export with supply of products back to the State, and strictly export (in some cases with ancillary benefits to the State).

All of the State's royalty oil from Prudhoe Bay and Kuparuk (approximately 197,500 b/d at current production levels) was

available for sale through this solicitation except for the 15% of State royalty production committed to Mapco Alaska and Golden Valley Electric Association under their 1978 contracts. Cook Inlet royalty crude oil is committed to Tesoro Alaska Petroleum (approximately 9,000 b/d). The statutes governing royalty oil sales are AS 38.05.182-183 and AS 38.06.

III. Procedures

Initial meetings were held with each company in October to review their proposals. Letters were sent to each company setting forth the basic criteria to be used by the State in evaluating proposals. The State also revised its standard royalty contract and invited each proponent to make recommendations on that contract, including the price term mechanism. After consultation with the Royalty Board, an initial round of eliminations took place in which the proposals of the following companies were rejected: A Ruddy Petina Oil Company, Alaska Interior Resources Company, Alaska Oil Company, American Mining and Manufacturing Corp., Amoco Supply and Trading Company, Arco Petroleum Products Company, Ashland Petroleum Company, Exxon Company, Koniag, Inc., and Sohio Alaska Petroleum Company.

Negotiations continued through December and January. During the course of the negogiations, the following companies withdrew voluntarily from further consideration: Alaska Pacific Oil and Refining, Amerada Hess, American Mexican Petroleum Corp., Dow Chemical Company, Northwest Holdings, Nikiski Offshore, Sealaska, Tanana Valley Refining, Tosco Corporation and Union Oil.

In addition, mutually satisfactory agreements could not be reached with Mapco Alaska and Shell Oil Company.

The Department consulted with the Royalty Board at each critical stage of the negotiations.

The Department has submitted three contracts to the Royalty Board as of February 26, which will be forwarded to the Legislature with the Board's recommendation after public hearings are conducted on March 15-16. One of the contracts is with Tesoro Alaska Petroleum and two are with Doyon, Ltd. Negotiations are continuing with Chevron USA, and an agreement with Chevron may be forthcoming during this legislative session. The Department is still continuing discussions with Suneel and with Provident/Kodiak Industries, but has not yet determined whether a sale to either of those parties is in the best interest of the State.

All of the procedures, policies, and information utilized in arriving at decisions under this solicitation are documented in a 238 page Finding issued by the Commissioner on February 26, 1982, and presented to the Royalty Board.

IV. Effects of In-Kind Sales on State Revenues

In conjunction with this disposition, the Department reviewed the workings of domestic and crude oil markets to more fully understand the context in which State royalty oil sales would be made. This review of the market factors affecting the value of Alaska North Slope crude verified that the in-kind taking of royalty oil (as opposed to leaving it in-value with the North Slope producers) may have a significant adverse impact on the State of Alaska's revenue receipts in the form of lowered royalty payments and severance taxes.

The basis for the calculation of State severance taxes and royalty receipts is the price received by the North Slope producers for all of the ANS crude they market. Transportation charges and pipeline tariffs are subtracted from the destination sales price, leaving a "netback" or "wellhead" price; the results are averaged for all producers by volume, yielding a weighted average field price upon which the calculations are made. If the State leaves its royalty oil in-value to be

marketed by the producers, their disposition of royalty oil is included in the calculation. Conversely, any royalty oil taken in-kind by the State is deleted from the calculation of the weighted average field price.

ANS crude oil is sold by the producers both in the West Coast and Gulf Coast markets; about 850,000 b/d of the 1,600,000 b/d of ANS currently being produced goes to the West Coast, with the remainder marketed in the Gulf. The factor which impacts State revenues stems from the different characteristics of the West Coast market, which have traditionally caused the netback price from West Coast sales to be significantly higher (as much as $3 per barrel) than for sales in the Gulf of Mexico. Consequently, West Coast sales by the producers generally yield higher wellhead values (and therefore higher royalty and severance tax payments) than sales in the Gulf Coast.

If the State takes royalty oil in-kind and makes sales which displace West Coast sales by the producers (which may often be the case for sales to in-state refiners and suppliers), the effect is to delete a substantial volume of the higher netback West Coast sales from the calculation of the weighted average field price, thereby lowering that average and the amounts received by the State in royalty and severance tax payments. Were the State to take all of its nearly 200,000

b/d in-kind and make sales comprised entirely of West Coast placements, the State could lose in excess of $10 million annually at the current West Coast/Gulf Coast netback price differential.

There are, however, several factors which mitigate against this potential loss. First, the State is not proposing to take all of its royalty oil in-kind, but rather a maximum of about 130,000 b/d out of its 197,500 b/d total. Second, not all of the barrels sold pursuant to the contracts resulting from this solicitation would be likely to displace West Coast sales by the producers. Third, there is no guarantee that the West Coast/Gulf Coast netback differential will persist, and several prospective changes in market characteristics may at least cause the gap to narrow. Fourth, to the extent royalty oil sales to in-state refiners perpetuate their existence, economic benefits from the operation of said refineries tend to offset any loss. Nevertheless, this is a very significant consideration in assessing the State's interest in making royalty oil sales; absent the statutory preference for sales to in-state refiners and suppliers, the contracts which the Department would be presenting to the Legislature might well be different.

Two other consequences of the West Coast/Gulf Coast netback price differential deserve mention.

First, while the State always receives the legally preferred in-value price for its royalty oil, purchasers of State royalty oil get a significant price break over their other alternatives. The in-value price (i.e., the weighted average price of all producer sales) is a mixed-market price (West Coast and Gulf Coast). Because of the West Coast/Gulf Coast netback price differential producers' West Coast commercial prices tend to be higher than the weighted average field price upon which the State bases its contract price term. As a result, an in-state refiner/supplier or other royalty oil purchaser may obtain ANS crude oil for substantially less (possibly in excess of $1 per barrel) than it would have to pay if it were purchasing from one of the producers. This explains the significant interest in purchases of State royalty oil by all types of companies even in times of plentiful supplies of crude oil.

Second, an export sale of royalty oil to a reseller (i.e., a company with no West Coast refining capacity) places that party in the position of having to essentially outmarket the North Slope producers in order to profit on the resale. If adverse market circumstances place the reseller in the position of having to make distress sales (as may have been the case in 1980 for Alaska Oil Company and several of the State's royalty auction purchasers), a destructive and illogical price war may ensue which can adversely affect the West Coast/Gulf Coast netback differential, as well as ANS

prices generally, thereby lowering the State's royalty and severance tax payments. Therefore, the State must be very cautious in making sales to resellers and should not consummate transactions purely for export absent a substantial price premium, if at all.

The foregoing market factors and implications with respect to State finances are discussed in greater detail in Part V(H) and Part VI(A) of the Findings document.

V. Policies on Disposition of Royalty Oil

After review of market factors, governing statutes, the various proposals submitted, and other matters affecting the State's interest, the Department adopted the following policies with respect to dispositions of royalty oil under the current solicitation.

1. Despite the potential adverse financial consequences from in-kind takings discussed under the previous section, it was determined that the preferences for in-state refining and supply contained in the royalty statutes (AS 38.05.182-183; AS 38.06) took precedence over those considerations. Consequently, this solicitation was approached as an oppor-

tunity to satisfy requirements of in-state refiners and to entertain responsible proposals from in-state suppliers. Concurrently, it was considered that strictly export contracts are not expressly favored by the statutes and that absent a substantial premium or other valuable consideration, they are not in the State's interest.

2. The possibility of a sale to the Strategic Petroleum Reserve (SPR) was explored, but mutually divergent economic objectives precluded an agreement at present. The potentiality of the Federal Government lifting the restriction against foreign export of ANS crude was considered to be sufficiently remote to render unnecessary any preparatory actions based on that contingency.

3. The Department recognized the State's sometimes conflicting role as a government and as an oil marketer. The negotiations were substantially complicated because of the Department's desire to achieve procedural equity and substantive consistency in approaching the proposals. Concurrently, the State attempted to remain market neutral in the negotiations because of the competitive relationship between many of the proponents. The position taken by the Department on a common issue was the same with respect to all similarly situated parties.

The only exceptions were directed towards the Doyon proposal, where the Department believed that enhanced competition from a new entrant in the refining business warranted some concessions to provide them with a realistic opportunity to compete. Other in-state refiners have received similar treatment during their break-in period.

4. The Department agreed to become the 100% supplier of crude oil to in-state refiners given sufficient contractual guarantees regarding in-state processing and marketing of crude oil products. However, in view of the demand for royalty oil during this solicitation, the Department was constrained to limit sales to amounts which could be processed in existing facilities. Sales for new refineries or expansions of existing refineries were considered only where a company had made a firm commitment to undertake the new facility or expansion.

5. The Department attempted to limit the term of any contracts to 8 years (the beginning of Prudhoe Bay decline). Because of amortization requirements for the proposed new Doyon refinery, the maximum term was extended to 12 years (estimated as the earliest date at which Prudhoe decline might cause West Coast supply shortages, at which point a maximum range of options with respect to royalty oil disposition will be imperative). Requests from various pro-

ponents (including Doyon) for contract terms ranged up to 20 years or more.

6. The Department carefully reviewed alternative pricing mechanisms to determine if some of the undesirable side effects of using producers' reported prices as the basis of the price term could be avoided. It was readily apparent, however, that shifting to a different mechanism was fraught with risks to both the State and its royalty oil purchasers, and that the existing mechanism was preferable. This view was confirmed by the comments solicited by the Department from prospective purchasers on alternate pricing mechanisms. The Department concurrently determined that there are no circumstances under which the State's interest would be served by a sale of royalty oil for less than the legally preferred in-value price. However, the Department did not request a cash premium from any in-state refiner or supplier.

7. The Department recognized that the State of Alaska is one of the very few politically stable sources of long term crude oil contracts anywhere in the world. Consequently, the State must be wary of vague or impractical proposals underlain by a primary interest simply in obtaining a crude supply or using that supply to finance a development project. Therefore, the Department notified all purchasers that no

crude oil would be delivered until the processing facility or other proposed use was completed; interim taking pending construction of a project (such as in the case of the Alpetco contract) would not be allowed. Calls on future royalties, also a feature of the Alpetco contract, were similarly excluded.

8. The Department attempted to avoid complicated performance benchmarks such as those in the Alpetco contract which were the source of misunderstanding and controversy; instead, relatively simple and concise standards were employed. Since interim taking is not allowed under any contract, the benchmark issue is minimized further.

9. While the Department agreed to supply in-state refiners with the maximum volume which could be run through their facility, it also responded to their request that they not be required to take the full volume at all times if market circumstances dictated otherwise. In return for the fact, however, that the maximum volume would legally be committed to the purchaser for the entire 12 year term (severely limiting the State's flexibility to devote temporarily unused volumes to other purposes), an option fee is charged to a purchaser on the difference between the maximum contract volume and the volume actually being taken at a given time.

10. The Department attempted to use the current solicitation to maximize benefits to the State through several proposals rather than concentrating on a single large scale project. While it would have preferred to have consummated more agreements than has been the case, current depressed market conditions provide scant margins within which to negotiate mutually beneficial transactions. However, contracts are being submitted for Tesoro (an in-state refiner) and Doyon (a new entrant in the Alaska refining business) to complement the existing contract with Mapco, also an in-state refiner. If an agreement is finally reached with Chevron, contracts will exist with all present and immediately prospective Alaska refiners.

11. The Department sought from each prospective purchaser possible avenues for reducing the burden of high fuel costs in rural (especially Western) Alaska. It became evident, however, that these high costs are primarily attributable to the actual expenses incurred in handling and distributing individual cargoes of crude oil products to numerous small localities under adverse conditions, and that prices could not be substantially reduced absent a direct subsidy. Enhanced competition among refiners and in-state suppliers coupled with lowering crude oil costs should bring some relief to Western Alaska in the immediate future, however.

12. Because of the interest in enhancing exports of Alaska coal through the use of petroleum coke, the Department sought options from all parties on residual products and any petroleum coke produced by that party from its refining facilities. It would be the Department's intention to make the option available to any bonafide exporter of Alaska coal.

13. Finally, the Department reviewed and revised its standard royalty oil contract both to protect the State's interest (reflecting some past experiences with royalty sales) and to achieve basic fairness. In addition, the Department endeavored to approach all proponents on the basis of commercial realism and to avoid asking purchasers to undertake obligations which would be contrary to rational business principles.

THE LEGISLATURE OF THE STATE OF ALASKA
TWELFTH LEGISLATURE

FISCAL NOTE

I. REQUEST
Bill/Resolution No. HB 888
Title Act relating to sale of royalty oil to Tesoro Alaska Petroleum
Requested by House Resources Date 4/7/82

II. FISCAL DETAIL
Agency Affected Natural Resources/Revenue
Program Category Affected Royalty Payments/Severance Tax Payments
BRU, Program, Or Subprogram(s) Affected
(Note: If more than one budget component is affected, separate line-item amounts and funding for each component in the analysis section.)

EXPENDITURES (Thousands of Dollars)

	FY 82	FY 83	FY 84	FY 85	FY 86	FY 87 - FY 95
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC.						
Revenues Lost	0	0	0	0	0	0
TOTAL						

FUNDING (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER (Specify Source)						

POSITIONS

FULL TIME						
PART TIME						
TEMPORARY						

III. ANALYSIS (See Fiscal Note Preparation Instruction, Section III)

[See Attachment]

IV. DATE April 7, 1982 PREPARED BY Jeff Haynes, Deputy Commissioner
AGENCY DNR
PHONE 465-2400

Original: Legislative Finance
cc: Budget and Management
Prime Sponsor (First Legislator Named)
33-001 (Rev. 12/81)

An assessment of the fiscal impacts of consummation of the royalty oil contract with Tesoro Alaska Petroleum is necessarily speculative for the following reasons:

1. The potential losses to the State in royalty and severance tax payments because of existing characteristics of the West Coast and Gulf Coast crude oil markets may approach $4 million annually for the reasons stated in the Commissioner's Findings. However, such losses are contingent on the persistence of those characteristics and the degree to which they remain in effect, which requires predicting the behavior of the domestic and foreign crude oil and products markets over the next 12 years. Moreover, there are conceivable conditions in which the reverse would be true, and the State would actually gain in royalty and severance tax payments through an in-kind taking and sale to Tesoro.

2. Any losses incurred by the State in royalty and severance tax payments from a sale to Tesoro must be weighed against the quantifiable and intangible benefits provided by the existing Tesoro refinery as well as possible expansions thereof. Current revenues provided to the State and its political subdivisions by the Tesoro operation through taxes amount to over $8 million annually. Direct economic benefits total $25 million per year. There are also secondary and intangible benefits, including security of supply and competition, which cannot be accurately calculated. Against these benefits must be considered the extent to which a State royalty contract will be likely to contribute to their continuation over the next 12 years.

Again, the actual effect on State revenues and interests is highly speculative and cannot be predicted with much accuracy. Nevertheless, given the comparable magnitude of the potential positive and negative effects, a zero fiscal note is reasonable.