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MEMORANDUM State of Alaska

TO: Esther Wunnicke
Commissioner
Department of Natural Resources

DATE: May 5, 1983

FILE NO:

TELEPHONE NO: 465-3600

FROM: Norman C. Gorsuch
Attorney General

SUBJECT: Overview of royalty oil contract terms

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The state's royalty oil contracts are unique. Normally, oil sales contracts are for cash or equal amounts of oil, are for a relatively short term (three months to one year), and are very short documents (usually no more than three or four pages). In fact, large sales of oil are often accomplished merely by exchanging telex's, with industry custom filling in all non-expressed terms of the agreement. The flexibility of each company to respond to changes and conditions and the concern solely with price and quality of the oil sold allows these contracts to be generally sufficient. In addition, even the longer term contracts (up to five years) have clauses that allow either party to get out the contract, usually after each quarter, if they cannot continue to agree on the price of the oil sold.

The state's contracts, on the other hand, are unique in that not only are they long term (11 to 25 years), but also they have extensive and detailed provisions. The reason for the general difference is that the state is not in the oil market with the same goals as private companies. Nor does the state have a private company's flexibility.

Also, the state is much more risk adverse than the normal oil company. About 40 percent of total state revenues derive from the money the state gets for its royalty oil. Whereas a private company is often willing to "gamble" on making greater profit, the state interest is often more conservative.

Without taking "in-kind", the state would receive what the producers receive when they market their own oil. These companies, primarily Exxon, Sohio, and Arco, have large and expert marketing staffs and are generally able to approach or exceed the values the state could receive over the long term by a

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similar marketing effort. Therefore, if the state decides to take its oil in kind it is making a decision that it can get greater consideration for its oil when it sells than the companies as a whole receive when they market their oil. Under certain circumstances this can occur, but it must occur either through unusual circumstances or through the offering of a benefit for the sale of royalty oil that the companies do not offer when they sell their oil in the normal commercial transaction.

In any event, the state is otherwise guaranteed a certain level of revenues from royalty oil when it leaves it with the producers. Taking the oil in kind not only puts an element of risk upon the state that the state should try to minimize, but also entails other problems that make the sale of the royalty oil a more complicated transaction. One of these considerations is that the state as a government has procedures for the sale of oil that bind its flexibility much more than that of a private oil company. For example, the constitution gives the legislature the power to set the terms and conditions of royalty oil sales. The legislature in the past has not given (and there are strong arguments why it should not give) complete discretion and flexibility to one state official in daily transactions for the sale of 40 percent of the state treasury. The delegation of that much control and authority in such a high risk area has been viewed by the legislature as too much of a gamble. Consequently, the statutes set forth a very detailed and, to a private company, cumbersome procedure before the state can commit any significant quantities of royalty oil.

Another practical problem is that it would be extremely difficult for the state to duplicate the marketing expertise of the individual oil companies. First, large staffs would have to be manned with experts in the area. It is doubtful that the state could be able to hire those expert traders on a state salary system. The only alternative would be to hire those experts by contract or to give them a percentage of the transaction.

Even so, the state also doesn't have the backup facilities or expertise in the other aspects of oil transportation and sale that the majors have acquired. The state does not have the ability to instantaneously take oil from or give oil back to the producers -- instead, the state must give six months notice before it can force the producers to either give the state oil or take oil back in case of a problem. Consequently, the state must be prepared to arrange for or invest

in tankers, storage facilities, or other backup systems that would be necessary to handle oil on any emergency basis.

Because of these and other considerations, the state has not attempted to enter the day to day oil marketing business in the same manner as the rest of the industry. Not only would it be difficult to consistently outperform the majors in that type of business transaction, but also there are practical and political barriers to the state attempting to run its royalty oil business in that manner.

Instead, the state has attempted to take advantage of unique conditions for the sale of oil or has attempted to offer a unique advantage to the purchaser of royalty oil that that purchaser could not receive in a normal commercial oil transaction. The occurance of conditions for the short term sale of royalty oil for greater cash consideration are few and far between -- they usually depend upon holes in the market created by government regulation (e.g., government price controls and entitlements). And, those short term sales are only available for relatively small volumes (20 to 50 thousand barrels a day) of oil. Examples of the state taking advantage of unique conditions for a sale are the 1979 sale back to the producers of royalty oil for the ceiling price (which netted the state approximately three to four hundred million dollars) or the auction of state royalty oil in 1980, which ultimately netted the state approximately 60 to 70 million dollars (even with the various bankruptcies and some companies walking on the state contracts).

Otherwise, there is only one unique advantage the state can offer in the world oil market -- a long-term royalty oil contract. The state is the only place in the world where a purchaser can receive a long-term guaranteed supply of oil from a secure source of supply. That guarantee of a long-term supply has some, often unquantifiable, worth which the state can lever into additional consideration above the market value of the oil itself (since market value is determined by the relatively short-term sales of Prudhoe Bay oil).

In offering long-term contracts, however, the state entered into an area for which there was no real precedent. There were no form contracts or proven provisions for long-term oil contracts. As has been seen in the last decade in the oil markets, there are many unknown changes in world circumstances which will occur over the term of the contract. Thus the contract would have to anticipate possible problems and protect the state in the event that an unknown danger arose. Not knowing the exact nature of that unknown condition made the task much

more difficult. In addition, because of the relatively cumbersome procedures for disposing of royalty oil, the state has much less flexibility in amending a contract when problems arise in the future.

One example of this problem is the determination of a price for the oil over the long-term. The price of world oil has gyrated wildly just in the past six years. Negotiating a price term without the benefit of price reopeners over the long-term is a difficult task -- no outside referent (such as OPEC postings, product worth, etc.) has proved to be a reliable guide for the value of Prudhoe Bay oil from year to year. Thus in negotiating for the additional consideration for the long-term nature of the contract, the state must first identify the base consideration that it would otherwise have received for those years. In other words, whether or not the state wishes that additional consideration be in cash or in non-monetary benefits (e.g., in-state processing or in-state supply), a key term is the underlying base consideration representing the short-term value of royalty oil for any particular year. An additional, and extremely important consideration here is that the monetary income for the base price of the royalty oil is a large component of total state revenues. Thus the price term that m t be picked should not carry with it the risk of the state receiving less for its oil than it would have if it never entered into a royalty contract at all.

The <u>only</u> price term which accomplishes these purposes is tying the <u>base</u> of the royalty oil to that which the state would have received from the producers if it had continued to take the oil in value rather than in kind. This term would rise and fall over time in proportion to the other sales of North Slope crude oil, and thus be in line with the short-term value of that royalty oil. At the same time it would leave the state in the exact same position as if it had never taken the oil in kind at all.

Therefore the base price for the royalty oil contracts is the "in-value" price term. If the state wishes to take the additional consideration for the long-term nature of the contract in cash, the state would ask for a premium above the in-value price (for example, the in-value price plus thirty cents). If the state wanted non-monetary consideration, it would simply ask for the in-value price and then provide for that non-monetary consideration in other parts of the contract (for example, requiring that the oil be processed in state).

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As a general matter, the bulk of the royalty oil contract, and all of the terms of the contract which are unique to the state's sale of oil, revolve around the long-term nature of that contract. On the one hand are those terms which deal with the additional consideration be given to the state because of the long term nature of the contract.

On the other hand are those terms which protect the state from potential adverse consequences of entering into a long-term royalty oil contract. These derive not only from the unknowns which would arise from entering into a contact over a number of years, but also the problems that the state faces from its lack of flexibility if an emergency should arise.

These terms in effect shift the risk of unknown conditions or adverse consequences from the state to the purchaser. It must be emphasized that these terms also represent "consideration" to the state for entering into a long-term contract. As an example, if the benefit of a long-term contract to purchaser is equal to one dollar, terms protecting the state from adverse consequences over the long-term might be worth 40 cents of that dollar (like paying for insurance), leaving the additional consideration available for the cash portion of the price term to be only 60 cents. In other words, every time the state insists on being protected from adverse consequences, it reduces the state's ability to demand greater benefits for in-state benefits or cash from the purchaser.

And, as a matter of policy, the state has decided that if it is to make concessions in the negotiation process, it would make no concessions on those provisions which protect the state from adverse consequences. Consequently, the state, if necessary, would make some concessions in the area of guaranteeing the additional benefits, and make many more concessions on those relatively minor benefits that might be added to the contract. For example, the state would not budge from the strigent guarantees that would require the purchaser to pay the in-value price or guarantee its payment (e.g., a letter of credit for 60 days worth of oil which would require no documentation whatsoever to be submitted for instant payment except for the signature of the Attorney General and the Commissioner of Natural Resources). On the other hand, for in-state processing requirements the state was willing to give a little bit and make those provisions protections against abuse by the purchaser rather than absolute guarantees that certain goals would always be reached. In other words, the in-state processing and in-state supply provisions provide for minimum benchmarks that must be met, and rely upon market conditions in Alaska to

extract the greater benefits that may be realized. In the Tesoro ANS contract, for instance, the contract provides that all oil sold must be run through the plant, and at least 32% of that oil be converted to products marketed in Alaska. The proposed Tesoro plant, however, could produce a much higher percentage of product if Alaska demand required. The contract does not demand that higher percentage; rather, it relies on the market to realize that additional in-state use. It should be emphasized that these concessions were made in exchange for concessions by the purchaser to give the state protection against adverse consequences.

Specifically, there are four general types of provisions that the state has considered essential to protect its long-term interest. First, there are terms that insure that the state will be paid the amount that it would have received from the producers if it had not taken the royalty oil in kind, but instead had left the oil in value (the "in-value price). These include provisions that insure that in-value is the price paid, and assure the payment of that amount in case adverse circumstances arise. Provisions of the standard contract which implement these principles include Article 2.3 (price of royalty oil); Article 2.8 (absolute obligations); Article 5 (payments and accounting); Article 8.2 (inability to receive oil); Article 14 (sovereign power of the state); Article 12 (disposal of oil upon default or termination); Article 15 (security); Article 19 (amendment); and Article 23 (interpretations of terms and conditions).

Second, there are a group of terms which are designed to assure that the state is never in physical custody of the oil, or is otherwise left without someone to pick up the oil at Pump Station Number 1. First, such a situation might result in the state having to sell the oil at distressed prices without the hopes of ultimate recovery from a credit worthy party. Second, the state is simply not equipped, both legally and practically, to make instaneous dispositions of oil on the spot market. Third, because of the limited storage capacity for oil at Valdez, it would not take very long for unlifted oil to back up at Valdez and potentially shut down the pipeline. Such an event would have disastrous consequences on all state revenues. In addition, this catagory of terms also provides that the state is never in physical custody of the oil: that the transfer of oil from the producers to the state and the state to its purchaser is an instanteous transaction and that all risk passes to the purchaser at the time and point the state receives delivery of the oil. Thus these provisions provide that the purchaser must instaneously accept delivery, that the state can force the

purchaser to take delivery under all imaginable circumstances, or that in an emergency the state can take the oil from a purchaser and sell to a third party without interference from the original purchaser (this is to prevent the purchaser from tying the disposition of oil during a disagreement). Examples of these provisions are Article 7 (default), Article 8 (disposition of oil upon default or termination), and Article 11 (force majeure).

A third category of provisions are those provisions that protect the state from the purchaser using an excuse or other legal argument to attempt to get out of their obligation to pick up the royalty oil and pay for it. Thus the state insisted on strigent conditions concerning default, force majeure, and provisions which would provide that the state would not warrant anything except that it had title to the oil. Examples of these provisions are Article 2.1 (quantity); Article 2.2 (quality); Article 2.4 through 2.6 (point and time of deliverly, risk,); Article 4.1 (measurement); Article 18 (disclaimer of warranties); Article 7 (default or termination); Article 8 (disposition of oil); Article 2.8 (absolute obligation); Article 5.7 (late payment); and Article 5.3 (payment).

These provisions provide as close to complete protection as the state could reasonably devise by a contract. In addition, to cover the situation where the purchaser may argue that the contract might be ambiguous or vague when it attempted to be applied to some presently unforeseen event, the state insisted in Article 23 that such disagreements would first be resolved by the commissioner, and that the commissioner would make the initial determination of what the word, term, or application of that word, term or condition would be. In addition, the purchaser contracts to agree to accept that interpretation along as there is substantial evidence supporting the commissioner's findings, which is a standard of review similar to the limited review a court gives a finding of fact by a state agency when it is in its regulatory capacity. In addition, the state inserted some terms and conditions which would allow the state to monitor the purchaser's actions to see if there is any indication that the purchaser might be considering abandoning its obligations under the contract. Such provisions include Article 2.7 (transportation arrangements); Article 3.2 -- 3.3 (financial condition); and Article 22 (records).

In these areas the state insisted on extremely stringent conditions, and for the most part refused to consider any alteration even though it was recognized that these conditions would put burdens on the purchaser not matched any

where in the world under other oil contracts. These provisions were born from the experiences the state has undergone over the past seven years, including the present price dispute with the Alaska Oil Company, a previous bankruptcy of one of the state's purchasers (Energy Cooperative, Inc.), and the abandonment of the royalty oil contract by Alaska Petroleum Company. These terms were reviewed by outside counsel, who also suggested a number of the terms inserted in these contracts.

Although it is impossible to totally protect the state under all conceivable circumstances simply by a contract, there is little question that overall the state has the tightest oil contract in the world. Although this is a little like saying a person has the best sight in a room full of blind people (given the loose and flexible nature of almost all other oil contracts), it does provide a quantum level of increased protection for the state over any other oil contract known.

Like money spent for insurance, however, some premium must be paid by the insistence of the state upon such stringent conditions. Again, since the state was not willing to grant any concessions on terms it considered vital to protect it against risk, the state was not in a position to require as stringent provisions in the other terms of the contract dealing with the additional consideration. Thus in the in-state processing and in-state supply portions of the contract (the non-monetary consideration) the state was not able to insist upon stringent performance guarantees or other provisions which would require the purchaser to produce products in Alaska at a loss or break even point. Nor was the state in a position to insist upon levels of production or in-state processing which were above those reasonably required by Alaska market demand.

Instead, the in-state processing and supply provisions provided "sideboards" or minimum provisions that would protect the state against abuses by the purchaser from the intent of the contract. In other words, the state insisted that the oil be processed in an in-state refinery, that that refinery actually produce significant amounts of products, and that the purchaser otherwise exercise its best efforts to produce and market in Alaska some minimum quantity of oil products. The state left to the local demand the other economic decisions of the local refiner to increase production above that minimum quantity to either meet demand or increase market share.

Therefore, there are provisions in the contract which are designed to assure that to the extent the market in Alaska would support the economic processing and marketing of oil

products within the state, the oil sold to the purchaser would be processed and marketed in the state. Examples of these articles are Articles 2.9 (date of first delivery -- in the Tesoro ANS contract); Article 2.10 (performance guarantee and reservation fee); Article 2.11 (in-state processing); Article 2.12 (best efforts); Article 3.5 (option to purchase resid). As a subsidiary matter, there are also provisions which are designed to assure that the purchaser is not asking or taking more oil than their in-state needs would require (and thus be actually used for some out of state benefit). Article 2.1 (quantity) and Article 2.10 (performance guarantee) are examples of those types of articles which are designed to assist in that goal.

Finally, the state negotiated for some additional benefits, but did not insist upon many guarantees of those benefits. These additional minor benefits could someday be very valuable, but were not considered the primary consideration for the long-term contract. Examples of these provisions are Article 3.4 (expansion); Article 3.6 (petroleum coke); and Article 16 (local hire).

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PRESENTATION BEFORE THE JOINT MEETING OF THE
HOUSE AND SENATE RESOURCES COMMITTEE IN JUNEAU, ALASKA
ON APRIL 20, 1983

I AM ROBERT J. ALFREY, GENERAL MANAGER OF THE WESTERN REGION, SUPPLY & DISTRIBUTION DEPARTMENT FOR CHEVRON U.S.A. INC. IN SAN FRANCISCO.

FOR MANY YEARS, CHEVRON WAS A NET SELLER OF CRUDE ON A WORLD-WIDE BASIS. DURING THAT PERIOD, WE NEVER REQUESTED CONSIDERATION FOR PURCHASE OF ROYALTY OIL. HOWEVER, IN THE LAST FEW YEARS, THE WORLD SUPPLY OF OIL HAS CHANGED AND CHEVRON HAS BECOME A NET PURCHASER OF CRUDE TO MEET THE REQUIREMENTS OF OUR REFINERIES.

CURRENTLY, CHEVRON IS THE ONLY IN-STATE REFINER NOT PURCHASING ROYALTY OIL FROM THE STATE UNDER A LONG-TERM CONTRACT. LAST YEAR, WE SPENT CONSIDERABLE TIME NEGOTIATING A LONG-TERM CONTRACT WITH THE STATE BUT WERE NOT ABLE TO FINALIZE AN AGREEMENT BEFORE THE LEGISLATURE ADJOURNED.

SOME OF YOU ARE AWARE THAT WE HAVE BEEN REQUESTING 38,000 BPD OF ROYALTY OIL FROM THE STATE -- 18,000 BPD FOR OUR NIKISKI REFINERY AND 20,000 BPD FOR PROCESSING IN OUR CALIFORNIA REFINERIES -- TO MAKE THE MORE THAN 12,000 BPD OF PRODUCTS THAT WE BRING TO ALASKA FROM CALIFORNIA. BOTH WESTERN ALASKA AND SOUTHEAST ALASKA ARE SUPPLIED FROM OUR CALIFORNIA REFINERIES BECAUSE IT IS MORE ECONOMIC TO DO SO.

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THE CALIFORNIA REFINERIES PRODUCE AVIATION GASOLINE AND ASPHALT CHARGE STOCK WHICH CANNOT BE PRODUCED BY ANY ALASKAN REFINERY. THE 18,000 BPD LONG-TERM CONTRACT, WHICH IS THE SUBJECT OF TODAY'S HEARING, ONLY PARTIALLY MEETS OUR OBJECTIVE FOR A TOTAL VOLUME OF 38,000 BPD.

WE PLAN TO CONTINUE DISCUSSIONS WITH THE DEPARTMENT OF NATURAL RESOURCES FOR THE ADDITIONAL 20,000 BPD OF ROYALTY CRUDE AND WOULD HOPE TO HAVE AN EXECUTED CONTRACT THROUGH THE ROYALTY ADVISORY BOARD AND WAITING FOR LEGISLATIVE APPROVAL AT THE START OF THE 1984 SESSION.

HOWEVER, IT IS ESSENTIAL TO CHEVRON THAT THIS 18,000 BPD LONG-TERM CONTRACT BE APPROVED BY THE LEGISLATURE THIS YEAR TO ENSURE OUR HAVING A CONTINUOUS SUPPLY OF CRUDE FOR NIKISKI. SUCH ACTION WOULD BE CONSISTENT WITH CONTRACTS THE STATE HAS ALREADY MADE WITH ALL OTHER IN-STATE REFINERS, EXCEPT CHEVRON.

WE ARE AWARE THAT SOME QUESTIONS ARE BEING RAISED AS TO THE BEST DISPOSITION OF ROYALTY OIL INCLUDING COMPETITIVE BIDDING AND EVEN EXPORT TO JAPAN. CHEVRON REPRESENTATIVES FIRST APPEARED BEFORE THE ALASKA ROYALTY OIL AND GAS ADVISORY BOARD OVER THREE YEARS AGO AND REQUESTED THAT THE STATE SELL CHEVRON NORTH SLOPE ROYALTY OIL. AT THAT TIME, WE SAID IT WAS NOT REASONABLE FOR THE STATE TO EXPECT TO SELL NORTH SLOPE ROYALTY OIL TO COMPANIES WHICH DO NOT OPERATE REFINERIES OR MARKET PRODUCTS IN ALASKA, AND THEN EXPECT EXISTING ALASKAN REFINER/MARKETERS TO CONTINUE TO BE ABLE TO MEET THE PRODUCT REQUIREMENTS IN ALASKA WHILE FACING RAPID DECLINES IN CRUDE AVAILABILITY. THIS STATEMENT IS STILL APPROPRIATE TODAY, AS CHEVRON'S WORLD-WIDE CRUDE SUPPLY HAS CONTINUED TO DECLINE SINCE THAT TIME.

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CHEVRON WAS THE FIRST COMPANY TO MARKET PETROLEUM PRODUCTS IN ALASKA STARTING IN 1889 AND HAS SERVED ALASKA CONTINUOUSLY SINCE THAT TIME. WE ARE THE ONLY STATEWIDE MARKETER AND ARE THE SOLE SUPPLIER OF PETROLEUM PRODUCTS IN FOURTEEN COMMUNITIES. CHEVRON SUPPLIES ABOUT 27,000 BPD OR SOME 36 PERCENT OF THE LIGHT PRODUCTS USED IN THE STATE. IN ADDITION, CHEVRON OPERATES THE ONLY FINISHED PRODUCT TANKER BASED IN ALASKA -- THE "ALASKA STANDARD" -- WHICH IS DEDICATED TO SERVING ALASKANS IN REMOTE AREAS. IN ADDITION TO THIS TANKER, WE HAVE EXTENSIVE AND EXPENSIVE BARGING OPERATIONS IN THE BRISTOL BAY, BERING SEA AND SOUTHEAST ALASKA AREAS.

CHEVRON BUILT THE FIRST MODERN REFINERY IN ALASKA WHICH STARTED OPERATING IN 1963. IN ADDITION TO LIGHT PRODUCTS, WE HAVE HISTORICALLY MADE ABOUT 70 PERCENT OF THE STATE'S REQUIREMENT FOR ASPHALT AT NIKISKI AND WILL PROBABLY SUPPLY 100 PERCENT THIS YEAR, AS THE OTHER SUPPLIER HAS WITHDRAWN FROM SELLING ASPHALT IN ALASKA.

THE INDUSTRY HAS SEEN REDUCED DEMANDS RESULTING IN EXCESS REFINING CAPACITY NATIONWIDE, AND A SUBSTANTIAL NUMBER OF REFINERY CLOSINGS HAVE OCCURRED. CHEVRON, TOO, HAS REVIEWED CRITICALLY THE OPERATION OF ALL OUR REFINERIES. ABOUT THREE WEEKS AGO, WE ANNOUNCED PLANS TO SHUT DOWN ONE OF OUR LARGER REFINERIES ON THE EAST COAST WITH A CRUDE CAPACITY OF 168,000 BPD, AS IT WAS NO LONGER ECONOMIC TO PRODUCE LIGHT PRODUCTS IN TODAY'S ENVIRONMENT. NEEDLESS TO SAY, WE CONTINUE TO MONITOR VERY CLOSELY THE ECONOMIC CONTRIBUTION OF EACH OF OUR REFINERIES.

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CHEVRON HAS APPROXIMATELY 190 EMPLOYEES IN ALASKA DIRECTLY ASSOCIATED WITH THE VARIOUS OPERATIONS WE ARE INVOLVED IN. IN ADDITION, WE DO BUSINESS WITH ABOUT 190 INDEPENDENT RETAIL DEALERS WHO EMPLOY 800 PEOPLE AND 69 JOBBERS AND AGENTS WHO EMPLOY OVER 300 PEOPLE. IN TOTAL, CHEVRON'S INVOLVEMENT IN THE PETROLEUM INDUSTRY IN ALASKA RESULTS IN THE DIRECT AND INDIRECT EMPLOYMENT OF ALMOST 1300 PEOPLE.

ALL OF YOU ARE QUITE AWARE OF THE ROYALTY INCOME GENERATED FOR THE STATE AS A RESULT OF THE PETROLEUM INDUSTRY IN ALASKA. FOR MORE THAN TWENTY-FIVE (25) YEARS, CHEVRON HAS BEEN THE OPERATOR OF ALASKA'S FIRST MAJOR PRODUCING OIL FIELD -- THE SWANSON RIVER FIELD.

IN ADDITION TO OUR LARGE VISIBLE INVESTMENTS IN ALASKA IN THE NIKISKI REFINERY AND SOME 260 SERVICE STATIONS AND BULK PLANTS THROUGHOUT THE STATE, WE HAVE MADE LARGE EXPENDITURES -- NOT QUITE SO VISIBLE -- IN EXPLORING FOR NEW OIL FIELDS, WHICH IF SUCCESSFUL, WOULD GENERATE ADDITIONAL ROYALTY INCOME FOR THE STATE. OVER THE PAST FIVE (5) YEARS ALONE, CHEVRON HAS SPENT A TOTAL OF $598 MILLION IN CAPITAL EXPENDITURES AND OPERATING EXPENSES IN ALASKA IN OUR CRUDE OIL EXPLORATION AND PRODUCTION ACTIVITIES. IN ADDITION, OUR MARKETING DEPARTMENT CAPITAL EXPENDITURES AND OPERATING EXPENSES HAVE BEEN APPROXIMATELY $100 MILLION DURING THIS FIVE (5) YEAR PERIOD FOR A COMBINED TOTAL BY CHEVRON OF JUST UNDER $700 MILLION. THIS IS AN AVERAGE OF ABOUT $140 MILLION PER YEAR WHICH WAS PUT INTO THE STATE'S ECONOMY IN ONE WAY OR ANOTHER.

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THE STATE HAS ABOUT 197,000 BPD OF ROYALTY OIL FROM THE NORTH SLOPE, INCLUDING KUPARUK. OF THIS VOLUME, ABOUT 81,000 BPD IS COMMITTED TO IN-STATE REFINERS UNDER LONG-TERM CONTRACTS AND THE BALANCE OF ABOUT 110,000 BPD HAS BEEN LEFT WITH THE PRODUCERS, WHO ARE EXPORTING THE OIL TO THE LOWER 48 STATES. OVER HALF OF THE VOLUME BEING EXPORTED IS GOING THROUGH THE PANAMA CANAL TO THE GULF COAST AREA FOR SUPPLYING PRODUCTS IN THAT AREA, AND THE STATE, IS IN EFFECT PAYING THE TRANSPORTATION COST FROM ALASKA TO THE GULF COAST THROUGH LOWER REALIZATIONS FROM THE PRODUCERS. NONE OF THE THREE LARGEST PRODUCERS EXPORTING ROYALTY OIL RETURN PRODUCTS TO ALASKA FOR USE BY THE RESIDENTS IN ALASKA. IN CONTRAST, AS MENTIONED EARLIER, CHEVRON BRINGS OVER 12,000 BPD OF PRODUCTS TO ALASKA FROM OUR CALIFORNIA REFINERIES TO SUPPLEMENT THE PRODUCTS MADE AT OUR NIKISKI REFINERY. ONE OF THE PRODUCTS WE BRING TO ALASKA IS AVIATION GASOLINE, OF WHICH CHEVRON SUPPLIES ABOUT 80 PERCENT OF THE STATE'S TOTAL REQUIREMENT.

THE STATE HAS THE ALTERNATIVE OF (1) LEAVING 18,000 BPD OF ROYALTY OIL WITH THE PRODUCERS FOR EXPORTING TO THE LOWER 48 TO MAKE PRODUCTS IN THE GULF COAST AREA, OR (2) SELLING THIS VOLUME OF ROYALTY OIL TO CHEVRON UNDER A LONG-TERM CONTRACT AT A HIGHER PRICE THAN THE STATE WILL RECEIV FROM THE PRODUCERS. OUR CONTRACT WILL PROVIDE THAT WE REFINE THE OIL IN-STATE AT OUR NIKISKI REFINERY AND CONTINUE TO SUPPLY THE PRODUCT NEEDS OF THE CONSUMERS IN ALASKA INCLUDING DIESEL, HEATING OILS, JET FUELS, AND ASPHALT. A SALE TO CHEVRON WILL RESULT IN ALL IN-STATE REFINERS HAVING LONG-TERM CONTRACTS FOR ROYALTY OIL AND

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THEREBY RECEIVING THE BENEFITS OF USING LOWER PRICED ROYALTY OIL FOR IN-STATE PROCESSING. I DO NOT BELIEVE ANYONE CAN ARGUE THAT SUCH USE OF THE ROYALTY OIL IS NOT IN THE BEST INTEREST OF THE STATE AND ITS CITIZENS.

IN CLOSING, WE SINCERELY HOPE THAT THE LEGISLATURE WILL DETERMINE IT IS IN THE BEST INTEREST OF THE STATE AND ITS CITIZENS TO MAKE A LONG-TERM CONTRACT WITH CHEVRON, A COMPANY THAT HAS HISTORICALLY DONE BUSINESS IN ALASKA, HAS SIZABLE INVESTMENTS IN THE STATE AND WOULD LIKE TO CONTINUE OUR MAJOR INVOLVEMENT IN SERVING ALASKA.

I WILL BE HAPPY TO ANSWER ANY QUESTIONS THAT YOU MAY HAVE.

THANK YOU.

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COMMENTS TO

JOINT MEETING OF THE SENATE AND HOUSE

RESOURCE COMMITTEES

APRIL 20, 1983

JUNEAU, ALASKA

On January 26, our Board of Directors gave tentative approval to proceeding with a major expansion and modification of our Kenai refinery. The project includes an increase in crude oil processing capacity from 48,500 B/D to 80,000 B/SD, an expansion of the existing atmospheric gasoil hydrocracker from 7,500 B/D to 9,000 B/D, and the construction of a 14 million-cubic-foot per day hydrogen plant and 14.2 tons per day sulphur plant. Additional process units to maintain air and water quality and other facilities to accommodate the increased refinery capacity would also be constructed. When completed, the Kenai refinery would be capable of processing 100 percent higher sulphur Alaskan North Slope-type crude. Currently, the refinery is limited to processing only about 10% ANS type sour crude and 90% Cook Inlet type sweet crude. Engineering is in progress and orders for major process units are ready to be placed.

The project is estimated to cost $80 to $90 million and could be completed in mid-1984. At capacity, the expanded refinery would be capable of supplying 100 percent of the expected demand in our market area for motor gasoline, aviation turbine fuel, diesel and heating oil in Alaska for the decade of the '80s.

As with any significant refinery project, the assurance of a long term supply of crude is of critical importance. We have tried many times as our

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refinery has expanded over the years, to acquire a long term supply of crude direct from producers. We have never been successful in those efforts and have had discussions in this regard with all the major producers as recently as within the last month. The response is still the same: Crude can be made available, but only on a short term basis and, in some cases, with the obligation that we provide the supplier with crude oil in some other location on exchange for as much as 50 percent of the total volume. Obviously, it would be difficult to justify spending $80 to $90 million on a refinery expansion with no assurance that crude would be available for more than one year at a time.

Until last year, Tesoro had tried unsuccessfully since 1975 to purchase ANS Royalty Crude. Royalty Board records will show that Tesoro protested strongly when in 1977 the Royalty Board denied Tesoro's request for Royalty Crude and chose instead to make an award to the infamous Alpetco.

In 1981, the Department of Natural Resources issued a broad solicitation for proposals for the utilization of ANS royalty crude. Tesoro Alaska was one of 27 respondents to that solicitation. Our proposal was that we be allowed to purchase approximately 70,000 barrels per day of ANS royalty crude, half of which was to be sold to us with certainty and the other half was to be sold to us if and only if we proceeded with the refinery expansion which was then under study. Because Tesoro could not at that time irrevocably commit to go forward with our project, the Department of Natural Resources, as published in its January 1, 1983 Review of Alaska Royalty Oil document, stated, "Since Tesoro could not make a firm commitment to an expansion at the time, the State declined to further consider expansion volume . . ."

I truly wish we could have made the expansion commitment in 1981, but preparation for projects of this magnitude simply take time. We are moving

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forward now and I sincerely hope that you will follow through in support of this project which had its beginning over two years ago.

It is by no means our first project, as most of you well know. We have already invested over $120 million in our Alaskan operations since rather humble beginnings in 1969 and will be approaching one-quarter of a billion dollars invested when the proposed expansion is completed. That means, incidentally, that we have reinvested in Alaska substantially more than the cumulative net after tax earnings of our Alaskan operations since we first opened our doors in 1969.

- We will have grown from 14 employees in 1969 to over 200 when complete with a payroll in excess of $7 million annually. Two-hundred-fifty (250) to 300 workers will be employed during the construction phase.

- State income taxes have increased from $4,000 in 1969 to over one-half million dollars annually today; ad valorem taxes tripled to one-half million per year and annual sales, use, and excise taxes have increased from $8,000 in 1969 to over $7.6 million today.

- The purchase of local goods, services and supplies, exclusive of capital projects and payrolls, has increased from $1.6 million in 1969 to over $13 million per year currently.

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This represents a direct economic impact in Alaska of more than $27.5 million every year, and growing.

Through aggressive marketing, over 100 dealers, jobbers and distributors are now affiliated with Tesoro, providing in excess of 1,200 additional jobs for residents of Alaska, not only in the major metropolitan areas of Anchorage, Fairbanks and Kenai, but in more remote areas such as Delta Junction and Tok as well.

In recent Royalty Board meetings, there were three general areas of discussion relative to the proposed sale of ANS royalty crude to Tesoro Alaska. I would like to provide you with information regarding each of those areas, which I feel will be helpful to you in reaching a decision. I also believe that when you evaluate the facts, good judgement and the best interest of your constituents will favor your support of the sale of royalty crude to our company.

First, let's review the implication of the Charter Security Life Insurance Companies' recent acquisition of common and preferred equity of Tesoro Petroleum Corporation. By contract, a copy of which has been furnished to the Royalty Board, the Attorney General and the Governor, Charter Security Life Insurance Companies have agreed to limit the percentage of voting securities they may own in Tesoro Petroleum Corporation to not more than 30 percent. On March 17, our General Counsel testified before the Royalty Board as to

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the nature of that agreement, and outlined the numerous constraints placed upon the Charter insurance companies with respect to voting, proxy solicitation, first refusal rights of Tesoro to buy back the shares should Charter attempt to make any distribution of the equity during the term of the agreement and preemptive rights to buy back the stock upon the termination of the agreement. Tesoro has had the strength of these restrictions and the enforceability of the agreement reviewed by one of the top corporate law firms in the U.S.-- Dewey, Ballantine, Bushby, Palmer & Wood, whom you may recognize as the firm which successfully represented Martin-Marietta Corporation in their recent takeover defense. In addition, the agreement has been reviewed by the New York Stock Exchange and filed with the Securities and Exchange Commission. Of no insignificant consequence is the fact that there is another block of Tesoro equity in the hands of a group who absolutely have no interest in seeing Charter Security Life or any other company make an attempt to take over Tesoro. Directors, officers and employees of the Company are the actual and/or beneficial owners of approximately one million shares of Tesoro equity, which represents about eight percent of the current outstanding common stock of the Company. The cold, hard facts are quite simple: Expert legal opinion is that Charter Security Life Insurance Companies' security ownership in Tesoro does not in any way constitute control and that there is an enforceable contract which restricts their ability to gain control in the future.

If these restrictions were not sufficient protection in and of themselves, and by any definition of "reasonable restrictions" they should be, the State

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has written into the proposed ANS royalty crude contract a clause which gives the State unilateral authority to summarily cancel the crude oil contract with Tesoro should Charter ever gain control. I truly do not understand why that single club alone in the hands of the State doesn't render the ntire Charter subject moot. But on the other hand, perhaps I do understand. Sunny Carpenter of Interior Energy Corporation in Fairbanks stated it quite simply in her testimony to the Royalty Board two weeks ago: The Charter subject is a red herring, or better yet, a rotten red herring. It has been suggested to me that, as distasteful as it may seem, some people feel that because of Charter Security Life Insurance Companies' investment in Tesoro, the proposed royalty crude contract (or the withholding of its approval) can be used as leverage to pressure Tesoro into pressing Charter to settle its litigation with the State of Alaska. If that is true, it is a cruel trick that is being played on the many Alaskans who stand to benefit from our project and it is totally repugnant to me as a businessman. Charter does not control Tesoro and Tesoro certainly cannot influence or control Charter. Consideration should be given to the [illegible]

[illegible]

[illegible] people who would otherwise have new permanent jobs with our company and the 300 unemployed construction workers who might otherwise have good jobs next summer, and to the many local suppliers of goods and services who would have shared in the benefits of our growth, and to the local and regional governments who would receive increased tax revenues.

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In the last Royalty Board meeting, the matter of contract term was discussed. I explained as best I could, the need for a supply of crude for a sufficient term to assure amortization of the investment and a reasonable return thereon. Any businessman will tell you that if someone suggests that he can predict earnings with accuracy over time, he is either a genius or a fool. In most businesses, you base capital investments on your best estimate of future income streams. In the current unstable refining environment, the probability of achieving a relatively short payout of five to seven years is not great. In fact, today, refinery margins are, on average, negative. Last year you heard Doyon testify that their bank group would not even consider financing their proposed refinery project without an assured crude supply of around 12 years. If there has been any change in the industry since last year, it's been for the worse, not better.

I would like to share two letters with you. One from Lazard Freres, a leading U.S. investment banking firm, and one from Manufacturers Hanover Trust Company, a top U.S. commercial bank. As you can see, these two financial institutions who are among the top in their field, feel quite strongly that, among other things, a long-term, secure source of crude for a term in the range of 10 to 12 years is one of several critical requirements from a financing perspective, in any major refinery project.

If you feel my own representations regarding the need for a long-term supply of 10 to 12 years are perhaps unduly biased, I urge you to give due

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consideration to the expert opinions of these two highly respected financial institutions.

The third topic of discussion concerned the fundamental wisdom of using 26,000 B/D of the approximately 96,000 B/D of currently uncommitted ANS royalty crude to support the expansion of in-state refining. It was suggested that perhaps the best interest of the State might be served by delaying a decision, thinking that federal legislation to permit the exportation of ANS crude might be possible in the near future, resulting in an increase in the price of ANS crude and thereby increasing Alaska's royalty and tax revenues. You are probably aware that there are about four or five different acts which deal with the exportation of crude oil and that there is intense lobbying for both sides taking place in Washington right now. While I have serious doubts that the removal of all the obstacles to exportation will be accomplished in the next year or so, let's assume that the effort is successful. What would be the result with respect to our proposed contract?

First, the value of ANS crude should increase, but if it does, so does the average price at pump station one and, therefore, so does the price Tesoro Alaska pays for its royalty crude, since our price is based upon that average at pump station one . . . plus, please remember, we have also agreed to pay to the State of Alaska a premium on top of that average that will exceed $33 million over the term of the contract. Thus, unless the State believes that it can out-perform the average in selling crude oil, the State

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will always be ahead, in terms or price, by selling the crude to Tesoro Alaska. But under any circumstance, the State, by awarding this contract to Tesoro is by no means disposing of all its royalty crude. There will still be a very substantial volume uncommitted after satisfying our contract, with which the State may do any number of things, including playing the export game, if it chooses. In addition, under the terms of our contract, the State has call on all of our residual fuel production, which at full capacity, could amount to 30- to 35,000 B/D, which could be exported, sold to someone who wanted feedstock for a coker, used to make coal-oil mistures, or whatever.

Second, if the State chooses to ignore the price consideration and exports the crude, they have effectively exported jobs and tax base which would otherwise accrue to Alaskans. Why should Alaska send a critical raw material to Japan or Korea to have value added by foreign labor when we have Alaskan refineries and labor ready, willing, and able to do the same right here at home?

Third, what happens if there is another major interruption of worldwide crude supplies as there was in 1974 and again in 1978? True, the shipments to Japan and Korea could probably be curtailed in three to six months, but what about the refining capacity to turn that crude into products in Alaska? You certainly can't build refineries in just a couple of months, or even a couple of years. [handwritten insertion: If you lived in Alaska in 1973-74 or 1978-79, and watched the national news, etc.] In November 1980, the Royalty Board reviewed the criteria

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for the disposition of royalty crude in the context of the royalty crude auction which was then being contemplated by the Department of Natural Resources. I would like to quote the comment of Don Weld, Executive Director of the Royalty Board addressing criteria (2) which deals with the projected and present local and regional needs for refined products:

". . . although existing economic conditions exist which allow imported products to economically compete with products refined locally, it seems illogical for this to continue in the long term. Further, it would seem to be in the State's interest, from a security of supply point of view, to have Alaska-consumed products refined in Alaska if economically possible . . . This problem could be particularly serious should a major world crisis occur, such as the shutdown of the Middle East, creating a serious worldwide shortage which may require lower 48 refiners to discontinue the less economic Alaska market."

I think those words holds as true today as it did almost three years ago.

I was in Washington, D.C. last Wednesday and spoke with Senator Murkowski who, as you all know, has been carrying the banner for allowing the export of ANS crude. I expressed enthusiasm that the opportunity might exist for Alaska to increase its revenues; but at the same time, concern, that exportation might impact future product availability in Alaska by limiting royalty crude available for in-state refiners. The

AGO 786432

Alaska State Legislature

Official Business

Pouch V
State Capitol
Juneau, Alaska 99811

April 26, 1983

Rep. John Ringstad, Co-chairman
and Members
House Resources Committee

Dear Rep. Ringstad:

This letter is written in support of the Tesoro Alaska and Chevron USA Royalty Oil contracts which are pending before your committee.

AS 38.05.183(d) states in pertinent part, "Oil or gas taken in kind by the state as its royalty share may not be sold or otherwise disposed of for export from the state until the commissioner determines that the royalty-in-kind oil or gas is surplus to the present and projected intrastate domestic and industrial needs." Commissioner Wunnicke has found that there is a need for in-state refining. Based on those findings and based upon the benefits which can accrue to the state, we believe that the 13th Legislature should go forward in a positive manner with these contracts.

Both Chevron USA and Tesoro Alaska have been extremely good corporate citizens of our community. The Chevron refinery has been in operation 20 years and Tesoro 14 years. During this time they have provided a stable product supply for the state and a stable work force in our area. Both have been community leaders, especially in the establishment at the Kenai Peninsula Community College of the first oil technology program in the state of Alaska. Not only do they provide expertise, equipment, and direction, they hire many of the graduates.

Approximately three years ago, Tesoro expanded the present refinery. Over 90% of the labor force on that expansion came from the local community. All sub-contractors, except those used for some technical applications, were from local contracting firms. Since our unemployment this winter has been running in excess of 20%, the expansion of the Tesoro facility, which would employ 300 workers, is a real shot in the arm for our economy. The 25 or so ongoing jobs also add another

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dimension to the stabilization of the community. Needless to say, the 80-90 million dollar added tax base will more than pay its own way for any additional community services.

Last year Tesoro Alaska could probably have secured the 26,000 additional barrels of royalty oil had they been in the same position as they are now - that is to commit construction dollars. In fact much of the testimony in last year's hearing was based on the now proposed addition. There is no question that Tesoro Alaska was encouraged to proceed with plans for expansion.

This past October, Chevron was awarded 18,000 barrels for their Nikiski refinery. While that was for only one year, the findings by both Commissioner Katz and Commissioner Wunnicke were the same. The oil is needed to ensure a stable supply of products in the state.

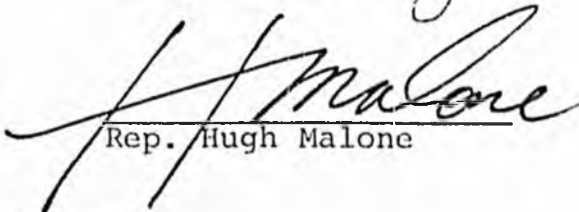
In summary, execution of these contracts by the state would help diversify Alaska's economic base, creating jobs and providing a secure supply of petroleum products. This is consistent with current state policy established by law. We believe the contracts should be approved.

We wish to thank you for your time and consideration of this matter.

Sincerely,

Rep. Milo Fritz

Senator Don Gilman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Senator Paul Fischer

Rep. Bette Cato

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E) COPY OF HB 320 WITH FISCAL NOTE AND GOVERNOR'S TRANSMITTAL LETTER

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AGO 786442

Resource Development Council for Alaska, Inc.

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May 2, 1983

SUBJECT: <u>Royalty Oil Legislation</u>

Joe Hayes, Speaker
Alaska House of Representatives
Pouch V
Juneau, Alaska 99811

MAY 3 1983

Dear Mr. Hayes:

As an organization devoted to fostering responsible economic development within Alaska, the Resource Development Council reviews measures introduced in the legislature and comments on those we feel may have significant influence on our state's economy. It was, therefore, with strong interest that we reviewed House Bills 370 and 371 and Senate Bills 268 and 269, which support the sale of state royalty oil to Tesoro and Chevron oil companies. The Council wishes to express its strong support for the proposed legislation.

On April 26, 1983, the statewide Board of Directors for the Council adopted the enclosed policy statements supporting Economic Development, Manufacturing, Energy Resource Development and Natural Gas and Petrochemicals Development.

It is our understanding that the sale of royalty oil to Tesoro and Chevron would provide sufficient quantities of crude oil to enable them to expand their refineries in Alaska and be able to satisfy in-state needs for gasoline and jet fuel. Such value-added processing of Alaska's resources is particularly in line with our policy statement on natural gas and petrochemicals.

To the extent that these bills support the expansion of Alaska's economic base and embrace the concept of the policy statements we have adopted, we express our wholehearted support for the legislation.

Sincerely,

RESOURCE DEVELOPMENT COUNCIL
for Alaska, Inc.

Chuck Webber

Charles R. Webber
President

encl.

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Resource Development Council for Alaska, Inc.

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POLICY STATEMENT NO. 1

ECONOMIC DEVELOPMENT

Section 1 of the Alaska Constitution states "It is the policy of the state to encourage the settlement of its land and the development of its resources by making them available for maximum use consistent with the public interest."

Section 2 states "The legislature shall provide for the utilization, development and conservation of all natural resources belonging to the state, including land and waters, for maximum benefit of its people."

The Resource Development Council maintains that economic utilization of the state's resources is consistent with the Constitution of Alaska because all other considerations the government must take into account are predicated on a sound economy.

Extractable resources in the ground or otherwise in a natural state are potential wealth. However, they must be developed and used if they are to be of benefit to Alaska and the nation.

The Resource Development Council believes Alaska's public and private economies, for the foreseeable future, will be built by utilization of the state's natural resources.

Therefore:

I

The Resource Development Council recommends that the state make a definite and demonstrated commitment to increase the public and private economies of Alaska through purposeful development of Alaska's abundant natural resources.

II

The Resource Development Council further recommends that state administrative and legislative leaders recognize that a strong and diversified private economy (free enterprise) is the mainstay of our state, and that state policies be directed to utilizing our resources for the benefit of this private economy, and not for the sole benefit of a larger, more expensive government structure.

-continued-

III

The Resource Development Council maintains that a state policy providing a climate for private development of Alaska's public resources consistent with sound conservation principles is in line with the intent of the Constitution of the State of Alaska.

To further the goals of a sound economy, stable employment and a desirable quality of life, the Resource Development Council specifically recommends that the State of Alaska encourage economic development that:

(1) offers long-term benefits and increased employment to Alaskans by strengthening and diversifying its present economic base and encouraging new activities that are economically feasible;

(2) is environmentally sound and mitigates adverse impact on the state's wildlife and scenic resources;

(3) provides opportunities for increased personal income and reduces living costs by creating activity in economic sectors not presently in existence or not fully developed;

(4) has a positive effect on the revenue needs and fiscal conditions of the state and local communities and does not impose burdensome costs in excess of its positive effect;

(5) is undertaken after close coordination and full consideration of the views of citizens most impacted by the development;

FURTHER, that the State of Alaska, to take advantage of investment opportunities afforded by Alaska's abundant resources, shall undertake activities that serve as a catalyst to responsible economic development in the state for the benefit of its citizens. The State shall:

(1) assist present and potential domestic and foreign investors in acquiring and developing information necessary to evaluating project feasibility;

(2) with cooperation from investors, seek to identify constraints to economic development imposed by all levels of government and work with government agencies to solve problems created by those constraints;

(3) with cooperation from investors, seek to identify constraints to economic development such as lack of transportation and energy systems necessary to support the extraction, production and transport of resources to markets, and implement capital improvement or other programs to resolve such deficiencies when proved to be in the state's overall best interests;

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POLICY STATEMENT NO. 6

MANUFACTURING

Basic manufacturing in the United States accounts for nearly 25% of all employment. In Alaska, jobs in manufacturing constitute less than 6% of total employment. During the past decade, the increase in manufacturing jobs was 16% less than the growth rate of jobs in all other sectors of the Alaska economy.

In a 1982 estimate by the Alaska Department of Labor, out of a total labor force of 194,400, only 11,100 people made their living in jobs related to the transformation of materials and substances into new products. Many of those jobs were held by non-Alaskans working briefly in seasonal industries.

Manufacturing is said to be the link between the state's natural resources and the consuming elements of national and international economies. Processing and packaging of Alaska seafood, forest and food products; manufacturing of petroleum, chemicals, concrete and fabricated metal products, and miscellaneous items while now only a relatively small percentage of total state production, show great potential for expansion.

Alaska's circumstances have resulted in creation of products for which greater markets may emerge. These range from high-quality craft items to agricultural products to manufactured items designed to serve specific climatic and geographical factors.

Value-added processing of natural resources is a legitimate state goal for strengthening the economy; so as is the encouragement of transforming other materials and substances into new products. Alaska-based manufacturing offers freedom of dependence on imported goods and a wider variety of employment opportunities for the existing and future labor markets. As the state's population grows, more manufacturing ventures become economic. Greater use of export trading companies as vehicles for entering foreign markets will encourage Alaska manufacturing as well.

-continued-

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In addition to the recommendations contained in the Economic Development Policy Statement No. 1, and industry-specific statements, the Resource Development Council recommends:

I

That the State of Alaska and federal agencies, to the greatest extent possible, procure products and services from Alaskan firms. In the bid review process, government agencies should consider the multiplier effects of dollars placed in the Alaska economy as opposed to hard-dollar bid figures.

II

That local and state government agencies enact incentives routinely used by other states to encourage location of manufacturing firms--extension of roads and utilities, discovery royalties state-of-the-art market research assistance, time limits on permitting, tax holidays, land availability, innovative financing programs, tax exemptions on inventories, investment tax credits, vocational training programs, etc., and develop current information on the cost of doing business in specific communities.

Adopted April 26, 1983, as amended.

AGO 786447

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POLICY STATEMENT NO. 15

ENERGY RESOURCE DEVELOPMENT

Alaska is singularly blessed with energy resources--oil, natural gas, coal, timber, geothermal, tidal, peat, wind, falling water and sunshine.

Alaska is also a net exporter of energy. This condition is not likely to change in the foreseeable future, and the volume of energy resources in Alaska will far outstrip any projected instate demands.

Alaska will continue to grow and as it does, energy demands will increase. The opportunity to satisfy such needs by renewable means further allows the state to market other energy resources for more diverse purposes.

The Resource Development Council thus recommends:

I

That Alaska increase its commitment to maintain and enhance a position of world-scale net exporter of energy resources, particularly oil, natural gas and coal, while reserving for in-state use that amount of raw material required for manufacturing and energy.

II

That Alaska consider and only commit funding to those renewable resource energy sources that are practical on the scale desired. The test, however, must be on cost effectiveness over the project's life.

Adopted April 26, 1983

AGO 786448

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POLICY STATEMENT NO. 16

NATURAL GAS AND PETROCHEMICALS DEVELOPMENT

Petrochemical development represents a significant opportunity for increasing permanent employment by establishing an industry that adds value to petroleum resources produced from Alaska's lands.

The Alaska Legislature and administration can greatly influence whether a petrochemical industry is developed in the state. The following are examples of actions the state should consider taking and that RDC believes are reasonable and in the best interests of the people of Alaska:

I

That the State of Alaska identify and remove all barriers that detract from and retard the establishment of a petrochemical industry in Alaska.

II

That the legislature, in cooperation with the administration, develop a clear economic policy which will encourage development of manufacturing industries in the state and which, specifically, will facilitate the use and processing of natural gas and gas liquids within the state.

III

That the State of Alaska develop a regulatory policy which would facilitate construction of natural gas and gas liquids pipelines and petrochemical facilities.

IV

That Alaska's Congressional delegation work to remove federal statutory and regulatory prohibitions on the export of liquefied natural gas and surplus gas liquids.

That the State of Alaska work to promote the sale of petroleum products from the North Slope and other areas of the state to foreign markets.

-continued-

AGO 786449

V

That the State of Alaska expand and develop infrastructure which would facilitate and make less costly the development of natural gas and gas liquids and their transportation.

VI

That the state review and amend its pipeline regulatory and tax laws to ensure fair returns to private investors. Pipeline transportation of petroleum products from distant oil and gas fields to processing and export facilities should be expedited and encouraged.

VII

That the State of Alaska continue to support programs to train Alaskans for jobs available in the operation of natural gas, gas liquids and liquefied natural gas pipelines and facilities.

Adopted April 26, 1983, as amended

AGO 786450

Please review!
John Cowdery

MEMORANDUM REGARDING PRICE DISPUTE BETWEEN THE STATE OF ALASKA AND ALASKA OIL COMPANY

April 19, 1983

AGO 786451

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1 I. INTRODUCTION

2 The litigation between the State of Alaska ("State")
3 and Alaska Oil Company ("AOC") arises from AOC"s failure to
4 pay approximately $62.6 million of the full invoiced price
5 for royalty oil purchased by AOC from the State in 1981 and
6 1982. The State has insisted from the beginning of the dis-
7 pute that the price invoiced by the State was calculated in
8 accordance with the contract between the State and AOC, and
9 that the full invoiced price must be paid. But AOC claims
10 that the price invoiced by the State exceeds the "market
11 price" which AOC asserts was agreed to in the contract, and
12 AOC has therefore paid the State a lower price in accordance
13 with AOC's unilateral calculations of the "market value" of
14 the oil.

15 Section II of this memorandum briefly discusses
16 the State's right to and its options for the disposition
17 of royalty oil from Prudhoe Bay. Then, in Section III, the
18 negotiation and amendment of the AOC contract will be con-
19 sidered, and the price terms will be examined. AOC's with-
20 holding from payments to the State, and AOC's claimed reasons
21 for such withholding, are described in Section IV. Finally,
22 in Section V, the ongoing litigation between the State and
23 AOC is reviewed.

24 II. ROYALTY OIL FROM PRUDHOE BAY LEASES

25 During the 1960s, the State sold leasehold interests
26 at Prudhoe Bay to various oil companies. Each lease reserves
27 for the State a one-eighth (12.5%) royalty share, to be taken
28

"in kind" or "in value," in any production which might occur after the leases are explored and developed.

Under the lease terms, if the State opts to take all or part of its royalty share "inkind," the State takes possession of the royalty oil at Pump Station No. 1 after giving the North Slope Producers six months notice of the volume of oil desired. Traditionally, the State does not take physical custody of the oil, but rather resells it at Pump Station No. 1.

Under the "in value" alternative in the Prudhoe Bay leases, the State can receive cash payments from the North Slope Producers for the value of some or all of the State's 12.5% of Prudhoe Bay oil. Although in this case the State has no control of how the oil is marketed, the State is empowered to audit the Producers to insure that proper value is received for the State's royalty oil.

Disposition of the royalty oil to which the State is entitled under the Prudhoe Bay leases is governed by AS 38.05.182-183. Section 182(a) requires the Commissioner of Natural Resources to take royalty oil "in-kind" unless the Commissioner finds that "in value" taking is in the best interest of the State. Section 183(e) requires the Commissioner to evaluate royalty oil purchase proposals (where sale is other than by competitive bid) in light of, among other things, the cash value offered, the benefits of refining or processing in the State, and the ability of the purchaser to supply refined products in-state with price or

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supply benefits. These statutory directives imply a preference for taking royalty oil "in kind" rather than "in value," and a preference for in-state processing over purely export sales.

In 1974 the Alaska Legislature established the Alaska Royalty Oil and Gas Development Advisory Board, and invested it with authority to approve or disapprove any royalty oil disposition contracts submitted by the Commissioner of Natural Resources. Under the 1974 legislation, proposals for the sale of royalty oil first had to be approved by the Royalty Board, and then submitted to the Alaska Legislature for its concurrence.

III. ALPETCO AOC CONTRACT

A. Negotiations

In the summer of 1977, the Department of Natural Resources formally solicited bids for the sale of the State's royalty oil from Prudhoe Bay. The solicitation required each bid to provide for the use in Alaska of "some or all" of the purchased royalty oil. Concurrently, the Royalty Board supplemented the existing statutory guidelines with several policies to guide the disposition of the State's royalty oil. Among the policies was the requirement that the price at which the State sold royalty oil should be no less than the amount the State would have received had the State opted for "in value" cash payments from the Producers instead of taking the oil "in kind."

Ten preliminary proposals responding to the State's solicitation were received by August 1, 1977. After the

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1 Commissioner of Natural Resources evaluated the proposals,
2 the list of bidders was reduced to four companies who sub-
3 mitted final proposed contracts for large-volume purchases of
4 royalty oil. Following intensive negotiations with the final
5 four bidders, on February 22, 1978 the Commissioner signed,
6 and the Royalty Board approved, an Agreement for the Sale and
7 Purchase of State Royalty Oil (the "Contract") between the
8 State and Alaska Petrochemical Company ("APC"). The initial
9 Contract was for a term of 27 years and authorized the pur-
10 chase of up to 150,000 barrels per day of royalty oil for
11 processing in a world-scale petrochemical plant APC agreed to
12 construct in Alaska.

13 B. Amendments to APC Contract

14 The APC Contract was amended twice. The first
15 amendment occurred as a result of the legislative approval
16 process for the initial Contract; changes were mandated by
17 the Legislature in some of the terms of the Contract relating
18 to required expenditures and construction obligations. The
19 amended Contract required Alpecto to expend certain amounts
20 in furtherance of the project at specified intervals, to
21 enter into arrangements for construction and financing by
22 December of 1979. The amended Contract was approved by the
23 Legislature on June 13, 1978.

24 The second amendment stemmed from three events.
25 First, the project sponsors indicated that the petrochemical
26 portion of the project was not immediately feasible, and that
27 the facility constructed would in fact be a refinery (although
28 a highly sophisticated refinery using state of the art technology).

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1 Second, the State's determination in December 1979 that Alpetco
2 had met required conditions regarding construction and financing
3 arrangements, entitling them to interim taking of royalty
4 oil, met with substantial public criticism. Third, the owner-
5 ship of the project changed substantially in 1979 when APC
6 assigned its interest in the Contract to the Alpetco Company,
7 which later changed it name to Alaska Oil Company ("AOC").
8 AOC is a general partnership presently consisting of Charter
9 Oil (Alaska) Inc. (85.31%), Valdez Oil, Inc. (8.04%) and
10 Barbour Oil Company (6.65%). Charter Oil (Alaska), Inc. and
11 Valdez Oil, Inc. are both wholly owned subsidiaries of The
12 Charter Company, which therefore has an indirect 93.35% inter-
13 est in AOC.

14 The second amendment, entered into in May 1980,
15 reduced the volume of oil to be purchased by AOC beginning in
16 July 1980 from 150,000 to 75,000 barrels per day. Only when
17 the promised refinery was operational would AOC be permitted
18 to purchase up to 100,000 barrels per day. To ensure that
19 AOC constructed the refinery in an expeditious manner, the
20 amended Contract also required AOC to meet specific project
21 development criteria by December 31, 1981, before the
22 Commissioner would approve further sales of North Slope
23 crude to AOC.

24 C. Contract Price Provisions

25 The price provisions of the Contract were not
26 altered by either amendment. Since price is at the center of
27 the State's dispute with AOC, the price provisions are des-
28 cribed below in some detail.

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The State had insisted from the outset that the minimum acceptable price for its royalty oil would be the equivalent of the "in value" price the State would have received from the Producers had the State not opted to take its oil "in kind." In keeping with the State's unwavering position on price, the Contract expressly provides that the final price to be paid by APC/AOC "shall be equal to the sum the [State] would have received from the [Producers] had [the State] received its royalty in value instead of . . . in kind." (Article 8.1.1.) This provision reflects the simple fact that the State had no intention of diminishing its royalty income as a result of taking its royalty oil "in kind" (for sale to AOC) instead of "in value" (i.e., cash).

At the time the Contract was signed, the method of determining the "in-value" price of royalty oil was the subject of a still unresolved lawsuit entitled State of Alaska, et al. vs. Amerada Hess Corporation, et al. Since the "in value" price had yet to be determined in the Amerada Hess litigation, the Contract provided for two prices: a final price to be paid once Amerada Hess establishes the "in value" price, and an interim price to charged pending the resolution of Amerada Hess.

Article 8.1.1 of the Contract provides that the final price under the Contract will equal the "in value" price to be judicially determined in Amerada Hess.

> After such time as [Amerada Hess] shall be resolved among Seller and [the Producers], the parties hereto will be bound by the terms of such resolution, judicial or otherwise. Seller and Buyer expressly

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recognize that adjustments in prices previously paid may be necessary following said resolution . . .

Article 8.1.1 of the Contract also specifies the interim price to be used until Amerada Hess is decided:

> Pending resolution of said dispute among Seller and [Producers], by judicial decision or settlement in the [Amerada Hess] case, the in value royalty under the Leases, and therefore the price hereunder, shall be computed in accordance with Exhibit "B", attached [to the Contract.]

Exhibit B was designed to yield a price akin to what the State believes the Court in Amerada Hess will eventually determine is the proper "in value" price. The Exhibit B price is calculated each month in two steps. First, a per barrel royalty oil "value" is determined for each Producer, by taking the higher of the weighted average of the actual prices received by that Producer or the weighted average of the actual prices received by all other Producers. The "values" for each Producer are then used in the second step of the Exhibit B calculation, which computes the weighted average of the "values" of all the Producers. The effect of this method of price calculation is to disregard, for purposes of the final weighted average, the lower prices received by some Producers, and unless all Producers report exactly the same prices, the Exhibit B price will always exceed the weighted average of all Producers' prices for that month.

The fact that neither the final price nor the Exhibit B price under Contract would necessarily equal "market"

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1 value was repeatedly recognized during negotiation of the
2 Contract, and on at least three occasions the parties re-
3 jected use of "market price" as a price standard. APC's
4 original contract proposal called for a "market price" tied
5 to the price of Saudi crude oil. But the State insisted on
6 receiving an "in value" price pegged to the price the Pro-
7 ducers would have paid the State had the State's royalty been
8 taken "in value" rather than "in kind," and Alpetco eventually
9 agreed.

10 Later in the negotiations, discussion turned to the
11 interim price to be paid by APC pending resolution of Amerada
12 Hess. Until Amerada Hess is decided, royalty payments by the
13 Producers are based on a weighted average of all Producers'
14 actual sales, a formula which yields a price lower than the
15 "in value" price which the State in Amerada Hess claims is
16 appropriate, and which Exhibit B approximates. APC objected
17 to paying a higher interim price than the interim price the
18 Producers were paying, and sought to base its interim price
19 on the weighted average of the prices reported to the State
20 by all the Producers. The State, however, was unwilling to
21 allow APC to follow the Producers in paying less than the
22 price the State expects Amerada Hess to establish since APC
23 had no security in Alaska comparable to the Producers' leases.
24 APC eventually agreed to base the interim price (Exhibit B)
25 on the State's position in Amerada Hess, and thus agreed to a
26 price higher than the weighted average of the Producers'
27 prices.
28

Thereafter, during the detailed negotiation on using the State's position in Amerada Hess as a basis for the interim price, market price was once again rejected, this time by APC. In Amerada Hess, the State asserts that each Producer should pay the highest of three price standards, one of them being "market price." The State proposed using the same three-part standard for APC's interim price, but APC objected that "market price" is too subjective to use in computing price. The parties then agreed to exclude "market price" from Exhibit B calculations, a decision reflected in Footnote 5 to Exhibit B:

> "Market" . . . value shall not be used in calculating the "In Value Price to Buyer" unless and until the methodology of determining same is judicially decided.

Thus, during negotiation of the Contract, the subject of using "market price" as a standard arose three times. On each occasion, its use was rejected.

IV. THE PRICE DISPUTE

A. AOC Cancellation of Refinery Project

By meeting certain "benchmark" requirements of the Contract pertaining to progress on the refinery project, AOC became entitled to and began receiving 75,000 barrels per day of royalty oil in July 1980. Each month thereafter, the State tendered an invoice to AOC for the oil purchased the previous month. The price used in each invoice was computed by applying the formula in Exhibit B of the Contract to data reported by Producers for royalty purposes. The State also provided AOC with certain data from the Producers' royalty

1 reports which were used to calculate the Exhibit B price.
2 For almost one year, AOC paid each monthly invoice, based on
3 the interim Exhibit B price, in full.

4 On May 21, 1981, AOC announced the cancellation of
5 the refinery project, claiming that they had determined that
6 they would be unable to obtain adequate project financing
7 before the Contract deadline of December 31, 1981. The State
8 and AOC thereafter mutually agreed to terminate the Contract.
9 But because of the notice requirement in the Prudhoe Bay Unit
10 Agreement for denominating royalty oil, the Contract provided
11 that AOC had to continue taking royalty oil for seven months
12 after notice of termination unless the State could make alter-
13 nate sales arrangements. The State was unable to place the
14 oil elsewhere under satisfactory terms, and AOC therefore
15 continued to take 75,000 barrels per day until January 12,
16 1982, when the Contract was officially terminated.

17 B. AOC Witholding from Payments to State

18 In mid-1981, shortly after AOC's cancellation of
19 the refinery project, AOC became dissatisfied with the interim
20 Exhibit B price established by the Contract and decided to
21 set the price unilaterally. Thereafter, during the remaining
22 months of the Contract, AOC paid about $62.6 million less for
23 the State's royalty oil than the amount invoiced by the State
24 pursuant to Exhibit B.

25 In underpaying the State for oil delivered from
26 June 1981 to January 1982, AOC not only unilaterally "ad-
27 justed" the Exhibit B price to a lower price arbitrarily set
28

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by AOC; it also subtracted a portion of its payments previously made at the Exhibit B price for the months of February through May 1981. For example, for the month of November 1981, AOC underpaid the State approximately $3 million on the basis of its unilateral price adjustment for the month of November, and withheld an additional $7.5 million as a "retroactive adjustment" for February 1981 -- even though AOC had previously paid the February 1981 invoice in full.

By this device of "retroactive adjustment," AOC attempted to disguise the magnitude of its unilateral price revisions. For example, AOC purported to reduce the price it paid for oil in November 1981 by $1.92 per barrel and attributed the remainder of its November underpayment to a "retroactive adjustment" of $3.53 per barrel for the month of February, 1981; the combined effect of these "adjustments," however, was a price reduction of more than $6 a barrel below the $22.91 invoiced price calculated pursuant to Exhibit B for oil delivered in November.

The oil for which AOC had underpaid the State was re-sold by AOC, through an affiliate, for a profit which has been estimated at between $32 million and $38 million. The disposition of this profit by AOC is difficult to trace with precision, but it is clear that AOC itself retained virtually none of the profit. Instead, the profit was transferred to AOC's partners and to other affiliates of The Charter Company (which indirectly owns 93.35% of AOC).

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C. AOC's Claimed Justification for Withholding

AOC claims that the Contract price for the oil should represent a "market price," and that AOC does not have to pay any price higher than the "market price" calculated by AOC. The basis for AOC's claim that it should pay only a "market price" (rather than the invoice price computed pursuant to Exhibit B of the Contract) has never been thoroughly explained. But AOC argues that the invoiced Exhibit B price was too high because the prices reported by the Producers, on which the Exhibit B calculation is based, were too high. Despite repeated requests from the State for evidence supporting AOC's claim that the Producer reported prices were too high, AOC's only evidence to date consists of theoretical calculations by AOC of what the true "market price" for Prudhoe Bay oil should be. AOC's claim of inflated price reports from the Producers is especially implausible since the severance tax paid to the State by the Producers is based on the prices they report. In other words, if, as AOC claims, the Producers are reporting prices which are too high, then the Producers are thereby deliberately increasing the amount of severance tax they must pay to the State.

Although the factual basis for AOC's withholding remains murky, the claimed legal basis for that withholding is more focused. Article 9.3 of the Contract provides in its entirety:

> Billing Disputes. Should any portion of the account furnished to Buyer by Seller be disputed in good faith, Buyer and Seller agree to mutually arrive at a fair and equitable resolution of such dispute,

1 if possible, and Buyer agrees to pay the amount so determined to be due to Seller
2 within fifteen (15) days after such resolution. Buyer shall pay for such amounts
3 as it does not in good faith dispute in accordance with the provisions of this
4 Article IX.

5 The State's position is that this Contract provision is designed
6 to cover routine and relatively minor billing disputes, and
7 that, in any event, AOC's price dispute is not in "good faith."
8 But AOC interprets the provision much more broadly, arguing
9 that it covers matters as fundamental as the method of calcula-
10 ting the price, and that AOC has no obligation to pay amounts
11 it unilaterally disputes until fifteen days after the resolu-
12 tion of such dispute.

13 V. LITIGATION BETWEEN THE STATE AND AOC

14 The State met on numerous occasions with AOC and
15 its lawyers in an attempt to determine if AOC had any valid
16 grounds for claiming the existence of a pricing dispute within
17 the meaning of the Contract, and to hear various presentations
18 made by AOC in support of their claim. On December 14, 1981,
19 a letter was sent by the State to AOC setting forth the State's
20 determination that no cause for a price dispute existed, and
21 demanding payment of the full amount due to the State under
22 the Contract. The day following receipt of this letter, AOC
23 filed a Complaint for declaratory judgment against the State
24 in Fairbanks Superior Court. The State answered, alleging
25 that the Contract price term controls, and that AOC had en-
26 gaged in various fraudulent conveyances and other transactions
27 which had depleted its assets. That case is currently pending,
28 but has been stayed by the petition filed by the State in the

AGO 786465

United States Bankruptcy Court in Anchorage seeking to have AOC declared an involuntary bankrupt.

The decision to proceed against AOC in the Bankruptcy Court rather than in Fairbanks Superior Court reflected the fact that AOC itself has virtually no assets, having transferred them to its affiliates. In order to recover any substantial portion of the money owed to the State by AOC, it will be necessary for the State to collect from AOC's parent (The Charter Company) and its affiliates -- a process which is far easier in the Bankruptcy Court than in State Court. Moreover, the Bankruptcy Court has broader jurisdiction over witnesses and documents outside of Alaska, and Bankruptcy proceedings tend to be resolved more quickly than State Court actions.

The bankruptcy proceeding was commenced by the State in February 1982 and the matter was tried in January 1983. During the intervening months, nine separate hearings were held, dozens of briefs and memoranda were filed by both sides, thirty-one depositions were taken in four states, and tens of thousands of pages of documents were exchanged and reviewed.

Trial commenced in Anchorage on January 17, 1983, and continued for five very full trial days. At the conclusion of the trial, the Bankruptcy Judge denied the State's petition to have AOC placed in involuntary bankruptcy. This ruling does not, however, prevent the State from now proceeding against AOC in the Alaska State Courts.

The Findings of Fact and Conclusions of Law which the Bankruptcy Judge must issue to conclude the bankruptcy

AGO 786466

proceedings are still the subject of memoranda and argument before the Court, and are not expected to be issued before the end of April. But even in the absence of a definitive statement from the Court, the oral ruling by the Judge at the close of the trial in Anchorage gives a fair indication of the basis for his ruling.

The Bankruptcy Judge stated that, based solely on the price provisions of the Contract, AOC has a debt to the State for at least some portion of the amount withheld from AOC's payments for royalty oil. But the Judge also concluded that AOC's price dispute is in good faith within the meaning of Article 9.3, and that Article 9.3 of the Contract gives AOC the right to withhold payment of any amounts disputed in good faith until such time as the dispute is resolved. Therefore, the Court concluded, AOC's debt to the State is not yet "due" to be paid because of the good faith price dispute, and AOC could not be judged to be bankrupt for failing to pay that debt. Counsel for the State believe that the Court's ruling is not consistent with existing law, and the prospects for an appeal of the Bankruptcy Court's decision are now being evaluated.

The State is also considering the extent to which it will be fruitful to pursue the State Court action against AOC to recover the $62.6 million withheld by AOC from its payments for royalty oil. Among the factors to be considered in connection with that decision is the fact that Article 9.3, which proved to be the major stumbling block in the Bankruptcy Court proceeding, would have little bearing on an action in Alaskan Courts. AOC was able to avoid involuntary

bankruptcy by convincing the Bankruptcy Court that its dispute with the State was in good faith, and that (because of Article 9.3) AOC's debt was not yet "due" to be paid. But in State Court, the central issue would be simply whether or not AOC has paid the price called for by the Contract, and AOC's good faith (or lack thereof) would not control whether AOC must pay the State the amount withheld. Another important consideration bearing on the decision whether to pursue the State Court case is the fact that much of the research and discovery already conducted in the bankruptcy proceeding would be used in a State Court action.

AGO 786468

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y · STATE CAPITOL
JUNEAU, ALASKA 99811
907-465-3800

M E M O R A N D U M   May 5, 1983

SUBJECT: Royalty oil sales under AS 38.06.055
(Work Order No. 13-1361)

TO: Representative John Cowdery

FROM: Richard C. Folta
Legislative Counsel

You have asked if the legislature does not approve a royalty oil sale under the above statute, may the commissioner of natural resources sell the oil without legislative approval to the same company on a negotiated short term contract substantially different from the original sale.

The answer is yes, if the sale is determined by the commissioner to be needed to "relieve storage and market conditions". AS 38.06.055(b)(1) provides that legislative approval is not required when the sale, exchange, or other disposition of oil or gas for one year or less if the sale, exchange, or other disposition is entered into to relieve storage or market conditions. The commissioner may also forego competitive bidding if in the "best interest of the state" after notice to the Royalty Board (AS 38.05.183(a)).

The transaction may be viewed with suspicion by the legislature, who after disapproving a sale of royalty oil sees the commissioner finding a sudden storage and market crisis and proceeding with a sale under AS 38.06.055(b)(1). If there was litigation over the sale the standard of review by the courts would be as set out in National Bank of Alaska v. Department of Revenue, 642 P.2d 811 (1982).

The reasonable basis standard is used where the question at issue, i.e., determination of "relieve storage or market conditions" implicates special agency expertise or the determination of fundamental policies within the scope of the agency's statutory functions. The second test or independent judgment standard is when the court makes its own determination of the meaning of the statute and need not

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follow the agency's construction even if it is one of several reasonable readings. Very likely the court would invoke the former rule in coming to a decision.

RCF:ljb
17/031

Introduced by: Mayor
Date: May 3, 1983
Vote:
Action:

KENAI PENINSULA BOROUGH

RESOLUTION 83-119

SUPPORTING APPROVAL OF STATE ROYALTY OIL CONTRACTS TO CHEVRON USA AND TESORO ALASKA.

WHEREAS, contracts for the supply of the State's royalty oil for Chevron USA and Tesoro Alaska are currently pending the approval of the State Legislature; and

WHEREAS, the supplies of crude oil from Cook Inlet and Peninsula fields have been dwindling annually since 1970 necessitating the companies to look to the State for assured supplies; and

WHEREAS, it has been the expressed interest of the State to pledge its royalty oil for in-State processing and to trigger new industrial investment and employment; and

WHEREAS, the contracts call for an eleven-year supply of 18,000 barrels per day to the Chevron refinery, and 26,000 barrels per day to the Tesoro refinery for in-State processing of products for Alaska markets; and

WHEREAS, the supply of the royalty oil will add measurably to the economic well-being of the State of Alaska and the Kenai Peninsula assuring the continuing operation for the Chevron refinery and the further expansion of the Tesoro refinery; and

WHEREAS, the Chevron and Tesoro refineries are annual contributors to the economy with a combined payroll of $4 million from the 105 year-round jobs, operations impacting another 100 jobs and $2.5 million in wages in the service and supply sector, $1.5 million in local purchases, and sizeable tax contributions from a combined $125 million in assessed valuations; and

WHEREAS, such contributions to the economy would be increased by an $80-$90 million expansion of the Tesoro refinery, a 250-member construction work force, and the addition of 20-30 new year-round jobs for the expanded operations of the plant; and

WHEREAS, it has been determined by the State Commissioner of Natural Resources, and the State's Royalty Oil and Gas Advisory Board that the approval of contracts to provide long-term supplies of the State's North Slope crude to the two companies is in

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the best interest of the State of Alaska, and a wise and expedient use of the State's oil resources;

NOW THEREFORE, BE IT RESOLVED BY THE ASSEMBLY OF THE KENAI PENINSULA BOROUGH:

Section 1. That the Assembly recommends that the State Legislature approve contracts for the supply of the State's royalty oil from the North Slope to the in-State refining facilities of Chevron USA and Tesoro Alaska.

Section 2. That the Kenai Peninsula Borough Assembly supports the concept of approval and ratification of those contracts as provided in HB 320; HB 370; HB 371; SB 268, and SB 269.

Section 3. That the Borough Clerk shall distribute a copy of this resolution to Governor William J. Sheffield; to Senate President Jalmar Kerttula; to House Speaker Joe L. Hayes; to the Chairmen of the Senate and House Resources Committees; to Senators Don Gilman and Paul Fischer; and to Representatives Hugh Malone, Bette Cato, Milo Fritz, and Vern Hurlbert.

Section 4. That this resolution takes effect immediately on the date of its adoption.

ADOPTED BY THE ASSEMBLY OF THE KENAI PENINSULA BOROUGH ON THIS ________ DAY OF ____________________, 1983.

____
Donald L. McCloud, Assembly President

ATTEST:

____
Borough Clerk

AGO 786472

Chevron U.S.A. Inc.
P.O. Box 7-839, Anchorage, AK 99510 • Phone (907) 279-9666

J. E. Day
Public Affairs Manager

May 11, 1983

Honorable John Ringstad
Honorable Richard Shultz
Co-Chairmen
House Resources Committee

Gentlemen:

At the House Resource Committee hearing on May 5, 1983 there were questions raised for which we had incomplete answers at the time. This letter will provide more complete responses to the specific questions listed.

1. What is the total petroleum product demand in Alaska, and what is the individual refiner market share?

   It is difficult to provide a precise and up-to-date summary of product demands and refiner market share within the time frame needed for your deliberations. However, we feel that the data presented in the Alaska Petroleum Product Pricing Report (L. F. DeLong and L. M. Pernela, February 1, 1983) is reasonably accurate and does report figures that approximate our own estimates that were made in 1979. Therefore, we summarize them on Attachment A, giving you the source pages in the Pricing Study Report. For a separate break-out of "Railbelt" demand Page 34 of that report is enclosed as Attachment B.

   Our own 1979 study anticipated Alaska's demand for product to increase over a 1980 base of 1 by the following factors:

	1980	1985	1990	2000
AV GAS	1	1.00	1.18	1.36
MO GAS	1	.98	.95	.93
JET FUEL	1	1.18	1.35	1.41
DISTILLABLE FUELS	1	1.13	1.21	1.31

AGO 786473

2. What is the price of Cook Inlet Crude?

This crude is priced by the individual producers and the most recent price posting we have is by ARCO dated February 17, 1983. That posting was at $25.00/Bbl. for crude at a gravity between 34.0 and 34.9 °API. For every gravity increase of 1° API the price goes up 10¢; e.g., 36.5° API crude would be $25.20/Bbl.

We also should point out that this is a premium crude; it is low surfur and contains a much higher percent of light products (in the order of magnitude of 55% vs. 35% from ANS).

3. How much Jet Fuel does Chevron import? How much Jet Fuel is imported at Anchorage International Airport?

It might help to first provide a brief description of the airport consortium. It is currently a consortium of ten (10) airline members operated by Butler Aviation. Each airline purchases its own fuel from various suppliers for delivery to common tankage. The fuel is comingled but each airline maintains its own inventory. The consortium itself does not purchase fuel, it only operates the facility.

Chevron supplies fuel to various airlines and during the year of 1982 supplied approximately 2.8 million Bbls. (7.7 MBD). The source of this fuel was as follows:

	%	MBD
Imported via tanker	43	3.3
Produced at Nikiski Refinery	24	1.9
Exchange or purchase agreement from other in-state refiners	33	2.5
	100	7.7

The total thru-put for the Anchorage terminal for 1982 is in the order of magnitude of 5,000,000 Bbls. or about 13.7 MBD.

4. What is Chevron's distribution system for Western Alaska?

This can be best described by use of a map (see Attachment C). The map gives general routes, but some additional detail is provided to help in understanding the magnitude of the handling costs.

In the summer time, tankers deliver product to Dutch Harbor and since the wharf is too small to accomodate them, a barge lightering operation is required. Large barges then move the product from Dutch Harbor up to Kotzebue, Nome and St. Michael, but again, because of shallow water, the fuel is lightered to shore on smaller barges.

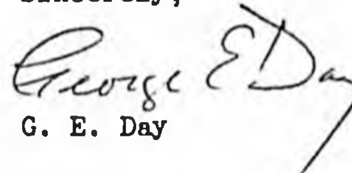
Because product resupply can only be accomplished during summer months these terminals are much larger than those that can be resupplied year around. Also, for this same reason average annual inventory at these terminals is much higher than the average which adds a higher than normal inventory cost to the ultimate fuel price.

For the use of the committee only we have also provided some dollar values of ice locked terminal inventories and plant facilities. We ask that this particular information because of its proprietary nature not be released to the press or made available to our competitors.

PLANT	ESTIMATED MARKET VALUE OF PLANT	ESTIMATED VALUE OF AVERAGE INVENTORY
Bethel	$ 2,739,000	$ 4,681,000
St. Michael	809,000	1,474,000
Nome	1,159,000	5,582,000
Kotzebue	2,587,000	5,726,000
Dillingham	1,582,000	1,374,000
Fort Yukon	557,000	670,000
Galena	971,000	1,198,000
Naknek	875,000	1,206,000

We hope that this information is the complete response to your questions. If there is other information that would be desired, please let Mr. Ray Plummer know and we'll try and respond.

Sincerely,



G. E. Day

AGO 786475

ATTACHMENT A

SUMMARY OF SELECTED PRODUCT DEMANDS IN ALASKA AND IN-STATE REFINERY PRODUCTIONS

	CHEVRON		TESORO		NPR			
	(1) 1982 (Adjusted)	(3) Capacity	(1) 1982	(4) Capacity	(1) 1982	(5) Capacity	(6) Alaska Demand -	Product 1982
	(7) BPCD	BPSD	BPCD	BPSD	BPCD	BPSD	BPCD	
MO GAS			11.5	12.28	-	-	14.4	
JP-4	.9	1.1	1.0	1.07	2.7	3.72	29.1 (JP-4 and JET A-1)	
JET A-1	2.3	2.8	12.6	12.2	5.4	8.37(3)		
#1 OIL			3.9 (#1 and #2 OIL)	4.[illegible] (#1 and #2 OIL)	4.4 (#1 and #2 OIL)	2.42 (#1 and #2 OIL)	31.6	
#2 OIL	2.2	2.8						
CRUDE FUEL	(2) 14.5	18.0	45.2	48.5	43.0	46.5		

(7) BPCD = Bbls per calendar day (Average annual production that allows for some down time.)

BBSD = Bbls per stream day (Capacity on any given single day.)

(1) Source is Page 54 of Pricing Report. Chevron's numbers have been adjusted to reflect anticipated operation at 18 MBSD.

(2) BPCD adjusted for refinery maintenance and asphalt production. (Pg. 7 of "Agreement for Sale and Purchase of Royalty Oil" between State of Alaska and Chevron U.S.A. Inc.) Also yield of Jet A-1 in winter is less as that product is used to produce low pour diesel.

(3) Source is Pg. 39 of Pricing Study with yields corrected to reflect current operation.

(4) Source is Pg. 46 of Pricing Study. The split between Mo Gas and JP-4 is an estimate because the Pricing Study lumps them together.

(5) Source is Pg. 42 of Pricing Study.

(6) Source is Pg. 27 of Pricing Study.

AGO 786476

D. RAILBELT DEMAND

The demand for petroleum products in the Railbelt was determined from a number of data sources, including but not limited to: the volumes and types of petroleum products moved thru the ports of Anchorage, Whittier, and Nikiski; the production of products at the Alaska refineries and the product/crude oil movements through the GVEA, Nikiski, and Whittier pipelines. Utilizing the above data and formulating an input/output model, the 1981 and 1982 Railbelt demand on a BPCD basis was determined as outlined below:

RAILBELT PRODUCT DEMAND

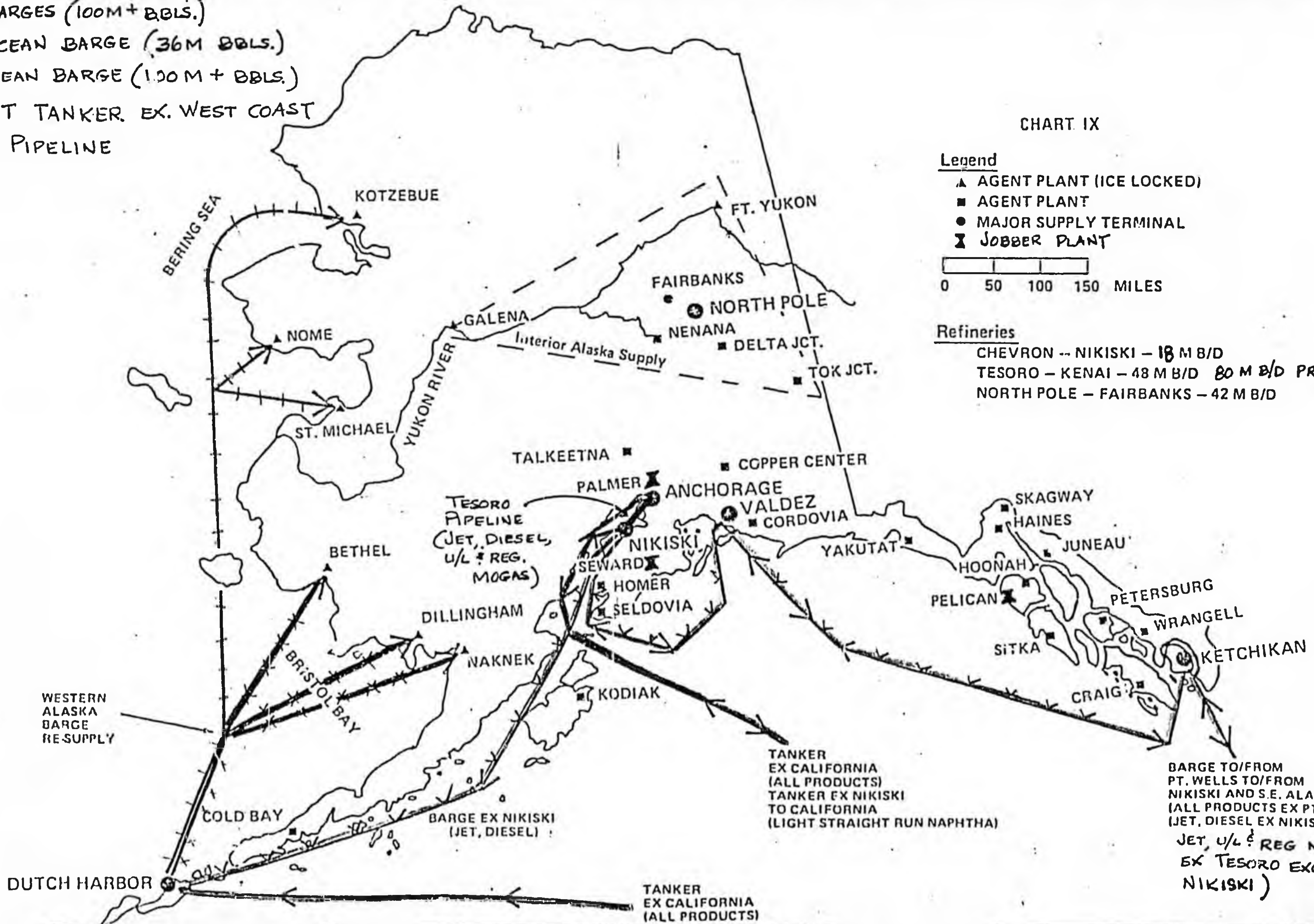
Product	MPBCD 1981	MPBCD 1982
MoGas	10.2	10.8
JP-4	4.6	4.6
JET B	1.7	.5
AvGas	.9	.7
Jet A-1	20.1	23.0
#1 HO/diesel/DFA	1.6	1.8
#2 HO/diesel	4.4	4.3
#4 FO	.6	.8
Asphalt	.6	.9
Total	44.0	46.5

The Railbelt volumes shown above reflect actual purchases and deliveries by refiners and wholesalers. Not included in the above figures are the TAPS turbine fuel manufactured and used exclusively by TAPS. Also year to year inventory changes would modify some of the above numbers in a minor way. For example, the changes in yearly inventory of the asphalt mix used in the manufacture of asphalt by Union at their topping plant at their Anchorage terminal is a clear indication of the types of problems encountered when interpreting data. In this example the numbers presented above do not reflect inventory carry-overs or drawdowns, yet in 1981 Union used 1980 asphalt in their plant, whereas in 1982 they imported asphalt mix and used it all in that year. The apparent "increase" in asphalt demand

AGO 786477

Alaska Primary Distribution

ATTACHMENT C



Memorandum

San Francisco, CA
May 11, 1983

ALASKA PRODU[illegible] STUDY

[illegible]. J. C. LEUTHYLER:

[illegible] have developed the following responses to the questions raised in Mr. J. F. Mayer's [illegible]ay 9 letter to you on the above subject:

Q. What is the cost to produce Nikiski jet fuel versus West Coast jet fuel?

We have never attempted to allocate refinery costs to individual product yields at our refineries and, therefore, these data are not available. We do maintain refinery optimization programs at most of our refineries to determine cost to produce incremental products based on assumed incremental raw material supply. However, these data would not be applicable to determine average costs.

GO 786479

Q. What is the in-state refinery output versus capacity?

Total in-state refinery capacity reflected on page 36 of the study is 130.5 MBPCD. Total output reflected in the refinery yield data incorporated in the study and assuming that Arco is operating its North Slope Refinery at capacity (14.0 MBPCD) totals 84.5 MBPCD.

Q. With the Tesoro expansion what will be the total in-state refinery output?

Based on a February 7, 1983 Oil and Gas Journal article indicating that Tesoro plans to expand its refinery to 80.0 MBD by mid-84, total in-state refinery output would be increased about 30 MBPCD to a total of about 114.5 MBPCD if Tesoro operated that increment at capacity.

Q. What products are imported into the state? From where?

All premium unleaded mogas and avgas must be imported because local refi eries are unable to manufacture these premium products. This coupled with the deficits of jet and diesel oil are all imported from the West Coast with the exception of a small amount of foreign jet fuel as discussed in the next question. Asphalt charge stock is also imported from the West Coast for further processing at our Nikiski Refinery to manufacture finished asphalt.

Q. Does the consortium in Anchorage import jet fuel into the state? From where?

It is our understanding that essentially all imported jet into Anchorage flows through the consortium. On page 31 of the study, the import of jet fuel is indicated as follows:

3490 BPCD is imported from the West Coast

540 BPCD from foreign sources

However, we believe the import of foreign-source jet has now been swtiched to the West Coast.

Please advise if you have any questions regarding the above.

W. T. DANKER

WTD:jh

AGO 786480

6/14/83

Tesoro Stake Lowered To 28.9% by Charter Co.

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON—Charter Co. said it lowered to 28.9% its stake in Tesoro Petroleum Corp.

In a filing with the Securities and Exchange Commission, Charter said a subsidiary, Charter Security Life Insurance Co., New York, sold 250,000 shares of Tesoro common stock from May 16 through May 20 at prices ranging from $14.675 to $15.25 a share on the open market. The filing also said that 36,800 shares were purchased on April 18 at prices ranging from $14.675 to $15 a share.

The filing also said that on May 23 Charter Security of New York sold 1,276,685 Tesoro common shares to another Charter subsidiary, Charter Security Life Insurance Co., Louisiana, for $14 a share. It also sold all of the Tesoro preferred shares it held to Charter Security of Louisiana for $17.60 apiece. Charter said that its New York unit sold all of its voting stock of Tesoro after New York state Insurance Department representatives indicated that its stake might be violating New York law governing stock ownership by insurance companies.

As a result of the purchases and sales, the filing said that Charter Co. holds 2,184,085 common shares and 2,875,000 preferred shares convertible into 2,500,100 common shares.

As of Dec. 31, Tesoro had 13.7 million common shares outstanding.

In Jacksonville, Fla., a spokeswoman for Charter, an oil, insurance and communications concern, said the company didn't have any comment about the filing. "It's just a regular 13D," she said.

In San Antonio, Texas, Tesoro officals couldn't be reached for comment.

AGO 786481

ALASKA RURAL ELECTRIC COOPERATIVE ASSOCIATION, INC.

237 E. FIREWEED LANE • SUITE 301
ANCHORAGE, ALASKA 99503 • (907) 276-3235

Hon. Frank Ferguson
Alaska State Legislature
Pouch V
Juneau, AK 99811

June 14, 1983

Dear Sen. Ferguson,

Several weeks ago, I had the opportunity to testify before the House and Senate Resources Committees regarding pending state royalty oil contracts with Tesoro Petroleum and Chevron USA.

Our support of these contracts was voiced in an effort to create a condition where competition and free market forces would force lower fuel prices in Western Alaska, both for our member electric utilities and consumers who must now pay more than 50% of their total household income for heat and light.

In the intervening weeks, we have been able to obtain some fuel prices which reinforce our position and should, we feel, be taken into consideration as these contracts are acted upon.

As you know, Western Alaska is supplied exclusively by Chevron USA from bulk shipments of fuel that originate on the West Coast. We have met with the company three times in an effort to negotiate lower prices but these talks have been singularly unproductive. Their prices are their prices and we don't like them; that's too bad. Their prices are also set community by community and are not effected by decreases in prices in Anchorage where Chevron must compete against other suppliers.

Tesoro, on the other hand, has been more than willing to assist our efforts at obtaining lower prices. And the president of Tesoro, Mr. Dennis Jurens, has made good faith commitments to us regarding a continuation of their pricing policies for this year and for the years to come. His company, he says, is interested in moving its products and to do that, it must have additional sales points and a more widespread

distribution system.

The savings that Tesoro can give our member utilities right now are substantial. In the case of Naknek, Tesoro will sell us fuel at their Nikiski price of $.79 a gallon. We can barge this fuel into Naknek for $.10 a gallon with a landed price of $.89. This compares to $1.1425 per gallon from Chevron. The savings for the co-op in Naknek amount to $256,000 this year.

At Unalakleet, we are looking forward to saving a proportionate amount since Chevron's landed price is $1.38 while we can get supplied from a delivery point outside of St. Michael's at less than $1.16. Instead of prices in excess of $1.40 at Kotzebue, deliveries from competitive markets at Dutch Harbor will come in for just over $1.16.

Tesoro's Nikiski price, by the way, is lower than the jobber prices in Puget Sound. So much lower, in fact, that even piggybacking major shipments to the North Slope on already hired barges is more expensive than buying in-state and shipping from Cook Inlet.

Chevron's comments to us indicate that their prices will only respond to actual competition in the marketplace. None of the other major oil companies in Alaska we have contacted have expressed willingness to market products in Western Alaska in the immediate future. Lower fuel prices in the Western Alaska district are directly tied to Tesoro's ability to process more crude in-state and sell it here to existing markets. We feel that this opportunity to see Alaskans directly benefit from Alaska's oil resource should not be passed up since competition will result in lower prices for home heating fuel as well.

The state has a direct financial interest in these fuel prices, not only as a user of fuels but as a subsidizer of energy costs through the Power Cost Assistance Program and the Energy Cost Assistance Program. The lower the retail price of fuel, the less state money will have to be committed to support these programs.

As an aside, our fuel purchasing efforts are not being confined only to electric co-ops. We are in the process of contacting canneries and other major users who can take deliveries of large quantities to help us achieve an economy of scale. Mr. Jurens has indicated Tesoro's willingness to help us in this effort by arranging trades with other suppliers to provide the

quantities necessary in the event that there is a delay in their refinery expansion.

We feel strongly that it is in the best interests of the state, particularly Western Alaska, to approve these contracts and we would ask your support in this matter.

Regards,

Bill Blessington
Information Director

cc Dennis Jurens

Alaska State Legislature

COMMITTEES
OIL & GAS—(CO-CHAIR)
STATE OF AFFAIRS—(VICE CHAIR)
LABOR & COMMERCE
RESOURCES

House of Representatives

REPRESENTATIVE
JOHN J. COWDERY
DISTRICT EIGHT

ANCHORAGE
P.O. BOX 10-1623
ANCHORAGE, AK 99511
(907) 344 0950

JUNEAU
POUCH V
JUNEAU, AK 99811
(907) 465-4905
465-4906

June 15, 1983

The Honorable Bill Sheffield
Governor
State of Alaska
Juneau, Alaska 99811

Dear Governor Sheffield:

I am seriously concerned by your recent statements regarding the proposed royalty oil contracts for Tesoro and Chevron. I note that, at your cabinet meeting this week, you accused several "large oil companies" of interfering with your attempts to seek legislative approval of the royalty oil contract legislation. Yet you declined to mention any of these "interferers" by name.

In a free enterprise system it seems quite appropriate to me that competition be allowed to flourish. You evidently disagree as evidenced by your statements. Further, if you intend to make such accusations, I would think you would have the courtesy to specifically name your detractors rather than brand the oil industry wholesale for what you perceive to be improper actions. I would request that you name the "large oil companies" which you are accusing so that the public will not be led to believe that the State's Chief Executive is dealing in rumor spreading or plain gossip.

I also am concerned that you are urging legislative ratification of these contracts and that you feel they deserve to be voted on. Yet, much of the information requested of Tesoro and Chevron by the House and Senate committees has not been forthcoming. Am I to assume by your statements that you wish the Legislature to vote on these contracts while many important questions about the financial feasibility of these long term contracts remain unanswered? I certainly hope not. You recently forced some legislators to vote on another matter without allowing questions to be answered via the committee process, and we have seen the less than ideal results of that debacle.

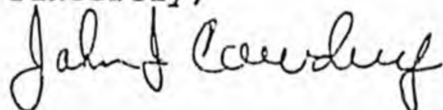
The committee process is in place to ask the questions that, perhaps, your Administration would rather not ask. We owe that obligation to Alaskans. The people of Alaska trust that their representatives will vote only after they are properly informed on the issues. Some of us respect the Constitutional duties we have been elected to uphold.

The contracts before us deserve critical and prolonged examination. I, personally, do not believe, at this time, they should be entered into. If the questions I have asked of the oil companies are satisfactorily answered, I might change that opinion.

Finally, I would note that House and Senate priorities were agreed upon during the time you were out of state attending a zoo opening in Oregon. If these contracts were so vital to you, it seems to me you would have been present in Juneau during the critical negotiations between the House and Senate to bring this session to a close.

I urge that you give greater consideration to these contracts and the unanswered questions. I further urge that you refrain from negatively branding the oil industry on which this state depends so greatly without adequate justification.

Sincerely,



Representative John Cowdery
Chairman
Joint Legislative Committee on Oil and Gas

AGO 736486

THE ALLIANCE

P.O. Box 100100 / Anchorage, Alaska 99510 / (907) 562-0100

RESOLUTION IN SUPPORT OF
ENACTMENT OF MEASURES
WHICH ALLOW THE STATE TO
PROCEED WITH THE SALE OF
ROYALTY OIL TO BOTH TESORO
ALASKA PETROLEUM CO. AND
CHEVRON U.S.A.

Whereas, the Alaska Support Industry Alliance has reviewed the complicated issues attendant to the contracts between the State of Alaska and the Tesoro Alaska Petroleum Co. and Chevron U.S.A. and,

Whereas, after such review, it appears to be in the best interest of the State to proceed to enter into these agreements.

Now Therefore Be It Resolved that the Alaska Support Industry Alliance hereby does call upon the Legislature of the State of Alaska to expeditiously proceed with passage of those bills which are required to ratify both of the agreements executed by the Commissioner of Natural Resources and the in-state refiners.

Dated this 2nd day of June, 1983

Milton Byrd
Milton Byrd, President

Alaska Support Industry Alliance...for responsible economic development

Milton Byrd — President
Frontier Companies of Alaska
Ann Curtis — Vice President
Crowley Maritime
Paul Harding — Secretary
Universal Services, Inc., Int'l
Joe Mathis — Treasurer
Universal Services, Inc., Int'l
Virgil Gillespie
Alaska International Construction, Inc.
Len Kelley
Greyhound Support Services, Inc
John Martin
Dresser Atlas
Val Molyneu
VECO
Roger Spencer
Alaska Bussell Electric, Inc
Bill Webb
Arctic Hosts, Inc
Chuck Becker
Executive Director

AGO 786487

Alaska State Legislature

HOUSE OF REPRESENTATIVES

COMMITTEE ON RESOURCES

JOHN RINGSTAD, CO-CHAIRMAN
RICHARD SHULTZ, CO-CHAIRMAN
POUCH V
JUNEAU, ALASKA 99811
(907) 465-3715

April 20, 1983

TO: All Members, House & Senate Resources Committee
Joint Oil & Gas Committee

FROM: Committee Staff

RE: Royalty Oil Sales to Tesoro and Chevron
Petroleum Companies

The Senate Resources Committee and members of the Joint Oil & Gas Committee will join the House Resources Committee on Wednesday, April 20, to hear testimony on the proposed State royalty oil sales to Tesoro and Chevron Petroleum Companies. These hearings will be held at 3:00 p.m. in the Senate Finance Committee room.

There are three different contracts before the Legislature for the sale of royalty oil. The first contract is for the sale of approximately 8,200 b/d of Cook Inlet crude to Tesoro Petroleum Company. The contract would commence January 1984, with a term of eleven years. The price term is the weighted average price which the State would have received had the State taken the oil in-value. Tesoro has committed to manufacture the Cook Inlet crude in their Nikiski refinery.

The second contract is between Chevron, USA, and the State. This agreement is for 18,000 b/d of ANS royalty crude which will be run at Chevron's Nikiski refinery. Chevron has agreed to pay $.30 over the producers weighted average field price which the Department of Natural Resources claims will offset and avoid creating any significant downward trend in the oil market. The term of this contract is twelve years.

The third contract before the Committee is an agreement between Tesoro Petroleum Company and the State for the sale of approximately 26,000 b/d of ANS royalty crude. In consideration for the royalty crude, Tesoro has agreed to pay $.30 over the producers weighted average field price to diminish the possible displacement of ANS on the West Coast. Tesoro has further agreed to refine this crude in their Nikiski refinery, which they plan to expand to refine additional petroleum products for sale in Alaska. Because of the concern over Tesoro's agreement with Charter Security Life Insurance Company, which is a subsidiary of Charter Company, this contract provides that if a third party acquires control of Tesoro, the State may cancel the contract at its sole discretion.

Additional information on these three contracts has been attached.

ACO 786488

4/19/83
DNR

ROYALTY OIL INFORMATION

I. Existing Agreements

A. Cook Inlet - Tesoro takes all royalty oil under 1969 contract; expires in 1983; a ten-year renewal is now before the Legislature (HB 320).

B. Prudhoe Bay

1. Golden Valley Electric Association - may take up to 5,000 barrels a day (b/d) under their 1977 agreement which expires in 1984. Currently working with Department on renewal.

2. North Pole Refining (Mapco) - entitled to 15 percent, or up to 35,000 b/d under their 1978 agreement, which expires in 2003.

3. Tesoro - entitled to 24.5 percent, or up to 46,000 b/d under their 1982 agreement, which expires in 1994.

All of the existing Prudhoe Bay agreements were approved by the Alaska Legislature. Two other long-term proposals, by Alpetco and Doyon, were approved by the Legislature in 1978 and 1982, respectively, but have since been terminated.

AGO 786489

The basic provisions of the pending long-term Prudhoe Bay Unit (PBU) agreement,

Tesoro

- an 11-year contract for almost 14 percent of PBU production (about 26,000 b/d at current levels);
- for every barrel, a 30-cent premium over the in-value price;
- special provisions to avert control of Tesoro by Charter;
- enables $90 million expansion of Nikiski refinery by Tesoro; entire quantity must be processed in-state.

Chevron

- an 11-year contract for about 9½ percent of PBU production (about 18,000 b/d at current levels);
- as with Tesoro, a 30-cent premium for each barrel over the in-value price;
- will avert the closure of the Kenai refinery;

- will require the in-state production of specified petroleum products, including asphalt (which is in high demand).

Major benefits of the agreements:

In-state processing of more than 23 percent of Alaska's royalty oil promising

- adequate supplies of gasoline, asphalt, and other petroleum products for Alaskans;
- over $4 3/4 million annually above the amount that would have been received in-value;
- continuation of Chevron's Kenai refinery; nearly $90 million expansion of Tesoro's Nikiski refinery;
- attendant tax base and employment benefits.

AGO 786491

Tesoro Alaska Petroleum Company

March 15, 1983

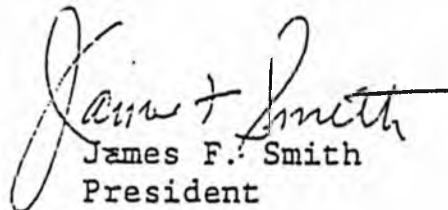
Ms. Esther C. Wunnicke,
Commissioner
State of Alaska
Department of Natural Resources
Pouch M
Juneau, Alaska 99811

Dear Commissioner Wunnicke:

Please find enclosed a fully executed original of the Letter Agreement between the State of Alaska and Tesoro Alaska Petroleum Company concerning third party control of Tesoro.

A copy of this letter has been retained for our records.

Yours very truly,



James F. Smith
President

JFS:pw

AGO 786492

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

POUCH M
JUNEAU, ALASKA 99811
PHONE: (907) 465-2400

March 12, 1983

Mr. James F. Smith
President
Tesoro Alaska Petroleum
Company
8700 Tesoro Drive
San Antonio, Texas 78286

Dear Mr. Smith:

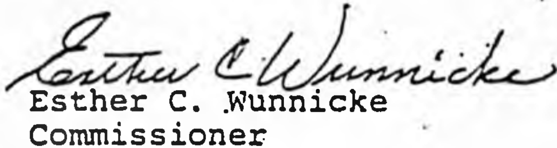
On March 12, 1983, the State of Alaska and Tesoro Alaska Petroleum Company ("Tesoro Alaska") entered into an Agreement for the Sale and Purchase of Royalty Oil (the "Agreement"). Article 7.5 of the Agreement provides that the State may elect to terminate the Agreement in the event that a "third party" obtains "control" (as such terms are defined therein) of Tesoro Alaska or its parent, Tesoro Petroleum Corporation ("Tesoro").

During the negotiations which led to the execution of the Agreement, you informed the State that, on January 26, 1983, two Charter Security Life Insurance Companies, subsidiaries of The Charter Company ("Charter"), had entered into a Purchase Agreement, a Stockholders Agreement, a Registration Rights Agreement and a Certificate of Designation Establishing A Series of $2.20 Cumulative Covertible Preferred Stock (the "agreements") with Tesoro to purchase 2,875,000 shares of a new series of Cumulative Convertible Preferred Stock of Tesoro. Furthermore, those agreements contemplate that the Charter Security Life Insurance Companies or other companies affiliated with The Charter Company may purchase additional shares of Tesoro so that The Charter Company and companies affiliated with The Charter Company may own up to 30 percent of the voting interest in Tesoro. You also informed us that the Charter Security Life Insurance Companies will be entitled to up to three seats on Tesoro's Board of Directors, depending upon the size of Tesoro's Board.

0-J9 LH

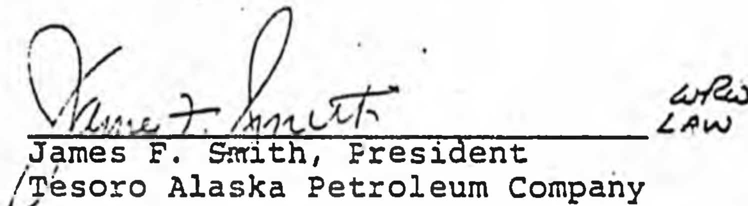
The purpose of this letter is to set forth the understanding and intent of the State and Tesoro Alaska with respect to the application of Article 7.5 of the Agreement to the contemplated relationship between Charter and Tesoro. If the arrangements described in the preceding paragraph are effected, it is the understanding and intent of the parties that Charter and/or its affiliates will not control Tesoro or Tesoro Alaska within the meaning of Article 7.5 of the Agreement. If, however, Charter and/or its affiliates materially increases its or their ability to direct or cause direction of the management and policies of Tesoro or Tesoro Alaska over that contemplated in the agreements, Article 7.5 will be applicable.

Sincerely,



Esther C. Wunnicke
Commissioner

ACCEPTED AND AGREED TO:



James F. Smith, President
Tesoro Alaska Petroleum Company

BILL SHEFFIELD
GOVERNOR

HB 32(

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 31, 1983

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

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill which provides for legislative approval of a royalty oil contract between the state and Tesoro Alaska Petroleum Company for the sale of Cook Inlet royalty oil.

This contract is described in the findings entitled "Proposed Disposition of Royalty Oil, Tesoro Alaska Petroleum Company" issued by the Department of Natural Resources on February 22, 1983. Copies of these findings have been made available to the legislature and the public for review.

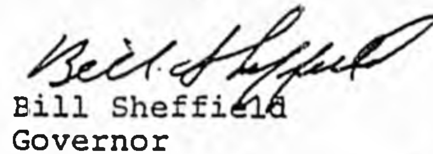
This contract is being submitted for legislative approval for two reasons. First, although this and the previous administration have consistently taken the position that the statutory requirement of legislative approval of royalty oil contracts is unconstitutional (AS 38.06.055), as a matter of comity I respect the legislature's desire to have a direct voice in major disposals of royalty oil. Therefore, this contract contains provisions requiring approval by the legislature before it becomes effective. Second, this bill would ratify the agreement for the sale of oil. This ratification would cure any procedural defect that may have occurred in the process of entering into this contract.

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

AGO 786496

"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 this contract for legislative approval and ratification at this time.

Sincerely,



Bill Sheffield
Governor

STATE OF ALASKA
FISCAL NOTE

Revision Date , 1983

I. REQUEST
Bill/Resolution No.: HB 320
Title: Approving Cook Inlet royalty oil agreement
Sponsor: Governor
Requestor: Governor

II. FISCAL DETAIL
Agency Affected: Natural Resources
Program Category Affected: Mgmt. of Enerc
BRU, Program of Subprogram(s) Affected:
Oil & Gas Mgmt.

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC						
TOTAL OPERATING	0	0	0			
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER (Specify Source)						
	0	0	0			

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						
	0	0	0			

III. SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

IV. ANALYSIS: Attach a separate page for any Analysis

Prepared By: Mark Wittow Mark Wittow Phone: 465-2400
Division: Commissioner's Office, DNR Date: 3/30/83

Approved for by Commissioner: [signature] Date: 3/30/83
Department: Natural Resources

Distribution:
Original to Legislative Finance
Copy to Office of Management and Budget (for Legislature introduced bills)
Copy to Department (for Governor introduced bills)
Copy to Sponsor

AGO 786498

BILL SHEFFIELD
GOVERNOR

HB 370

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

April 19, 1983

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

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill which provides for legislative approval of a royalty oil contract between the state and Chevron, U.S.A., Inc. for the sale of Prudhoe Bay royalty oil.

This contract is described in the findings entitled "Proposed Disposition of Royalty Oil, Chevron, U.S.A." issued by the Department of Natural Resources on March 16, 1983. Copies of these findings have been made available to the legislature and the public for review.

This contract is being submitted for legislative approval for two reasons. First, although this and the previous administration have consistently 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 respect the legislature's desire to have a direct voice in major disposals of royalty oil. Therefore, this contract contains provisions requiring approval by the legislature before it becomes effective. Second, this bill would ratify the agreement for the sale of oil. This ratification would cure any procedural defect that may have occurred in the process of entering into this contract.

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

AGO 786500

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 this contract for legislative approval and ratification at this time.

Sincerely,

Bill Sheffield
Governor

STATE OF ALASKA
FISCAL NOTE

Revision Date , 1983

I. REQUEST
Bill/Resolution No.: HB 370
Title: Chevron Prudhoe Bay Unit Royalty Oil Agreement
Sponsor: Governor
Requestor: Governor

II. FISCAL DETAIL
Agency Affected: Natural Resource Mgm
Program Category Affected: Mgmt. of Energ
BRU, Program of Subprogram(s) Affected: Oil and Gas Management

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC						
TOTAL OPERATING	0	0	0	0		
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
GENERAL FUND						
FEDERAL FUNDS						
OTHER (Specify Source)	0	0	0	0		

POSITIONS:

	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
FULL-TIME						
PART-TIME						
TEMPORARY						
	0	0	0	0		

III. SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

IV. ANALYSIS: Attach a separate page for any Analysis

Prepared By: Mark Wittow Mark Wittow Phone: 465-2400
Division: Commissioner's Office, DNR Date: 4/8/83

Approved for by Commissioner: [signature] Date: 4/8/83
Department: Natural Resources

Distribution:
Original to Legislative Finance
Copy to Office of Management and Budget (for Legislature introduced bills)
Copy to Department (for Governor introduced bills)
Copy to Sponsor
Copy to Requestor (if different from Sponsor)

AGO 786502

BILL SHEFFIELD
GOVERNOR

+16371

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

April 19, 1983

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

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill which provides for legislative approval of a royalty oil contract between the state and Tesoro Alaska Petroleum Company for the sale of Prudhoe Bay royalty oil.

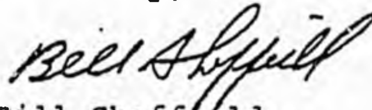
This contract is described in the findings entitled "Proposed Disposition of Royalty Oil, Tesoro Alaska Petroleum Company" issued by the Department of Natural Resources on March 16, 1983. Copies of these findings have been made available to the legislature and the public for review.

This contract is being submitted for legislative approval for two reasons. First, although this and the previous administration have consistently 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 respect the legislature's desire to have a direct voice in major disposals of royalty oil. Therefore, this contract contains provisions requiring approval by the legislature before it becomes effective. Second, this bill would ratify the agreement for the sale of oil. This ratification would cure any procedural defect that may have occurred in the process of entering into this contract.

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 this contract for legislative approval and ratification at this time.

Sincerely,



Bill Sheffield
Governor

STATE OF ALASKA
FISCAL NOTE

Revision Date , 1983

I. REQUEST
Bill/Resolution No.: HB 371
Title: Tesoro Prudhoe Bay Unit Royalty oil Agreement
Sponsor: Governor
Requestor: Governor

II. FISCAL DETAIL
Agency Affected: Natural Resource Mgmt.
Program Category Affected: Mgmt. of Enerc
BRU, Program of Subprogram(s) Affected: Oil and Gas Management

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
OPERATING						
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC						
TOTAL OPERATING	0	0	0	0		
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
GENERAL FUND						
FEDERAL FUNDS						
OTHER (Specify Source)	0	0	0	0		

POSITIONS:

	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
FULL-TIME						
PART-TIME						
TEMPORARY						
	0	0	0	0		

III. SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

IV. ANALYSIS: Attach a separate page for any Analysis

Prepared By: Mark Wittow [signature] Phone: 465-2400
Division: Commissioner's Office, DNR Date: 4/8/83

Approved By Commissioner: [signature] Date: 4/8/83
Department: Natural Resources

Distribution:
Original to Legislative Finance
Copy to Office of Management and Budget (for Legislature introduced bills)
Copy to Department (for Governor introduced bills)
Copy to Sponsor
Copy to Requestor (if different from Sponsor)

AGO 786506

3/8/

RECEIVED
MAR 15 1983
Department of
Natural Resources

EXHIBIT C

STOCKHOLDERS AGREEMENT

This Stockholders Agreement is entered into this 26th day of January, 1983, between CHARTER SECURITY LIFE INSURANCE COMPANY, a New Jersey corporation, and CHARTER SECURITY LIFE INSURANCE COMPANY (NEW YORK), a New York corporation (collectively "Charter" and individually "the Purchasers") and TESORO PETROLEUM CORPORATION, a Delaware corporation ("Tesoro").

W I T N E S S E T H:

WHEREAS, Charter has agreed to purchase from Tesoro and Tesoro has agreed to sell to Charter 2,875,000 shares of Tesoro's $2.20 Cumulative Convertible Preferred Stock (the "Preferred Stock") pursuant to, and in accordance with, a Purchase Agreement (the "Purchase Agreement") dated January 26, 1983 between Tesoro and Charter; and

WHEREAS, as contemplated by the Purchase Agreement, Tesoro and Charter wish to provide for certain arrangements with respect to the Preferred Stock and any shares of common stock (the "Common Stock") of Tesoro which Charter may receive upon conversion of the Preferred Stock or may otherwise acquire from time to time, including the 504,000 shares of Common Stock owned by Charter on the date hereof (such shares of Common Stock and the Preferred Stock are hereinafter referred to as the "Stock") and with respect to certain relationships between Tesoro and Charter;

NOW, THEREFORE, Tesoro and Charter agree as follows:

Section 1. Representations and Warranties.

1.1 Representations and Warranties of Tesoro. Tesoro hereby represents and warrants to Charter as follows:

(a) Tesoro is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware.

(b) The authorized capital stock of Tesoro consists of (i) 50,000,000 shares of Tesoro common stock, of which at January 1, 1983, 13,708,403 shares were validly issued and outstanding, fully paid and nonassessable and no shares were held in Tesoro's treasury and (ii) 5,000,000 series preferred shares, with no par value, of which, at January 1, 1983, 40,000 were designated 8% Convertible Preferred Stock, of which 1,000 were validly issued and outstanding, 4,600,000 were designated $2.16 Cumulative Convertible Preferred Stock, of which 1,323,862 were validly issued and outstanding. In addition, at January 1, 1983, an aggregate of 1,620,619 shares of Tesoro common stock and 200,000 shares of $2.16 Cumulative Preferred Stock (including authorized but unissued shares and treasury shares) were reserved for issuance pursuant to currently existing and future stock incentives, under currently existing stock incentive plans and an aggregate of 2,473,902 shares were reserved for issuance upon conversion of Tesoro's preferred shares and convertible debentures. There are outstanding no other options, warrants, rights or convertible securities providing for the issuance of Tesoro capital stock.

(c) Tesoro has full legal right, power and authority to enter into and perform this Agreement, and the execution and delivery of this Agreement by Tesoro and the consummation of the transactions contemplated hereby have been duly authorized by the Board of Directors of Tesoro and require no other action by the Board of Directors or stockholders of Tesoro. This Agreement constitutes a valid and binding agreement of Tesoro.

1.2 <u>Representations and Warranties of Charter.</u> Charter hereby represents and warrants to Tesoro as follows:

(a) Each of the Purchasers is a corporation duly organized, validly existing and in good standing under the laws of their respective states of incorporation as set forth above.

(b) Charter has full legal right, power and authority to enter into and perform this Agreement, and the execution and delivery of this Agreement by Charter and the consummation of the transactions contemplated hereby have been duly authorized by the Board of Directors of Charter and require no other action by the Board of Directors or stockholders of Charter. This Agreement constitutes a valid and binding agreement of Charter, except that no representation or warranty is made that the restrictions contained in Sections 3.1, 3.2 and 3.3 of this Agreement will be enforceable.

AGO 786508

Section 2. Covenants of Charter with Respect to the Stock and Other Matters.

2.1 Restrictions on Resale or Other Disposition. Until the Expiration Date (as defined in Section 4.1) or the early termination of this Agreement pursuant to Section 4.2 or Section 4.4. Charter covenants and agrees that for so long as it or any of its affiliates owns, directly or indirectly, any Stock or any voting securities of Tesoro (any and all voting securities of Tesoro, including the Stock, are hereinafter referred to as the "Tesoro Voting Securities"), or any other Tesoro securities convertible into or exchangeable or exercisable for the purchase of Tesoro Voting Securities (all such other Tesoro securities and the Tesoro Voting Securities are hereinafter referred to as the "Tesoro Restricted Securities"), Charter and its affiliates will not sell, transfer, pledge, hypothecate or otherwise dispose of any Tesoro Restricted Securities, or any beneficial interest therein, except with the prior written consent of Tesoro. Such consent shall be conclusively presumed and may not be withdrawn by Tesoro, if the proposed sale, transfer, pledge, hypothecation or other disposition is to occur pursuant to:

(a) a public offering of Stock pursuant to the registration rights granted under the Registration Rights Agreement between Tesoro and Charter dated January 26, 1983 (the "Registration Rights Agreement") made in accordance with Section 2.2; or

(b) sales of Stock made in accordance with Rule 144 of the General Rules and Regulations of the Securities and Exchange Commission under the Securities Act of 1933, as amended (the "Securities Act") or sales in conventional brokerage transactions made in compliance with all applicable securities laws, provided that such sales are made in accordance with Section 2.2 and further provided that Charter shall notify Tesoro at least two days prior to the date of entering any such sale or transfer order by Charter, and provided further that, if Tesoro shall thereupon notify Charter of the pendency of a sale under any public offering by it of any Tesoro Voting Securities, and if the managing underwriter of such public offering shall advise Charter that in its good faith judgment sales by Charter pursuant to this paragraph (b) would make it impracticable to conduct Tesoro's public offering at the price at which the securities to be sold in such public offering could be sold without such sales by Charter pursuant to this paragraph (b), neither Charter nor any of its affiliates shall effect any sales pursuant to this paragraph (b) within 10 days prior to the commencement of or during such offering; or

AGO 786509

(c) sales of Stock pursuant to a tender offer or exchange offer which the Board of Directors of Tesoro does not oppose; or

(d) sales of Stock which are exempt from the registration provisions of the Securities Act, provided that no sales of Stock shall be made to any person or group (within the meaning of the Securities Exchange Act of 1934, as amended (the "Exchange Act")), if Charter knows, or upon the exercise of its best efforts, should have known, that the person or group purchasing such Stock owns, or will own, directly or indirectly, following such sale, Tesoro Voting Securities having an aggregate of 5% or more of the voting power of all of the then outstanding Tesoro Voting Securities (assuming for the purposes of such calculation that all Tesoro securities which may, by their terms, be converted into Tesoro Voting Securities without the payment to Tesoro of any consideration, have been so converted) and provided that, prior to making such sales, Charter and its affiliates comply with the provisions of Section 2.3 hereof; or

(e) sales of Stock which are exempt from the registration provisions of the Securities Act, provided that each person purchasing such Stock executes and is bound by an agreement with Tesoro which contains the provisions and restrictions of this Stockholders Agreement and provided that, prior to making such sales, Charter and its affiliates comply with the provisions of Section 2.3 hereof.

2.2 Covenant with Respect to Distribution of Shares. In any transaction or transactions described in Section 2.1(a) or (b), the seller of Stock will use its best efforts to effect the sale or transfer of such Stock in a manner which will effect the broadest possible distribution, with no sales or transfers of Stock to any one person or group (within the meaning of the Exchange Act) in excess of 3% of the then outstanding Tesoro Voting Securities.

2.3 Right of First Refusal. Prior to any sale of shares of Stock pursuant to Sections 2.1(d) or (e), Charter or its affiliates shall notify Tesoro, in writing (the "Purchase Notice"), of their intention to sell such Stock, stating the identity of the purchaser, the price at which the shares of Stock are to be sold, the proposed manner in which sales will be made, the number of shares of Stock to be sold, the proposed closing date for such sales (which closing date may be set by Charter irrespective of any time periods relating to actions to be taken by Tesoro as set forth in Section 2.4) and the other terms and conditions of the sale. In the event that sales are to be made to more than one purchaser, a separate Purchase Notice shall be given with respect to each purchaser. Tesoro shall have, during the periods specified in Section 2.4, the right and option to purchase all, but not less than all, of the shares

of Stock covered by any Purchase Notice in the manner set forth in Section 2.4. In the event that Tesoro notifies Charter that it does not intend to exercise its option or if it does not exercise its option within the periods specified in Section 2.4, Charter and its affiliates may sell the shares covered by the Purchase Notice, at no less than the price, in substantially the manner and to the purchaser specified in the Purchase Notice, provided that such sales are consummated within 120 days of the written notification to Charter by Tesoro that Tesoro does not intend to exercise its option or the failure by Tesoro to exercise its option within the time periods specified in Section 2.4.

2.4 Exercise of First Refusal Right. Tesoro may exercise its right and option arising under Sections 2.3, 4.3(a), 4.3(b) and 4.5 by giving Charter notice in writing ("Notice of Exercise"), within the 15 day period following receipt by Tesoro of the Purchase Notice, of Tesoro's election, subject, if Tesoro so desires, to obtaining financing for the purchase, to exercise its option to purchase all, but not less than all, of the shares covered by the Purchase Notice. The Notice of Exercise shall state the amount and terms of the financing, if any, which Tesoro shall require in connection with its purchase. Tesoro shall use its best efforts during the period ending 60 days after the receipt by Tesoro of the Purchase Notice, to obtain financing in the amount and on the terms specified in the Notice of Exercise. If Tesoro shall arrange financing within such period on terms at least as favorable to Tesoro as those specified in the Notice of Exercise, Tesoro shall, or if Tesoro has not been able within such period to arrange such financing, Tesoro may, at its option, notify Charter of its irrevocable election to purchase the shares covered by the Purchase Notice and shall specify the closing date for the purchase, which shall be a date not more than 90 days after the date on which the Purchase Notice was delivered to Tesoro. On such closing date, Charter shall deliver or cause to be delivered the certificate or certificates representing the appropriate number of shares, endorsed in blank or with appropriate stock powers attached, to Tesoro, or to such other purchaser as Tesoro shall designate to Charter, in writing, against payment of the purchase price by certified or official bank check payable in New York Clearing House funds. The purchase price payable for any shares purchased pursuant to this Section 2.4(c) shall be an amount in cash equal in value to the price set forth in the Purchase Notice, with any property, notes, securities or other non-cash consideration included in the price set forth in the Purchase Notice being valued by agreement between Tesoro and Charter or, in lieu of such agreement, by a nationally recognized investment banking firm agreeable to Tesoro and Charter, plus, with respect to shares of Preferred Stock, the dividends which have accrued and remained unpaid on the shares of Preferred Stock to be purchased during the period

AGO 786511

between the proposed closing date specified in the Purchase Notice and the actual closing date for the purchase of such shares by Tesoro. With respect to shares of Common Stock purchased by Tesoro, Tesoro shall pay to Charter, at the end of the fiscal quarter in which the actual closing date occurred, the pro rata (based on the number of days such shares of Common Stock were owned by Charter during such fiscal quarter) amount of the dividends, if any, that would have been paid on the shares of Common Stock purchased by Tesoro had they been owned by Charter during all of such fiscal quarter. In the event that Tesoro shall fail to give a Notice of Exercise within the 15 day period set forth above, or having given such Notice of Exercise, shall fail to notify Charter of its irrevocable election to purchase the shares covered by the Purchase Notice within the 60 day period from the receipt by Tesoro of the Purchase Notice as set forth above, then Charter may sell the shares covered by the Purchase Notice in the manners specified in Sections 2.3, 4.3(a) and 4.3(b).

Section 3. Voting, Ownership and Other Restrictions.

3.1 Obligation to be Counted for Quorum. Charter agrees, as a stockholder, to be present, and to use its best efforts to cause its affiliates who are stockholders of Tesoro to be present, in person or to be represented by proxy, at all stockholder meetings of Tesoro so that all shares of Tesoro Restricted Securities beneficially owned by Charter or its affiliates may be counted for the purpose of determining the presence of a quorum at such meetings.

3.2 Voting by Charter. Charter and its affiliates agree, as stockholders, if so requested by the Board of Directors of Tesoro, to vote or cause to be voted all Tesoro Restricted Securities beneficially owned by them in the same proportion as the votes cast by or on behalf of all other holders of Tesoro Voting Securities, except that Charter and its affiliates may vote at all times in their discretion with respect to any matter that would materially and adversely affect Charter if it did not own Tesoro securities and with respect to any amendment of the Certificate of Incorporation or By-Laws of Tesoro which imposes limitations on the legal rights of Charter as a Tesoro stockholder, other than those imposed pursuant to the terms hereof, based on the size of security holdings or other considerations applicable to Charter and not to security holders of Tesoro generally.

3.3 Certain Agreements of Charter. Charter and its affiliates shall not, unless the prior written consent of the Board of Directors of Tesoro has been obtained (and then only to the extent such written consent has been obtained):

AGO 786512

(a) solicit proxies or become a "participant" in a "solicitation" (as such terms are defined in Regulation 14A under the Exchange Act) in opposition to the recommendation of the Board of Directors of Tesoro with respect to any matter; or

(b) deposit any Tesoro Voting Securities in a voting trust or subject them to a voting agreement or other arrangement of similar effect; or

(c) acquire or offer to acquire or agree to acquire, directly or indirectly, by purchase or otherwise, any Tesoro Restricted Securities, if after such acquisition Charter and its affiliates would own, directly or indirectly, Tesoro Voting Securities representing more than 30% of the combined voting power of all Tesoro Voting Securities (assuming for the purposes of such calculation that all Tesoro securities which may, by their terms, be converted into Tesoro Voting Securities without the payment to Tesoro of any consideration, have been so converted); or

(d) join or permit any affiliate of Charter to join a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, holding or disposing of Tesoro Voting Securities within the meaning of Section 13(d) of the Act unless such partnership, limited partnership, syndicate, or other group consists solely of Charter and its affiliates; or

(e) initiate, propose or otherwise solicit stockholders for any matter at any time, or induce or attempt to induce any other person to initiate any stockholder proposal or a tender offer for shares of Tesoro securities or any change of directors or control of Tesoro, or for the purpose of convening a stockholders' meeting of Tesoro; or

(f) acquire, other than for investment purposes, by purchase or otherwise, shares representing more than 5% of the voting power of all of the voting securities of any entity, if Charter or its affiliates know, or in the exercise of their best efforts, should have known, that such entity and its affiliates are the beneficial owner of Tesoro Voting Securities having an aggregate of 5% or more of the voting power of all of the then outstanding Tesoro Voting Securities; or

(g) take any action as a Tesoro stockholder by written consent in lieu of a meeting.

3.4 <u>Legend and Stop Transfer Order</u>. To assist in effectuating the provisions of this Agreement, Charter and its affiliates hereby consent:

(a) to the placement of the following legend on all certificates representing ownership of Tesoro Restricted Securities beneficially owned by Charter or its affiliates until such shares have been sold, transferred or disposed of pursuant to the requirements of Section 2 hereof, at which time Tesoro will promptly remove such legend:

> The shares represented by this certificate are subject to the provisions of an Agreement among Tesoro Petroleum Corporation, Charter Security Life Insurance Company and Charter Security Life Insurance Company (New York), and may not be sold, transferred, pledged, hypothecated or otherwise disposed of except in accordance therewith. A copy of said Agreement is on file at the office of the Secretary of Tesoro Petroleum Corporation.

(b) to the entry of a stop transfer order with the transfer agent or agents of Tesoro securities against the transfer of the Tesoro Restricted Securities except in compliance with the requirements of this Agreement, which stop transfer order shall be removed promptly from the shares being transferred upon transfer in compliance with the requirements of this Agreement, or if Tesoro is its own transfer agent with respect to any Tesoro Restricted Securities, to the refusal by Tesoro to transfer any such securities except in compliance with the requirements of this Agreement.

3.5 Certain Agreements of Tesoro. Tesoro agrees that it will not, at any time prior to the earlier of the Expiration Date (as defined in Section 4.1 hereof) or any early termination of this Agreement pursuant to Section 4.2 or Section 4.4 hereof, unless the prior written consent of Charter has been obtained, acquire or offer to acquire or agree to acquire, directly or indirectly, by purchase or otherwise, any voting securities of The Charter Company.

Section 4. Term of Agreement; Certain Provisions Regarding Termination.

4.1 Term of Agreement. Except as otherwise provided in Section 4.2 or Section 4.4, the respective covenants and agreements of Charter and its affiliates and Tesoro contained in this Agreement will continue in full force and effect from the date first above written until January 25, 1993 (such date being referred to herein as the "Expiration Date"). Upon the Expiration Date, unless there is an early termination of this Agreement pursuant to Section 4.2 (in which case the continuing rights and obliga-

AGO 786514

tions of Charter and its affiliates and Tesoro shall be governed by Section 4.3) or Section 4.4 (in which case the continuing rights and obligations of Charter and its affiliates and Tesoro shall be governed by that Section), all rights and obligations of Charter and its affiliates and Tesoro shall terminate except as specifically provided in Section 4.5.

4.2 Early Termination. Charter may, at its sole option, 10 days after written notice (the "Termination Notice") has been received by Tesoro, terminate this Agreement prior to the Expiration Date, if one of the following events has occurred:

(i) if, in Charter's opinion, there is a change in the members of Tesoro's senior officer group which significantly affects the business strategy or prospects of Tesoro;

(ii) if, at any time, in the opinion of Charter's independent public acountants, Charter may no longer account for its ownership of Tesoro Common Stock using the equity method (Charter's accountants shall assume, for the purpose of making this determination, that the number of shares of Tesoro Voting Securities held by Charter is the number that would be obtained if it were assumed that Charter initially purchased 2,875,000 shares of Preferred Stock and 1,625,000 shares of Common Stock and that Charter made no transfers or other dispositions (other than conversions of Preferred Stock to Common Stock) of any Tesoro Restricted Securities held by it from the time of such initial purchase to the time of the determination);

(iii) if any one of the individuals designated by Charter and accepted by Tesoro, pursuant to Section 5 below, for election to the Board of Directors of Tesoro, is not nominated for election as a director or is not elected as a director of Tesoro (other than by reason of such individual's incapacity or unwillingness to serve);

(iv) if, at any time, Tesoro shall be in default in the payment of dividends on the Preferred Stock in an amount equivalent to or exceeding four quarterly dividends (whether or not consecutive) and Charter shall, at such time, own any shares of Preferred Stock;

(v) if, at any time, Tesoro shall be adjudicated as bankrupt or insolvent, or admit in writing its inability to pay its debts as they mature, or make an assignment for the benefit of creditors, or shall apply for or consent to the appointment of any receiver, trustee, or similar officer for it or for all or any

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substantial part of its property, or such receiver, trustee or similar officer shall be appointed without the application or consent of Tesoro or Tesoro shall institute any bankruptcy, insolvency, readjustment of debt or similar proceeding relating to the rights of creditors or if any such proceedings shall be commenced against Tesoro and shall remain undismissed for 60 days; or

(vi) if, at any time, indebtedness of Tesoro (except indebtedness as to which there is no recourse against Tesoro or any of its subsidiaries and except an amount of purchase money mortgage indebtedness not exceeding in the aggregate the lesser of (i) 5% of the total assets of Tesoro and its subsidiaries on a consolidated basis or (ii) $50 million, which indebtedness was incurred with respect to special project financings and with respect to which the only recourse is against subsidiaries of Tesoro formed specifically to accommodate such financings) in an amount in excess of $10 million shall become due and payable, by reason of a default, prior to the date on which such indebtedness was, by its terms, to become due and payable or if, at any time, Tesoro shall receive a notice that such an amount of indebtedness will become due and payable, by reason of a default, prior to the date on which such indebtedness was, by its terms, to become due and payable, and such notice shall not be properly waived or withdrawn within 30 days of its receipt by Tesoro.

Ten days after receipt by Tesoro of the written notice by Charter pursuant to this Section 4.2 electing to terminate this Agreement, unless such notice shall have been rescinded by Charter in writing, all rights and obligations of Tesoro and Charter under this Agreement shall terminate except as shall be provided in Section 4.3. hereof. For purposes of clause (i), "senior officer group" shall mean executives at or above the level currently designated as group vice president; also, the retirement or other loss of members of senior management who at the date of this Agreement are age 63 or older shall not be the basis for a Termination Notice.

4.3 <u>Rights of Tesoro and Charter Upon Early Termination</u>. If, at any time prior to the Expiration Date, Charter shall terminate this Agreement pursuant to Section 4.2 above, the following provisions shall apply:

(a) <u>Right of First Refusal</u>. Prior to any sale by Charter or its affiliates of shares of Common Stock pursuant to Sections 2.1(d) or (e) or pursuant to a bona fide offer by a person unaffiliated with Charter to purchase shares of Common Stock, other than sales pursuant to Sec-

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tions 2.1(a), (b) or (c), which sale is to occur during the two year period following the effective date of the early termination of this Agreement pursuant to Section 4.2 but in no event later than the Expiration Date (the "Common Stock Restricted Period") and prior to any sale by Charter or its affiliates of shares of Preferred Stock pursuant to Sections 2.1(d) or (e) or pursuant to a bona fide offer by a person unaffiliated with Charter to purchase shares of Preferred Stock, other than sales pursuant to Sections 2.1(a), (b) or (c), which sale is to occur during the five year no call period of the Preferred Stock (the "Preferred Stock Restricted Period"), Charter or its affiliates shall notify Tesoro in writing (the "Purchase Notice") of such proposed sale, naming the prospective purchaser, stating the price at which the shares are to be sold, the number of shares sought to be purchased and the other terms and conditions of the proposed sale. In the event that sales are to be made to more than one prospective purchaser, a separate Purchase Notice shall be given with respect to each prospective purchaser. Tesoro shall have, during the periods specified in Section 2.4, the right and option to purchase all, but not less than all, of the shares covered by any Purchase Notice in the manner set forth in Section 2.4. In the event that Tesoro notifies Charter that it does not intend to exercise its option or if it does not exercise its option within the periods specified in Section 2.4, Charter or its affiliates may sell the shares covered by the Purchase Notice to the purchaser at no less than the price and in substantially the manner specified in the Purchase Notice, provided that such sale is consummated within 120 days of the written notification to Charter by Tesoro that Tesoro does not intend to exercise its option or the failure by Tesoro to exercise its option within the time periods specified in Section 2.4.

(b) Right of Repurchase. Tesoro shall have the right, during the Common Stock Restricted Period, to repurchase any or all shares of Common Stock of Tesoro owned by Charter or its affiliates on the effective date of the early termination of this Agreement or received thereafter upon conversion of Preferred Stock. Tesoro may exercise this right of repurchase by notifying Charter in writing (the "Repurchase Notice") of such intention, which Repurchase Notice shall set a closing date for the repurchase of the shares covered by such Repurchase Notice, which closing date shall be a date not less than 120 days or more than 180 days after the date of the Repurchase Notice. If during the 90 day period following the receipt by Charter of the Repurchase Notice Charter or its affiliates shall receive a bona fide offer by a person unaffiliated with Charter to purchase any or all of the shares covered by the Repurchase Notice, which offer Charter or its affiliates intends to accept, then Charter shall notify Tesoro of such offer by means of a Purchase Notice in the manner provided in subparagraph (a) above and Tesoro shall have the right and

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option to purchase all, but not less than all of the shares covered by such offer as provided in subparagraph (a) above. Tesoro may purchase at the closing date specified in the Repurchase Notice any or all shares covered by the Repurchase Notice for which no bona fide offer is received by Charter or its affiliates during the 90 day period following receipt by Charter of the Repurchase Notice at a price per share which shall equal 110% of the average closing price for a share of Tesoro Common Stock on the New York Stock Exchange for the 10 trading days immediately preceding such purchase. On the closing date specified in the Repurchase Notice, Charter or its affiliates shall deliver or cause to be delivered the certificate or certificates representing the appropriate number of shares, endorsed in blank or with appropriate stock powers attached, to Tesoro, or to such purchaser as Tesoro shall designate to Charter, in writing, against payment of the purchase price by certified or official bank check payable in New York Clearing House funds.

(c) Restrictions on Transfer. Charter or its affiliates shall not sell, assign or otherwise transfer any shares of Common Stock during the Common Stock Restricted Period or any shares of Preferred Stock during the Preferred Stock Restricted Period except in the manner provided in paragraphs (a), (b), (c), (d) and (e) of Section 2.1 or pursuant to bona fide offers by persons unaffiliated with Charter after complying with the provisions of this Section 4.3.

(d) Restrictions on Purchase. During the Preferred Stock Restricted Period, so long as Charter or its affiliates shall own any shares of Preferred Stock, Charter and its affiliates shall continue to be subject to the restrictions contained in Section 3 hereof. If Charter or its affiliates shall desire that such restrictions shall no longer apply, Charter shall notify Tesoro in writing (the "Restrictions Notice") of such desire. Tesoro shall have the right and option, for a period of 60 days following the receipt of the Restrictions Notice, to purchase any or all of the shares of Preferred Stock owned by Charter or its affiliates at the price of $20 per share plus accrued and unpaid dividends, if any. Tesoro may exercise this right and option by giving Charter notice in writing of Tesoro's election, which notice shall specify the number of shares of Preferred Stock to be purchased and the closing date for the purchase, which shall be a date not more than 90 days after the receipt by Tesoro of the Restrictions Notice. Tesoro may pay the purchase price of the shares of Preferred Stock, by delivery to Charter at the closing of, (i) a certified or official bank check (the "Check") payable in New York Clearing House funds for at least 20% of the aggregate purchase price and (ii) a note (the "Note") for the remaining amount of the aggregate purchase price. The Note shall bear interest at the rate that Charter would charge in a loan to a

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company with a credit rating comparable to Tesoro at the date the Restrictions Notice is received by Tesoro. The principal amount of the Note shall be payable in equal annual installments, plus all accrued and unpaid interest, on each succeeding anniversary of the closing date, provided that Tesoro shall pay any unpaid principal amount and all accrued and unpaid interest on the last day of the Preferred Stock Restricted Period and provided that the principal amount of the Note, or any portion thereof, may be prepaid without penalty at any time. Upon delivery to Charter of the Check and the Note, if applicable, on the closing date, Charter and its affiliates shall deliver or cause to be delivered the certificate or certificates representing the appropriate number of shares, endorsed in blank or with stock powers attached, to Tesoro or to such other person as Tesoro shall designate to Charter, in writing. If Tesoro shall have assigned its right to purchase any of the shares covered by the Restrictions Notice to any other purchaser, Tesoro shall unconditionally guaranty all the obligations of such purchaser under the Note, if any, delivered to Charter at the closing. Upon such a closing, or if Tesoro shall have not elected to purchase any shares of Preferred Stock, on the date 61 days after the receipt by Tesoro of the Restrictions Notice, Charter and its affiliates shall cease to be subject to the restrictions contained in Section 3 hereof.

4.4 Other Termination. If, at any time, the Tesoro Voting Securities held by Charter or its affiliates shall represent less than 5% of the voting power of all the then outstanding Tesoro Voting Securities, both Tesoro and Charter shall have the option, during such time as Charter or its affiliates shall continue to own Tesoro Voting Securities representing less than 5% of the voting power of all the then outstanding Tesoro Voting Securities, to terminate this Agreement by written notification to the other party. Ten days after the receipt of such written notice by the other party all rights and obligations of Tesoro and Charter under this Agreement shall terminate.

4.5 Rights of Tesoro and Charter Upon Expiration. After the Expiration Date, for so long as Charter or its affiliates own any of the shares of Stock that were owned by them on the Expiration Date, unless this Agreement has been terminated prior to the Expiration Date pursuant to Section 4.2 (in which case the continuing rights and obligations of Charter and its affiliates and Tesoro shall be governed by Section 4.3) or Section 4.4 (in which case the continuing rights and obligations of Charter and its affiliates and Tesoro shall be governed by that Section), Charter and its affiliates shall not transfer any shares of Stock that were owned by Charter or its affiliates on the Expiration Date, or any interest therein, except pursuant to a bona fide sale. Tesoro shall have a right of first refusal with re-

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spect to any such bona fide sales ("Restricted Transfers") except sales of Stock made by Charter or its affiliates in the manner specified in Sections 2.1(a), (b), (c) or (d); provided that with respect to any sale of stock in the manner specified in Section 2.1(d), such sale need not comply with Section 2.3. Prior to any Restricted Transfer, Charter or its affiliates shall notify Tesoro, in writing (the "Purchase Notice") of their intention to sell such Stock, stating the identity of the purchaser., the price at which the shares of Stock are to be sold, the proposed manner in which sales will be made, the number of shares of Stock to be sold, the proposed closing date for such sales (which closing date may be set by Charter irrespective of any time periods relating to actions to be taken by Tesoro as set forth in Section 2.4) and the other terms and conditions of the sale. In the event that sales are to be made to more than one purchaser, a separate Purchase Notice shall be given with respect to each purchaser. Tesoro shall have, during the periods specified in Section 2.4, the right and option to purchase all, but not less than all, of the shares of Stock covered by any Purchase Notice in the manner set forth in Section 2.4. In the event that Tesoro notifies Charter that it does not intend to exercise its option or if it does not exercise its option within the periods specified in Section 2.4, Charter and its affiliates may sell the shares covered by the Purchase Notice, at no less than the price, in substantially the manner and to the purchaser specified in the Purchase Notice, provided that such sales are consummated within 120 days of the written notification to Charter by Tesoro that Tesoro does not intend to exercise its option or the failure by Tesoro to exercise its option within the time periods specified in Section 2.4.

Section 5. Election of Directors. Tesoro agrees that it will nominate and use its best efforts to the end that two individuals (or, if the total number of directors of Tesoro other than those designated by Charter shall equal or exceed 15, three individuals) designated by Charter and reasonably acceptable to Tesoro shall be, at all times, members of the Board of Directors of Tesoro; provided, however, that at any time when Charter and its affiliates beneficially own shares of Tesoro Voting Securities with less than an aggregate of 1,850,000 votes but more than an aggregate of 925,000 votes, Charter shall have the right to designate one such individual (or, if the total number of directors of Tesoro other than those designated by Charter shall equal or exceed 15, two individuals) and Charter shall use its best efforts to cause one of its designees on the Tesoro Board of Directors to resign forthwith; and provided, further, however, that at any time when Charter and its affiliates beneficially own shares of Tesoro Voting Securities with an aggregate of 925,000 votes or less, Charter shall not have the right to designate any such person and Charter shall use its best efforts to cause its designee or

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designees on the Tesoro Board of Directors to resign forthwith. Charter's rights under this Section 5 shall be in addition to any rights which Charter may have as a holder of Preferred Stock.

Section 6. General

6.1 Specific Enforcement; Other Remedies. (a) Charter acknowledges and agrees that Tesoro would be irreparably damaged in the event any of the provisions of this Agreement were not performed by Charter and its affiliates in accordance with their specific terms or were otherwise breached. It is accordingly agreed that Tesoro shall be entitled to an injunction or injunctions to prevent breaches of the provisions of this Agreement and to enforce specifically the terms and provisions hereof in any court of the United States or any state thereof having jurisdiction, in addition to any other remedy to which Tesoro may be entitled at law or equity.

(b) In the event any of the provisions of this Agreement are not performed by Tesoro in accordance with their specific terms or are otherwise breached, Charter and its affiliates shall be entitled to an injunction or injunctions to prevent breaches of the provisions of this Agreement and to enforce specifically the terms and provisions thereof or seek recovery of money damages in any court of the United States or any state thereof having jurisdiction, in addition to any other remedy to which Charter and its affiliates may be entitled at law or equity, provided that any such nonperformance or breach shall not entitle Charter to terminate this Agreement prior to the Expiration Date unless such non-performance or breach was willful and material and further provided that no action taken by Tesoro which constitutes an event specified in Section 4.2 or which causes an event specified in Section 4.2 to occur, shall entitle Charter to terminate this Agreement except in the manner specified in Section 4.2.

6.2 Severability. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction to be invalid, void, or unenforceable, the remainder of the terms, provisions, covenants and restrictions shall remain in full force and effect and shall in no way be affected, impaired or invalidated. It is hereby stipulated and declared to be the intention of the parties that they would have executed the remaining terms, provisions, covenants and restrictions without including any of such which may be hereafter declared invalid, void or unenforceable.

6.3 Definitions. As used herein the term "affiliate" shall have the meaning set forth in Rule 12b-2 under the Exchange Act and shall also include any person

acting on behalf of a person or its affiliate, the term "person" shall mean any individual, partnership, corporation, trust or other entity and the term "voting power" shall refer to the ordinary right of the holder of a security to vote for the election of directors (without reference to any special rights which may arise with respect to defaults in the payment of dividends or defaults under any other terms of preferred stock).

6.4 Amendments. This Agreement may be amended only by an agreement in writing.

6.5 Descriptive Headings. Descriptive headings are for convenience only and shall not control or affect the meaning or construction of any provision of this Agreement.

6.6 Counterparts. For the convenience of the parties, any number of counterparts of this Agreement may be executed by either party hereto and each such executed counterpart shall be, and shall be deemed to be, an original instrument.

6.7 Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of and be enforceable by the successors and assigns of the parties hereto except that Tesoro may only assign its rights of repurchase and first refusal set forth in Sections 2.3, 4.3 and 4.5 in the manner provided in those Sections.

6.8 Transfers. Nothing in this Agreement shall prohibit transfers of Tesoro Voting Securities among Charter and controlled affiliates of Charter, so long as all limitations and covenants herein on the part of Charter shall apply to such controlled affiliates to the same extent as they apply to Charter.

6.9 Accounting Matters. Tesoro will, and will cause its employees, independent public accountants and other representatives to, provide all information and any certificates or documents to, and otherwise cooperate with, Charter so as to enable Charter to (i) account for its investment in Tesoro pursuant to the equity method, (ii) prepare financial statements and related information in accordance with generally accepted accounting principles and with statutory accounting principles applicable to insurance companies and (iii) to comply with its reporting requirements and other disclosure obligations under applicable laws and regulations. In that regard, Tesoro acknowledges and agrees not to dispute that Charter has the ability, by virtue of its ownership of Stock or its representation on Tesoro's Board of Directors, to influence the management of Tesoro. Nothing in this Section 6.9 shall restrict the right of Tesoro to issue its securities at any time.

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6.10 Redemption of Preferred Stock. Until the Expiration Date or the effective date of any early termination of this Agreement, Tesoro will not, so long as Charter or its affiliates own any shares of Preferred Stock, redeem any shares of Preferred Stock without the prior written consent of Charter.

6.11 Effect of Stock Splits, etc. Whenever any rights under this Agreement are available only when at least a specified minimum number of Tesoro Voting Securities or votes is involved, such specified number shall be appropriately adjusted to reflect any stock split, stock dividend, combination of securities into a smaller number of securities or reclassification of stock.

6.12 Notices. Any notice to be given hereunder shall be deemed sufficiently given when in writing and delivered to an officer of Tesoro or Charter, transmitted by tested telecopier, telex or TWX, or deposited in the United States mail, postage prepaid and registered or certified and addressed as set forth below in this Section 6.12 or to such other address for a party as may be specified in a notice. Tested telecopier, telex and TWX notices shall be effective upon transmission and notices delivered personally to an officer of Charter or Tesoro shall be effective when given. Notices that are mailed shall be effective upon receipt or upon rejection by the party to whom addressed:

To Tesoro:

Tesoro Petroleum Corporation
8700 Tesoro Drive
San Antonio, Texas 78286
Attn: Chairman of the Board

To Charter:

Charter Security Life Insurance Company
21 West Church Street
Jacksonville, Florida 32202
Attn: President

with a copy to:

Smith & Hulsey
500 Barnett Bank Building
Jacksonville, Florida 32202
Attn: E. Ellis Zahra, Jr., Esq.

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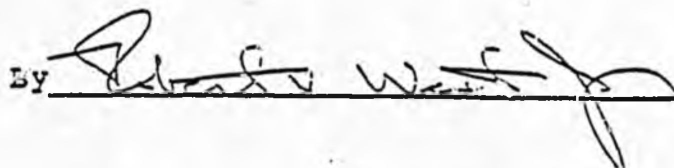
6.13 Counterparts. This Agreement may be executed simultaneously in one or more counterparts, each of which shall be deemed an original.

IN WITNESS WHEREOF, Tesoro and Charter have caused this Agreement to be duly executed by their respective officers, each of whom is duly and validly authorized and empowered, all as of the day and year first above written.

TESORO PETROLEUM CORPORATION

By 

CHARTER SECURITY LIFE INSURANCE COMPANY

By______________________________

CHARTER SECURITY LIFE INSURANCE COMPANY (NEW YORK)

By______________________________

The Charter Company agrees that it and its affiliates who are not otherwise parties to this agreement will be bound by the restrictions placed upon them as set forth in this agreement.

THE CHARTER COMPANY

By: ____________________

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ALASKA ROYALTY OIL AND GAS DEVELOPMENT ADVISORY BOARD

Resolution 83-3

WHEREAS, the State of Alaska, through the Commissioner of the Alaska Department of Natural Resources, and Chevron U.S.A. Inc. have entered into an "Agreement for the Sale and Purchase of Royalty Oil" dated the 16th day of March 1983; 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 or, 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 38.05.183; or

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

WHEREAS, the Board did on March 17, 1983 receive from the Commissioner of Natural Resources the above-mentioned agreement with Tesoro as well as a document entitled "Proposed Disposition of Royalty Oil, Tesoro Alaska Petroleum Company, Findings and Determinations Required for Disposals of Royalty Oil", dated March 16, 1983 and the Board did act and call public hearings, in accordance with the regulations outlined in 3 ACC 56, in Juneau and by teleconference in Fairbanks, Anchorage, and Kenai on April 5, 1983 and received 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 March 17, 1983 until April 20, 1983; and

WHEREAS, the Board did, on April 20, 1983, meet to discuss the agreement, related Findings and Determinations, 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.

THEREFORE, the Board finds as follows:

1. that the Commissioner of Natural Resources has followed the board policies, applicable statutes, and regulations relating to the disposal of oil and gas royalty interests.

2. that the sale of the royalty oil interests to Chevron U.S.A. Inc., as per the agreement, was made because:

   (a) the oil is to be refined or processed in the existing Chevron refinery near Kenai, Alaska.

   (b) Chevron is an in-state refiner which supplies products to the Alaska market with 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 theprice the State would receive by taking this royalty in-value.

   (d) that Chevron is a qualified company which has been operating its refinery to produce products for the Alaska market for many years.

   (e) Chevron has advised the State that its refining system is short of crude and without additional crude supplies the closure of the Nikiski refinery might be imminent. It is in the State's interest to have the refinery continue to operate.

   (f) Chevron is the State's only road asphalt producer and closure of the refinery would eliminate the State's only local supplier.

   (g) 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 Thirteenth Alaska Legislature that the "Agreement for the Sale and Purchase of Royalty Oil" between the State of Alaska and Chevron U.S.A. Inc., dated March 16, 1983 be approved.

Board Member Jack Roderick moved the adoption of the Resolution. Board Member Richard Lyon seconded. The vote was as follows:

APPROVE	DISAPPROVE
Dan Tyndelhorn	
Joseph K Donohue	
John R. Roderick	
Vh	

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ALASKA ROYALTY OIL AND GAS DEVELOPMENT ADVISORY BOARD

Resolution 83-2

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 16th day of March, 1983; 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 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

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(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 March 17, 1983 receive from the Commissioner of Natural Resources the above-mentioned agreement with Tesoro as well as a document entitled "Proposed Disposition of Royalty Oil, Tesoro Alaska Petroleum Company, Findings and Determinations Required for Disposals of Royalty Oil", dated March 16, 1983 and the Board did act and call public hearings, in accordance with the regulations outlined in 3 ACC 56, in Juneau and by teleconference in Fairbanks, Anchorage, and Kenai on April 5, 1983 and received 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 March 17, 1983 until April 20, 1982; and

WHEREAS, the Board did, on April 20, 1983, meet to discuss the agreement, related Findings and Determinations, 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 Pirnciples and Policies" as outlined in the Board's development plan.

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THEREFORE, the Board finds as follows:

1. that the Commissioner of Natural Resources has followed the Board policies, applicable statutes, and regulations relating to the disposal of oil and gas royalty interests.

2. that the sale of the royalty oil interests to Tesoro Alaska Petroleum Company, as per the agreement, was made because:

   (a) the oil is to be refined or processed in the Tesoro refinery near Kenai, Alaska.

   (b) Tesoro-Alaska is an in-state refiner which supplies products to the Alaska market with supply benefits to State citizens.

   (c) the sale is made to support Tesoro-Alaska's refinery expansion plans to increase the capacity from the current 48,500 BPD to approximately 80,000 BPD. The construction program is expected to include a new crude distillation tower, expansion of the hydrocracker from 7,500 to 9,000 BPD, a hydrogen plant to produce 14 million cubic feet of hydrogen from natural gas, and a sulfur plant to recover and produce 14.2 tons per day of sulfur. Necessary offsite facilities, such as tankage, pipelines, etc., to support the expansion also are to be constructed. The expansion has an announced cost of $80-90 million and is to be completed to mid-1984.

   (d) 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.

   (e) that Tesoro-Alaska is a qualified company which has been operating its refinery to produce products for the Alaska market for over 13 years.

   (f) that this agreement is consistant 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 Thirteenth Alaska Legislature that the "Agreement for the Sale and Purchase of Royalty Oil" between the State of Alaska and Tesoro-Alaska Petroleum Company, dated March 16, 1983 be approved.

Board Member Jack Roderick moved the adoption of the Resolution. Board Member Richard Lyon seconded. The vote was as follows:

APPROVE	DISAPPROVE
Don Tungleborn	
Joseph K Donahue	
John R. Roderick	
L	

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STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

POUCH M
JUNEAU, ALASKA 99811
PHONE: 907/465-2400

Pursuant to the Alaska Statutes and the recommendations of the Alaska Royalty Oil and Gas Development Advisory Board, the Commissioner of the Alaska Department of Natural Resources intends to sell the State's royalty oil from Cook Inlet. The Commissioner desires to sell the oil competitively to someone able to process the crude within the State of Alaska or supply products in-state from crude processed elsewhere. Preference will be given to companies capable of processing the crude in Alaska. Only in the case of an exceptional premium would he consider selling it for export from the State.

The amount of crude oil available over the term of the contract will vary with production. The Cook Inlet field is in decline, and it is anticipated that the volume of oil that will be available for sale on January 1, 1984, will be approximately 6,900 barrels per day (b/d). The volume will decline to approximately 2,700 b/d by 1990.

At the present time, the Cook Inlet royalty crude oil is committed by contract to Tesoro Alaska Petroleum. The Tesoro contract, which expires on December 31, 1983, has been in effect since 1970. Tesoro currently processes the crude in its refinery at Kenai, Alaska.

The price of the oil, if sold, will be no less than in-value. The sale is being considered under Title 38 of the Alaska statutes and the regulations contained in 11 AAC 03, and potential buyers should be aware of those provisions.

In addition to the statutory criteria, the financial responsibility of the bidders will be considered and initial information relating to such responsibility should be submitted with the proposal.

It is anticipated that negotiations may begin with the qualified respondents shortly after the close of the solicitation period and that a contract will be finalized in February, 1983, for submittal to the 13th Alaska Legislature. Because of the short timeframe for negotiations and submittal of a contract to the Legislature, proposals must be as specific as possible and should include price, volume and term of

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contract. The purchaser of the royalty oil must be able to process or begin supplying products in-state by January 1, 1984.

The Commissioner may reject submitted proposals at any time after receipt of the proposals, and may not hold negotiating sessions with every prospective buyer who submits a proposal. To the extent possible provisions of the Prudhoe Bay standard form contract will be included in any contract negotiated. The State's policy regarding royalty oil is discussed in the document prepared in February, 1982, entitled "Review of Alaska Royalty Oil Policy and Findings for Proposed Disposition of Royalty Oil." Copies of this document and further information can be obtained by contacting:

Lennie Boston
Special Assistant to the Commissioner
Department of Natural Resources
Pouch M
Juneau, Alaska 99811
(907) 465-2400

Responses to this solicitation must be received by the Commissioner of Natural Resources at the above address by close of business on December 17, 1982.

John W. Katz

John W. Katz, Commissioner
Department of Natural Resources

11/16/82

Date

Union 76 Division

Union Oil Company of California
Union Oil Center, Box 7600, Los Angeles, California 90051
Telephone (213) 977-6560

R. C. Beach
Vice President
76 Division Crude Supply

December 10, 1982

Commissioner Esther C. Wunnicke
Department of Natural Resources
State of Alaska
Pouch M
Juneau, Alaska 99811

Dear Commissioner Wunnicke:

This letter is in response to your department's solicitation of November 16, 1982, for the sale and purchase of Alaska Cook Inlet area royalty oil commencing January 1, 1984.

Union Oil Company is a major supplier of petroleum products throughout the State of Alaska. Although we will not be able to process the royalty oil within the State, we believe the proposal below will help provide a secure supply of petroleum products to our customers in Alaska.

Proposal

1. The State of Alaska will sell and Union will purchase the full volume of the State's Cook Inlet area royalty oil commencing January 1, 1984.

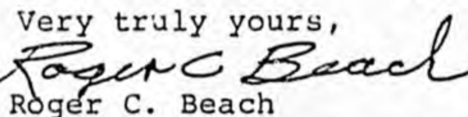
2. Contract term will be firm for a period of five years.

3. Price paid by Union for the royalty oil will be Union's posted price.

If this response to your solicitation is of interest to the State, Union is prepared to meet with you and pursue the matter further.

Thank you for your consideration. We look forward to meeting with you in Juneau at an early date.

Very truly yours,



Roger C. Beach

RCB:jv

AGO 786535

Shell Oil Company

Two Shell Plaza
P.O. Box 2099
Houston, Texas 77001

December 10, 1982

Mr. John W. Katz, Commissioner
Department of Natural Resources
State of Alaska
Pouch M
Juneau, Alaska 99811

Dear Mr. Katz:

This responds to your solicitation letter of November 16, 1982, for proposals to purchase Cook Inlet royalty crude oil beginning January 1, 1984. Shell has carefully considered this matter and has decided not to make a proposal.

Even though Shell could physically transport this crude to its West Coast refineries and process it, it is a higher quality crude than we will require in 1984 and beyond. It is better suited to the Alaskan refineries designed to run it, while Shell's West Coast refineries are more economically suited to heavier crudes - especially California and Alaskan North Slope (ANS) crudes. In addition, unit transportation costs for the relatively low volumes of Cook Inlet royalty crude would be high.

We take this opportunity, however, to re-state our continuing interest in purchasing ANS royalty crude from the State of Alaska. We stand behind our proposal of October 7, 1982, to purchase 20 MB/D of ANS crude and to supply products, as needed, on a one-year term, and stand ready to negotiate a longer-term arrangement. We have been encouraged by recent discussions with you and your staff, and are especially interested in pursuing an arrangement whereby Shell would enter the Alaskan asphalt market in a substantial way.

We appreciate your inclusion of Shell in your solicitation of potential Cook Inlet crude purchasers and we look forward to an opportunity to further develop Shell's ANS crude purchases/product sales proposal to you and the incoming administration.

Most sincerely,

W. L. Kreps, Manager
Trading & Scheduling
Domestic Raw Materials Supply

AGO 786536

bc: M. J. Nevill
R. C. McMahan
O. Runnels
A. J. McNemar
C. G. Chew
R. T. Klope
R. A. Broderick
T. C. Moody
R. J. Bertus
D. R. Salzman
G. R. Nemetz
A. M. Raymond
J. F. Hall

Chevron

Chevron U.S.A. Inc.
575 Market Street, San Francisco, CA 94105

Robert F. Walsh
Vice-President
Supply and Distribution

December 13, 1982

Commissioner John W. Katz
Department of Natural Resources
State of Alaska
Pouch "M"
Juneau, AK 99811

Dear Commissioner Katz:

This is in response to your November 16, 1982 solicitation for proposals to purchase Cook Inlet royalty oil starting January 1, 1984.

Chevron's proposal to purchase the Cook Inlet royalty oil is briefly summarized below:

> Volume: Entire volume of royalty oil estimated to be about 6,900 BPD in January 1984 and declining to about 2,700 BPD by 1990.
>
> Term: Six (6) years ending December 31, 1989 but Chevron is open to consider other periods.
>
> Price: Chevron will pay the same price the State would have received if the State had taken the oil in value from the producers. This would be a weight average producer in-value price.
>
> Additional Consideration: Chevron will commit to make available for sale in Alaska our historic level of aviation gasoline during the term we are purchasing the Cook Inlet royalty oil.

Chevron has been awarded 18,000 BPD of ANS royalty oil for processing at our Nikiski Alaska refinery under a one year contract starting about May 30, 1983. Consequently, we could not process the Cook Inlet royalty oil in-state for a short period of time between January 1, 1984 and May 30, 1984. Chevron is both an in-state refiner as well as a large in-state supplier of refined products that are produced in our California refineries and shipped to Alaska. As the Alaskan demand for products has increased, Chevron has shipped to Alaska as much as 15,000 BPD of gasoline, heating fuels and aviation gasoline. We currently supply about 40% of the motor gasoline, 30% of the heating and distillate fuels and 80% of the aviation gasoline used in Alaska.

Chevron was the first company to market petroleum products in Alaska starting in 1889 and has served Alaska continuously since that time. We are the only statewide marketer in Alaska and are the sole supplier of petroleum products in eighteen (18) Alaskan communities.

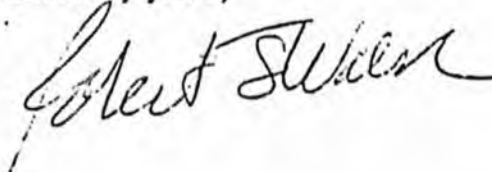
In support of our consideration to continue to make aviation gasoline available for sale in Alaska, we offer the following comments. None of the Alaskan refineries produce aviation gasoline. Consequently, in-state processing of Cook Inlet royalty oil to produce the Alaskan requirements for aviation gasoline cannot be achieved and aviation gasoline will have to be imported to Alaska from California. At least one historic supplier has already withdrawn from some of the aviation gasoline market in Alaska, leaving a greater responsibility on the remaining marketers. Chevron sincerely believes aviation gasoline is essential to the growth and economy in Alaska -- particularly in the Bush communities -- and a commitment by Chevron to meet these requirements is of great value to the State of Alaska. We hope the State will give this aviation gasoline commitment the proper consideration.

Chevron and the State spent considerable time during the past couple of years negotiating a long term agreement to purchase 38,000 BPD of ANS royalty oil. Although an agreement was not finalized, it is still of considerable interest to us. There may be some inter-relationship between a long term agreement for ANS royalty oil and the present solicitation for Cook Inlet royalty oil. Accordingly, Chevron would like the opportunity to discuss this overall royalty oil subject with the appropriate Department of Natural Resources representatives. We would appreciate a meeting in early January 1983 before any decision is made on the Cook Inlet royalty oil disposition.

Attached is a copy of the 1981 annual Report for Standard Oil Company of California (parent company of Chevron U.S.A.). We believe this will meet the request for initial information on the financial responsibility of bidders for Cook Inlet royalty oil.

Please contact Messrs. R. J. Alfrey or R. J. Engelhart at (415) 944-6204 regarding any questions on this proposal for Cook Inlet royalty oil and to set a meeting date in Juneau for discussions on the overall royalty oil subject.

Sincerely yours,



RJA:dw
Attachment

AGO 786539

Tesoro Alaska Petroleum Company

December 13, 1982

Jeff: Duration life of the field. Jack

Ms. Esther Wunnicke
Commissioner
State of Alaska
Department of Natural Resources
Pouch M
Juneau, Alaska 99811

Dear Commissioner Wunnicke:

On November 16, 1982, the Department of Natural Resources solicited proposals for the purchase of Cook Inlet Basin royalty crude oil. Attached in contract form is Tesoro Alaska's response. Crude oil from the Cook Inlet Basin has been the principal feedstock for Tesoro Alaska's refinery on the Kenai Peninsula since it was built in 1969. Our refinery is the natural market for the Cook Inlet crude oil based on proximity to the production facilities. Tesoro Alaska is the only in-state refiner manufacturing the full range of petroleum products required by Alaskans.

During January, 1983, Tesoro Alaska will initiate purchases of State royalty crude oil from the Alaskan North Slope under a twelve year contract approved last year by the Legislature. Under the contract for Alaskan North Slope crude oil, Cook Inlet royalty crude oil reduces the volume available for purchase by Tesoro of ANS. In other words, Tesoro Alaska will not have any larger amount of State royalty crude oil by virtue of the State continuing sales of Cook Inlet royalty crude oil to us.

AGO 786540

The principal points of the attached Cook Inlet contract proposed for your review are as follows:

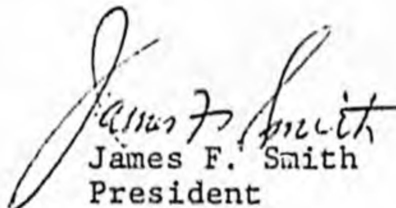
Volume - 100% of the royalty oil available to the State from leases in the Cook Inlet Basin.

Term - Eleven years beginning January 1, 1984 and ending December 31, 1995 concurrent with the end of the existing purchase agreement for State royalty oil from the Alaskan North Slope.

Price - The weighted average price which the State would have received had it elected to take its royalty "in-value" based on prices paid and information provided by the producers of the Cook Inlet crude oil.

We look forward to meeting with you to discuss any point of the contract with the expectation that a mutually beneficial contract will be approved by the Legislature in its next session.

Sincerely,



James F. Smith
President

JFS:pw
Attachment

MW

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

BILL SHEFFIELD, GOVERNOR

POUCH M
JUNEAU, ALASKA 99811
PHONE: 907/465-2400

April 14, 1983

Donald H. Triplehorn
Chairman
Alaska Royalty Oil and Gas
Development Advisory Board
620 East Tenth St.
Anchorage, Alaska 99501

Dear Chairman Triplehorn:

I very much appreciated the comments of you and the other Board members at our April 5th meeting. During our discussion, several questions concerning the proposed long-term Prudhoe Bay royalty oil agreements with Tesoro and Chevron were raised. I thought it might aid the consideration of the Board to have the key points of our rationale for the two contracts before you in writing, along with a response to your questions.

The contract with Tesoro is the more controversial of the two. It would commit the State to providing 13.867% of Prudhoe Bay Unit production, or approximately 26,000 barrels a day (b/d) at current production levels, if Tesoro expands the capacity of their refinery to process the oil by 1986. The agreement expires on January 1, 1995; at the same time Tesoro's existing royalty oil contract for 46,000 b/d terminates. The basic rationale for this contract is fairly straightforward - providing a long-term guaranteed crude supply enables Tesoro to make a significant, <u>new</u> in-state investment, with attendant employment, supply, and tax base benefits.

The Board has understandably questioned the recent acquisition by two Charter Co. life insurance subsidiaries of 20% of Tesoro's stock, and the placing of Charter directors Raymond Mason and Gerald Ford on the Tesoro board. The involvement of a corporation with which the State has significant litigation was a cause of serious concern to us at the time of contract negotiations. In response to that concern, we took the following measures to protect the State from possible harm because of the involvement of Charter:

AGO 786542

1. A "third-party control" provision in the royalty agreement allows the Commissioner to unilaterally terminate the contract if Charter gains a greater degree of influence over the management of Tesoro.

2. An agreement between Tesoro and Charter requires that Charter vote its shares in the same proportion as the shares held by all other Tesoro stockholders, and prevents Charter from seeking proxy votes.

3. Tesoro may not take the oil unless the Commissioner determines that the refinery will be capable of processing the additional crude; the contract terminates if the refinery expansion has not been completed by July 1986; and all oil taken under the contract must be run at the Tesoro Kenai refinery, and may not be traded, exchanged or otherwise disposed of.

4. The State retains the option to purchase and resell the substantial volumes of residual oil produced by the refinery.

5. Tesoro owns facilities worth over a hundred million dollars in Alaska.

We would hope that the concerns expressed do not stem from a desire to "punish" Charter by rejecting this agreement. We do not believe that Charter would be much affected by rejection of this contract. A vigorous legal effort to collect the money owed the State by Alaska Oil Co. seems to us to be the proper course at this point. Tesoro is a long-standing Alaska business, and deserves to have its contract treated on the merits.

The Chevron contract would furnish their Kenai refinery with 9.6% of Prudhoe Bay production, currently 18,000 b/d, until 1995. The Kenai refinery is not an economic component of Chevron's West Coast refining system, and the company has threatened to close it without a long-term supply of oil from the State. Chevron has consistently requested a 38,000 b/d contract, and will continue to seek an additional 20,000 b/d for processing on the West Coast and return to Alaska in the form of products. The 18,000 b/d agreement will enable the company to operate the Kenai refinery for as long as possible; that volume of oil must be processed at the Kenai plant to maintain the effectiveness of the contract.

The Board has also questioned the duration (eleven years) of the Chevron and Tesoro contracts. The reasons for the concern, to our knowledge, include a desire to leave royalty oil uncommitted so that it can later be offered as an incentive for economic development projects, or so that it can be sold in Japan or elsewhere at a higher price, or a

general desire to retain flexibility in the face of ever-changing oil markets and the future decline in Prudhoe Bay production. We agree that these are valid points, but feel that they have been addressed in the following ways:

1. The contracts provide for a certain percentage of Prudhoe production, not a certain volume. As Prudhoe production declines, so will the contract volumes. At current levels, the contracts leave available 62,500 b/d of Prudhoe royalty production, as well as all Kuparuk royalty oil (currently 12,000 b/d) and any future royalty oil. Approximately 50,000 b/d of residual oil may also be available for sale by the State as a result of the option that the State retains for that oil in most of its royalty oil agreements.

2. Chevron's competitors in Alaska, Mapco and Tesoro, have royalty contracts until 2005 and 1995, respectively, for their base volumes. Although those contracts were consummated by the previous Administration, we felt that Chevron's request for a contract at least as long deserved some consideration in the interest of preserving equity among competing refineries.

3. The term was a negotiated item; although the State originally sought a shorter term, the additional premium over the in-value price of $.30 was agreeable to the companies partially because the State was willing to offer the eleven-year term.

4. The contract's price term is tied to the in-value price, based on producer sales. If Japanese exports become a reality, the price to royalty purchasers will increase if sales to Japan result in higher average prices for North Slope oil.

5. We have reviewed the previous Administration's determination that the highest and best use for royalty oil is for in-state processing, all other things being equal, and concur with it, in light of the existing royalty oil statutes. These contracts are for that use.

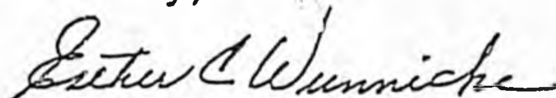
The Board has also questioned the meaning of the "future dispositions" clause of the current contracts. I have attached a written opinion by the Attorney General which should clarify that clause. I do not intend to include the provision in any future royalty oil contracts.

The Governor has asked a Cabinet group composed of Attorney General Gorsuch, Commissioner Lyon, and myself to report to him on the petroleum product pricing report which was

submitted in February to the Senate Resources Committee. We should be able to provide you with our written report before the Board's April 20th meeting.

I appreciate all the time you have devoted to royalty oil issues during the past months. Please let me know if we can be further assistance in any way.

Sincerely,



Esther C. Wunnicke
Commissioner

Attachment

MEMORANDUM State of Alaska

TO: Esther Wunnicke
Commissioner
Department of Natural Resources

DATE: April 8, 1983

FILE NO: 366-541-83

TELEPHONE NO: 465-3600

FROM: Norman C. Gorsuch
Attorney General

SUBJECT: Royalty Oil Contract's Preference Provision

By: Robert M. Maynard RMM
Assistant Attorney General
Oil and Gas-Juneau

You have asked for our opinion on the effect of the following clause in proposed state royalty oil contracts:

"2.13 FUTURE DISPOSITIONS OF ROYALTY OIL. Seller recognizes that AS 38.05.183, which governs disposition of Royalty Oil by the State of Alaska, established a statutory preference for dispositions proposing: (1) in-state processing of Royalty Oil, and (2) in-state supply of products generated from processing of Royalty Oil, in that order. Seller represents that, in conjunction with future dispositions of Royalty Oil, Purchaser will be afforded the consideration contemplated by AS 38.05.183."

You have asked whether this provision will in some manner tie the State's hands in future dispositions of Royalty Oil if the statutes were subsequently changed to reflect a different legislative policy.

The answer to your question is no. This contract term enbodies in contractual form an administrative interpretation of a statutory scheme. As such, this language would bind the state as long as the present statutory scheme is not altered. This contractual term cannot, however, be read to bind the legislature's hands in changing the statutory scheme to impose a different policy or preference than that expressed in the contractual clause.

Article VIII of the Alaska Constitution, and particularly Article VIII, sections 2 and 9, give the legislature exclusive authority over prescribing the policy and procedures in the sale of state resources including royalty oil. Article VIII, section 2 provides that "the legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for

the maximum benefit of its people." Article VIII, section 9 provides that

> "subject to the provisions of this section, the legislature may provide for the sale or grant of state lands, or interests therein, and establish sales or sales procedures.

Consequently, the commissioner's only authority is to interpret and execute existing statutory schemes: the commissioner does not have authority to go beyond the express authorization of these statutes and tie future legislature's hands. See, e.g., Udall v. Oil Shale Corp., 406 F.2d 759, 764 (10th Cir. 1969) r'vsd on other grounds Hickel v. Oil Shale Corp., 400 U.S. 48 (1970):

> The Government here argues in effect that the Secretary [of Interior] has all the powers mentioned in the Constitution relating to public lands, but this cannot be. The powers are not in the Secretary, but are vested in Congress and he has what the statutes provide that he have and no more.

Consequently, the commissioner would be acting outside the scope of his or her authority by agreeing to a provision that did actually tie the ability of the legislature to provide for the disposition of state resources. The present law only authorizes the commissioner to dispose of interests for present sales under that law. It does not authorize the commissioner to contractually grant his or herself the power to ignore future laws that may be passed by the legislature. Such a term would be inconsistent with the present law or, more accurately, would be outside the limits presently authorized by law. Such a provision would be invalid and of no effect. Union Oil Company of California v. Morton, 512 F.2d 743, 748 (9th Cir. 1975) (and cases cited therein); Burke v. Southern Pacific Railroad Company, 234 U.S. 669, 693-706, (1941); Central Advertising Co. v. Michigan Highway Commission, 172 N.W. 2d 432 (Mich. 1969); Schoenbroad v. United States, 410 F.2d 400, 404 (Ct. Cl. 1969); Hickman v. Mylander, 362 P.2d 500, 502 (N.M. 1961).

Instead, this clause must be read or construed so as to conform to the statute and the constitution of the state. Wood v. Lovett, 313 U.S. 362, 370 (1941); Hobbs v. McLean, 117 U.S. 567 (1886); Wright v. Paine, 289 F.2d 766, 789 (D.C. Cir. 1961); Sheridan-Wyoming Coal Co. v. Krug, 172 F.2d 282 (D.C. Cir. 1949), r'vds on other grounds 338 U.S. 621; Union Oil Company of California v. Morton, 512 F.2d 743, 749 (9th Cir. 1975).

Generally, 1 McBride & Wectal, Government Contracts, §2.120 (1972); 81 C.J.S. "States" §168(b) at pp. 635-636. See also Skagway City School Board v. Davis, 543 P.2d 218, 222 (Alaska 1975); 3 Corbin on Contracts §551 at 200-201. Here that reading is the reading that we believe is actually intended--namely that the commissioner is merely putting in writing an administration interpretation of the present statute.

This intent and more limited effect of the clause can be seen by its history. This clause first appeared in royalty oil contracts entered into during the early part of 1982. At that time, the state entered into royalty oil contracts with Tesoro Alaska Petroleum Company and Doyon, Inc. In conjunction with those contracts, the commissioner of Natural Resources issued his "Review of Alaska Royalty Oil Policy and Findings for Proposed Disposition of Royalty Oil", dated February 26, 1982. In those findings and review, the comissioner discussed at some length the policies guiding the disposition of royalty oil, including AS 38.05.183. In particular, the commissioner noted that the present royalty oil statutes were not totally clear. In particular, the commissioner stated:

> Although the royalty statute envisions transactions through which royalty oil is used in state, it also demonstrates the inherent conflicts and the many desires expressed by the legislature and the people of the State for the disposal of royalty oil. On the one hand, the statute does not permit sales for export unless there is a determination that present and anticipated in-state domestic and industrial needs are met. Further, there is a preference for in-kind taking and in conjunction with any sale, the commissioner is required to consider the effects on the economy, the projected benefits of any refining or processing, the ability of any prospective buyer to provide products in-state with price or supply benefits. On the other hand, the statute expresses a preference for competitive bidding with the award to go to the highest responsible bidder, and competitive bidding [can] not be waived without a finding that it is in the state's best interests. Examination of the cash value of any proposed transaction is also a primary factor in the determination of whether an award should be made. Consequently, the royalty statute speaks both to in-state development and enhancement of the state's finances as primary objectives for state royalty oil dispositions.

AGO 786548

Findings and Review at pp. 121-122.

At that time, and in those contracts, the commissioner of Natural Resources interpreted these conflicting interests by stating in those findings and in the contracts that the statute should be read to give a preference for in-state processing and in-state supply in that order. In the Findings and Review, the commissioner stated that

> "on balance however, it is evident from both the text and the history of the royalty statute that the legislature intended a preference for in-kind taking and for proposals focusing on in-state processing and supply unless a compelling showing can be made that such an approach is contrary to the state's interest.

The contractual provision at Article 2.13 is merely a companion statement of that interpretation. The provision was originally inserted in the standard form contract during the 1982 negotiations with Doyon and Tesoro. At that time, the companies were requesting amounts of oil not only for their base charge, but also for planned increases in refinery capacity. The commissioner would not consider committing royalty oil for future expansions. He told the companies that if an expansion would take place, then under the statutes they would be first in line for royalty oil to meet their increased base needs at that time. Doyon, in particular, was not satisfied with the commissioner's statement or the mere existence of the statutes because of perceived difficulties with their bankers. Doyon was afraid that the bankers would not accept simply Doyon's word that the statutes presently gave Doyon a preference for future calls on royalty oil if an expansion of the domestic refinery occurred. Other in-state refineries also expressed similar, but not as strenuous, concerns. As a result, the commissioner agreed that although he would not grant an option on future royalty oil, he would embody his interpretation of the present statute in the contract. As such, and like a contemporaneous and long-standing administrative interpretation, the state will be bound in the future to that interpretation as long as the present statutory scheme remains essentially unaltered. And, also like administrative interpretations of statutes, that interpretation will not be binding or effective when the legislature changes the underlying statute to eliminate the basis for that interpretation. Not only was this the intent of the provision, but any contrary reading would be invalid and of no effect under the Alaska Constitution and its statutes.

We would also like to note that the preference expressed both in the contract and by the commissioner's previous findings do not create an absolute preference for either in-state processing of royalty oil or in-state supply of products generated from the processing of royalty oil. As the contractual provision states, the preference is only to the extent of that "contemplated by AS 38.05.183." As was noted in the commissioner's findings in February of 1982, 38.05.183 envisions a balancing of many considerations, including monetary value. The statutory interpretation is only that, on balance, the statutes prefer in-state processing of royalty oil or in-state supply of products generated from the processing of royalty oil. This finding is largely based on the express provisions of AS 38.05.183 that "oil and gas taken in kind by the state as its royalty share may not be sold or otherwise disposed of for export from the state until the commissioner determines that the royalty-in-kind oil or gas is surplus to the present and projected intrastate domestic and industrial needs." This particular provision in combination with the criteria set forth in AS 38.05.183(e) and, by reference, AS 38.06.070(a) led the commissioner to make his interpretation of the statute. But a reading of all those provisions, in context, along with other provisions such as the preference for competitive bid and sale to the highest responsible bidder in AS 38.05.183(a), shows that the preference is by no means absolute. In fact, the preference may be outweighed if competing concerns are found by the commissioner to be of greater importance under that particular sale.

AGO 786550

PROPOSED DISPOSITION OF ROYALTY OIL
TESORO ALASKA PETROLEUM COMPANY

FINDINGS AND DETERMINATIONS REQUIRED FOR DISPOSALS OF ROYALTY OIL

Under AS 38.05, AS 38.06, and 11 AAC 03, I must make various determinations and findings before I may dispose of royalty oil. This document constitutes those determinations and findings regarding the proposed disposal of Prudhoe Bay royalty oil to Tesoro Alaska Petroleum Company (TAPC).

Under the relevant statutes and regulations I must make the following findings and determinations prior to the execution of an agreement for the disposal of royalty oil:

(1) That the disposal is in the best interest of the State. 11 AAC 03.010(d); AS 38.05.020(2).

(2) If the disposal necessitates a taking in-value (such as return of the oil to the producers) that that taking in-value is in the best interest of the State. 11 AAC 03.010(c); AS 38.05.182.

(3) If the disposal would allow for the export of royalty oil from the State, that that royalty oil is surplus to present and projected intrastate domestic and industrial needs. 11 AAC 03.010(e); AS 38.05.183(d).

(4) If the royalty oil is disposed of to relieve storage or market conditions, that the agreement will relieve the storage or market condition. 11 AAC 03.010(f).

(5) If the disposal is other than by competitive bid, either that no competition exists, or the best interest of the State requires noncompetitive disposals. 11 AAC 03.030(a); AS 38.05.183(c).

(6) That a proposal or proposed disposition offers the maximum benefits to the State. 11 AAC 03.060(a); AS 38.05.183(e).

The determination that a proposal reasonably offers the maximum benefits to the citizens of Alaska is the best interest determination described in 11 AAC 03.010(d). 11 AAC 03.060(b). In making that determination I must consider the criteria described in AS 38.05.183(e), state which of those criteria apply to the proposed disposition, and discuss the weight given to the applicable criteria in determining the maximum benefit to the State. The criteria described in AS 38.05.183(e) are:

1. the cash value offered;

2. the projected effects of the sale, exchange, or other disposal on the economy of the State;

3. the projected benefits of refining or processing the oil and gas in the State;

4. the ability of the prospective buyer to provide refined products or by-products for distribution and sale in the State with price or supply benefits to the citizens of the State;

5. the criteria described in AS 38.06.070(a).

The criteria described in AS 38.06.070(a) are:

1. the revenue needs and projected fiscal condition of the State;

2. the existence and extent of present and projected local and regional needs for oil and gas products and by-products, the effect of state or federal commodity allocation requirements which might be applicable to those products and by-products, and the priorities among competing needs;

3. the desirability of localized capital investment, increased payroll, secondary development, and other possible effects on the sale, exchange, or other disposition of oil and gas or both;

4. the projected social impacts of the transaction;

5. the projected additional costs and responsibilities which could be imposed upon the State and affected political subdivisions by development related to the transaction;

6. the existence of specific local or regional labor or consumption markets which should be met by the transaction;

7. the projected positive and negative environmental effects related to the transaction;

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

In addition, AS 38.06 and 3 AAC 56 govern the actions of the Alaska Royalty Oil and Gas Development Advisory Board and require, among other things, that they hold public hearings

on proposed disposals of royalty oil to determine compliance with AS 38.06.070.

Background and Chronology

The State currently receives 187,500 barrels per day (b/d) of royalty oil from the Prudhoe Bay Unit. Since the commencement of production in 1977, the State has entered into a variety of contracts for the disposition of its royalty oil. (See Review of Alaska Royalty Oil, dated January 1, 1983 and prepared by the Deputy Commissioner of Natural Resources Geoffrey Haynes, for a detailed discussion of these dispositions.) In 1981, a general solicitation for proposals was issued for disposition of Alaska North Slope royalty oil, and a contract with Tesoro Alaska Petroleum Company (TAPC) for approximately 46,000 b/d was ratified by the state legislature and the governor in 1982 as a result of that solicitation. The contract runs for twelve years beginning January 1983.

During the discussions with TAPC that occurred during 1981 and 1982, the company sought to obtain a total of 70,000 b/d of royalty oil, to provide for both existing refinery needs and a proposed expansion. At that time, the State determined that it was not in the State's best interest to provide for uses which were not imminent, and so declined to provide the prospective expansion volumes.

On January 26, 1983, the Tesoro Petroleum Board of Directors met and approved a 80-90 million dollar expansion of the TAPC Kenai refinery, contingent on obtaining a long-term contract from the State for royalty oil for the increased capacity of the refinery. The modification would increase the capacity of the plant from 48,500 b/d to 80,000 b/d and enable it to run solely on Alaska North Slope crude oil. (The refinery currently requires a significant volume of the sweeter, lighter crude oil produced in Cook Inlet.

Based on the firm decision by the company to make the investment at Kenai, State officials met with TAPC representatives to discuss the key provisions of a contract, to determine if a royalty oil contract beneficial to the State could be negotiated. The key areas of discussion were price, term, security, the "trigger" for taking, and the effect of another Tesoro Board action involving the Charter Company.

At the January 1983 meeting, Tesoro directors approved the acquisition of approximately a 20% interest in the company by two life insurance subsidiaries of the Charter Company. The State of Alaska is currently in litigation with the Alaska Oil, a wholly-owned subsidiary of Charter, over non-payment of approximately $60 million under that

company's now-defunct royalty oil contract with the State. Concern on the part of State officials over possible future effects of Charter's interest in TAPC led to the insertion of a third party control provision in the contract.

Negotiations with TAPC on contract provisions were considerably eased by the experience and basis provided by the efforts leading to TAPC's 1982 Prudhoe Bay Unit royalty oil contract. Detailed discussions on contract terms began on February 7, 1983, and continued on an intensive basis throughout the month. The provisions discussed below represent the key issues of consideration.

In general, the information and analysis which guided this disposition is contained in the report, Review of Alaska Royalty Oil, cited above. I hereby include the full body and text of that report as additional background for my findings for this disposal.

Key Provisions of the Proposed Sale

1. Price

TAPC will pay the in-value price, plus a $.30 premium. The State required this premium for all sales entered into this year, as a general policy, in recognition of the uncertainty of the West Coast market at this time. State sales can have a significant influence on that market; the premium should mitigate that effect. It does so by taking into account the fact that the in-value price, on which the sale to TAPC is based, is an average of the wellhead values of both West Coast and Gulf Coast sales. Gulf Coast wellhead prices are currently somewhat lower than West Coast prices, due to the difference in transportation costs. To the extent that a State sale displaces a sale by a producer at a higher price, the State lowers the in-value price on which all royalty and severance tax payments are based. The State sought the premium in light of these factors. (For a more complete discussion of these issues, see Review of Alaska Royalty Oil, cited above, at pp. 68-69 and 86-208.)

The premium will also generally enhance the revenues received by the State during the period of taking under the contract. The premium represents an additional $2.84 million a year in revenues to the State than would have been received at the in-value price.

2. Term and "Trigger" for Taking

The Tesoro contract becomes effective on the date a bill ratifying the contract is enacted into law, which must occur before September 1, 1983, or the contract is void.

Nomination of royalty oil under the contract may not begin unless the State believes that the refinery will be capable of refining the oil (i.e, expanded) in seven months, when actual delivery would occur. If the refinery expansion has not been completed by June 30, 1986, the State may, in its sole discretion, cancel the contract. In addition, if the refinery does not run the oil, a $2.00 per barrel penalty will be paid for each barrel taken but not processed at the refinery.

The contract terminates on January 1, 1995. This date parallels the existing TAPC Prudhoe Bay royalty oil contract. The company proivded information that a period of that duration was necessary to ensure recovery of its investment in the expansion facilities. A term beyond that date was rejected for two reasons. First, the decline in Prudhoe Bay production will be significant by that date. Second, the State should have the opportunity to reevaluate its royalty oil policy as frequently as is consistent with the other objectives stated in the royalty statutes.

3. Third Party Control

During the negotiations which led to the TAPC contract, company officials informed the State that two Charter Security Life Insurance Companies, subsidiaries of the Charter Company, had entered into various agreements with Tesoro to purchase stock and be represented on the Tesoro Board of Directors. Under that agreement, Charter may own up to 30% of the voting interest in Tesoro.

The TAPC contract provides that if a third party acquires control of Tesoro, the State must be notified and may, in its sole discretion, cancel the contract. In particular, if Charter increases its present influence or control over Tesoro beyond that contemplated by the present agreement between Charter and Tesoro, the State may, in its sole discretion, cancel the contract.

4. Other Provisions

All other contract terms, including a State option on the residual oil and petroleum coke production, security, local hire, performance guarantee and reservation fees, in-state processing requirements, and interpretations and definitions, are substantially identical to the provisions contained in the 1982 TAPC Prudhoe Bay contract. These provisions are discussed in detail in Review of Alaska Royalty Oil, at pp. 240-274.

Findings

(1) I find and determine that the taking of royalty oil in-kind and the disposal of that royalty oil to TAPC for

processing in-state is in furtherance of the intent of AS 38.05.1982-183 and AS 38.06, and is in the best interest of the State for the reasons stated above and for the following reasons:

a. The volume is to be run entirely at Nikiski. Therefore, the entirety of the sale is for in-state processing, which is entitled to a high preference under the governing statutes.

b. The price term is that which the State would have received if the State had taken the oil in-value plus a premium, plus a $.30 per barrel premium. Therefore the requirements of AS 38.05.182 and 11 AAC 03.010(c) relating to taking in-value are met.

(2) AS 38.05.183(c) requires that I make public the findings and conclusions for sales not made by competitive bid. Generally, the purpose of seeking competitive bids is to obtain the highest possible price on a standard form contract. The purpose of this disposal is to maximize the variety of benefits to the State cited in AS 38.05.183 and 38.06, including in-state processing and investment. Obtaining and balancing those benefits requires a negotiation process, as opposed to a one-factor bid process. In addition, other concerns which lie beyond the pale of the competitive bid process include the security arrangements to insure payments to the State, provisions designed to forestall any possible responsibility or liability on the part of the State for handling royalty oil at Pump Station One, and provisions unique to the circumstances of each purchaser.

For those reasons, I waive the competitive bid requirement of AS 38.05.183(c) in favor of direct negotiation.

(3) I find and determine that the findings required by AS 38.05.183(d) and 11 AAC 03.010(e) relating to the export of royalty oil from the State are not applicable to this proposed disposal.

(4) With respect to the criteria set forth in AS 38.05.183(e), I make the following findings and determinations for the proposed disposal to TAPC:

The cash value is the Producers' weighted average field price, plus a .$30 per barrel premium. Therefore, as discussed above the cash value is equivalent to, and above, what the State would have received if it did not enter into this agreement.

A disposal to TAPC will have a favorable effect on the economy of the State because it will enable a significant new investment of $80-90 million to be made

in the State, with the attendant employment, local taxation, and other benefits. Crude oil products would be processed in-state, insuring that industries dependent on petroleum products would likely have adequate supplies.

The benefits of the expanded operation of the Nikiski refinery include the aforementioned employment, tax base, and security of supply benefits, and there would therefore be direct favorable results of processing the royalty crude in-state. Secondary industries partially or wholly connected with TAPC's refining operation would also continue to benefit from that relationship.

With respect to the criteria set forth in AS 38.06.070(a), I make the following findings and determinations with respect to the proposed disposal to TAPC:

Regarding the effect of the disposal on the revenue needs and projected fiscal conditions of the State, the matter is covered above.

The supply needs of crude oil products in various localities and regions are generally met by TAPC. The proposed expansion would increase the supply of products in Alaska, and help satisfy any currently-unmet needs for petroleum products.

The continued operation and expansion of the Nikiski refinery would provide payroll and secondary development benefits to the citizens of the State.

The potential adverse social impacts, adverse governmental costs and responsibilities, adverse private impacts, and adverse environmental effects from the proposed expansion will be provided for under existing State statutes and regulations. The expansion will be immediately adjacent to the existing structure, in an existing industrial area, and should therefore result in minimum adverse effects.

The proposed expansion of the TAPC refinery will help alleviate existing unemployment in the Kenai and Southcentral Alaska areas, by creating both short-term construction and long-term operational jobs. Products from the refinery will largely be supplied to the State's largest market, the Railbelt region.

The proposed expansion should have little or no adverse impact on existing commercial enterprise and investment. All the expected effects are beneficial, as described above.

For the foregoing reasons, I find and determine that the Tesoro Alaska Petroleum Company disposal is in the best interest of the State and maximizes benefits to the State.

Esther C. Wunnicke

Esther C. Wunnicke, Commissioner
Department of Natural Resources

March 16, 1983
Date

Corrected for typographical errors April 15, 1983
Esther C. Wunnicke

AGREEMENT FOR THE SALE AND

PURCHASE OF ROYALTY OIL

THIS AGREEMENT, entered into as of the 16th day of March, 1983, by and between THE STATE OF ALASKA ("Seller") and TESORO ALASKA PETROLEUM COMPANY, a Delaware corporation ("Purchaser").

ARTICLE I

DEFINITIONS

As used in this Agreement, the following terms shall have the following meanings:

1.1 "Commissioner" means the Commissioner of the Alaska Department of Natural Resources.

1.2 "Day" means a period of twenty-four (24) consecutive hours, beginning at 12:01 a.m., Alaska Standard Time.

1.3 "Leases" means the oil and gas leases which are subject to the terms of the Unit Agreement.

1.4 "Lessee" means any person owning a working interest in any of the Leases.

1.5 "Month" means the period beginning at 12:01 a.m., Alaska Standard Time, on the first day of the calendar month and ending at the same time on the first day of the next succeeding calendar month.

1.6 "Oil" or "crude oil" shall have the same meaning as the word "oil" under the Unit Agreement.

1.7 "Point of Delivery" shall have the meaning set out in Article 2.4.

1.8 "Royalty Oil" means the oil which the Seller may take in-kind (amount) as its royalty under the Leases whether or not Seller has elected to take or is taking that royalty in-kind.

1.9 "Daily Royalty Oil" means the quantity of Royalty Oil produced by the Lessees each day.

1.10 "Unit Agreement" means the Prudhoe Bay Unit Agreement effective April 1, 1977, by and between Seller and the Lessees, as it may be amended from time to time.

ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity. Seller agrees to sell to Purchaser and Purchaser agrees to buy from Seller up to that quantity of oil equal to 13.867% of the Daily Royalty Oil ("Maximum Quantity"). Upon at least nine (9) months' written notice to Seller, Purchaser may increase or decrease the amount of oil to be tendered by Seller at the Point of Delivery, but the amount tendered by Seller under this Agreement shall not exceed the Maximum Quantity. It is understood and agreed that the volume of Daily Royalty Oil available to Seller will vary and may be interrupted from time-to-time, and depends upon a variety of factors, including the

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rate of production from the Leases. Seller disclaims and Purchaser waives any representation, covenant or warranty, express or implied, as to the specific quantity or the total or daily, monthly, average, or aggregate volume of Royalty Oil to be sold or tendered under this Agreement. Seller warrants that it has good title to the oil tendered under this Agreement. Seller shall hold the Purchaser harmless from all liens, encumbrances and valid adverse claims that may affect the Royalty Oil at the time the Royalty Oil is tendered to the Purchaser.

If Purchaser has not taken the Maximum Quantity of oil within five (5) years after the effective date of this Agreement, Seller, at its option, may permanently decrease the Maximum Quantity to the greatest percentage of Daily Royalty Oil tendered by Seller under this Agreement within that five-year period. Purchaser may permanently decrease the Maximum Quantity or terminate this Agreement upon nine (9) months' written notice to Seller.

If Seller underlifts or stores Royalty Oil at Prudhoe Bay, or if Seller recovers underlifted or stored Royalty Oil, the quantity of Royalty Oil tendered under this Agreement shall be calculated as if no Royalty Oil was underlifted or stored or recovered.

2.2 Quality. The Royalty Oil sold shall be the same quality as the oil delivered by the Lessees to the Seller at the Point of Delivery. It is understood and agreed that the quality

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of the Royalty Oil sold may vary from time to time. Seller disclaims, and Purchaser waives, any guarantee, representation, or warranty, either expressed or implied, of the merchantability, fitness for use, or suitability for any particular use or purpose, or otherwise, of any of the oil delivered under this Agreement or as to any specific, average or overall quality or characteristic of Royalty Oil to be sold or tendered under this Agreement.

2.3 Price of the Royalty Oil. The price for the oil tendered under this Agreement shall be equal to the amount that Seller would have received from its Lessees for the Royalty Oil tendered if that royalty had been payable in money (taken in value) rather than taken in kind plus $0.30 per barrel plus the Field Cost Allowance incurred by that oil as determined under the Prudhoe Bay Royalty Settlement Agreement (dated April 1, 1980 for reference purposes only), which was entered as part of a final judgment dated August 13, 1980 in State of Alaska, et al. v. Amerada Hess Corp., et al., (Superior Court for the State of Alaska, First Judicial District at Juneau) ("Amerada Hess") ("Settlement Agreement") ("Purchase Price"). The Purchase Price shall be determined by Seller based upon the reports submitted by the Lessees for royalty purposes or, when those reports are unavailable, incomplete, or inaccurate, upon information submitted by the Lessees for production tax or other tax purposes, as may be adjusted from time to time as provided in this Agreement. Buyer will only be entitled to review or request material or information which is not confidential under state law or regulation.

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The method, basis and amount of royalty due Seller when it takes its royalty in value from the Leases is presently the subject of litigation in Amerada Hess. One of the issues involved is the proper method to be used by the Lessees in calculating the state's royalty when the royalty is payable in money (in value). Until there is a resolution of that dispute through judicial resolution or settlement, the Purchase Price will be based upon the calculation of an amount per barrel equal to the per barrel volume weighted average of the in-value prices reported by the Lessees to Seller for royalty purposes or, when the royalty reports are unavailable, incomplete, or inaccurate, upon information submitted by the Lessees for production tax or other tax purposes, plus $0.30 per barrel, plus the Field Cost Allowance as determined under the Settlement Agreement. Upon resolution of each of the various issues that are or will be involved in Amerada Hess, adjustments will be made to previous payments in accordance with each resolution.

If, however, the State should prevail on the theory it advances in its Motion for Partial Summary Judgment on Count V of Plaintiff's Amended Complaint by Plaintiff State of Alaska dated September 19, 1980 and filed in Amerada Hess ("Exhibit B Theory"), then the $0.30 per barrel additional amount called for herein shall no longer be owed and the precise amount paid as a result of that $0.30 per barrel additional amount shall be credited against additional adjusted amounts owed by Purchaser due solely to the effectuation of the state's "Exhibit B Theory."

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Purchaser and Seller recognize that other adjustments besides those due under the "Exhibit B Theory" may be necessary upon resolution of Amerada Hess.

If additional amounts are owed by Purchaser to Seller, interest on those amounts will be paid at a variable interest rate which is the higher of: (1) the prime rate as may be announced from time to time by The Bank of America, San Francisco, California, plus three percent (3%); or (2) the rate of return as is realized from time to time in the investment of the State of Alaska's general fund. Amounts owed from Seller to Purchaser shall be repaid at the rate set out in Article 5.6. Buyer will not voluntarily intervene or otherwise participate in Amerada Hess unless Seller expressly consents to that participation in writing. A settlement of Amerada Hess will be binding upon Buyer whether or not Buyer agrees with or consents to the terms of that settlement.

If any applicable law of the United States of America or any rule or regulation promulgated by a federal agency will, in the judgment of Seller, operate to prohibit or prevent Seller from receiving the full amount due under the above provisions, Buyer's obligation to pay the amount of the Purchase Price in excess of the amount permitted will be suspended or adjusted to the minimum extent required for Seller to comply with that law, rule or regulation.

2.4 Point and Time of Delivery. Simultaneous with receipt of its Royalty Oil from its Lessees, Seller shall tender the oil

to Purchaser at the point at which Seller receives the Royalty Oil from its Lessees. That point as presently agreed to by Seller and its Lessees in Article 2.3 of the Settlement Agreement is the custody transfer meters into the Trans Alaska Pipeline System at Prudhoe Bay.

2.5 Passage of Title and Risk of Loss. Title and risk of loss to the Royalty Oil sold under this Agreement shall pass from Seller to Purchaser for all purposes when Seller tenders the oil at the Point of Delivery.

2.6 Purchaser's Responsibility. Purchaser shall be responsible for the oil after passage of title. Purchaser will indemnify and hold Seller harmless from and against any and all claims, costs, damages (including reasonably foreseeable consequential damages), expenses or causes of action as a result of any loss, injury, or damage incurred by any party as a result of any transaction or event which relates to the crude oil after title has passed to Purchaser.

2.7 Transportation Arrangements. Purchaser shall make all necessary arrangements for transporting the oil sold under this Agreement from the Point of Delivery, including satisfaction of line fill obligations and storage tank bottom requirements of the Trans Alaska Pipeline System, if any. If and as requested by the Seller, Purchaser shall submit specific information concerning the arrangement it has made for transportation of the Royalty Oil sold under this Agreement through and away from the Trans Alaska

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Royalty Oil. Such information may include the specific tenders of oil made to the Trans Alaska Pipeline System and identification of tankers which will transport the Royalty Oil. In addition, Purchaser will provide Seller, if and as requested by Seller, with satisfactory evidence or reasonable assurance of the existence and continuing validity of adequate arrangements for the transportation or disposal of the Royalty Oil subject to this Agreement. Failure to provide information, evidence or assurances requested will, at Seller's election by notice to Purchaser, be a material default under this Agreement.

2.8 Absolute Obligations. The obligations of Purchaser to accept, pay for, and arrange for the transportation of the Royalty Oil tendered or sold under this Agreement are absolute and will not be excused or discharged by the operation of any disability of Purchaser, event of force majeure, impracticability of performance, change in conditions, or any other reason or cause.

2.9 Date of First Delivery. Purchaser may not nominate Royalty Oil under this Agreement until (i) Seller is satisfied that Purchaser's Nikiski, Alaska Refinery is able to process 71,000 barrels per day of Alaska North Slope (ANS) crude oil; or (ii) Seller is satisfied that Purchaser's Nikiski, Alaska Refinery will be able within seven (7) months to process 71,000 barrels per day of ANS crude oil. For each day after receipt at the Refinery

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of crude oil purchased under this Agreement, the Refinery is not able to process 71,000 barrels per day of ANS crude oil, Purchaser will pay Seller a sum equal to $2.00 times the difference between 71,000 barrels and the number of barrels of ANS crude oil actually processed that day (but in no event shall this sum exceed $52,000 per day) until the first day that the Refinery processes 71,000 barrels per day of ANS crude oil from which point in time the $2.00 per barrel assessment shall no longer be in force or effect. "Process" means producing Crude Oil Products in a volume of approximately 32% of the Royalty Oil tendered under this Agreement. "Crude Oil Products" does not include residual fuel oil exported from Alaska, but does include bunker fuel loaded in Alaska.

The foregoing notwithstanding, should however, after initial nomination of Royalty Oil is made by Purchaser under this Agreement, there occur a delay in the completion of the expansion of Purchaser's Kenai, Alaska Refinery, the cause of which is beyond the control of Purchaser, in such event Purchaser shall:

(i) immediately notify Seller of such delay and the circumstances attendant thereto;

(ii) make all efforts to denominate any volumes of Crude Oil possible, given with the time limitations Seller must observe in the Leases.

Under such circumstances, Purchaser's obligation as stated herein to pay Seller $2.00 per barrel for underlifted oil shall be suspended and null for the duration of any such delay.

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If by June 30, 1986 Purchaser has not been able to process 71,000 barrels per day of ANS crude oil the Seller, at its sole discretion, may terminate this Agreement.

2.10 Performance Guaranty and Reservation Fee. If Purchaser does not take the Maximum Quantity on the Date of First Delivery, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to 1.25% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the actual quantity tendered to and accepted by Purchaser ("Actual Quantity") for each day Purchaser does not take the Maximum Quantity on and after the Date of First Delivery. The payment of this fee shall end on the day that Purchaser accepts delivery of the Maximum Quantity. When Purchaser accepts the Maximum Quantity, all of the amounts paid under this Acticle 2.12 will be allowed to be credited against future payments for oil tendered under this Agreement except for an amount to be retained by Seller equal to .75% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the Actual Quantity for each day Purchaser did not take the Maximum Quantity on and after the Date of First Delivery. If Purchaser should thereafter decrease the amount of Royalty Oil to be tendered under this Agreement, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to .75% of the Purchase Price per barrel per day after the date that the decrease in the amount of Royalty Oil to be tendered by Seller takes effect on the difference between the Maximum Quantity and the Actual Quantity.

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2.11 <u>In-State Processing.</u> Purchaser agrees that any and all of the Royalty Oil tendered under this Agreement shall be processed through Purchaser's refinery near Kenai, Alaska. "Process" means producing oil products in significant quantities, but which quantities may be less than 32% of the volume of Royalty Oil tendered under this Agreement.

Purchaser's obligation to process Royalty Oil in-state may only be suspended or excused under the provisions of Articles VIII and XI.

Seller may, at its option, waive the in-state processing requirement in whole or in part, if Seller is satisfied that Purchaser is using its best efforts to process the Royalty Oil tendered under this Agreement at Purchaser's refinery and that the waiver would not be contrary to the underlying intent of the other provisions of this Agreement.

2.12 <u>Best Efforts.</u> Purchaser agrees to use its best efforts to produce and market in Alaska an amount of crude oil products not less in volume than 32 percent (32%) of the Royalty Oil tendered under this Agreement. "Crude oil products" does not include residual fuel oil exported from Alaska unless the Commissioner, in his sole discretion, otherwise agrees, but does include bunker fuel loaded in Alaska. Purchaser also agrees to use its best efforts to nominate no more than that amount of Royalty Oil that will be necessary to produce and market crude oil products not less in volume than 32 percent (32%) of the Royalty

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Oil that will be tendered under this Agreement. On or before the 20th (twentieth) day after the end of each month of the term of this Agreement, the Purchaser shall provide to the Seller an affidavit certified by the Purchaser stating the quantity of crude oil products produced and marketed in the State of Alaska from in-state processing of the Daily Royalty Oil tendered under this Agreement.

A determination of "best efforts" under this Article shall include consideration of Purchaser's capabilities and the surrounding business circumstances. Purchaser's obligation to use its best efforts include reasonable, diligent, and good faith efforts, but shall not require Purchaser to produce and market crude oil products in Alaska at a loss. "Best efforts" would, however, require Purchaser to produce and market products in Alaska even though Purchaser could make a greater profit by another disposition of the Royalty Oil or the products refined from that oil.

2.13 Future Dispositions of Royalty Oil. Seller recognizes that AS 38.05.183, which governs disposition of Royalty Oil by the State of Alaska, establishes a statutory preference for dispositions proposing: (1) in-state processing of Royalty Oil, and (2) in-state supply of products generated from processing of Royalty Oil, in that order. Seller represents that, in conjunction with future dispositions of Royalty Oil, Purchaser will be afforded the consideration contemplated by AS 38.05.183.

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ARTICLE III

REPRESENTATION AND OBLIGATIONS OF PURCHASER

Purchaser warrants, represents, and agrees:

3.1 Good Standing and Due Authorization. Purchaser is, and at all times during the operation of this Agreement shall remain, a corporation qualified to do business in, and in good standing with, the State of Alaska. Purchaser has all necessary corporate power to enter into this Agreement and to perform its covenants and obligations under this Agreement. All necessary corporate action has been taken to authorize Purchaser's entering into this Agreement and performing its covenants and obligations under this Agreement.

3.2 Financial Condition. The financial information submitted to Seller is complete and correct and fairly presents Purchaser's financial condition at the time the information was submitted to Seller. The financial information was prepared in accordance with generally accepted accounting principles consistently applied. Since the date the information was submitted, the condition, business and properties of Purchaser have not been materially adversely affected in any way. Purchaser agrees to inform Seller immediately if during the term of this Agreement there is any material adverse change in the condition, business, or properties of Purchaser which would have an appreciable adverse effect on Purchaser's performance under this Agreement. Purchaser, in addition, will immediately inform Seller of any significant change in

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ownership of either the Purchaser or any of its affiliates or parent company, and of any change in Purchaser's operations or agreements, which would appreciably affect Purchaser's performance under this Agreement.

3.3 Financial Statements. As soon as possible after the end of each fiscal year of Purchaser, and in any event within one hundred twenty (120) days thereafter, Purchaser will furnish to Seller, at Purchaser's sole cost and expense, complete financial statements, in the form filed with the Securities and Exchange Commission.

3.4 Expansion/Modification. Purchaser agrees, for so long as Purchaser, in its sole judgment, determines that an expansion or modification of its in-state refining capacity is potentially viable for Purchaser, to conduct feasibility studies concerning the expansion or modification of its in-state refining capacity, including analysis of the various options for producing refined products and by-products, including petroleum coke. Purchaser shall report to Seller annually on the status of such studies.

3.5 Option to Purchase Resid. Subject to Purchaser's existing contracts, Purchaser grants to Seller an option to purchase all, or any quantity, of the residual oil ("resid") produced or refined from the Royalty Oil sold hereunder. Seller shall exercise this option by giving Purchaser written notice nine (9) months in advance of purchase by Seller. The notice shall specify the quantity Seller will purchase. Thereafter

Seller may increase, decrease, or terminate the quantity of resid by giving written notice nine (9) months in advance, and Seller may again, subject to Purchaser's existing contracts, commence purchases after having terminated such purchase by giving written notice nine (9) months in advance of Seller's purchase. Seller shall take the resid for a period of at least nine (9) months unless the Royalty Oil is run in Purchaser's refinery for a period of less than nine (9) months. In that case, Seller shall be obligated to purchase resid only for that shorter period of time.

This option shall remain in effect for the term of this Agreement. Failure to exercise this option for any period of time shall not affect Seller's right to exercise the option at a later time. This option, in whole or in part and for any term, shall be freely assignable by Seller and such assignment shall release Seller from all obligations to receive or pay for the resid sold under this option; provided, however, that Purchaser shall have the right to demand of an assignee of Seller reasonable security for the resid sold to that assignee. If authorized in an assignment by Seller, an assignee shall have the further right freely to assign that option, however, that assignment shall not release that assignee (or any subsequent assignee) of any responsibilities or liabilities to Purchaser unless agreed to by Purchaser in writing.

Seller shall pay the same price for resid as the highest price the Purchaser is offered for the same product from any other bona fide buyer of the resid. In the event Purchaser has no similar offer to buy from a bona fide buyer, the price shall be Purchaser's posted price for a like grade of resid in effect on date of loading at its Kenai, Alaska refinery, provided, however, that at no time shall the price be more than the cost of the Royalty Oil purchased hereunder plus actual transportation cost to Kenai, Alaska. Purchaser shall have the right to supply a comparable or better quality of resid from any source, domestic or foreign, so long as the laid-in cost of the resid at Seller's intended destination does not exceed the laid-in cost based upon Seller purchasing the resid at Kenai, Alaska.

3.6 Petroleum Coke. Purchaser agrees that if it modifies or expands its refinery at Kenai, Alaska so that the refinery is able to produce and handle petroleum coke, Purchaser will at that time enter into good faith negotiations with Seller for an option to purchase that petroleum coke.

ARTICLE IV

MEASUREMENTS AND TESTS

4.1 Measurement Standards and Procedures. The quantity and quality of the crude oil sold under this Agreement shall be determined at the Point of Delivery. Procedures and methods for measuring and metering the oil sold under this Agreement shall be

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in accordance with the practices then in effect at Prudhoe Bay, Alaska.

ARTICLE V

PAYMENTS AND ACCOUNTING

5.1 Billing. Seller will send to Purchaser, on or before the 10th (tenth) business day of each month after delivery of Royalty Oil, an invoice statement of account of all Royalty Oil estimated to have been measured at the custody transfer meter into the Trans Alaska Pipeline System and tendered to Purchaser under this Agreement during the immediately preceding month according to the best information available to Seller, the estimated price or prices applicable to those deliveries, and the total amount due ("initial billing"). The estimates will be made by Seller according to the best information reasonably available to Seller. Seller may render its initial billing to Purchaser based in part upon information reported by the Lessees to Seller and information published by the U.S. Government. Seller shall thereafter adjust its initial billing under this Article as soon as more accurate information concerning the quantity and price or prices of Royalty Oil delivered each month is available. Seller, however, shall not be required to adjust the initial billing prior to the sending of the next month's invoice statement of account.

5.2 Initial Adjustment. After the monthly invoice under Article 5.1, the subsequent monthly invoice will also state Seller's initial adjustments to be made, if any, to the invoice rendered in the immediately preceding calendar month, in accor-

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dance with any additional or more accurate information which may have become available to Seller. Whether or not initial adjustments are made, however, subsequent adjustments may be made under Article 5.5.

5.3 Payment. Purchaser will make payment of that amount billed under this Article within ten (10) days after receipt of the invoice statement of account. Payment shall be made without any deduction, set off, or withholding in immediately available funds to Seller at the following address:

Bank of America, NT & SA
San Francisco, California
Securities Department 3255

Credit to: State of Alaska Investment Account

Payment may be made in such other manner or to such other address as Seller may specify in the invoice statement of account or by other written notice. All other payments to be made under this Agreement shall be paid in the same manner. If payment is due on a Saturday, Sunday, or legal holiday of the place where payment is to be received, payment shall be made on the next following business day. It is recognized that Seller may bill, and that Purchaser will pay, amounts that are based upon confidential information held or received by Seller. If confidential information is used as the basis for a billing, then upon request Seller will furnish Purchaser with the certified statement of the Commissioner that the amounts billed are correct based upon the best information available to Seller. Except for obvious clerical

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mistakes, if a dispute concerning a bill arises, it is agreed that Purchaser will pay the full amount billed by Seller pending final resolution of the dispute. Upon final resolution, the amount paid will be refunded to the Purchaser with interest, if such a refund is appropriate.

5.4 Payment to Lessee. Purchaser, at the request of Seller in the invoice statement of account or otherwise in writing, shall pay all or any portion designated by Seller of that payment required to be made to one or more of the Lessees at an address or addresses and in the manner designated by Seller. The payment will be made within the time limit specified in Article 5.3. Seller may authorize and designate a third party to make the request and designate the amount, manner and place of payment under this provision. Unless otherwise specified, the balance of the payment due, if any, and payment for subsequent months, shall be made in accordance with Article 5.3.

5.5 Subsequent Adjustments. Purchaser acknowledges that more accurate information concerning the quantity of or Purchase Price for Royalty Oil tendered may subsequently become available to Seller. In the event that any such information should subsequently become available to Seller, Seller shall promptly furnish a corrected invoice statement of account to Purchaser and the parties will adjust the amount billed and pay or refund the amount of those adjustments.

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In the event that Seller should render a corrected invoice to Purchaser, the parties will adjust the amount previously billed accordingly. Any amount to be refunded from Seller to Purchaser or paid from Purchaser to Seller will be paid within fifteen (15) days after the date of the corrected invoice. The time for paying an adjustment will be different, however, when the adjustment concerns an amount last invoiced more than sixty (60) days before the corrected invoice, in which case the amount will be paid by Purchaser or refunded by Seller, as the case may be, in equal monthly installments over the same period of time as that over which the adjustment accrued or six (6) months, whichever is the shorter period. No adjustment will be made more than twelve (12) months after the date of the last original invoice to which the adjustment relates, except for adjustments resulting from: (i) regulatory or court proceedings (including appeals) commenced or pending during that twelve (12) month period, whether or not Seller or Purchaser is a party to the proceeding, or (ii) bona fide audits by Seller of any Lessee(s) commencing at any time during the period six (6) years after the date of the last invoice to which such adjustment relates, or any resolution of disputes arising out of those audits. Adjustments due to audits or regulatory proceedings or court proceedings may be made at any time. The provisions of this Article 5.5 will survive any termination of this Agreement.

5.6 Interest. Except for adjustments made upon resolution of *Amerada Hess* under Article 2.3, the amount of all sums which are

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not paid when due under this Agreement or which are subsequently determined to be due under an adjustment under Article 5.5, or refunds, shall bear interest from the date accrued until paid in full at a variable rate per annum equal to the prime rate as announced from time to time by the Bank of America, San Francisco, California, plus one and one-quarter percent (1.25%) per annum.

5.7 <u>Late Payment Penalty.</u> Except for unintentional failures to pay, including clerical mistakes or occurrences not within the reasonable control of Purchaser, or insignificant underpayments, if Purchaser fails to make payment within one (1) day of the date that payment is due, then in addition to the amount due plus interest from the date that payment was due until the date of payment, Purchaser will pay an amount equal to one percent (1%) of the amount owed.

5.8 <u>Payment to Third Parties.</u> Seller may direct that Purchaser pay any amount due or which may become due directly to a third party in the manner and time as may be directed by Seller in written notice to the Purchaser if, in the Seller's sole discretion, the payment to the third party will assist Seller in monitoring or enforcing this Agreement.

ARTICLE VI

<u>TERM</u>

6.1 <u>Term.</u> This Agreement shall become effective upon execution by the parties and after enactment of legislation by the State of Alaska (including approval by the Governor)

approving this Agreement. This Agreement shall be null and void if it is not so approved by September 1, 1983. Subject to the other provisions contained in this Agreement, Seller's obligation to sell and Purchaser's obligation to buy Royalty Oil shall begin as set forth in Section 2.9 hereof, and end January 1, 1995.

ARTICLE VII

DEFAULT OR TERMINATION

7.1 Default. If any one or more of the following events ("Events of Default") occur, then at Seller's option, Seller may terminate or suspend its obligation to tender and sell Royalty Oil and proceed to exercise any one or more of the rights and remedies provided in this Agreement:

(i) except for obvious clerical errors, Purchaser does not pay in full any sum owed under this Agreement at the time when payment is due; or

(ii) Purchaser fails to observe or perform any of its other covenants and obligations under Article II; or

(iii) Purchaser does not perform any act required or contemplated under this Agreement and either: (a) the nonperformance continues for more than thirty (30) days after Seller

has notified the Purchaser of Purchaser's nonperformance; or (b) Purchaser had failed to perform the same or any other act required or contemplated under this Agreement during the immediately preceding twelve (12) month period; or

(iv) there is a material adverse change in Purchaser's condition, business or property which appreciably affects the ability of the Purchaser to perform any of its obligations under this Agreement, and Purchaser is unable to give Seller adequate assurance of continued performance either within fourteen (14) days of a request for such an assurance or within such other shorter time period as Seller may reasonably request under the circumstances; or

(v) any representation or warranty made by Purchaser in this Agreement proves to have been false or incorrect in any material respect at the time that the representation or warranty was made.

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7.2 <u>Failure to Pay Debts.</u> If at any time Purchaser becomes unable to pay any of its debts when those debts are due, or should otherwise become insolvent (without regard to how that insolvency may be evidenced), Purchaser will immediately give notice of that fact to Seller. Whether or not that notice is given, if Purchaser becomes unable to pay any of its debts when those debts are due or should otherwise become insolvent, Seller's obligation to tender and sell Royalty Oil under this Agreement will automatically and immediately terminate without any requirement of notice or other action by Seller; however, Purchaser will nevertheless be and remain liable for payment and performance of all of its obligations and covenants under this Agreement with respect to Royalty Oil actually tendered by Seller to and after any such termination. Within thirty (30) days after receipt of Purchaser's notice or, if no notice is given, after Seller otherwise becomes aware (as determined in Seller's sole discretion) of Purchaser's insolvency, Seller will have the right, upon written notice to Purchaser, to reinstate all of Seller's and Purchaser's obligations under this Agreement retroactively to the date of termination.

7.3 <u>Seller's Remedies.</u> Upon the occurrence of any Event of Default or if Seller's obligation to tender and sell Royalty Oil under this Agreement is terminated or suspended under Articles 7.1 and 7.2, all obligations of Purchaser accrued but not otherwise due and payable under this Agreement will immediately be due and payable in full. In addition, Purchaser

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will indemnify and hold Seller harmless from and against all other liability, damages (including reasonably foreseeable consequential damages), costs, losses and expenses (including reasonable attorneys' fees and disbursements) incurred by Seller and arising out of the Event of Default, termination, or suspension. Seller shall have the right cumulatively to exercise any and all other rights and remedies and to obtain all other relief available under applicable law or at equity, including mandatory injunction and specific performance. The Seller, upon occurrence of any Event of Default, in its sole discretion, may arrange for any disposition to third parties of Royalty Oil to be tendered and sold under this Agreement. Upon the occurrence of any Event of Default, the Purchaser is released from the obligations set forth in Articles 2.11 (In-State Processing) and 2.12 (Best Efforts) until the Event of Default no longer exists or the obligation of the Purchaser to take Royalty Oil under this Agreement expires. If upon occurrence of any Event of Default the Seller makes arrangement for disposition to third parties of Royalty Oil or if the Purchaser is released from Articles 2.11 and 2.12, whether or not this Agreement is terminated, Purchaser will nevertheless be and remain liable to Seller for the full amount of the Purchase Price for that Royalty Oil in excess of the Purchase Price over any amount or amounts received by Seller on account of that disposition, net of the expenses of that disposition and for all other costs, expenses (including reasonable attorneys' fees and disbursements), damages (including

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reasonably foreseeable consequential damages) and losses incurred by Seller and arising out of the Event of Default or disposition.

7.4 Purchaser's Exclusive Remedies. Upon any breach of, or default in, the due and timely observance or performance of any of Seller's covenants or obligations under this Agreement, Purchaser acknowledges and agrees that Purchaser's remedies will not include a temporary restraining order or preliminary injunction preventing Seller from taking any action with regard to the Royalty Oil sold under the Agreement.

7.5 Third Party Control. If a third party as hereafter defined acquires control of Purchaser or Tesoro Petroleum Corporation, either alone or through a "group" as defined in regulation 13d-5(b) of the Securities and Exchange Commission under the Securities and Exchange Act of 1934, Purchaser will give notice to Seller of such fact within 15 days of the time that such control is acquired, and Seller will have the right, to be exercised within 30 days of receipt of such notice, to elect, in its sole discretion, to cancel this Agreement by giving notice to Purchaser. As used in this Article: "control" means possession of the power to direct or cause direction of management and policies; "third-party" means a person, corporation, partnership or joint venture and their respective affiliates which, directly or through an affiliate, on the date of this Agreement or thereafter up to the date that "control" was acquired was engaged in litigation with Seller which litigation involved (i) claims in excess of sixty million dollars and (ii) the purchase of crude oil from Seller.

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ARTICLE VIII

DISPOSITION OF OIL

8.1 Disposition of Oil Upon Default or Termination.

Purchaser acknowledges and agrees that under the Unit Agreement and Leases Seller's election to take Royalty Oil in-kind can be revoked or reversed only upon the satisfaction of various conditions, including the giving of six (6) months notice to return all or more than ten percent (10%) of Seller's then current nominations. Purchaser acknowledges and agrees that Seller's election to invoke its rights to return to taking its Royalty Oil in value on less than six (6) months notice, or to attempt to secure a waiver of any condition or requirement, is at Seller's sole and complete discretion. Notwithstanding termination of this Agreement for default or for any other reason, including expiration or termination under any provision contained in this Agreement, Purchaser shall continue to take and purchase Seller's Royalty Oil in the amount and for the price set forth in this Agreement for up to seven (7) months following termination of this Agreement if Seller, in its discretion, so requires.

8.2 Inability to Receive Oil. If for any reason Purchaser is unable or refuses to accept or receive any Royalty Oil tendered under this Agreement, Purchaser shall nevertheless be and remain responsible for the disposal of that Royalty Oil and for paying the Seller for the oil as though it had been received and accepted by Purchaser unless Seller, in its sole discretion, elects to waive this requirement.

8.3 <u>No Right to Storage or Underlift.</u> Purchaser waives and disclaims any interest or right that it may assert to storage of Royalty Oil, including by underlift or other means, to which Seller is or may come to be entitled under the Leases or any other agreement.

ARTICLE IX

<u>WAIVER</u>

9.1 <u>Waiver.</u> The failure of either party to insist upon strict performance of any provision of this Agreement shall not constitute a waiver of, or estoppel against, asserting the right to require that performance in the future. A waiver or estoppel in any one instance shall not constitute a waiver or estoppel with respect to a later breach of a similar nature or otherwise. A course of performance established by a party shall also not estop the other party from complaining of a later breach similar in nature.

ARTICLE X

<u>VALIDITY</u>

10.1 <u>Validity.</u> If any provision or clause of this Agreement or application of this Agreement to any person or circumstance is held invalid, that invalidity shall not affect other provisions or applications of this Agreement which can be given effect without the invalid provision or application. If, however, an invalidity should operate to impair any material right or remedy of a party

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to this Agreement, that party may terminate this Agreement by notice to the other.

ARTICLE XI

FORCE MAJEURE AND CHANGE IN CONDITION

11.1 Effect of Force Majeure. Except for Purchaser's obligations to make payment of money for Royalty Oil tendered under this Agreement and except for Purchaser's obligations to accept and dispose of Royalty Oil, neither party shall be liable for any failure to perform the terms of this Agreement when the failure is due in whole or in substantial part to force majeure. The term "force majeure" as applied to this Agreement shall mean Acts of God, strikes, lockouts and industrial disputes or disturbances, civil disturbances, arrests and restraints from rulers or people, interruptions by government or court orders or by present or future orders of any regulatory body having or asserting jurisdiction, acts of the public enemy, wars, riots, blockades, insurrections, inability to secure materials by reasons of allocations promulgated by authorized governmental agencies, epidemics, landslides, lightning, earthquakes, fires, storms, floods, washouts, explosions, breakage or accident to machinery or lines of pipe, freezing of wells or pipelines, or any other event or condition, whether of the kind herein enumerated or otherwise, not within the reasonable control of the party claiming the benefit of this excuse. If, however, any material obligation of Purchaser is excused or suspended because of a claim of force majeure for a period of three hundred sixty-five (365) successive days or more,

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Seller will have the right to terminate this Agreement. Prior to the Seller exercising its right to terminate this Agreement the Seller and Purchaser shall enter into good faith negotiations to restore, to the fullest extent possible, the Seller and Purchaser to the benefits and obligations that existed under this Agreement before the occurrence of the force majeure condition.

11.2 Responsibility. Upon the occurrence and discovery of an event providing the basis for a claim of force majeure, the party making a claim shall notify the other party to this Agreement of its claim of force majeure. Upon the occurrence of an event constituting force majeure that event shall, so far as possible, be remedied with all reasonable diligence and dispatch. Except for Purchaser's obligations to make payment of money for Royalty Oil tendered under this Agreement and except for Purchaser's obligation to dispose of Royalty Oil, the obligations of the disabled party to perform under this Agreement, insofar as they are affected by that force majeure, shall be suspended from the time that force majeure occurs and for so long as the disability caused should have continued had the party claiming the existence of the force majeure had remedied the event providing the basis of the claim of force majeure with reasonable diligence and dispatch, and for no longer. The settlement of strikes or lockouts or industrial disputes or disturbances will be entirely within the discretion of the party having the difficulty, and the above requirement that any force majeure shall be remedied with diligence and dispatch shall not require the settlement of strikes, lockouts,

or industrial disturbances by acceding to the demands of any opposing party therein when such course is inadvisable in the sole discretion of the disabled party.

ARTICLE XII

NOTICES

12.1 Method. All notices, requests, demands or statements shall be in writing, and may be delivered personally to the party to be notified or may be sent by registered or certified United States mail, postage prepaid, with a return receipt requested to such party. Notice deposited in the mail in this manner shall be effective upon the expiration of seven (7) days after it is so deposited. Notice given in any other manner shall be effective only if and when received by the addressee. For the purposes of notice, the addresses of the parties to this Agreement shall be as follows:

If to Seller:

State of Alaska
Commissioner of Natural Resources
Pouch "M"
Juneau, Alaska 99811

and

Commissioner of Revenue
Pouch "S"
Juneau, Alaska 99811

and

Director, Division of Minerals and Energy Management
555 Cordova Street
Anchorage, Alaska 99501

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If to Purchaser: Tesoro Alaska Petroleum Company
8700 Tesoro Drive
P. O. Box 17536
San Antonio, Texas 78286

12.2 Change of Address. Each party may change its address for notice by giving notice of the change.

ARTICLE XIII

RULES AND REGULATIONS

13.1 Rules and Regulations. This Agreement is subject to all present and future valid laws, orders, rules and regulations of the United States, the State of Alaska, and any duly constituted agency thereof.

ARTICLE XIV

SOVEREIGN POWER OF THE STATE

14.1 Sovereign Power of the State. This Agreement and its covenants shall not be interpreted as a limit on the exercise by the State of Alaska of any of its sovereign or regulatory powers, whether conferred on the State by constitution, statute or regulation, including but not limited to, its regulatory power over the Leases. The exercise by the State of Alaska of any sovereign or regulatory power will not operate or be deemed to enlarge any rights of Purchaser or to limit or impair any obligations or liability of Purchaser under this Agreement except for state statutes enacted after the effective date of this Agreement which have a direct and significant adverse affect on the ability of Purchaser to perform an obligation under this Agreement other than

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the obligations to accept, dispose, and pay for Royalty Oil tendered under this Agreement.

ARTICLE XV

SECURITY

15.1 Letter of Credit. At least ninety (90) days before the Date of First Delivery, unless waived by Seller, Purchaser shall cause to be furnished to Seller an irrevocable stand-by letter of credit for the benefit of Seller, issued by a state or national banking institution of the United States which is a member of the Federal Deposit Insurance Corporation and has an aggregate capital and surplus of not less than One Hundred Million Dollars ($100,000,000), or other banking institution acceptable to Seller in its sole discretion. The principle face amount of the letter of credit shall initially be Thirty-One Million, Two Hundred Thousand Dollars ($31,200,000). The letter of credit shall be substantially in a form satisfactory to the Commissioner, but in any event shall not require any documents to be submitted in support of drafts drawn against this letter of credit other than the certified statement of the Commissioner or his designee and the Attorney General of the State of Alaska or his designee that Purchaser is liable to Seller for a sum equal to the amount of such draft, and that that sum is due and payable in full and has not been timely paid. In the event that Seller should have reasonable grounds for asserting any claims against Purchaser under this Agreement and does assert those claims in an aggregate amount in excess of the aggregate principal face amount of the letter of credit then in

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effect, Purchaser shall upon Seller's request (whether or not Purchaser may deny, reject or otherwise resist such claims) cause the principal face amount of the letter of credit to be increased by an amount equal to the excess. The principal face amount of the letter of credit shall also be automatically increased by Purchaser without request from Seller whenever the face amount is less than the expected Purchase Price of sixty (60) days of Royalty Oil tenders under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Royalty Oil tenders. The principal face amount of the letter of credit may be decreased by Purchaser upon approval of Seller if the face amount is less than the expected Purchase Price of sixty (60) days of Royalty Oil tenders under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Royalty Oil tenders. The Commissioner may accept such other or additional security as he, in his sole discretion, considers adequate to protect Seller.

ARTICLE XVI

PREFERENTIAL HIRING AND NON-DISCRIMINATION

16.1 Compliance with Alaska Law. Purchaser will comply with all applicable Alaska statutes and regulations in effect at the time this Agreement becomes effective, as well as all amendments to them and subsequent enactments, providing for preferential hiring of Alaska residents and non-discrimination against them.

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16.2 Preference to Qualified Alaska Residents. To the extent not superceded by or inconsistent with present or subsequently enacted legislation or regulations, Purchaser will use its best efforts to assure that work done by or for it within the State of Alaska in connection with this Agreement shall, to the extent they are available, willing and qualified, be performed by Alaska residents who, at the time of their initial employment by Purchaser, its contractors or subcontractors, fall within one or more of the following employment target groups, as determined by the State or an agency or agencies designated by the State:

(1) "chronically unemployed resident," defined as either:

(A) a resident who has been unemployed for a minimum of eight (8) months, cumulatively, of the twelve (12) months immediately preceding the time of application for determination of status, so long as the individual's income for the 12-month period does not exceed $25,000; or

(B) a resident who has exhausted benefits available under the Alaska Employment Security Act, AS.23.20, within the twelve (12) months immediately preceding the time at which he makes the application for certification

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and is currently not eligible for unemployment benefits;

(2) "economically disadvantaged resident," defined as a resident whose total household income for the twelve (12) months immediately preceding the time of application for determination of status falls below seventy percent (70%) of the minimums set by the U.S. Bureau of Labor Statistics "lower living standard income level" as adjusted for Alaska; and

(3) "training-qualified resident," defined as a resident who, within the twelve (12) months immediately preceding the time of application for determination of status, has successfully completed a program of job training designed to qualify the resident for employment on projects carried out in connection with this Agreement.

16.3 Assurance of Compliance. Purchaser shall use its best efforts to assure that neither it, nor its contractors and subcontractors, hire nonresidents when residents falling within one or more of the employment target groups set out in Article 16.2 are known to be available, willing, and qualified for employment for work performed in connection with this Agreement within the State of Alaska.

16.4 Exceptions. The requirements of this Article do not apply to bona fide administrative, executive or professional employees of the Purchaser or its contractors or subcontractors, as those terms are defined in 8 AAC 15.910.

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16.5 <u>Collective Bargaining Agreements.</u> In implementing the requirements of this Article, Purchaser shall assure that it and its contractors and subcontractors use their best efforts to include in all collective bargaining agreements with labor unions covering work to be performed in connection with this Agreement provisions that will assure employment preference to Alaska residents falling within the target groups set out in Article 16.2 in accordance with the requirements of this Article.

16.6 <u>Non-Discrimination.</u> Purchaser shall assure that neither it nor its contractors or subcontractors engage in discriminatory practices against Alaska residents falling within the employment target groups set out in Article 16.2 who are employed or seeking employment by Purchaser or its contractors or subcontractors. Prohibited discriminatory practices include, but are not necessarily limited to:

(1) rejection of a resident referred to an employer by a collective bargaining agent in favor of a nonresident of similar qualifications in employment covered by a collective bargaining agreement;

(2) rejection of a resident in favor of a nonresident of similar qualifications in employment not covered by a collective bargaining agreement;

(3) termination of a resident in favor of a nonresident of similar qualifications; and

(4) differentiation in payment of wages, salaries, fringe benefits, and working conditions between a resident and nonresident.

16.7 Definitions. In this Article,

(1) "qualified" means able, by education, training and experience or combinations of them, to perform the duties and satisfy the terms and conditions which are usual in the offered employment, provided that the duties, terms and conditions meet the reasonable standards of the industry as required of other employees performing the same type of work in the industry; and

(2) "resident" means a person who:

(A) except for brief intervals, military service, attendance at an educational or training institution, or for absences for good cause, is physically present in the state for a period of at least thirty (30) days immediately before the time that person's status is determined;

(B) maintains a place of residence in the state.

(C) has established residency for voting purposes in the state;

(D) has not, within the period of required residency, claimed residency in another state; and

(E) shows by all attending circumstances that that person's intent is to make Alaska his or her permanent residence.

ARTICLE XVII

APPLICABLE LAW

17.1 Alaska Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Alaska, excluding any conflict-of-law rule or principle which might refer such construction to the laws of another state or country.

17.2 Submission to Jurisdiction. Any legal action or proceeding arising out of or relating to this Agreement or for the enforcement of the covenants or obligation of either party must be instituted in a State court of general jurisdiction sitting in the State of Alaska, and Purchaser hereby irrevocably submits to the jurisdiction of that court in any such action or proceeding.

ARTICLE XVIII

WARRANTIES

18.1 No Warranties. The purchase and sale of Royalty Oil under this Agreement is subject only to the warranties of Seller expressly set forth in this Agreement and Seller disclaims and Purchaser waives all other warranties, express or implied in law, whatsoever.

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ARTICLE XIX

AMENDMENT

19.1 Amendment. This Agreement may be supplemented, amended or modified at any time, but only by written instrument duly executed by the parties to this Agreement. In addition, material amendments to this Agreement which appreciably reduce the consideration to Seller must be approved by the Legislature of the State of Alaska.

ARTICLE XX

SUCCESSORS AND ASSIGNS

20.1 General Prohibition. No assignment, pledge or encumbrance of this Agreement shall be made by either party without first obtaining the written consent of the other party. The Commissioner may grant such consent on behalf of the Seller. The Commissioner shall have sole and complete discretion in granting or denying a proposed assignment, pledge or encumbrance. Subject to the above requirements in this Article, this Agreement will be binding upon and inure to the benefit of each of the parties and its successors and permitted assigns. In addition, if Purchaser gains or acquires a controlling interest in an entity which has an agreement with Seller for the sale of Royalty Oil ("Other Agreement"), then upon at least one year's notice Seller, at its option may require Purchaser to terminate either this Agreement or the Other Agreement. The choice of which Agreement to terminate will be Purchaser's. Purchaser may

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request that Seller waive this option in advance of Purchaser gaining a controlling interest in an entity which has an agreement with Seller for the sale of Royalty Oil. The Commissioner has sole and complete discretion in granting or denying the requested waiver.

ARTICLE XXI

HEADINGS

21.1 Headings. Headings used in this Agreement are for convenience only and shall not affect the construction of this Agreement.

ARTICLE XXII

RECORDS

22.1 Preservation of Records. Purchaser will preserve and maintain all books, accounts, and records relating to or arising out of the performance of this Agreement, including but not limited to the purchase or sale of Royalty Oil and its refined products, for a period of six (6) years. Purchaser will also maintain and preserve all similar books, accounts, and records of which it has possession belonging to those third parties with whom it contracts for the performance of various parts of this Agreement. Neither Purchaser nor Seller shall be required to retain any records for more than six (6) years unless retention of such records is specifically required by applicable law or regulation. Purchaser shall either maintain its records within

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the State of Alaska or make such records available to Seller at Purchaser's principal office in the State of Alaska within thirty (30) days after written request by Seller.

22.2 Inspection of Records of Parties. Purchaser and Seller will accord to each other and to their authorized agents, attorneys, and auditors during reasonable business hours access to any and all property, records, books, documents, and indexes directly relating to the Purchaser's or Seller's performance of this Agreement and which are under the control of the party from which access is desired so that the other party may inspect, photograph and make copies of that property, records, books, documents and indexes. In no event, however, shall Seller be required to disclose any information, data, or records which are required to be held confidential by state law or regulation. If the information obtained by Seller may be held confidential under state or federal law or regulation, Purchaser may request that that information be held confidential by Seller.

ARTICLE XXIII

INTERPRETATION OF TERMS AND CONDITIONS

23.1 Commissioner Finding and Review. In the event that there is a disagreement about the meaning or application of a word, term, or condition in this Agreement, Purchaser will present the arguments supporting its view in writing to the Commissioner for his consideration. The Commissioner will subsequently, within a reasonable time, issue a finding on the meaning or application

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of the disputed word, term, or condition, and setting forth the basis for his conclusions. Purchaser agrees to accept findings by the Commissioner under this Article as long as there is substantial evidence supporting the Commissioner's findings.

DATED this 16th day of March, 1983.

SELLER: THE STATE OF ALASKA

Commissioner,
Department of Natural Resources

PURCHASER: TESORO ALASKA PETROLEUM COMPANY

By
James F. Smith,
President

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PROPOSED DISPOSITION OF ROYALTY OIL
CHEVRON U.S.A. - March 1983

Findings and Determinations Required for Disposals of Royalty Oil

Under AS 38.05, AS 38.06, and 11 AAC 03, I must make various determinations and findings before I may dispose of royalty oil. This document constitutes those determinations and findings regarding the proposed disposal of royalty oil to Chevron USA.

Under the relevant statutes and regulations I must make the following findings and determinations prior to the execution of an agreement for the disposal of royalty oil:

(1) That the disposal is in the best interest of the State. 11 AAC 03.010(d); AS 38.05.020(2).

(2) If the disposal necessitates a taking in-value (such as return of the oil to the producers) that taking in-value is in the best interest of the State. 11 AAC 03.010(c); AS 38.05.182.

(3) If the disposal would allow for the export of royalty oil from the State, that royalty oil is surplus to present and projected intrastate domestic and industrial needs. 11 AAC 03.010(e); AS 38.05.183(d).

(4) If the royalty oil is disposed of to relieve storage or market conditions, that the agreement will relieve the storage or market condition. 11 AAC 03.010(f).

(5) If the disposal is other than by competitive bid, either that no competition exists, or the best interest of the State requires noncompetitive disposal. 11 AAC 03.030(a); AS 38.05.183(c).

(6) That a proposal or proposed disposition offers the maximum benefits to the State. 11 AAC 03.060(a); AS 38.05.183(e).

The determination that a proposal reasonably offers the maximum benefits to the citizens of Alaska is the best interest determination described in 11 AAC 03.010(d). 11 AAC 03.060(b). In making that determination I must consider the criteria described in AS 38.05.183(e), state which of those criteria apply to the proposed disposition, and discuss the weight given to the applicable criteria in determining the maximum benefit to the State. The criteria described in AS 38.05.183(e) are:

1. the cash value offered;

2. the projected effects of the sale, exchange, or other disposal on the economy of the State;

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3. the projected benefits of refining or processing the oil and gas in the State;

4. the ability of the prospective buyer to provide refined projects or by-products for distribution and sale in the State with price or supply benefits to the citizens of the State;

5. the criteria described in AS 38.06.070(a).

The criteria described in AS 38.06.070(a) are:

1. the revenue needs and projected fiscal conditions of the State;

2. the existence and extent of present and projected local and regional needs for oil and gas products and by-products, the effect of state or federal commodity allocation requirements which might be applicable to those products and by-products, and the priorities among competing needs;

3. The desirability of localized capital investment, increased payroll, secondary development, and other possible effects on the sale, exchange, or other disposition of oil and gas or both;

4. the projected social impacts of the transaction;

5. the projected additional costs and responsibilities which could be imposed upon the State and affected political subdivisions by development related to the transaction;

6. the existence of specific local or regional labor or consumption markets which should be met by the transaction;

7. the projected positive and negative environmental effects related to the transaction;

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

In addition, AS 38.06 and 3 AAC 56 govern the actions of the Alaska Royalty Oil and Gas Development Advisory Board and require, among other things, that they hold public hearings on proposed disposals of royalty oil to determine compliance with AS 38.

Background and Chronology

The Commissioner of Natural Resources issued a solicitation for the sale of royalty oil in February, 1981, which was amended in July, 1981. The solicitation invited proposals from companies interested in purchasing royalty oil, but stressed that preference would be given to proposals for the processing of royalty oil in-state or the supply in-state of products from royalty oil processed elsewhere, as required by statute.

Twenty-seven companies responded to the solicitation. The Commissioner conducted negotiations with each proponent, and subsequently narrowed consideration to those companies whose proposals appeared most meritorious. Chevron USA was one of the finalists.

Chevron USA is one of the largest West Coast refiners and marketers of petroleum products, with a total refining capacity of 870,000 b/d. Chevron owns a small and now antiquated refinery in Nikiski, Alaska, with a capacity of 18,000 b/d, as part of its West Coast refining network. It is also the largest supplier of petroleum products in Alaska, which products are refined both in Nikiski and at Chevron's California refineries. Chevron owns productive leases in both Cook Inlet and at Prudhoe Bay. Currently, Chevron trades its Cook Inlet production to Tesoro Alaska Petroleum to be run in Tesoro's Nikiski refinery. All 12,000 b/d of Chevron's North Slope production is being used in Chevron's Nikiski refinery.

Chevron USA submitted a proposal in response to the solicitation requesting a long term contract for the sale of 45,000 b/d of royalty oil. Of the 45,000 b/d, 18,000 b/d represented an amount equal to the full refinery charge for the Nikiski refinery, 7,000 b/d was for a possible expansion of the Nikiski refinery, and the remaining 20,000 b/d would be refined in California and returned to Alaska in the form of petroleum products. The State was not considering the dedication of royalty oil to a mere tentative expansion; consequently, 7,000 b/d was excised from the proposal and negotiations centered on a volume of 38,000 b/d for a term of 12 years.

Negotiations between the State and Chevron USA continued until the deadline for submitting completed contracts to the legislature for approval/disapproval was reached. At that point, in return for a 12 year contract for 38,000 b/d, Chevron was willing to (1) use its best efforts to market specified petroleum products from its Nikiski refinery, (2) use its best efforts to supply historic levels of specified petroleum products produced from the 20,000 b/d processed in California, (3) supply Alaska needs first in the event of products shortage to the extent permitted by Federal law,

(4) continue to supply any local market in which Chevron is or becomes the sole supplier, (5) investigate a possible expansion of the Nikiski refinery and facilities in Western Alaska, and (6) provide the State with an option to purchase up to 400,000 tons annually of petroleum coke. Among other features, Chevron requested the right to terminate the contract on one year's notice.

The State came to the following conclusions with respect to Chevron's offer:

a. Much of what Chevron was proposing appeared to be in Chevron's interest anyway, and likely to be done by Chevron regardless of whether it received a royalty oil contract from the State.

b. Chevron could not offer petroleum coke to the State until 1986, which was not soon enough to satisfy the State's purposes in obtaining such an option.

c. The consideration being offered by Chevron, especially with respect to the 20,000 b/d to be exported from Alaska, was not sufficient to offset the potential losses which the State could experience from displacement and market downtrends created by a State sale. 1/

As a result, the State and Chevron USA were unable to come to an agreement for a long term contract at the time the deadline for submission of proposals to the 1982 legislature was reached. Negotiations were, therefore, suspended with the proviso that further discussions would be conducted subsequent to the legislative session to determine whether common ground could be identified. In the event it were possible for Chevron USA and the State to reach agreement, a contact would be drafted by the Commissioner and presented to the next Governor for action at the Governor's discretion. 2/

Several meetings were held after the legislative session between the State and Chevron regarding a possible long term contract. While some additional consideration was identified, it was not deemed sufficient by the State to justify a long term agreement.

In conjunction with a discussion held in the fall of 1982, however, Chevron notified the State that it expected its refining system would be short of crude oil in the immediate future. Therefore, while Chevron remained interested in a long term contract, their preference was now for a one year agreement with delivery as soon as possible. Chevron's initial request was for 100,000 b/d, later scaled back to 38,000 b/d and finally to 18,000 b/d. Chevron stated that

without additional crude supplies, the closure of the inefficient Nikiski refinery might be imminent.

At the time of Chevron's request, it was generally known that Chevron's principal supplier on the West Coast was Sohio, through an exchange agreement that had been in force for some time. Trade journals placed the volume of ANS received by Chevron from Sohio as high as 300,000 b/d, and stated that Chevron (through its parent Standard of California, an Aramco partner) returned Arabian Oil to Sohio for its refineries in the eastern US. At the time Chevron altered its request to the State from a long term to a short term contract and stated that they were crude short, articles began appearing in the press that the exchange agreement was being renegotiated with a substantial possibility that no agreement would be reached. Were this to happen, the State assumed that Chevron would replace some or all of the ANS formerly received from Sohio with foreign crude, thereby reducing the amount of higher-netback West Coast ANS placements. Consequently, the State did not want to become in any way a factor in the bargaining between Chevron and Sohio over continuation of their exchange agreement.

In discussing a possible short term agreement with Chevron, the State set forth the following elements as its position:

a. The State may not sell royalty oil on a short term (less than one year) basis except for a price premium or to relieve a market situation. The State notified Chevron that it would not consider a short term sale absent a price which would plainly return more to the State than if it made no sale, or a demonstration by Chevron that failure to make the sale would make closure of the Nikiski refinery imminent and likely.

b. The State would consider only a volume of 18,000 b/d (representing the full refinery charge for Nikiski) for in-state processing. The State would consider a greater volume only if the premium were so high it would be irresponsible for the State to ignore it.

c. Even if Chevron could demonstrate that closure of the Nikiski refinery was imminent and likely absent a sale of royalty oil, a premium equalizer over and above the Producers' Weighted Average Field Price would be required to obviate any losses from displacement and to avoid creating a market downtrend by serving as an acquisition bargain in contrast to Chevron's existing suppliers. Further, the State could not view as consideration the benefits which would accrue through a long term contract in which the relationship between the company and the State were maximized.

d. Chevron would be required to run the royalty oil through the Nikiski refinery and to produce specified levels of stated petroleum products on a best efforts standard. Further, Chevron would be required to use its best efforts to produce historic levels of asphalt and to produce additional amounts if demand so required. 3/

e. The State would not attempt to blend a short term contract into a long term contract, with the latter being approved by the legislature; only a short term contract would be considered.

f. A public hearing in Kenai would be required at which Chevron aired its reasons for needing royalty oil in order to keep the refinery open. Other parties would be permitted to testify. A sufficient justification for selling royalty oil short term would have to be placed on the public record by Chevron, both as a legal prerequisite and to avoid any appearance that a contract was being concluded behind closed doors in the final days of the Administration.

At the public hearing in Nikiski, Chevron presented written and oral testimony regarding its refining needs and the fact that it is presently crude short. 4/ This was later supplemented with additional written testimony. Chevron has stated for the record that, without additional crude oil in the form of State royalty oil, Chevron would have to seriously consider closing the Nikiski refinery as it is the least efficient member of its refining system (see attached letter). 5/ They have characterized a decision on closure of the refinery as imminent and likely to be adverse to its continued operation.

Chevron also agreed to the conditions set forth by the State (summarized on the previous page), including a price consisting of the Producers' Weighted Average Field Price, adjusted for the outcome of the present litigation, plus $.94 per barrel.

In February 1983, Chevron again approached the State with a proposal for a long-term contract for 38,000 b/d, to see if the new Administration would treat their proposal differently from the previous one. Because market conditions on the West Coast have not changed from the fall, the concerns cited above are still applicable. However, in the interest of keeping Chevron's Nikiski refinery operational for as long as possible, the State was willing to consider a long-term contract for volumes to be run at the Nikiski refinery. Those volumes will be sold at the in-value price, plus a .$30 premium.

The long-term contract, if approved by the legislature and governor, will supercede the one-year contract negotiated by the previous commissioner.

For general information on previous dispositions of Alaska royalty oil, and the marketing factors to be considered, I have also relied upon the Review of Alaska Royalty Oil, dated January 1, 1983, and prepared by former deputy commissioner Geoffrey Haynes, and hereby adopt the body of that report as part of these findings. That report also contains an analysis of all of the standard terms of the contract, which I hereby cite as an alternative to a discussion of them in this document.

Findings and Determinations

(1) I find and determine that the taking of royalty oil in-kind and the disposal of that royalty oil to Chevron for processing in-state is in furtherance of the intent of AS 38.05.182-183 and AS 38.06, and is in the best interest of the State for the following reasons:

a. The volume is limited to 18,000 b/d which will be run at Nikiski. Therefore, the entirety of the sale is for in-state processing, which is entitled to the highest preference under governing statutes.

b. Without the supply of royalty oil to Chevron, there is a substantial possibility that the refinery at Nikiski would be closed. There are numerous reasons (not limited to the availability of crude oil) which might cause Chevron to consider closing the facility, not the least of which is the decline in demand for petroleum products. However, Chevron has stated that they will keep the facility open for at least an additional year given a royalty oil contract for the amount of the Nikiski refinery charge. The combination of the adverse economic effects of closing Nikiski on the surrounding region together with the immediate absence thereafter of in-state capability for asphalt production at a time of high demand renders such a sale in the public interest. 6/

c. The price equalizer of $.30 over the Producers' Weighted Average Field Price will likely offset the adverse effects of displacement, and avoid creating any significant downward trend in the market through an acquisition bargain for Chevron. While it is impossible to forecast the spread in the two-tier price structure over the period of the contract, the amount of the equalizer is likely to cover a reasonable differential. Therefore, the equalizer is expected to leave the State in the same position financially as if no sale had been made, and avoids placing the State in

a position of inadvertently affecting any negotiations between Chevron and its other suppliers.

d. Public sentiment expressed at the hearing in Kenai and in other settings supports the sale of royalty oil to Chevron for the purpose of keeping the Nikiski refinery open.

(2) I find and determine that the findings required by AS 38.05.182 and 11 AAC 03.010(c) relating to taking in-value and to relief of storage conditions are not applicable to this proposed disposal.

(3) I find and determine that the findings required by AS 38.05.183(d) and 11 AAC 03. 010(e) relating to the export of royalty oil from the State are not applicable to this proposed disposal.

(4) I have determined in accordance with AS 38.05. 183 (a) that the best interest of the State does not require competitive bidding. The best interest of the State is served by requiring several contractual provisions designed to protect the State from factors which lay outside the realm of the competitive bid process. These include provisions designed to preclude the placing of royalty oil in a market which could have the effect of lowering the State's in-value price. Other concerns which lie beyond the pale of the competitive bid process include the security arrangements to insure payments to the State, provisions designed to forestall any possible responsibility or liability on the part of the State for handling royalty oil at Pump Station One, and provisions unique to the circumstances of each purchaser.

I find and determine that, in order to realize the objectives intended by AS 38.05.182-183 respecting instate processing and supply, disposal strictly by competitive bid with the award determined entirely upon the cash value offered is not in the best interest of the State. Rather, it is in the best interest of the State to dispose of royalty oil for a minimum of the in-value price to purchasers who offer the maximum benefits to the State under contracts which protect the interests of the State, recognizing the objectives intended by AS 38.05.182-183.

(5) With respect to the criteria set forth in AS 38.05.183(e), I make the following findings and determinations with respect to the proposed disposal to Chevron USA:

The cash value is the Producers' Weighted Average Field Price, plus .$30 per barrel. Therefore, as discussed above the cash value is equivalent to, and possibly

above, what the State would receive if it did not enter into this agreement.

A disposal to Chevron will have a favorable effect on the economy of the State because it will ensure the continued operation of the refinery with attendant employment and tax base benefits for the term of the contract. Crude oil products (including asphalt), would be processed in-state, insuring that industries dependent on those products would likely have adequate supplies. Moreover, continuation of existing processing and supply would maintain competition to the benefit of products consumers.

The benefits of the continued operation of the Nikiski refinery include the aforementioned employment, tax base, and security of supply benefits, and there would therefore be direct favorable results of processing 18,000 b/d in-state. Secondary industries partially or wholly connected with Chevron's refining operation would also continue to benefit from that relationship.

Chevron is the largest supplier of petroleum products in Alaska, and has demonstrated for over 90 years their ability to provide refined products or by-products for distribution and sale in the State. Continued operation of the Nikiski refinery promotes competition in the petroleum products market in Alaska and therefore benefits the citizens of the State.

(6) With respect to the criteria set forth in AS 38.06.070(a), I make the following findings and determinations with respect to the proposed disposal to Chevron USA:

Regarding the effect of the disposal on the revenue needs and projected fiscal conditions of the State, the matter is covered above.

The supply needs of crude oil products in various localities and regions are generally best met by Chevron, which has the most extensive marketing structure in the State of any refiner/supplier. Commodity allocation requirements are not applicable to this disposal.

The continued operation of the Nikiski refinery with attendant payroll and secondary benefits would have a positive and desirable effect on the citizens of the State. Although this disposal will not result in new capital investment or development, it will enable existing investment and development to continue to be utilized.

The projected social impacts of a disposition to Chevron are anticipated to be favorable. The benefits presently received from the operation of the Nikiski refinery plus the supply of products through Chevron's distribution system would continue. Should the refinery close, the social impact would be negative.

Since most of the essential provisions of the proposed disposal to Chevron relate to operation of its existing facilities and systems the additional costs and responsibilities which could be imposed upon the State and affected subdivisions are likely to be minimal.

While local labor markets are primarily confined to the Nikiski area, regional consumption markets could be directly and favorably affected by the Chevron disposal.

Environmental effects from consummating the proposal are negligible, if any, since the facility is already in existence.

The effects of the proposed disposal upon existing commercial private enterprise and patterns of investments could only be enhanced because of the continued operation of the Nikiski refinery and the continued supply of Chevron's full range of products to the State.

For the foregoing reasons, I find and determine that the proposed Chevron disposal is in the best interest of the State and maximizes benefits to the State.

Esther C. Wunnicke — March 16, 1983

Esther C. Wunnicke, Commissioner — Date
Department of Natural Resources

Corrected for typographical errors April 15, 1983
Esther C. Wunnicke

FOOTNOTES:

1. The price term for sales of royalty oil is founded on the average destination sales price (or internal transfer price) received by the Producers for all sales of Alaska North Slope (ANS) crude oil, netted back (i.e., with transportation and pipeline tariff charges subtracted) to Pump Station No. 1, the point of sale; this is referred to as the Producers' Weighted Average Field Price. Because ANS crude oil is marketed both on the West Coast and the Gulf Coast of the United States, the Weighted Average Field Price is necessarily a mixture of sales prices for both markets. Traditionally, the average netback price for West Coast sales has been higher than for Gulf Coast sales (as

explained on pp. 101 of the Commissioner's February 26, 1982 Findings). This differential netback is often called the two-tier price structure; the State believes this structure is a valid indication of the value of ANS in the respective markets and will persist in the future.

The two-tier price structure creates two potential adverse financial consequences to the State for a royalty oil sale to a West Coast destination. First, since the Producers' Weighted Average Field Price is used to calculate severance tax and royalty payments due the State, a State royalty sale to a West Coast destination may replace a higher netback West Coast producer sale in the calculation on pp. 116 of the Commissioner's February 26, 1982 Findings). The State estimated that the effect of displacement in a sale to Chevron would be in the neighborhood of $2,000,000 to $5,000,000 annually.

Second, if the State's mixed-market Producers' Weighted Average Field Price were substantially below the West Coast Commercial Price for ANS crude oil, large volume sales by the State on the West Coast could create a downward trend on the price of ANS generally with some major adverse effects on royalty and severance tax payments to the State. As explained in the Commissioner's Findings (pp. 99), this apparently happened once previously when approximately 159,000 b/d of the State's royalty oil was on the market short term from several of the State's purchasers. The potential losses to the State from creating a downtrend in the market can be in the tens of millions of dollars annually.

While economic and other benefits can generally be identified to offset potential losses with respect to instate processing, the same is not necessarily true regarding royalty oil processed elsewhere and simply brought back in the form of refined products. As a result, while the State offered Chevron a 12 year contract for 18,000 b/d (which Chevron declined), it did not believe that the consideration offered by Chevron for the remaining 20,000 b/d justified a sale. In addition to a lack of sufficient benefits to offset the consequences of displacement and market downtrends for the exported barrels, it was noted that a West Coast refiner such as Chevron may realize substantial savings in its crude oil acquisition costs if it purchases royalty oil from the State. This is because the Producers' Weighted Average Field Price used by the State (mixed Gulf Coast/West Coast price) will be lower than the West Coast commercial price charged by North Slope producers selling ANS on the West Coast to Chevron and others. The amount of savings would vary depending on the continuation of the two-tier price structure and the degree of difference between the Gulf Coast and West Coast netbacks. For 38,000 b/d over 12 years, however, the amount of reduced

acquisition costs could be as much as $200,000,000. The State did not believe that the consideration offered by Chevron was in proportion to these potential savings.

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2. This same provision was made for Suneel Alaska and for Provident Energy, for which agreement was unable to be reached in time for the legislative session. Both companies subsequently withdrew their proposals.

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3. The Department of Transportation and Public Facilities indicated the possibility of an asphalt shortage for the 1983 season which could slow the State's capital construction program. In addition, the State's other supplier of asphalt appears ready to terminate operations.

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4. Sohio correctly pointed out that a sale of royalty oil by the State in substitution for one of the producers would not result in a net increase in ANS crude oil on the West Coast.

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5. Chevron declined an 18,000 b/d contract at the Weighted Average for 12 years on the grounds that an obligation to keep Nikiski open for that period is not worth it unless Chevron gains additional oil for its California facilities. Therefore, we have concluded that Chevron will be unwilling to commit to keeping Nikiski open over the long term absent a royalty contract from the State for a volume including California barrels as well as Nikiski barrels.

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6. This unique combination of circumstances cannot be assumed to repeat itself at any time Chevron considers closing this facility.

AGREEMENT FOR THE SALE AND
PURCHASE OF ROYALTY OIL

THIS AGREEMENT entered into as of the 16th day of March, 1983, by and between the STATE OF ALASKA ("Seller") and CHEVRON U.S.A. INC., a California corporation ("Purchaser),

ARTICLE I
DEFINITIONS

As used in this Agreement, the following terms shall have the following meanings:

1.1 "Commissioner" means the Commissioner of the Alaska Department of Natural Resources.

1.2 "Day" means a period of twenty-four (24) consecutive hours beginning at 12:01 a.m., Alaska Standard Time.

1.3 "Leases" means the oil and gas leases which are subject to the terms of the Unit Agreement.

1.4 "Lessee" means any person owning a working interest in any of the Leases.

1.5 "Month" means the period beginning at 12:01 a.m., Alaska Standard Time, on the first day of the calendar month and ending at the same time on the first day of the next succeeding calendar month.

1.6 "Oil" or "crude oil" shall have the same meaning as the word "oil" under the Unit Agreement.

1.7 "Point of Delivery" shall have the meaning set out in Article 2.4.

1.8 "Royalty Oil" means the oil which the Seller may take in-kind amount as its royalty under the Leases whether or not Seller has elected to take or is taking that royalty in in-kind.

1.9 "Daily Royalty Oil" means the quantity of Royalty Oil produced by the Lessees each day.

1.10 "Unit Agreement" means the Prudhoe Bay Unit Agreement effective April 1, 1977, by and between Seller and the Lessees, as it may be amended from time to time.

ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity. Seller agrees to sell to Purchaser and Purchaser agrees to buy from Seller that amount of oil equal to 9.600% of the Daily Royalty Oil ("Maximum Quantity"). Upon at least nine (9) months written notice to Seller, Purchaser may increase or decrease the amount of Daily Royalty Oil to be tendered by Seller at the point of Delivery, provided that the amount tendered by Seller under this Agreement shall not exceed the Maximum Quantity. It is understood and agreed that the volume of Daily Royalty Oil available to Seller will vary and may be interrupted from time to time, and depends upon a variety of factors, including the rate of production from the Leases. Seller disclaims and Purchaser waives any representation, covenant or warranty, express or implied, as to the specific quantity or the total or daily, monthly, average, or aggregate volume of Royalty Oil to be sold or tendered under this Agreement. Seller warrants that it has good title to the oil tendered under this Agreement. Seller shall hold the Purchaser harmless from all liens, encumbrances and valid adverse claims that may affect the Royalty Oil at the time the Royalty Oil is tendered to the Purchaser.

If Purchaser has not taken the Maximum Quantity of oil within five (5) years after the effective date of this Agreement, Seller, at its option, may permanently decrease the Maximum Quantity to the greatest percentage of Daily Royalty Oil tendered by Seller within that five-year period or, (2) the maximum amount of oil that can be processed at Purchaser's refinery, located at Nikiski, Alaska. Purchaser may permanently decrease the Maximum Quantity or terminate this Agreement upon nine (9) months written notice to Seller.

If Seller underlifts or stores Royalty Oil at Prudhoe Bay, or if Seller recovers underlifted or stored Royalty Oil, the quantity of Royalty Oil tendered under this Agreement shall be calculated as if no Royalty Oil was underlifted or stored or recovered.

2.2 Quality. The Royalty Oil sold shall be the same quality as the oil delivered by the Lessees to the Seller at the Point of Delivery. It is understood and agreed that the quality of the Royalty Oil sold may vary from time to time. Seller disclaims, and Purchaser waives, any guarantee, representation, or warranty, either

expressed or implied, of the merchantability, fitness for use, or suitability for any particular use or purpose, or otherwise, of any of the oil delivered under this Agreement or as to any specific, average or overall quality or characteristic of Royalty Oil to be sold or tendered under this Agreement.

2.3 Price of the Royalty Oil. The price for the oil tendered under this Agreement shall be equal to the amount that Seller would have received from its Lessees for the Royalty Oil tendered if that royalty had been payable in money (taken in value) rather than taken in kind, plus a premium of $0.30 per barrel, plus the Field Cost Allowance incurred by that oil as determined under the Prudhoe Bay Royalty Settlement Agreement (dated April 1, 1980 for reference purposes only), which was entered as part of a final judgment dated August 13, 1980 in State of Alaska, et al. v. Amerada Hess Corp., et al., (Superior Court for the State of Alaska, First Judicial District at Juneau) ("Amerada Hess") ("Settlement Agreement") ("Purchase Price"). The Purchase Price shall be determined by Seller based upon the reports submitted by the Lessees for royalty purposes or, when those reports are unavailable, incomplete, or inaccurate, upon information submitted by the Lessees for production tax or other tax purposes, as may be adjusted from time to time as provided in this Agreement. Buyer will only be entitled to review or request material or information which is not confidential under state law or regulation.

The method, basis and amount of royalty due Seller when it takes its royalty in value from the Leases is presently the subject of litigation in Amerada Hess. One of the issues involved is the proper method to be used by the Lessees in calculating the state's royalty when that royalty is payable in money (in value). Until there is a resolution of that dispute through judicial resolution or settlement, the Purchase Price will be based upon the calculation of an amount per barrel equal to the per barrel volume weighted average of the in-value prices reported by the Lessees to Seller for royalty purposes or, when the royalty reports are unavailable, incomplete, or inaccurate, upon information submitted by the Lessees for production tax or other tax purposes, plus the Field Cost Allowance as determined under the Settlement Agreement. Upon resolution of each of the various issues

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that are or will be involved in Amerada Hess, adjustments will be made to previous payments in accordance with each resolution. If additional amounts are owed by Purchaser to Seller, interest on those amounts will be paid at a variable interest rate which is the higher of: (1) the prime rate as may be announced from time to time by The Bank of America, San Francisco, California plus three per cent (3%); or (2) the rate of return as is realized from time to time in the investment of the State of Alaska's general fund. Amounts owed from Seller to Purchaser shall be repaid at the rate set out in Article 5.6.

If any applicable law of the United States of America or any rule or regulation promulgated by a federal agency will, in the judgment of Seller, operate to prohibit or prevent Seller from receiving the full amount due under the above provisions, Buyer's obligation to pay the amount of the Purchase Price in excess of the amount permitted will be suspended or adjusted to the minimum extent required for Seller to comply with that law, rule or regulation.

2.4 Point and Time of Delivery. Simultaneous with receipt of its Royalty Oil from its Lessees, Seller shall tender the oil to Purchaser at the point at which Seller receives the Royalty Oil from its Lessees. That point as presently agreed to by Seller and its Lessees in Article 2.3 of the Settlement Agreement is the custody transfer meters into the Trans Alaska Pipeline System at Prudhoe Bay.

2.5 Passage of Title and Risk of Loss. Title and risk of loss to the Royalty Oil sold under this Agreement shall pass from Seller to Purchaser for all purposes when Seller tenders the oil at the Point of Delivery.

2.6 Purchaser's Responsibility. Purchaser shall be responsible for the oil after passage of title. Purchaser will indemnify and hold Seller harmless from and against any and all claims, costs, damages (including reasonably foreseeable consequential damages), expenses or causes of action as a result of any loss, injury, or damage incurred by any party as a result of any transaction or event which relates to the crude oil after title has passed to Purchaser.

2.7 <u>Transportation Arrangements</u>. Purchaser shall make all necessary arrangements for transporting the oil sold under this Agreement from the Point of Delivery, including satisfaction of line fill obligations and storage tank bottom requirements of the Trans Alaska Pipeline System, if any. If and as requested by the Seller, and at the time or times requested by Seller, Purchaser shall submit specific information concerning the arrangement it has made for transportation of the Royalty Oil sold under this Agreement through and away from the Trans Alaska Pipeline System and for the resale or other disposal of the Royalty Oil. Such information may include the specific tenders of oil made to the Trans Alaska Pipeline System and identification of tankers which will transport the Royalty Oil. In addition, Purchaser will provide Seller, if and as requested by Seller, with satisfactory evidence or reasonable assurance of the existence and continuing validity of adequate arrangements for the transportation or disposal of the Royalty Oil subject to this Agreement. Failure to provide information, evidence or assurances requested will, at Seller's election by notice to Purchaser, be a material default under this Agreement.

2.8 <u>Absolute Obligations</u>. The obligations of Purchaser to accept, pay for, and arrange for the transportation of the Royalty Oil tendered or sold under this Agreement are absolute and will not be excused or discharged by the operation of any disability of Purchaser, event of force majeure, impracticability of performance, change in conditions, or any other reason or cause.

2.9 <u>Date of First Delivery</u>. On May 30, 1983, or on the date of statutory approval as set forth in Article VI, whichever is later, Seller will initiate tenders of the Royalty Oil to Purchaser at the Point of Delivery the Maximum Quantity unless Purchaser, under the provisions of Article 2.1, decreases the amount of Royalty Oil to be tendered.

2.10 <u>Performance Guaranty and Reservation Fee</u>. If Purchaser does not take the Maximum Quantity on the Date of First Delivery, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to 1.25% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the actual quantity

tendered to and accepted by Purchaser ("Actual Quantity") for each day Purchaser does not take the Maximum Quantity on and after the Date of First Delivery. The payment of this fee shall end on the day that Purchaser accepts delivery of the Maximum Quantity. When Purchaser accepts the Maximum Quantity, all of the amounts paid under this Article 2.10 will be allowed to be credited against future payments for oil tendered under this Agreement except for an amount to be retained by Seller equal to .75% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the Actual Quantity for each day Purchaser did not take the Maximum Quantity on and after the Date of First Delivery. If Purchaser should thereafter decrease the amount of Royalty Oil to be tendered under this Agreement, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to .75% of the Purchase Price per barrel per day after the date that the decrease in the amount of Royalty Oil to be tendered by Seller takes effect on the difference between the Maximum Quantity and the Actual Quantity.

2.11 <u>In-state Processing</u>. Purchaser agrees that 100% of the Royalty Oil tendered under this Agreement shall be processed through Purchaser's refinery near Nikiski, Alaska, or shall be exchanged for other crude oil which shall be processed at that refinery. "Process" means producing oil products from the crude oil in significant quantities, but which quantities may be less than 34.44% of the volume of Royalty Oil tendered under this Agreement. "Exchange" means: (1) direct trades of equal volumes of crude oil; (2) trades of crude oil involving either cash or volume adjustments, or both, provided that those adjustments relate solely to quality or location differences; (3) sequential transactions in which Purchaser receives back crude oil from a party other than the party which receives the Royalty Oil in a trade from Purchaser; or (4) matching purchases and sales of crude oil. The terms under which Purchaser receives crude oil in any exchange shall not differ in any significant term from the terms under which Purchaser delivered Royalty Oil except for terms which adjust for differences in quality and location. Purchaser agrees that any trade or exchange shall not reduce the price to be paid to Seller and that trades or exchanges shall be at no cost or expense to Seller.

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Purchaser's obligation to process Royalty Oil in-state may only be suspended or excused under (1) the provisions of Articles VIII and XI, or (2) during refinery maintenance or asphalt production.

Seller may, at its option, waive the in-state processing requirement in whole or in part, if Seller is satisfied that Purchaser is using its best efforts to process the Royalty Oil tendered under this Agreement at Purchaser's refinery and that the waiver would not be contrary to the underlying intent of the other provisions of this Agreement.

2.12 Best Efforts. (1) Purchaser agrees to use its "best efforts" to produce and market in Alaska an amount of crude oil products from its refinery near Nikiski, Alaska not less in volume than 34.44% of the Royalty Oil tendered under this Agreement. Said crude oil products shall be comprised of at least jet kerosene, heating fuel, diesel, and asphalt. (2) In addition, Purchaser agrees to use its "best efforts" to sell to the Defense Fuels Supply Center JP-4 military jet fuel produced at said refinery. "Crude oil products" does not include residual fuel oil exported from Alaska unless the Commissioner, in his sole discretion, otherwise agrees, but does include bunker fuel loaded in Alaska. During periods of refinery maintenance or asphalt production where some or all of the Royalty Oil or exchanged oil is not being processed in-state (as described in Paragraph 2.11), the amount of crude oil products required under this paragraph which are not produced from the Nikiski refinery shall be produced from Purchaser's California refining facilities and made available. On or before the 20th day after the end of each month of the term of this Agreement, the Purchaser shall provide to the Seller an affidavit certified by the Purchaser stating the quantity of crude oil products produced and marketed in the State of Alaska from in-state processing of the Daily Royalty Oil tendered under this Agreement.

A determination of "best efforts" under this Article shall include consideration of Purchaser's capabilities and the surrounding business circumstances. Purchaser's obligation to use its best

efforts include reasonable, diligent, and good faith efforts, but shall not require Purchaser to produce and market crude oil products in Alaska at a loss. "Best efforts" would, however, require Purchaser to produce and market products in Alaska even though Purchaser could make a greater profit by another disposition of the Royalty Oil or the products refined from that oil.

2.13 Future Dispositions of Royalty Oil. Seller recognizes that AS 38.05.183, which governs disposition of Royalty Oil by the State of Alaska, establishes a statutory preference for dispositions proposing (1) in-state processing of Royalty Oil and (2) in-state supply of products generated from processing of Royalty Oil, in that order. Seller represents that, in conjunction with future dispositions of Royalty Oil, Purchaser will be afforded the consideration contemplated by AS 38.05.183.

ARTICLE III
REPRESENTATION AND OBLIGATIONS OF PURCHASER

Purchaser warrants, represents and agrees:

3.1 Good Standing and Due Authorization. Purchaser is, and at all times during the operation of this Agreement shall remain, a corporation qualified to do business in, and in good standing with, the State of Alaska. Purchaser has all necessary corporate power to enter into this Agreement and to perform its covenants and obligations under this Agreement. All necessary corporate action has been taken to authorize Purchaser's entering into this Agreement and performing its covenants and obligations under this Agreement.

3.2 Financial Condition. The financial information submitted to Seller is complete and correct and fairly presents Purchaser's financial condition at the time the information was submitted to Seller. The financial information was prepared in accordance with generally accepted accounting principles consistently applied. Since the date the information was submitted, the condition, business and properties of Purchaser have not been materially adversely affected in any way. Purchaser agrees to inform Seller immediately if during the

term of this Agreement there is any material adverse change in the condition, business, or properties of Purchaser which would have an appreciable adverse effect on Purchaser's performance under this Agreement. Purchaser, in addition, will immediately inform Seller of any significant change in ownership of either the Purchaser or any of its affiliates or parent company, and of any change in Purchaser's operations or agreements which would appreciably affect Purchaser's performance under this Agreement.

3.3 Financial Statements. As soon as possible after the end of each fiscal year of Purchaser, and in any event within 120 days thereafter, Purchaser will furnish to Seller, at purchaser's sole cost and expense, a report or a complete copy of a report in a form to be prescribed from time to time by Seller which will include Purchaser's balance sheet as of the close of the fiscal year and the income statement for that year prepared in each case in accordance with generally accepted accounting principles consistently applied by certified public accountants of recognized standing. For purposes of complying with this Article, Purchaser may submit, and Seller will accept, the annual report and supplement thereto of the Standard Oil Company of California.

3.4 Expansion/Modification. Purchaser agrees, for so long as Purchaser, in its sole judgement, determines that an expansion or modification of its in-state refining capacity is potentially viable for Purchaser, to conduct feasibility studies concerning the expansion or modification of its in-state refining capacity, including analysis of the various options for producing refined products and by-products, including petroleum coke. Purchaser shall report to Seller annually on the status of such studies.

3.5 Option to Purchase Resid. Subject to Purchaser's existing contracts, Purchaser grants to Seller an option to purchase all, or any quantity, of the residual oil ("resid") produced or refined from oil sold hereunder or the oil exchanged for the Royalty Oil refined at Purchaser's Nikiski, Alaska refinery. Seller shall exercise this option by giving Purchaser written notice nine (9) months in advance of purchase by Seller. The notice shall specify the quantity Seller will purchase. Thereafter Seller may increase, decrease, or terminate the quantity of resid by giving written notice

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nine (9) months in advance, and Seller may again subject to Purchaser's existing contracts, commence purchases after having terminated such purchase by giving written notice nine (9) months in advance of Seller's purchase. Provided, however, that Seller shall take the resid for a period of at least nine (9) months unless the Royalty Oil is run in Purchaser's refinery for a period of less than nine (9) months. In that case, Seller shall be obligated to purchase resid only for that shorter period of time.

This option shall remain in effect for the term of this Agreement. Failure to exercise this option for any period of time shall not affect Seller's right to exercise the option at a later time. This option, in whole or in part and for any term, shall be freely assignable by Seller and such assignment shall release Seller from all obligations to receive or pay for the resid sold under this option; provided, however, that Purchaser shall have the right to demand of an assignee of Seller reasonable security for the resid sold to that assignee. If authorized in an assignment by Seller, an assignee shall have the further right freely to assign that option, however, that assignment shall not release the assignee (or any subsequent assignee) of any responsibilities or liabilities to Purchaser unless agreed to by Purchaser in writing. Purchaser's obligations to supply resid, as set forth in this Article, following exercise of the purchase option by Seller, shall be freely assignable by Purchaser, in whole or in part and for any term; provided, however, that any such assignment shall not relieve purchaser of its obligations hereunder.

Seller shall pay the same price for resid as the highest price the Purchaser is offered for the same product from any other bona fide buyer of the resid. In the event Purchaser has no similar offer to buy from a bona fide buyer, the price shall be Purchaser's posted price for a like grade of resid in effect on date of loading at its Nikiski, Alaska refinery, provided, however, that at no time shall the price be more than the cost of the Royalty Oil purchased hereunder plus actual transportation cost to Nikiski, Alaska. Purchaser shall have the right to supply a comparable or better quality of resid from any source, domestic or foreign, so long as the laid-in cost of the

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resid at Seller's intended destination does not exceed the laid-in cost based upon Seller purchasing the resid at Nikiski, Alaska.

3.6 Petroleum Coke. Purchaser agrees that if it modifies or expands its refinery at Nikiski, Alaska so that the refinery is able to produce and handle petroleum coke, Purchaser will at that time enter into good faith negotiations with Seller for an option to purchase that petroleum coke.

ARTICLE IV

MEASUREMENTS AND TESTS

4.1 Measurement Standards and Procedures. The quantity and quality of the crude oil sold under this Agreement shall be determined at the Point of Delivery. Procedures and methods for measuring and metering the oil sold under this Agreement shall be in accordance with the practices then in effect at Prudhoe Bay, Alaska.

ARTICLE V

PAYMENTS AND ACCOUNTING

5.1 Billing. Seller will send to Purchaser, on or before the tenth (10th) business day of each month after delivery of Royalty Oil, an invoice statement of account of all Royalty Oil estimated to have been measured at the custody transfer meter into the Trans Alaska Pipeline System and tendered to Purchaser under this Agreement during the immediately preceding month according to the best information available to Seller, the estimated price or prices applicable to those deliveries, and the total amount due ("initial billing"). The estimates will be made by Seller according to the best information reasonably available to Seller. Seller may render its initial billing to Purchaser based in part upon information reported by the Lessees to Seller and information published by the U. S. government. Seller shall thereafter adjust its initial billing under this Article as soon as more accurate information concerning the quantity and price or prices of Royalty Oil delivered each month is available. Seller, however, shall not be required to adjust the initial billing prior to the sending of the next month's invoice statement of account.

5.2 Initial Adjustment. After the monthly invoice under Article 5.1, the subsequent monthly invoice will also state Seller's initial adjustments to be made, if any, to the invoice rendered in the

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immediately preceding calendar month, in accordance with any additional or more accurate information which may have become available to Seller. Whether or not initial adjustments are made, however, subsequent adjustments may be made under Article 5.5.

5.3 Payment. Purchaser will make payment of that amount billed under this Article within ten (10) days after receipt of the invoice statement of account. Payment shall be made without any deduction, set off, or withholding in immediately available funds to Seller at the following address:

Bank of America, NT & SA
San Francisco, California
Securities Department 3255
Credit to:
State of Alaska Investment Account

Payment may be made in such other manner or to such other address as Seller may specify in the invoice statement of account or by other written notice. All other payments to be made under this Agreement shall be paid in the same manner. If payment is due on a Saturday, Sunday, or legal holiday of the place where payment is to be received, payment shall be made on the next following business day. It is recognized that Seller may bill, and that Purchaser will pay, amounts that are based upon confidential information held or received by Seller. If confidential information is used as the basis for a billing, then upon request Seller will furnish Purchaser with the certified statement of the Commissioner that the amounts billed are correct based upon the best information available to Seller. Except for obvious clerical mistakes, if a dispute concerning a bill arises, it is agreed that Purchaser will pay the full amount billed by Seller pending final resolution of the dispute. Upon final resolution, the amount paid will be refunded to the Purchaser with interest, if such a refund is appropriate.

5.4 Payment to Lessee. Purchaser, at the request of Seller in the invoice statement of account or otherwise in writing, shall pay all or any portion designated by Seller of that payment required to be made to one or more of the Lessees at an address or addresses and in the manner designated by Seller. The payment will be made within the

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time limit specified in Article 5.3. Seller may authorize and designate a third party to make the request and designate the amount, manner and place of payment under this provision. Unless otherwise specified, the balance of the payment due, if any, and payment for subsequent months, shall be made in accordance with Article 5.3.

5.5 Subsequent Adjustments. Purchaser acknowledges that more accurate information concerning the quantity of or Purchase Price for Royalty Oil tendered may subsequently become available to Seller. In the event that any such information should subsequently become available to Seller, Seller shall promptly furnish a corrected invoice statement of account to Purchaser and the parties will adjust the amount billed and pay or refund the amount of those adjustments.

In the event that Seller should render a corrected invoice to Purchaser, the parties will adjust the amount previously billed accordingly. Any amount to be refunded from Seller to Purchaser or paid from Purchaser to Seller will be paid within fifteen (15) days after the date of the corrected invoice. The time for paying an adjustment will be different, however, when the adjustment concerns an amount last invoiced more than sixty (60) days before the corrected invoice, in which case the amount will be paid by Purchaser or refunded by Seller, as the case may be, in equal monthly installments over the same period of time as that over which the adjustment accrued or six (6) months, whichever is the shorter period. No adjustment will be made more than twelve (12) months after the date of the last original invoice to which the adjustment relates, except for adjustments resulting from (i) regulatory or court proceedings (including appeals) commenced or pending during that twelve-month period, whether or not Seller or Purchaser is a party to the proceeding, or (ii) bona fide audits by Seller of any Lessee(s) commencing at any time during the period six (6) years after the date of the last invoice to which such adjustment relates, or any resolution of disputes arising out of those audits. Adjustments due to audits or regulatory proceedings or court proceedings may be made at any time. The provisions of this Article 5.5 will survive any termination of this Agreement.

5.6 Interest. Except for adjustments made upon resolution of Amerada Hess under Article 2.3, the amount of all sums which are not paid when due under this Agreement or which are subsequently determined to be due under an adjustment under Article 5.5, or refunds, shall bear interest from the date accrued until paid in full at a variable rate per annum equal to the prime rate as announced from time to time by the Bank of America, San Francisco, California, plus one and one-quarter percent (1.25%) per annum.

5.7 Late Payment Penalty. Except for unintentional failures to pay, including clerical mistakes or occurrences not within the reasonable control of Purchaser, or insignificant underpayments, if Purchaser fails to make payment within one day of the date that payment is due, then in addition to the amount due plus interest from the date that payment was due until the date of payment, Purchaser will pay an amount equal to one percent (1%) of the amount owed.

5.8 Payment to Third Parties. Seller may direct that Purchaser pay any amount due or which may become due directly to a third party in the manner and time as may be directed by Seller in written notice to the Purchaser if, in the Seller's sole discretion, the payment to the third party will assist Seller in monitoring or enforcing this Agreement.

ARTICLE VI

TERM

6.1 Term. This Agreement shall become effective upon execution by the parties and after enactment of legislation by the State of Alaska (including approval by the Governor) approving this Agreement, or on May 30, 1983, whichever is later. This Agreement shall be null and void if it is not so approved by September 1, 1983. Subject to the other provisions contained in this Agreement, Seller's obligation to sell and Purchaser's obligation to buy Royalty Oil shall begin as provided above, and shall end January 1, 1995.

6.2 Termination of Existing Agreement. This Agreement as of the date it becomes effective as above provided shall terminate and supersede that certain "Agreement for the Sale and Purchase of Royalty

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Oil" dated November 30, 1982, now effective between the parties; provided, however, (a) that no financial obligation of Purchaser to Seller arising out of such certain Agreement shall be affected by said termination, and (b) that the Letter of Credit furnished to Seller pursuant to Article XV of said Agreement shall to the extent of its principal amount apply to the Letter of Credit required by Article XV of this Agreement.

ARTICLE VII

DEFAULT OR TERMINATION

7.1 Default. If any one or more of the following events ("Events of Default") occur, then at Seller's option, Seller may terminate or suspend its obligation to tender and sell Royalty Oil and proceed to exercise any one or more of the rights and remedies provided in this Agreement:

(i) Except for obvious clerical errors, Purchaser does not pay in full any sum owed under this Agreement at the time when payment is due; or

(ii) Purchaser fails to observe or perform any of its other covenants and obligations under Article II; or

(iii) Purchaser does not perform any act required or contemplated under this Agreement and either: (a) the nonperformance continues for more than 30 days after Seller has notified the Purchaser of Purchaser's nonperformance; or (b) Purchaser had failed to perform the same or any other act required or contemplated under this Agreement during the immediately preceding 12 month period; or

(iv) There is a material adverse change in Purchaser's condition, business or property which appreciably affects the ability of the Purchaser to perform any of its obligations under this Agreement, and Purchaser is unable to give Seller adequate assurance of continued performance either within fourteen (14) days of a request for such an assurance or within such other shorter time period as Seller may reasonably request under the circumstances; or

(v) Any representation or warranty made by Purchaser in this Agreement proves to have been false or incorrect in any material respect at the time that the representation or warranty was made.

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7.2 Failure to Pay Debts. If at any time Purchaser becomes unable to pay any of its debts when those debts are due, or should otherwise become insolvent (without regard to how that insolvency may be evidenced), Purchaser will immediately give notice of that fact to Seller. Whether or not that notice is given, if Purchaser becomes unable to pay any of its debts when those debts are due or should otherwise become insolvent, Seller's obligation to tender and sell Royalty Oil under this Agreement will automatically and immediately terminate without any requirement of notice of other action by Seller; however, Purchaser will nevertheless be and remain liable for payment and performance of all of its obligations and covenants under this Agreement with respect to Royalty Oil actually tendered by Seller to and after any such termination. Within thirty (30) days after receipt of Purchaser's notice or, if no notice is given, after Seller otherwise becomes aware (as determined in Seller's sole discretion) of Purchaser's insolvency, Seller will have the right, upon written notice to Purchaser, to reinstate all of Seller's and Buyer's obligations under this Agreement retroactively to the date of termination.

7.3 Seller's Remedies. Upon the occurrence of any Event of Default or if Seller's obligation to tender and sell Royalty Oil under this Agreement is terminated or suspended under Article 7.1 and 7.2, all obligations of Purchaser accrued but not otherwise due and payable under this Agreement will immediately be due and payable in full. In addition, Purchaser will indemnify and hold Seller harmless from and against all other liability, damages (including reasonably foreseeable consequential damages), costs, losses and expenses (including reasonable attorneys' fees and disbursements) incurred by Seller and arising out of the Event of Default, termination, or suspension. Seller shall have the right cumulatively to exercise any and all other rights and remedies and to obtain all other relief available under applicable law or at equity, including mandatory injunction and specific performance. The Seller, upon occurrence of any Event of Default, in its sole discretion, may arrange for any disposition to third parties of Royalty Oil to be tendered and sold under this Agreement. Upon the occurrence of any Event of Default, the Purchaser is released from the obligations set forth in Articles 2.11 (In-State

Processing) and 2.12 (Best Efforts) until the Event of Default no longer exists or the obligation of the Purchaser to take Royalty Oil under this Agreement expires. If upon occurrence of any Event of Default the Seller makes arrangement for disposition to third parties of Royalty Oil or if the Purchaser is released from Articles 2.11 and 2.12 whether or not this Agreement is terminated, Purchaser will nevertheless be and remain liable to Seller for the full amount of the Purchase Price for that Royalty Oil in excess of the Purchase Price over any amount or amounts received by Seller on account of that disposition, net of the expenses of that disposition and for all other costs, expenses (including reasonable attorneys' fees and disbursements), damages (including reasonably foreseeable consequential damages) and losses incurred by Seller and arising out of the Event of Default or disposition.

7.4 Purchaser's Exclusive Remedies. Upon any breach of, or default in, the due and timely observance or performance of any of Seller's covenants or obligations under this Agreement, Purchaser acknowledges and agrees that Purchaser's remedies will not include a temporary restraining order or preliminary injunction preventing Seller from taking any action with regard to the Royalty Oil sold under the Agreement.

ARTICLE VIII

DISPOSITION OF OIL

8.1 Disposition of Oil Upon Default or Termination. Purchaser acknowledges and agrees that under the Unit Agreement and Leases Seller's election to take Royalty Oil in-kind can be revoked or reversed only upon the satisfaction of various conditions, including the giving of six (6) months notice to return all or more than ten percent (10%) of Seller's then current nominations. Purchaser acknowledges and agrees that Seller's election to invoke its rights to return to taking its Royalty Oil in-value on less than six months notice, or to attempt to secure a waiver of any condition or requirements, is at Seller's sole and complete discretion. Notwithstanding termination of this Agreement for default or for any other reason, including expiration or termination under any provision contained in this Agreement, Purchaser shall continue to take and purchase Seller's Royalty Oil in the amount and for the price set

forth in this Agreement for up to seven (7) months following termination of this Agreement if Seller, in its discretion, so requires.

8.2 Inability to Receive Oil. If for any reason Purchaser is unable or refuses to accept or receive any Royalty Oil tendered under this Agreement, Purchaser shall nevertheless be and remain responsible for the disposal of that Royalty Oil and for paying the Seller for the oil as though it had been received and accepted by Purchaser unless Seller, in its sole discretion, elects to waive this requirement.

8.3 No Right to Storage or Underlift. Purchaser waives and disclaims any interest or right that it may assert to storage of Royalty Oil, including by underlift or other means, to which Seller is or may come to be entitled under the Leases or any other agreement.

ARTICLE IX
WAIVER

9.1 Waiver. The failure of either party to insist upon strict performance of any provision of this Agreement shall not constitute a waiver of, or estoppel against, asserting the right to require that performance in the future. A waiver or estoppel in any one instance shall not constitute a waiver or estoppel with respect to a later breach of a similar nature or otherwise. A course of performance established by a party shall also not estop the other party from complaining of a later breach similar in nature.

ARTICLE X
VALIDITY

10.1 Validity. If any provision or clause of this Agreement or application of this Agreement to any person or circumstance is held invalid, that invalidity shall not affect other provisions or applications of this Agreement which can be given effect without the invalid provision or application. If, however, an invalidity should operate to impair any material right or remedy of a party to this Agreement, that party may terminate this Agreement by notice to the other.

ARTICLE XI

FORCE MAJEURE AND CHANGE IN CONDITION

11.1 Effect of Force Majeure. Except for Purchaser's obligations to make payment of money for Royalty Oil tendered under this Agreement and except for Purchaser's obligations to accept and dispose of Royalty Oil, neither party shall be liable for any failure to perform the terms of this Agreement when the failure is due in whole or in substantial part to force majeure. The term "force majeure" as applied to this Agreement shall mean acts of God, strikes, lockouts and industrial disputes or disturbances, civil disturbances, arrests and restraints from rulers or people, interruptions by government or court orders or by present or future orders of any regulatory body having or asserting jurisdiction, acts of the public enemy, wars, riots, blockades, insurrections, inability to secure materials by reasons of allocations promulgated by authorized governmental agencies, epidemics, landslides, lightning, earthquakes, fires, storms, floods, washouts, explosions, breakage or accident to machinery or lines of pipe, freezing of wells or pipelines, or any other event or condition, whether of the kind herein enumerated or otherwise, not within the reasonable control of the party claiming the benefit of this excuse. If, however, any material obligation of Purchaser is excused or suspended because of a claim of force majeure for a period of 365 successive days or more, Seller will have the right to terminate this Agreement. Prior to the Seller exercising its right to terminate this Agreement the Seller and Purchaser shall enter into good faith negotiations to restore, to the fullest extent possible, the Seller and Purchaser to the benefits and obligations that existed under this Agreement before the occurrence of the force majeure condition.

11.2 Responsibility. Upon the occurrence and discovery of an event providing the basis for a claim of force majeure, the party making a claim shall notify the other party to this Agreement of its claim of force majeure. Upon the occurrence of an event constituting force majeure that event shall, so far as possible, be remedied with all reasonable diligence and dispatch. Except for Purchaser's obligations to make payment of money for Royalty Oil tendered under this Agreement and except for Purchaser's obligation to dispose of

Royalty Oil, the obligations of the disabled party to perform under this Agreement, insofar as they are affected by that force majeure, shall be suspended from the time that force majeure occurs and for so long as the disability caused should have continued had the party claiming the existence of the force majeure remedied the event providing the basis of the claim of force majeure with reasonable diligence and dispatch, and for no longer. The settlement of strikes or lockouts or industrial disputes or disturbances will be entirely within the discretion of the party having the difficulty, and the above requirement that any force majeure shall be remedied with diligence and dispatch shall not require the settlement of strikes, lockouts, or industrial disturbances by acceding to the demands of any opposing party therein when such course is inadvisable in the sole discretion of the disabled party.

ARTICLE XII
NOTICES

12.1 Method. All notices, requests, demands or statements shall be in writing, and may be delivered personally to the party to be notified or may be sent by registered or certified United States mail, postage prepaid, with a return receipt requested to such party. Notice deposited in the mail in this manner shall be effective upon the expiration of seven (7) days after it is so deposited. Notice given in any other manner shall be effective only if and when received by the addressee. For the purposes of notice the addresses of the parties to this Agreement shall be as follows:

If to Seller:

State of Alaska
Commissioner of Natural Resources
Pouch "M"
Juneau, Alaska 99811

and

Commissioner of Revenue
Pouch "S"
Juneau, Alaska 99811

and

Director, Division of Minerals and Energy Management
555 Cordova Street
Anchorage, Alaska 99501

If to Purchaser:

NOTICES AND CORRESPONDENCE:

CHEVRON U.S.A. INC.
P. O. Box 9000
Concord, CA 94524

INVOICES AND REFUNDS ONLY:

CHEVRON U.S.A. INC.
P. O. Box W, Section 424
Concord, CA 94524

12.2 Change of Address. Each party may change its address for notice by giving notice of the change.

ARTICLE XIII

RULES AND REGULATIONS

13.1 Rules and Regulations. This Agreement is subject to all present and future valid laws, orders, rules and regulations of the United States, the State of Alaska, and any duly constituted agency thereof.

ARTICLE XIV

SOVEREIGN POWER OF THE STATE

14.1 Sovereign Power of the State. This Agreement and its covenants shall not be interpreted as a limit on the exercise by the State of Alaska of any of its sovereign or regulatory powers, whether conferred on the State by constitution, statute or regulation, including but not limited to, its regulatory power over the Leases. The exercise by the State of Alaska of any sovereign or regulatory power will not operate or be deemed to enlarge any rights of Purchaser or to limit or impair any obligations or liability of Purchaser under this Agreement except for state statutes enacted after the effective date of this Agreement which have a direct and significant adverse effect on the ability of Purchaser to perform an obligation under this Agreement other than the obligations to accept, dispose, and pay for Royalty Oil tendered under this Agreement.

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ARTICLE XV

SECURITY

15. Letter of Credit. At least ninety (90) days before the date of First Delivery, unless waived by Seller, Purchaser shall cause to be furnished to Seller an irrevocable stand-by letter of credit for the benefit of Seller, issued by a state or national banking institution of the United States which is a member of the Federal Deposit Insurance Corporation and has an aggregate capital and surplus of not less than $100,000,000, or other banking institution acceptable to Seller in its sole discretion. The principal face amount of the letter of credit shall initially be $23,000,000.00. The letter of credit shall be substantially in a form satisfactory to the Commissioner, but in any event shall not require any documents to be submitted in support of drafts drawn against this letter of credit other than the certified statement of the Commissioner or his designee and the Attorney General of the State of Alaska or his designee that Purchaser is liable to Seller for a sum equal to the amount of such draft, and that that sum is due and payable in full and has not been timely paid. In the event that Seller should have reasonable grounds for asserting any claims against Purchaser under this Agreement and does assert those claims in an aggregate amount in excess of the aggregate principal face amount of the letter of credit then in effect, Purchaser shall upon Seller's request (whether or not Purchaser may deny, reject or otherwise resist such claims) cause the principal face amount of the letter of credit to be increased by an amount equal to the excess. The principal face amount of the letter of credit shall also be automatically increased by Purchaser without request from Seller whenever the face amount is less than the expected Purchase Price of sixty (60) days of Royalty Oil tenders under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Royalty Oil tenders. The principal face amount of the letter of credit may be decreased by Purchaser upon approval of Seller if the face amount is less than the expected Purchase Price of sixty (60) days of Royalty Oil tenders under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Royalty Oil tenders. The Commissioner may accept such other or additional security as he, in his sole discretion, considers adequate to protect seller.

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ARTICLE XVI

PREFERENTIAL HIRING AND NON-DISCRIMINATION

16.1 Compliance with Alaska Law. Purchaser will comply with all applicable Alaska statutes and regulations in effect at the time this Agreement becomes effective, as well as all amendments to them and subsequent enactments, providing for preferential hiring of Alaska residents and non-discrimination against them.

16.2 Preference to Qualified Alaska Residents. To the extent not superseded by or inconsistent with subsequently enacted legislation or regulations, Purchaser will use its best efforts to assure that work done by or for it within the State of Alaska in connection with this Agreement shall, to the extent they are available, willing and qualified, be performed by Alaska residents who, at the time of their initial employment by Purchaser, its contractors or subcontractors, fall within one or more of the following employment target groups, as determined by the State or an agency or agencies designated by the State:

(1) "chronically unemployed resident," defined as either:

(A) a resident who has been unemployed for a minimum of eight (8) months, cumulatively, of the twelve (12) months immediately preceding the time of application for determination of status, so long as the individual's income for the 12-month period does not exceed $25,000; or

(B) a resident who has exhausted benefits available under the Alaska Employment Security Act, AS 23.20, within the twelve months immediately preceding the time at which he makes application for certification and is currently not eligible for unemployment benefits;

(2) "economically disadvantaged resident," defined as a resident whose total household income for the twelve months immediately preceding the time of application for determination of status falls below seventy percent (70%) of the minimums set by the U.S. Bureau of Labor Statistics "lower living standard income level" as adjusted for Alaska; and

(3) "training-qualified resident," defined as a resident who, within the 12 months immediately preceding the time of

application for determination of status, has successfully completed a program of job training designed to qualify the resident for employment on projects carried out in connection with this Agreement.

16.3 Assurance of Compliance. Purchaser shall use its best efforts to assure that neither it, nor its contractors and subcontractors, hire nonresidents when residents falling within one or more of the employment target groups set out in Article 16.2 are known to be available, willing and qualified for employment for work performed in connection with this Agreement within the State of Alaska.

16.4 Exceptions. The requirements of this Article do not apply to bona fide administrative, executive or professional employees of the Purchaser or its contractors or subcontractors, as those terms are defined in 8 AAC 15.190.

16.5 Collective Bargaining Agreements. In implementing the requirements of this Article, Purchaser shall assure that it and its contractors and subcontractors use their best efforts to include in all collective bargaining agreements with labor unions covering work to be performed in connection with this Agreement provisions that will assure employment preference to Alaska residents falling within the target groups set out in Article 16.2 in accordance with the requirements of this Article.

16.6 Non-discrimination. Purchaser shall assure that neither it nor its contractors or subcontractors engage in discriminatory practices against Alaska residents falling within the employment target groups set out in Article 16.2 who are employed or seeking employment by Purchaser or its contractors or subcontractors. Prohibited discriminatory practices include, but are not necessarily limited to:

(1) rejection of a resident referred to an employer by a collective bargaining agent in favor of a nonresident of similar qualifications in employment covered by a collective bargaining agreement;

(2) rejection of a resident in favor of a nonresident of similar qualifications in employment not covered by a collective bargaining agreement;

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(3) termination of a resident in favor of a nonresident of similar qualifications; and

(4) differentiation in payment of wages, salaries, fringe benefits, and working conditions between a resident and nonresident.

16.7 Definitions. In this Article,

(1) "qualified" means able, by education, training and experience or combinations of them, to perform the duties and satisfy the terms and conditions which are usual in the offered employment, provided that the duties, terms and conditions meet the reasonable standards of the industry as required of other employees performing the same type of work in the industry; and

(2) "resident" means a person who:

(A) except for brief intervals, military service, attendance at an educational or training institution, or for absences for good cause, is physically present in the state for a period of at least 30 days immediately before the time that person's status is determined;

(B) maintains a place of residence in the state;

(C) has not established residency for voting purposes in the state;

(D) has not, within the period of required residency, claimed residency in another state; and

(E) shows by all attending circumstances that that person's intent is to make Alaska his or her permanent residence.

ARTICLE XVII
APPLICABLE LAW

17.1 Alaska Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Alaska, excluding any conflict-of-law rule or principle which might refer such construction of the laws of another state or country.

17.2 Submission to Jurisdiction. Any legal action or proceeding arising out of or relating to this Agreement or for the enforcement of the covenants or obligation of either party must be

instituted in a State court of general jurisdiction sitting in the State of Alaska, and Purchaser hereby irrevocably submits to the jurisdiction of that court in any such action or proceeding.

ARTICLE XVIII

WARRANTIES

18.1 No Warranties. The purchase and sale of Royalty Oil under this Agreement is subject only to the warranties of Seller expressly set forth in this Agreement and Seller disclaims and Purchaser waives all other warranties, express or implied in law, whatsoever.

ARTICLE XIX

AMENDMENT

19.1 Amendment. This Agreement may be supplemented, amended or modified at any time, but only by written instrument duly executed by the parties to this Agreement. In addition, material amendments to this Agreement which appreciably reduce the consideration to Seller must be approved by the Legislature of the State of Alaska.

ARTICLE XX

SUCCESSORS AND ASSIGNS

20.1 General Prohibition. No assignment, pledge or encumbrance of this Agreement shall be made by either party without first obtaining the written consent of the other party. The Commissioner may grant such consent on behalf of the Seller. The Commissioner shall have sole and complete discretion in granting or denying a proposed assignment, pledge or encumbrance. Subject to the above requirements in this Article, this Agreement will be binding upon and inure to the benefit of each of the parties and its successors and permitted assigns. In addition, if Purchaser gains or acquires a controlling interest in an entity which has an agreement with Seller for the sale of Royalty Oil ("Other Agreement"), then Seller, at its option and on one year's notice, may require Purchaser to terminate either this Agreement or the Other Agreement. The choice of which Agreement to terminate will be Purchaser's. Purchaser may request that Seller waive this option in advance of Purchaser gaining a controlling interest in an entity which has an agreement with Seller

AGO 786639

for the sale of Royalty Oil. The Commissioner has sole and complete discretion in granting or denying the requested waiver.

ARTICLE XXI

HEADINGS

21.1 Headings. Headings used in this Agreement are for convenience only and shall not affect the construction of this Agreement.

ARTICLE XXII

RECORDS

22.1 Preservation of Records. Purchaser will preserve and maintain all books, accounts, and records, relating to or arising out of the performance of this Agreement, including but not limited to the purchase or sale of Royalty Oil and its refined products, for a period of six (6) years. Purchaser will also maintain and preserve all similar books, accounts, and records of which it has possession belonging to those third parties with whom it contracts for the performance of various parts of this Agreement. Neither Purchaser nor Seller shall be required to retain any records for more than six (6) years unless retention of such records is specifically required by applicable law or regulation. Purchaser shall either maintain its records within the State of Alaska or make such records available to Seller at Purchaser's principal office in

the State of Alaska within thirty (30) days after written request by Seller.

22.2 Inspection of Records of Parties. Purchaser and Seller will accord to each other and to their authorized agents, attorneys, and auditors during reasonable business hours access to any and all property, records, books, documents, and indexes directly relating to the Purchaser's or Seller's performance of this Agreement and which are under the control of the party from which access is desired so that the other party may inspect, photograph and make copies of that property, records, books, documents and indexes. In no event, however, shall Seller be required to disclose any information, data,

or records which are required to be held confidential by state law or regulation. If the information obtained by Seller may be held confidential under state or federal law or regulation, Purchaser may request that that information be held confidential by Seller.

ARTICLE XXIII

INTERPRETATION OF TERMS AND CONDITIONS

23.1 Commissioner finding and review. In the event that there is a disagreement about the meaning or application of a word, term, or condition in this Agreement, Purchaser will present the arguments supporting its view in writing to the Commissioner for his consideration. The Commissioner will subsequently, within a reasonable time, issue a finding on the meaning or application of the disputed word, term, or condition, and setting forth the basis for his conclusions. Purchaser agrees to accept findings by the Commissioner under this Article unless there is clear and convincing evidence for a finding contrary to the Commissioner's findings.

DATED this 16 day of March, 1983.

SELLER:

THE STATE OF ALASKA

Commissioner, Department of Natural Resources

PURCHASER:

CHEVRON U.S.A. INC.

By: R. F. Walsh, Vice President

AGO 786641

ALASKA ROYALTY OIL AND GAS DEVELOPMENT ADVISORY BOARD

Resolution 83-1

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 State and Purchase of Royalty Oil from the Cook Inlet Basin" dated the 22nd day of February 1983; 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 38.05.132; or

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

WHEREAS, the Board did, on February 28, 1983 receive from the Commissioner of Natural Resources the above-mentioned agreement with Tesoro as well as a document entitled "Proposed Disposition of Royalty Oil, Tesoro Alaska Petroleum Company, Findings and Determinations Required for Disposals of Royalty Oil"' dated February 22, 1983 and the Board did act and call public hearings, in accordance with the regulations outlined in 3 AAC 56, in Anchorage on March 22, 1983 and received 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 28, 1983 until April [illegible], 1983; and

WHEREAS, the Board did, on April 5, 1983, meet to discuss the agreement, related Findings and Determinations, 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.

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 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 in the existing Tesoro refinery near Kenai, Alaska.

(b) Tesoro-Alaska is an in-state refinery which supplies products to the Alaska market with supply benefits to state citizens.

(c) the Commissioner of National Resources did issue a competitive solicitation for the disposition of Cook Inlet royalty oil. The Commissioner determined that other proposals received in response to this solicitation were not in the State's best interest.

(d) 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. However, the Board does not believe that the 10¢ per barrel cumulative capital investment for each barrel purchased is a significant factor.

(e) Tesoro has received 100% of the Cook Inlet royalty oil since 1969 and the existing Nikiski refinery is only equipped to process crudes of similar quality. Therefore, if Tesoro does not have access to this royalty oil, they would need to acquire this or similar quality crude by exchange or direct purchase. Further, if Tesoro does not receive this royalty oil they would have the ability to increase purchases of Prudhoe Bay royalty crude by a like amount in accordance with the agreement entered into in 1981 with Tesoro for Prudhoe Bay royalty crude.

(f) that Tesoro-Alaska is a highly qualified company which has been operating its refinery to produce products for the Alaska market for over 13 years.

(g) 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 Thirteenth Alaska Legislature that the "Agreement for the Sale and Purchase of Royalty Oil from the Cook Inlet Basin" between the State of Alaska and Tesoro-Alaska Petroleum Company, dated February 22, 1983 be APPROVED.

Board Member Richard Lyon moved the adoption of the Resolution. Board Member Fred Boeltcher seconded. The vote was as follows:

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

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

POUCH M
JUNEAU, ALASKA 99811
PHONE: (907) 465-2400

February 23, 1983

RECEIVED
FEB 28 1983
ALASKA ROYALTY
OIL & GAS BOARD

Mr. Don Wold
Executive Director
Alaska Royalty Oil and Gas
  Development Advisory Board
620 E. 10th Avenue
Anchorage, AK 99501

COOK INLET ROYALTY CRUDE

Dear Mr. Wold:

I have enclosed, for the consideration of the Board, findings and a signed contract for the long-term disposition of Cook Inlet royalty oil to Tesoro Alaska Petroleum Company. The contract has been reviewed by the Attorney General's Office. Our intention is to submit a bill approving the contract to the Legislature 30 days after you have received these documents.

I have previously transmitted to you the enclosed findings in draft form, including my rejection of the offers of Union Oil and Chevron USA for the Cook Inlet royalty oil, and my intention to waive competitive bid under AS 38.05.183(c).

Thank you for your cooperation. I look forward to the Board's review of the enclosed materials, which are the result of the solicitation issued by the Department in 1982 as a result of discussions with the Board.

Please let me know if I may be of assistance in any way.

Sincerely,

William D. Lynott, Deputy
for Esther C. Wunnicke
Commissioner

cc: Lennie Boston
    Robert Maynard
    Kay Brown

RECEIVED
FEB 28 1983
ALASKA [illegible]
OIL & GAS BOARD

PROPOSED DISPOSITION OF ROYALTY OIL
TESORO ALASKA PETROLEUM COMPANY

FINDINGS AND DETERMINATIONS REQUIRED FOR DISPOSALS OF ROYALTY OIL

Under AS 38.05, AS 38.06, and 11 AAC 03, I must make various determinations and findings before I may dispose of royalty oil. This document constitutes those determinations and findings regarding the proposed disposal of Cook Inlet royalty oil to Tesoro Alaska Petroleum Company (TAPC).

Under the relevant statutes and regulations I must make the following findings and determinations prior to the execution of an agreement for the disposal of royalty oil:

(1) That the disposal is in the best interest of the State. 11 AAC 03.010(d); AS 38.05.020(2).

(2) If the disposal necessitates a taking in-value (such as return of the oil to the producers) that that taking in-value is in the best interest of the State. 11 AAC 03.010(c); AS 38.05.182.

(3) If the disposal would allow for the export of royalty oil from the State, that that royalty oil is surplus to present and projected intrastate domestic and industrial needs. 11 AAC 03.010(e); AS 38.05.183(d).

(4) If the royalty oil is disposed of to relieve storage or market conditions, that the agreement will relieve the storage or market condition. 11 AAC 03.010(f).

(5) If the disposal is other than by competitive bid, either that no competition exists, or the best interest of the State requires noncompetitive disposals. 11 AAC 03.030(a); AS 38.05.183(c).

(6) That a proposal or proposed disposition offers the maximum benefits to the State. 11 AAC 03.060(a); AS 38.05.183(e).

The determination that a proposal reasonably offers the maximum benefits to the citizens of Alaska is the best interest determination described in 11 AAC 03.010(d). 11 AAC 03.060(b). In making that determination I must consider the criteria described in AS 38.05.183(e), state which of those criteria apply to the proposed disposition, and discuss the weight given to the applicable criteria in determining the maximum benefit to the State. The criteria described in AS 38.05.183(e) are:

1. the cash value offered;

2. the projected effects of the sale, exchange, or other disposal on the economy of the State;

3. the projected benefits of refining or processing the oil and gas in the State;

4. the ability of the prospective buyer to provide refined products or by-products for distribution and sale in the State with price or supply benefits to the citizens of the State;

5. the criteria described in AS 38.06.070(a).

The criteria described in AS 38.06.070(a) are:

1. the revenue needs and projected fiscal condition of the State;

2. the existence and extent of present and projected local and regional needs for oil and gas projects and by-products, the effect of state or federal commodity allocation requirements which might be applicable to those products and by-products, and the priorities among competing needs;

3. the desirability of localized capital investment, increased payroll, secondary development, and other possible effects on the sale, exchange, or other disposition of oil and gas or both;

4. the projected social impacts of the transaction;

5. the projected additional costs and responsibilities which could be imposed upon the State and affected political subdivisions by development related to the transaction;

6. the existence of specific local or regional labor or consumption markets which should be met by the transaction;

7. the projected positive and negative environmental effects related to the transaction;

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

In addition, AS 38.06 and 3 AAC 56 govern the actions of the Alaska Royalty Oil and Gas Development Advisory Board and require, among other things, that they hold public hearings

on proposed disposals of royalty oil to determine compliance with AS 38.

Background and Chronology

The State currently receives royalty oil from four oil fields in the Cook Inlet basin. These fields have been in decline since the early 1970's; royalty production currently totals approximately 8,200 barrels per day (b/d), and is anticipated to decline to approximately 6,900 b/d/ in 1984 and 2.700 b/d by 1990. In February 1969, Commissioner of Natural Resources Thomas E. Kelley signed an eight-year contract with the Alaska OIl and Refining Company. The contract required the in-state processing of up to 15,000 b/d or royalty oil. Alaska Oil and Refining Company merged into the Tesoro Petroleum Company in July of that year, and constructed a refinery in Nikiski for the manufacture of gasoline, kerosene, and diesel from Cook Inlet crude.

In 1977, Tesoro requested a one-year contract extension, which was granted in March, 1978. In 1978, Tesoro requested a five-year extension, which was approved by the commissioner and legislature. The current termination date for the Tesoro contract is December, 1983.

In November, 1982, the Royalty Board recommended that the commissioner issue a competitive solicitation for the disposition of Cook Inlet royalty oil. Pursuant to that recommendation, a general notice of the prospective availability of Cook Inlet royalty oil was issued and published during that month. Union Oil, Chevron U.S.A. and Tesoro Alaska Petroleum Company (TAPC) each expressed an interest in obtaining the oil. For the reasons explained below, TAPC has been selected as the successful applicant for Cook Inlet royalty oil.

Union Oil Company of California
Union submitted a proposal for the purchase of the full volume of the State's Cook Inlet area royalty oil commencing January 1, 1984. The contract term which was proposed was for the period of five years and the price offered to be paid by Union for the royalty oil would have been Union's posted price. This proposal was nonresponsive to the State's needs since it did not offer (1) a price equal to an in-value price; (2) in-state refining or processing; or (3) a term of significant duration.

Chevron U.S.A.
Chevron U.S.A. also submitted a proposal for the entire volume of Cook Inlet royalty oil commencing January, 1984.

The term offered was six years but they were open for consideration to other periods. The price term was that which the State would have received if the State has taken the oil in-value and the additional consideration offered was to make available for sale in Alaska Chevron's historic level of aviation gasoline during the term of the Cook Inlet royalty oil contract. Chevron's promise of aviation gasoline is significantly less than the amount of products which would be produced from the amount of Cook Inlet oil products taken. Further, they made no promises regarding grades (e.g., guaranteed 80/87) nor would they agree to provide it if they do not make it in California. While the proposal represented an adequate term and the in-value price, the overriding consideration and benefits offered by Tesoro of in-state refining made it the overwhelming preference.

Tesoro Alaska Petroleum Company

Tesoro Alaska Petroleum Company (TAPC) submitted a proposal for the entire volume of Cook Inlet royalty oil commencing January, 1984. The term offered was eleven years and the price term was the weighted average price which the State would have received had it taken the oil in-value.

In addition, TAPC was willing to commit to manufacturing the Cook Inlet crude oil in their Nikiski refinery. The commissioner's expressed intention was to sell the Cook Inlet royalty oil to someone capable of processing the crude within the State. Tesoro met that goal as well as having the most realistic term, meeting the in-value price requirement, and offering an investment premium. TAPC agreed, in addition to the in-value price to be paid, to make cumulative capital investments in Alaska relative to their refining, marketing, transportation, or terminalling activities during the term of the contract equal to ten cents per barrel for each barrel of crude oil purchased under this contract. The expected contribution to employment, ancillary industries, and local tax bases (or, alternatively, to the State treasury) was a significant factor.

In addition, the sale of Cook Inlet oil to TAPC will not be a "net" sale of oil. In 1981, the state sold ANS oil to TAPC. The amount sold was 46,000 b/d minus the amount of Cook Inlet oil sold to TAPC. At present, the State sells about 37,000 b/d of ANS and 9,000 b/d of Cook Inlet oil to Tesoro. Therefore, if the State does not sell this oil to TAPC, it will have to increase its ANS delivery to TAPC By selling Cook Inlet oil to TAPC, however, the State frees up an equal number of barrels of its ANS crude for other sales. In contrast, a sale to anyone besides TAPC will decrease available royalty oil to be sold.

Findings and Determinations

(1) I find and determine that the taking of royalty oil in-kind and the disposal of that royalty oil to TAPC for processing in-state is in furtherance of the intent of AS 38.05.1982-183 and AS 38.06, and is in the best interest of the State for the reasons stated above and for the following reasons:

a. The volume is the state's royalty share of Cook Inlet crude oil production to be run entirely at Nikiski. Therefore, the entirety of the sale is for in-state processing, which is entitled to a high preference under the governing statutes.

b. The price term is that which the state would have received if the state had taken the oil in-value plus premium. Therefore the requirements of AS 38.05.182 and 11 AAC 03.010(c) relating to taking in-value are met.

(2) AS 38.05.183(c) requires that I make public the findings and conclusions for sales not made by competitive bid. Generally, the purpose of seeking competitive bids is to obtain the highest possible price on a standard form contract. The purpose of this disposal is to maximize the variety of benefits to the state cited in AS 38.05.183 and 38.06, including in-state processing and investment. Obtaining and balancing those benefits requires a negotiation process, as opposed to a one-factor bid process. For that reason, I waive the competitive bid requirement of AS 38.05.183(c) in favor of direct negotiation.

(3) I find and determine that the findings required by AS 38.05.183(d) and 11 AAC 03.010(e) relating to the export of royalty oil from the State are not applicable to this proposed disposal.

(4) With respect to the criteria set forth in AS 38.05.183(e). I make the following findings and determinations with respect to the proposed disposal to TAPC:

The cash value is the Producers' weighted average field price, plus a ten cent (10c) per barrel premium for capital investments. Therefore, as discussed above the cash value is equivalent to, and above, that what the State would have received if it did not enter into this agreement.

A disposal to TAPC will have a favorable effect on the economy of the State because it will ensure the continued operation of the refinery with attendant employment and tax base benefits for the term of the contract. Crude oil products would be processed

in-state, insuring that industries dependent on those products would likely have adequate supplies.

The benefits of the continued operation of the Nikiski refinery include the aforementioned employment, tax base, and security of supply benefits, and there would therefor be direct favorable results of processing the Cook Inlet royalty crude in-state. Secondary industries partially or wholly connected with TAPC's refining operation would also continue to benefit from that relationship.

With respect to the criteria set forth in AS 38.06.070(a), I make the following findings and determinations with respect to the proposed disposal to TAPC:

Regarding the effect of the disposal on the revenue needs and projected fiscal conditions of the State, the matter is covered above.

The supply needs of crude oil products in various localities and regions are generally met by TAPC. The continued operation and expansion of the Nikiski refinery with attendant payroll and secondary benefits would have a positive and desirable effect on the citizens of the State.

The potential adverse social impacts, adverse governmental costs and responsibilities, adverse private impacts, and adverse environmental effects from consummating the proposal are negligible, if any, since the facility is already in existence. In fact, the effects of the proposed disposal upon existing commercial private enterprise and patterns of investments could only be beneficial because of the continued operation and expansion of Nikiski refinery and the continued supply of TAPC products to the State.

For the foregoing reason, I find and determine that the Tesoro Alaska Petroleum Company disposal is in the best interest of the State and maximizes benefits to the State.

Esther C. Wunnicke (signature) — February 22, 1983

Esther C. Wunnicke, Commissioner
Department of Natural Resources

Date

STATE OF ALASKA
FISCAL NOTE

Revision Date , 1983

I. REQUEST

Bill/Resolution No.: HB 320
Title: Approving Cook Inlet royalty oil agreement
Sponsor: Governor
Requestor: Governor

II. FISCAL DETAIL

Agency Affected: Natural Resources
Program Category Affected: Mgmt. of Energy
BRU, Program of Subprogram(s) Affected: Oil & Gas Mgmt.

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC						
TOTAL OPERATING	0	0	0			
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
GENERAL FUND						
FEDERAL FUNDS						
OTHER (Specify Source)						
	0	0	0			

POSITIONS:

	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
FULL-TIME						
PART-TIME						
TEMPORARY						
	0	0	0			

III. SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

IV. ANALYSIS: Attach a separate page for any Analysis

Prepared By: Mark Wittow *Mark Wittow* Phone: 465-2400
Division: Commissioner's Office, DNR Date: 3/30/83

Approved for by Commissioner: *[signature]* Date: 3/30/83
Department: Natural Resources

Distribution:
Original to Legislative Finance
Copy to Office of Management and Budget (for Legislature introduced bills)
Copy to Department (for Governor introduced bills)
Copy to Sponsor

AGO 786653

HB 319

limit would allow the authority to operate for at least another year without the necessity for an additional adjustment to the statutory limit.

Sincerely,

/s/ Bill Sheffield

Bill Sheffield
Governor

HB 320

HOUSE BILL NO. 320 by the Rules Committee by request of the Governor, 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."

was read the first time and referred to the Joint Committee on Oil and Gas for review and comment, and the Resources Committee.

A zero fiscal note accompanied HB 320.

The Governor's transmittal letter dated March 31, 1983, follows:

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill which provides for legislative approval of a royalty oil contract between the state and Tesoro Alaska Petroleum Company for the sale of Cook Inlet royalty oil.

This contract is described in the findings entitled "Proposed Disposition of Royalty Oil, Tesoro Alaska Petroleum Company" issued by the Department of Natural Resources on February 22, 1983. Copies of these findings have been made available to the legislature and the public for review.

AGO 786655

HB 320

This contract is being submitted for legislative approval for two reasons. First, although this and the previous administration have consistently 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 respect the legislature's desire to have a direct voice in major disposals of royalty oil. Therefore, this contract contains provisions requiring approval by the legislature before it becomes effective. Second, this bill would ratify the agreement for the sale of oil. This ratification would cure any procedural defect that may have occurred in the process of entering into this contract.

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( )), 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 this contract for legislative approval and ratification at this time.

Sincerely,

/s/ Bill Sheffield

Bill Sheffield
Governor

HB 321

HOUSE BILL NO. 321 by the Rules Committee by request of the Governor, entitled:

RECEIVED
FEB 28 1983
ALASKA OIL & GAS BOARD

AGREEMENT FOR THE SALE AND PURCHASE OF ROYALTY OIL FROM THE COOK INLET BASIN

THIS AGREEMENT, entered into as of the 22nd day of February, 1983, by and between THE STATE OF ALASKA ("Seller") and TESORO ALASKA PETROLEUM COMPANY ("Buyer").

ARTICLE I

DEFINITIONS

As used in this Agreement, the following terms shall have the following meanings:

1.1 "Commissioner" means the Commissioner of Alaska Department of Natural Resources.

1.2 "Day" means a period of twenty-four (24) consecutive hours, beginning at 12:01 a.m., Alaska Standard Time.

1.3 "Leases" means the below-listed oil and gas leases located within the State of Alaska:

ADL-17579, ADL-17586. ADL-17587, ADL-17594, ADL-17595, ADL-17597, ADL-17602, ADL-18716, ADL-18729, ADL-18730, ADL-18731, ADL-18742, ADL-18744, ADL-18746, ADL-18754, ADL-18756, ADL-18758, ADL-18761, ADL-18772, ADL-18776, ADL-18777, ADL-21068, and ADL-35431.

AGO 786656

1.4 "Lessee" means any person owning a working interest in any of the Leases.

1.5 "Month" means the period beginning at 12:01 a.m., Alaska Standard Time, on the first day of the calendar month and ending at the same time on the first day of the next succeeding calendar month.

1.6 "Oil" or "crude oil" shall mean crude petroleum oil and other hydrocarbons, regardless of gravity which are produced and saved in liquid form at the well or its separator by ordinary production methods and this agreement does not cover natural gas or any liquified products separated from natural gas by other than conventional lease oil and gas separators.

1.7 "Point of Delivery" shall have the meaning set out in Article 2.4.

1.8 "Royalty Oil" means the oil which the Seller may take in kind (amount) as its royalty under the Leases whether or not Seller has elected to take or is taking that royalty in kind.

1.9 "Daily Royalty Oil" means the quantity of Royalty Oil produced by the Lessees each day.

1.10 "Capital Investment" means the expenditure of funds for an asset which benefits future periods or which would extend the useful life of an asset beyond the asset's original life. Capital Investment does not include normal maintenance or operating expenses.

AGO 786657

ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity. Seller agrees to sell to Purchaser and Purchaser agrees to buy from Seller 100.00% of the Daily Royalty Oil from the "Leases" ("Quantity"). It is understood and agreed that the volume of Daily Royalty Oil available to Seller will vary and may be interrupted from time-to-time, and depends upon a variety of factors, including the rate of production from the Leases. Seller disclaims and Purchaser waives any representation, covenant or warranty, express or implied, as to the specific quantity or the total or daily, monthly, average, or aggregate volume of Royalty Oil to be sold or tendered under this Agreement. Seller warrants that it has good title to the oil tendered under this Agreement. Seller shall hold the Purchaser harmless from all liens, encumbrances and valid adverse claims that may affect the Royalty Oil at the time the Royalty Oil is tendered to the Purchaser.

2.2 Quality. The Royalty Oil sold shall be the same quality as the oil delivered by the Lessees to the Seller at the Point of Delivery. It is understood and agreed that the quality of the Royalty Oil sold may vary from time to time. Seller disclaims, and Purchaser waives, any guarantee, representation, or warranty, either expressed or implied, of the merchantability, fitness for use, or suitablility for any particular use or purpose, or otherwise, of any of the oil delivered under this Agreement or as

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to any specific, average or overall quality or characteristic of Royalty Oil to be sold or tendered under this Agreement.

2.3 Price of the Royalty Oil. The price for the oil tendered under this Agreement shall be equal to the amount that Seller would have received from its Lessees for the Royalty Oil tendered if that royalty had been payable in money (taken in-value) rather than taken in kind. That Purchase Price shall be determined by Seller based upon the reports submitted by the Lessees for production, severance, or other tax purposes, as may be adjusted from time to time as provided in this Agreement. Buyer will only be entitled to review or request material or information which is not confidential under state law or regulation. The Purchase Price will be the calculation of an amount per barrel equal to the per barrel volume weighted average of the in-value prices as reflected by information submitted by the Lessees for production, severance, or other tax purposes.

In the event that the tax reports no longer adequately reflect the amount that the State would have received from its lessees for the crude oil sold to purchaser hereunder, then at the request of either party, the parties shall meet to negotiate the revisal of the price term of this Agreement.

Any such request shall be made in writing and sent by registered mail, telegram, or telex, pursuant to Section 12 hereof.

The first meeting shall take place within fifteen (15) days from the receipt of said notice.

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The parties shall have thirty (30) days from the receipt of said notice to reach an agreement over the alteration(s) to be made to the Agreement.

If the parties reach an accord within the time period of thirty (30) days, the alteration(s) which have been decided shall become effective on the first day of the month following the month during which the agreement has been reached.

If on expiration of the thirty (30) day period no agreement between the parties has been reached, then in such event either party shall have the option to terminate this Agreement, subject to the provisions of Article VIII.

Pending, or in the absence of, any agreement between the parties, the price to be in effect shall be the arithmetic average of the following postings for Cook Inlet Crude Oil: (1) Arco, (2) Union of California, (3) Chevron and (4) Mobil.

In settlement of litigation over various claims between and among the State, Purchaser and the eleven (11) companies holding lessee interests in twenty-three (23) specific oil and gas leases (listed below) issued by the State in the Cook Inlet Basin, the State, Purchaser and each of those Lessees agreed to various cash payments between and among themselves and to the establishment of certain "Platform-to-Shore Charges" and "C & D Allowances" under the terms of the settlement agreements, which were approved by the Court and made final in the Court's orders

dismissing the litigation. These "Platform-to-Shore Charges" and "C & D Allowances" arose solely under the explicit terms of the settlement agreements; and the full consideration for them was the settlement and compromise of the various claims being then litigated, upon the terms set forth in the settlement agreements. The State and Purchaser reaffirm the separate nature of these costs from this Agreement and from any other lease, contract or agreement of any kind (other than the settlement agreements); and the "Platform-to-Shore Charges" and "C & D Allowances" established by those settlement agreements shall, if applicable, be paid, without regard to any provision hereof and without effect on any price to be paid hereunder to the State by Purchaser. The leases to which the settlement agreements apply are:

ADL-17579, ADL-17586, ADL-17587, ADL-17594, ADL-17595, ADL-17597, ADL-17602, ADL-18716, ADL-18729, ADL-18730, ADL-18731, ADL-18742, ADL-18744, ADL-18746, ADL-18754, ADL-18756, ADL-18758, ADL-18761, ADL-18772, ADL-18776, ADL-18777, ADL-21068, and ADL-35431.

If any applicable law of the United States of America or any rule or regulation promulgated by a federal agency will, in the judgment of Seller, operate to prohibit or prevent Seller from receiving the full amount due under the above provisions, Buyer's obligation to pay the amount of the Purchase Price in excess of the amount permitted will be suspended or adjusted to

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the minimum extent required for Seller to comply with that law, rule or regulation.

2.4 Capital Investment Premium. Purchaser agrees, in addition to any other consideration paid to Seller, to make cummulative capital investments in Alaska relative to Purchaser's refining, marketing, transportation or terminalling activities during the term of this Agreement equal to ten cents ($.10) per barrel for each barrel of crude oil purchased under this Agreement. The Capital Investment Premium may be accumulated by Purchaser and expended either in parcels or in total at any time during the term of this Agreement. If at the expiration or termination of this Agreement the Purchaser has not made cummulative Capital Investments greater than, or equal to, the accrued Capital Investment Premiums to the date of expiration or termination, the amount of under investment will be paid directly to the Seller within one hundred twenty (120) days of such expiration or termination.

2.5 Points of Delivery. Delivery and receipt of all Royalty Oil purchased hereunder shall be at the point or points where such oil is delivered to the Seller by its Lessees, subject to all rights and obligations the State may have under any oil and gas lease subject hereto or other agreements hereafter made between the State and the Lessees; provided, however, nothing in this Section shall authorize any reduction in the price to be paid by Purchaser pursuant to Section 2.3 hereof, and no such other agreement hereafter made by the State and its Lessees shall diminish Purchaser's rights hereunc . .

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2.6 Passage of Title and Risk of Loss. Title and risk of loss to the Royalty Oil sold under this Agreement shall pass from Seller to Purchaser for all purposes when Seller tenders the oil at the Point of Delivery.

2.7 Purchaser's Responsibility. Purchaser shall be responsible for the oil after passage of title. Purchaser will indemnify and hold Seller harmless from and against any and all claims, costs, damages (including reasonably foreseeable consequential damages), expenses or causes of action as a result of any loss, injury, or damage incurred by any party as a result of any transaction or event which relates to the crude oil after title has passed to Purchaser.

2.8 Transportation Arrangements. Purchaser shall make all necessary arrangements for transporting the oil sold under this Agreement from the Point of Delivery. If and as requested by the Seller, and at the time or times requested by Seller, Purchaser shall submit specific information concerning the arrangement it has made for transportation of the Royalty Oil sold under this Agreement.

2.9 Absolute Obligations. The obligations of Purchaser to accept, pay for, and arrange for the transportation of the Royalty Oil tendered or sold under this Agreement are absolute and will not be excused or discharged by the operation of any disability of Purchaser, event of force majeure, impracticability

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of performance, change in conditions, or any other reason or cause.

2.10 Date of First Delivery. On January 1, 1984, or seven months after statutory approval as set forth in Article VI, whichever is later, Seller will tender to Purchaser at the Point of Delivery the Quantity.

2.11 In-State Processing. Purchaser agrees that any and all of the Royalty Oil tendered under this Agreement shall be processed through Purchaser's refinery near Kenai, Alaska, or shall be exchanged for other crude oil which shall be processed at that refinery. "Process" means producing oil products in significant quantities, but which quantities may not be less than 40% of the volume of Royalty Oil tendered under this Agreement. "Exchange" means: (1) direct trades of equal volumes of crude oil; (2) trades of crude oil involving either cash or volume adjustments, or both, provided that those adjustments relate solely to quality or location differences; (3) sequential transactions in which Purchaser receives back crude oil from a party other than the party which receives the Royalty Oil in a trade from Purchaser; or (4) matching purchases and sales of crude oil. The terms under which Purchaser receives crude oil in any exchange shall not differ in any significant term from the terms under which Purchaser delivered Royalty Oil except for terms under which adjust for differences in quality and location. Purchaser agrees that any trade or exchange shall not reduce the

price to be paid to Seller and that trades or exchanges shall be at no cost or expense to Seller.

Purchaser's obligation to process Royalty Oil or exchanged oil in-state may only be suspended or excused under the provisions of Articles VIII and XI.

Seller may, at its option, waive the in-state processing requirement in whole or in part, if Seller is satisfied that Purchaser is using its best efforts to process the Royalty Oil tendered or the oil exchanged for Royalty Oil tendered under this Agreement at Purchaser's refinery, and that the waiver would not be contrary to the underlying intent of the other provisions of this Agreement.

2.12 <u>Best Efforts.</u> Purchaser agrees to use its best efforts to produce and market in Alaska an amount of crude oil products not less in volume that 40% of the Royalty Oil tendered under this Agreement. "Crude oil products" does not include residual fuel oil exported from Alaska unless the Commissioner, in his sole discretion, otherwise agrees, but does include bunker fuel loaded in Alaska. [~~[illegible]~~] On or before the 20th (twentieth) day after the end of each month of the term of this Agreement, the Purchaser shall provide to the Seller an affidavit certified by the Purchaser

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stating the quantity of crude oil products produced and marketed in the State of Alaska from in-state processing of the Daily Royalty Oil tendered under this Agreement.

A determination of "best efforts" under this Article shall include consideration of Purchaser's capabilities and the surrounding business circumstances. Purchaser's obligation to use its best efforts include reasonable, diligent, and good faith efforts, but shall not require Purchaser to produce and market crude oil products in Alaska at a loss. "Best efforts" would, however, require Purchaser to produce and market products in Alaska even though Purchaser could make a greater profit by another disposition of the Royalty Oil or t e products refined from that oil.

2.13 Future Dispositions of Royalty Oil. Seller recognizes that AS.38.05.183, which governs disposition of Royalty Oil by the State of Alaska, establishes a statutory preference for dispositions proposing: (1) in-state processing of Royalty Oil, and (2) in-state supply of products generated from processing of Royalty Oil, in that order. Seller represents that, in conjunction with future dispositions of Royalty Oil, Purchaser will be afforded the consideration contemplated by AS.38.05.183.

2.14 Refinery Modification. In the event that the Purchaser modifies the Purchaser's r finery near Kenai, Alaska, to process one hundred percent (100%) Alaskan North Slope crude oil, the Purchaser will notify the Seller nine (9) months in advance of

the date when one hundred percent (100%) Alaskan North Slope crude oil could be processed in the refinery. Upon such notification, the Seller will have a one-time option to terminate the Agreement at the end of the nine (9) months notification period or continue the Agreement relieving the Purchaser, however, from the obligations imposed by Sections 2.11 and 2.12.

ARTICLE III

REPRESENTATION AND OBLIGATIONS OF PURCHASER

Purchaser warrants, represents, and agrees:

3.1 Good Standing and Due Authorization. Purchaser is, and at all times during the operation of this Agreement, shall remain, a corporation qualified to do business in, and in good standing with, the State of Alaska. Purchaser has all necessary corporate power to enter into this Agreement and to perform its covenants and obligations under this Agreement. All necessary corporate action has been taken to authorize Purchaser's entering into this Agreement and performing its covenants and obligations under this Agreement.

3.2 Financial Condition. The financial information submitted to Seller is complete and correct and fairly presents Purchaser's financial condition at the time the information was submitted to Seller. The financial information was prepared in accordance with generally accepted accounting principles consistently applied. Since the date the information was submitted, the condition,

business and properties of Purchaser have not been materially adversely affected in any way. Purchaser agrees to inform Seller immediately if during the term of this Agreement there is any material adverse change in the condition, business, or properties of Purchaser which would have an appreciable adverse effect on Purchaser's performance under this Agreement. Purchaser, in addition, will immediately inform Seller of any significant change in ownership of either the Purchaser or any of its affiliates or parent company, and of any change in Purchaser's operations or agreements, which would appreciably affect Purchaser's performance under this Agreement.

3.3 Financial Statements. As soon as possible after the end of each fiscal year of Purchaser, and in any event within one hundred twenty (120) days thereafter, Purchaser will furnish to Seller, at Purchaser's sole cost and expense, complete financial statements, reflective of Purchaser's financial condition, in the form filed with the Securities and Exchange Commission.

3.4 Expansion/Modification. Purchaser agrees, for so long as Purchaser, in its sole judgment, determines that an expansion or modification of its in-state refining capacity is potentially viable for Purchaser, to conduct feasibility studies concerning the expansion or modification of its in-state refining capacity, including analysis of the various options for producing refined products and by-products, including petroleum coke. Purchaser shall report to Seller annually on the status of such studies.

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3.5 Option to Purchase Resid. Subject to Purchaser's existing contracts, Purchaser grants to Seller an option to purchase all, or any quantity, of the residual oil ("resid") produced or refined from the Royalty Oil sold hereunder or the oil exchanged for the Royalty Oil. Seller shall exercise this option by giving Purchaser written notice nine (9) months in advance of purchase by Seller. The notice shall specify the quantity Seller will purchase. Thereafter Seller may increase, decrease, or terminate the quantity of resid by giving written notice nine (9) months in advance, and Seller may again, subject to Purchaser's existing contracts, commence purchases after having terminated such purchase by giving written notice nine (9) months in advance of Seller's purchase. Seller shall take the resid for a period of at least nine (9) months unless the Royalty Oil is run in Purchaser's refinery for a period of less than nine (9) months. In that case, Seller shall be obligated to purchase resid only for that shorter period of time.

This option shall remain in effect for the term of this Agreement. Failure to exercise this option for any period of time shall not affect Seller's right to exercise the option at a later time. This option, in whole or in part and for any term,

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shall be freely assignable by Seller and such assignment shall release Seller from all obligations to receive or pay for the resid sold under this option; provided, however, that Purchaser shall have the right to demand of an assignee of Seller reasonable security for the resid sold to that assignee. If authorized in an assignment by Seller, an assignee shall have the further right freely to assign that option, however, that assignment shall not release that assignee (or any subsequent assignee) of any responsibilities or liabilities to Purchaser unless agreed to by Purchaser in writing.

Seller shall pay the same price for resid as the highest price the Purchaser is offered for the same product from any other bona fide buyer of the resid.

In the event Purchaser has no similar offer to buy from a bona fide buyer, the price shall be Purchaser's posted price for a like grade of resid in effect on date of loading at its Kenai, Alaska, refinery, provided, however, that at no time shall that price be more than the cost of the Royalty Oil purchased hereunder plus actual transportation cost to Kenai, Alaska. Purchaser shall have the right to supply a comparable or better quality of resid from any source, domestic or foreign, so long as

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the laid-in cost of the resid at Seller's intended destination does not exceed the laid-in cost based upon Seller purchasing the resid at Kenai, Alaska.

3.6 Petroleum Coke. Purchaser agrees that if it modifies or expands its refinery at Kenai, Alaska, so that the refinery is able to produce and handle petroleum coke, Purchaser will at that time enter into good faith negotiations with Seller for an option to purchase that petroleum coke.

ARTICLE IV

MEASUREMENTS AND TESTS

4.1 Measurement Standards and Procedures. The quantity and quality of the crude oil sold under this Agreement shall be determined at the Point of Delivery. Procedures and methods for measuring and metering the oil sold under this Agreement shall be in accordance with the practices then in effect in the Cook Inlet Basin area of Alaska.

ARTICLE V

PAYMENTS AND ACCOUNTING

5.1 Billing. Seller will send to Purchaser, on or before the 10th (tenth) business day of each month after delivery of Royalty Oil, an invoice statement of account of all Royalty Oil estimated to have been measured at the point of delivery and tendered to Purchaser under this Agreement during the immediately preceding month according to the best information available to Seller, the

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estimated price or prices applicable to those deliveries, and the total amount due ("initial billing"). The estimates will be made by Seller according to the best information reasonably available to Seller. Seller may render its initial billing to Purchaser based in part upon information reported by the Lessees to Seller and information published by the U.S. Government. Seller shall thereafter adjust its initial billing under this Article as soon as more accurate information concerning the quantity and price or prices of Royalty Oil delivered each month is available. Seller, however, shall not be required to adjust the initial billing prior to the sending of the next month's invoice statement of account.

5.2 Initial Adjustment. After the monthly invoice under Article 5.1, the subsequent monthly invoice will also state Seller's initial adjustments to be made, if any, to the invoice rendered in the immediately preceding calendar month, in accordance with any additional or more accurate information which may have become available to Seller. Whether or not initial adjustments are made, however, subsequent adjustments may be made under Article 5.5.

5.3 Payment. Purchaser will make payment of that amount billed under this Article within ten (10) days after receipt of the invoice statement of account. Payment shall be made without any deduction, set off, or withholding in immediately available funds to Seller at the following address:

Bank of America, NT & SA
San Francisco, California
Securities Department 3255

Credit to: State of Alaska Investment Account

Payment may be made in such other manner or to such other address as Seller may specify in the invoice statement of account or by other written notice. All other payments to be made under this Agreement shall be paid in the same manner. If payment is due on a Saturday, Sunday, or legal holiday of the place where payment is to be received, payment shall be made on the next following business day. It is recognized that Seller may bill, and that Purchaser will pay, amounts that are based upon confidential information held or received by Seller. If confidential information is used as the basis for a billing, then upon request Seller will furnish Purchaser with the certified statement of the Commissioner that the amounts billed are correct based upon the best information available to Seller. Except for obvious clerical mistakes, if a dispute concerning a bill arises, it is agreed that Purchaser will pay the full amount billed by Seller pending final resolution of the dispute. Upon final resolution, the amount paid will be refunded to the Purchaser with interest, if such a refund is appropriate.

5.4 Payment to Lessee. Purchaser, at the request of Seller in the invoice statement of account or otherwise in writing, shall pay all or any portion designated by Seller of that payment required to be made to one or more of the Lessees at an address or addresses and in the manner designated by Seller. The payment

will be made within the time limit specified in Article 5.3. Seller may authorize and designate a third party to make the request and designate the amount, manner and place of payment under this provision. Unless otherwise specified, the balance of the payment due, if any, and payment for subsequent months, shall be made in accordance with Article 5.3.

5.5 <u>Subsequent Adjustments.</u> Purchaser acknowledges that more accurate information concerning the quantity of or Purchase Price for Royalty Oil tendered may subsequently become available to Seller. In the event that any such information should subsequently become available to Seller, Seller shall promptly furnish a corrected invoice statement of account to Purchaser and the parties will adjust the amount billed and pay or refund the amount of those adjustments.

In the event that Seller should render a corrected invoice to Purchaser, the parties will adjust the amount previously billed accordingly. Any amount to be refunded from Seller to Purchaser or paid from Purchaser to Seller will be paid within fifteen (15) days after the date of the corrected invoice. The time for paying an adjustment will be different, however, when the adjustment concerns an amount last invoiced more than sixty (60) days before the corrected invoice, in which case the amount will be paid by Purchaser or refunded by Seller, as the case may be, in equal monthly installments over the same period of time as that over which the adjustment accrued or six (6) months, whichever

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is the shorter period. No adjustment will be made more than twelve (12) months after the date of the last original invoice to which the adjustment relates, except for adjustments resulting from: (i) regulatory or court proceedings (including appeals) commenced or pending during that twelve (12) month period, whether or not Seller or Purchaser is a party to the proceeding, or (ii) bona fide audits by Seller of any Lessee(s) commencing at any time during the period six (6) years after the date of the last invoice to which such adjustment relates, or any resolution of disputes arising out of those audits. Adjustments due to audits or regulatory proceedings or court proceedings may be made at any time. The provisions of this Article 5.5 will survive any termination of this Agreement.

5.6 Interest. The amount of all sums which are not paid when due under this Agreement or which are subsequently determined to be due under an adjustment under Article 5.5, or refunds, shall bear interest from the date accrued until paid in full at a variable rate per annum equal to the prime rate as announced from time to time by the Bank of America, San Francisco, California, plus one and one-quarter percent (1.25%) per annum.

5.7 Late Payment Penalty. Except for unintentional failures to pay, including clerical mistakes or occurrences not within the reasonable control of Purchaser, or insignificant underpayments, if Purchaser fails to make payment within one (1) day of the date that payment is due, then in addition to the amount due plus

interest from the date that payment was due until the date of payment, Purchaser will pay an amount equal to one percent (1%) of the amount owed.

5.8 Payment to Third Parties. Seller may direct that Purchaser pay any amount due or which may become due directly to a third party in the manner and time as may be directed by Seller in written notice to the Purchaser if, in the Seller's sole discretion, the payment to the third party will assist Seller in monitoring or enforcing this Agreement.

ARTICLE VI

TERM

6.1 Term. This Agreement shall become effective upon execution by the parties and after enactment of legislation by the State of Alaska (including approval by the Governor) approving this Agreement. This Agreement shall be null and void if it is not so approved by September 1, 1983. Subject to the other provisions contained in this Agreement, Seller's obligation to sell and Purchaser's obligation to buy Royalty Oil shall begin seven (7) months after the above approval or January 1, 1984, whichever is later, and end January 1, 1995.

ARTICLE VII

DEFAULT OR TERMINATION

7.1 Default. If any one or more of the following events ("Events of Default") occur, then at Seller's option, Seller may

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terminate or suspend its obligation to tender and sell Royalty Oil and proceed to exercise any one or more of the rights and remedies provided in this Agreement:

(i) Except for obvious clerical errors, Purchaser does not pay in full any sum owed under this Agreement at the time when payment is due; or

(ii) Purchaser fails to observe or perform any of its other covenants and obligations under Article II; or

(iii) Purchaser does not perform any act required or contemplated under this Agreement and either: (a) the nonperformance continues for more than thirty (30) days after Seller has notified the Purchaser of Purchaser's non-performance; or (b) Purchaser had failed to perform the same or any other act required or contemplated under this Agreement during the immediately preceding twelve (12) month period; or

(iv) There is a material adverse change in Purchaser's condition, business or property which appreciably affects the ability of the Purchaser to perform any of its obligations under this Agreement, and Purchaser is unable to give Seller adequate assurance of continued performance either within fourteen (14) days of a request for such an assurance or within such other shorter time period as Seller may reasonably request under the circumstances; or

(v) Any representation or warranty made by Purchaser in this Agreement proves to have been false or incorrect in any material respect at the time that the representation or warranty was made.

7.2 Failure to Pay Debts. If at any time Purchaser becomes unable to pay any of its debts when those debts are due, or should otherwise become insolvent (without regard to how that insolvency may be evidenced), Purchaser will immediately give notice of that fact to Seller. Whether or not that notice is given, if Purchaser becomes unable to pay any of its debts when those debts are due or should otherwise become insolvent, Seller's obligation to tender and sell Royalty Oil under this Agreement will automatically and immediately terminate without any requirement of notice or other action by Seller; however, Purchaser will nevertheless be and remain liable for payment and performance of all of its obligations and covenants under this Agreement with respect to Royalty Oil actually tendered by Seller to and after any such termination. Within thirty (30) days after receipt of Purchaser's notice or, if no notice is given, after Seller otherwise becomes aware (as determined in Seller's sole discretion) of Purchaser's insolvency, Seller will have the right, upon written notice to Purchaser, to reinstate all of Seller's and Buyer's obligations under this Agreement retroactively to the date of termination.

7.3 Seller's Remedies. Upon the occurrence of any Event of Default or if Seller's obligation to tender and sell Royalty Oil under this Agreement is terminated or suspended under Article 7.1 and 7.2, all obligations of Purchaser accrued but not otherwise due and payable under this Agreement will immediately be due and payable in full. In addition, Purchaser will indemnify

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and hold Seller harmless from and against all other liability, damages (including reasonably foreseeable consequential damages), costs, losses and expenses (including reasonable attorneys' fees and disbursements) incurred by Seller and arising out of the Event of Default, termination, or suspension. Seller shall have the right cumulatively to exercise any and all other rights and remedies and to obtain all other relief available under applicable law or at equity, including mandatory injunction and specific performance. The Seller, upon occurrence of any Event of Default, in its sole discretion, may arrange for any disposition to third parties of Royalty Oil to be tendered and sold under this Agreement. Upon the occurrence of any Event of Default, the Purchaser is released from the obligations set forth in Articles 2.11 (In-State Processing) and 2.12 (Best Efforts) until the Event of Default no longer exists or the obligation of the Purchaser to take Royalty Oil under this Agreement expires. If upon occurrence of any Event of Default the Seller makes arrangement for disposition to third parties of Royalty Oil or if the Purchaser is released from Articles 2.11 and 2.12, whether or not this Agreement is terminated, Purchaser will nevertheless be and remain liable to Seller for the full amount of the Purchase Price for that Royalty Oil in excess of the Purchase Price over any amount or amounts received by Seller on account of that disposition, net of the expenses of that disposition and for all other costs, expenses (including reasonable attorneys' fees and disbursements), damages (including reasonably foreseeable consequential damages) and losses incurred by Seller and arising out of the Event of Default or disposition.

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7.4 Purchaser's Exclusive Remedies. Upon any breach of, or default in, the due and timely observance or performance of any of Seller's covenants or obligations under this Agreement, Purchaser acknowledges and agrees that Purchaser's remedies will not include a temporary restraining order or preliminary injunction preventing Seller from taking any action with regard to the Royalty Oil sold under the Agreement.

ARTICLE VIII

DISPOSITION OF OIL

8.1 Disposition of Oil Upon Default or Termination.

Purchaser acknowledges and agrees that under the Leases Seller's election to take Royalty Oil in kind may be revoked or reversed; and in certain instances, only upon the satisfaction of various conditions, including the giving of notice to return all or part of Seller's then current nominations. Notwithstanding termination of this Agreement for default or for any other reason, including expiration or termination under any provision contained in this Agreement, Purchaser shall continue to take and purchase Seller's Royalty Oil in the amount and for the price set forth in this Agreement for up to seven (7) months following termination of this Agreement if Seller, in its discretion, so requires.

8.2 Inability to Receive Oil. If for any reason Purchaser is unable or refuses to accept or receive any Royalty Oil tendered under this Agreement, Purchaser shall nevertheless be and remain responsible for the disposal of that Royalty Oil and for paying

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the Seller for the oil as though it had been received and accepted by Purchaser unless Seller, in its sole discretion, elects to waive this requirement.

8.3 No Right to Storage or Underlift. Purchaser waives and disclaims any interest or right that it may assert to storage of Royalty Oil, including by underlift or other means, to which Seller is or may come to be entitled under the Leases or any other agreement.

ARTICLE IX

WAIVER

9.1 Waiver. The failure of either party to insist upon strict performance of any provision of this Agreement shall not constitute a waiver of, or estoppel against, asserting the right to require that performance in the future. A waiver or estoppel in any one instance shall not constitute a waiver or estoppel with respect to a later breach of similar nature or otherwise. A course of performance established by a party shall also not estop the other party from complaining of a later breach similar in nature.

ARTICLE X

VALIDITY

10.1 Validity. If any provision or clause of this Agreement or application of this Agreement to any person or circumstance is held invalid, that invalidity shall not affect other provisions

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or applications of this Agreement which can be given effect without the invalid provision or application. If, however, an invalidity should operate to impair any material right or remedy of a party to this Agreement, that party may terminate this Agreement by notice to the other.

ARTICLE XI

FORCE MAJEURE AND CHANGE IN CONDITION

11.1 Effect of Force Majeure. Except for Purchaser's obligations to make payment of money for Royalty Oil tendered under this Agreement and except for Purchaser's obligations to accept and dispose of Royalty Oil, neither party shall be liable for any failure to perform the terms of this Agreement when the failure is due in whole or in substantial part to force majeure. The term "force majeure" as applied to this Agreement shall mean acts of God, strikes, lockouts and industrial disputes or disturbances, civil disturbances, arrests and restraints from rulers or people, interruptions by government or court orders or by present or future orders of any regulatory body having or asserting jurisdiction, acts of the public enemy, wars, riots, blockades, insurrections, inability to secure materials by reasons of allocations promulgated by authorized governmental agencies, epidemics, landslides, lightning, earthquakes, fires, storms, floods, washouts, explosions, breakage or accident to machinery or lines of pipe, freezing of wells or pipelines, or any other event or condition, whether of the kind herein enumerated or otherwise, not within

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the reasonable control of the party claiming the benefit of this excuse. If, however, any material obligation of Purchaser is excused or suspended because of a claim of force majeure for a period of three hundred sixty-five (365) successive days or more, Seller will have the right to terminate this Agreement. Prior to the Seller exercising its right to terminate this Agreement the Seller and Purchaser shall enter into good faith negotiations to restore, to the fullest extent possible, the Seller and Purchaser to the benefits and obligations that existed under this Agreement before the occurrence of the force majeure condition.

11.2 <u>Responsibility.</u> Upon the occurrence and discovery of an event providing the basis for a claim of force majeure, the party making a claim shall notify the other party to this Agreement of its claim of force majeure. Upon the occurrence of an event constituting force majeure that event shall, so far as possible, be remedied with all reasonable diligence and dispatch. Except for Purchaser's obligations to make payment of money for Royalty Oil tendered under this Agreement and except for Purchaser's obligation to dispose of Royalty Oil, the obligations of the disabled party to perform under this Agreement, insofar as they are affected by that force majeure, shall be suspended from the time that force majeure occurs and for so long as the disability caused should have continued had the party claiming the existence of the force majeure had remedied the event providing the basis of the claim of force majeure with reasonable diligence and dispatch, and for no longer. The settlement of strikes or lockouts or industrial

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disputes or disturbances will be entirely within the discretion of the party having the difficulty, and the above requirement that any force majeure shall be remedied with diligence and dispatch shall not require the settlement of strikes, lockouts, or industrial disturbances by acceding to the demands of any opposing party therein when such course is inadvisable in the sole discretion of the disabled party.

ARTICLE XII

NOTICES

12.1 Method. All notices, requests, demands or statements shall be in writing, and may be delivered personally to the party to be notified or may be sent by registered or certified United States mail, postage prepaid, with a return receipt requested to such party. Notice deposited in the mail in this manner shall be effective upon the expiration of seven (7) days after it is so deposited. Notice given in any other manner shall be effective only if and when received by the addressee. For the purposes of notice, the addresses of the parties to this Agreement shall be as follows:

If to Seller: State of Alaska
Commissioner of Natural Resources
Pouch "M"
Juneau, Alaska 99811

and

Commissioner of Revenue
Pouch "S"
Juneau, Alaska 99811

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and

Director, Division of Minerals
and Energy Management
555 Cordova Street
Anchorage, Alaska 99501

If to Purchaser: Tesoro Alaska Petroleum Company
8700 Tesoro Drive
P. O. Box 17536
San Antonio, Texas 78286

12.2 Change of Address. Each party may change its address for notice by giving notice of the change.

ARTICLE XIII

RULES AND REGULATIONS

13.1 Rules and Regulations. This Agreement is subject to all present and future valid laws, orders, rules and regulations of the United States, the State of Alaska, and any duly constituted agency thereof.

ARTICLE XIV

SOVEREIGN POWER OF THE STATE

14.1 Sovereign Power of the State. This Agreement and its covenants shall not be interpreted as a limit on the exercise by the State of Alaska of any of its sovereign or regulatory powers, whether conferred on the State by constitution, statute or regulation, including, but not limited to, its regulatory power over the Leases. The exercise by the State of Alaska of any sovereign or regulatory power will not operate or be deemed to enlarge any

rights of Purchaser or to limit or impair any obligations or liability of Purchaser under this Agreement, except for state statutes enacted after the effective date of this Agreement which have a direct and significant adverse affect on the ability of Purchaser to perform an obligation under this Agreement other than the obligations to accept, dispose, and pay for Royalty Oil tendered under this Agreement.

ARTICLE XV

SECURITY

15.1 Letter of Credit. At least ninety (90) days before the Date of First Delivery, unless waived by Seller, Purchaser shall cause to be furnished to Seller an irrevocable stand-by letter of credit for the benefit of Seller, issued by a state or national banking institution of the United States which is a member of the Federal Deposit Insurance Corporation and has an aggregate capital and surplus of not less than One Hundred Million Dollars ($100,000,000), or other banking institution acceptable to Seller in its sole discretion. The principle fee amount of the letter of credit shall initially be Fourteen Million Dollars ($14,000,000). The letter of credit shall be substantially in a form satisfactory to the Commissioner, but in any event shall not require any documents to be submitted in support of drafts drawn against this letter of credit other than the certified statement of the Commissioner or his designee and the Attorney General of the State of Alaska or his designee that Purchaser is liable to Seller for a sum equal to the amount of such draft, and that that sum is due and payable

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in full and has not been timely paid. In the event that Seller should have reasonable grounds for asserting any claims against Purchaser under this Agreement and does assert those claims in an aggregate amount in excess of the aggregate principal face amount of the letter of credit then in effect, Purchaser shall, upon Seller's request (whether or not Purchaser may deny, reject or otherwise resist such claims) cause the principal face amount of the letter of credit to be increased by an amount of the letter of credit to be increased by an amount equal to the excess. The principal face amount of the letter of credit shall also be automatically increased by Purchaser without request from Seller whenever the face amount is less than the expected Purchase Price of sixty (60) days of Royalty Oil tenders under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Royalty Oil tenders. The principal face amount of the letter of credit may be decreased by Purchaser upon approval of Seller if the face amount is more than the expected Purchase Price of sixty (60) days of Royalty Oil tenders under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Royalty Oil tenders. The Commissioner may accept such other or additional security as he, in his sole discretion, considers adequate to protect Seller.

ARTICLE XVI

PREFERENTIAL HIRING AND NON-DISCRIMINATION

16.1 Compliance with Alaska Law. Purchaser will comply with all applicable Alaska statutes and regulations in effect at the

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time this Agreement becomes effective, as well as all amendments to them and subsequent enactments, providing for preferential hiring of Alaska residents and non-discrimination against them.

16.2 <u>Preference to Qualified Alaska Residents.</u> To the extent not superceded by or inconsistent with present or subsequently enacted federal or state legislation or regulations, Purchaser will use its best efforts to assure that work done by or for it within the State of Alaska in connection with this Agreement shall, to the extent they are available, willing and qualified, be performed by Alaska residents who, at the time of their initial employment by Purchaser, its contractors or subcontractors, fall within one (1) or more of the following employment target groups, as determined by the State or an agency or agencies designated by the State:

(1) "chronically unemployed resident," defined as either:

(a) a resident who has been unemployed for a minimum of eight (8) months, cumulatively, of the twelve (12) months immediately preceding the time of application for determination of status, so long as the individual's income for the twelve (12) month period does not exceed $25,000; or

(b) a resident who has exhausted benefits available under the Alaska Employment Security Act,

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AS.23.20, within the twelve (12) months immediately preceding the time at which he makes the application for certification and is currently not eligible for unemployment benefits;

(2) "economically disadvantaged resident," defined as a resident whose total household income for the twelve (12) months immediately preceding the time of application for determination of status falls below seventy percent (70%) of the minimums set by the U.S. Bureau of Labor Statistics, "lower living standard income level" as adjusted for Alaska; and

(3) "training-qualified resident," defined as a resident who, within the twelve (12) months immediately preceding the time of application for determination of status, has successfully completed a program of job training designed to qualify the resident for employment on projects carried out in connection with this Agreement.

16.3 Assurance of Compliance. Purchaser shall use its best efforts to assure that neither it, nor its contractors and subcontractors, hire non-residents when residents falling within one (1) or more of the employment target groups set out in Article 16.2 are known to be available, willing, and qualified for employment for work performed in connection with this Agreement within the State of Alaska.

16.4 Exceptions. The requirements of this Article do not apply to bona fide administrative, executive or professional

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employees of the Purchaser or its contractors or subcontractors, as those terms are defined in 8.AAC.15.910.

16.5 <u>Collective Bargaining Agreements.</u> In implementing the requirements of this Article, Purchaser shall assure that it and its contractors and subcontractors use their best efforts to include in all collective bargaining agreements with labor unions covering work to be performed in connection with this Agreement provisions that will assure employment preference to Alaska residents falling within the target groups set out in Article 16.2 in accordance with the requirements of this Article.

16.6 <u>Non-Discrimination.</u> Purchaser shall assure that neither it nor its contractors or subcontractors engage in discriminatory practices against Alaska residents falling within the employment target groups set out in Article 16.2 who are employed or seeking employment by Purchaser or its contractors or subcontractors. Prohibited discriminatory practices include, but are not necessarily limited to:

(1) rejection of a resident referred to an employer by a collective bargaining agent in favor of a non-resident of similar qualifications in employment covered by a collective bargaining agreement;

(2) rejection of a resident in favor of a non-resident of similar qualifications in employment not covered by a collective bargaining agreement;

(3) termination of a resident in favor of a non-resident of similar qualifications; and

(4) differentiation in payment of wages, salaries, fringe benefits, and working conditions between a resident and non-resident.

16.7 Definitions. In this Article:

(1) "qualified" means able, by education, training and experience or combinations of them, to perform the duties and satisfy the terms and conditions which are usual in the offered employment, provided that the duties, terms and conditions meet the reasonable standards of the industry as required of other employees performing the same type of work in the industry; and

(2) "resident" means a person who:

(a) except for brief intervals, military service, attendance at an educational or training institution, or for absences for good cause, is physically present in the State for a period of at least thirty (30) days immediately before the time that person's status is determined;

(b) maintains a place of residence in the State.

(c) has established residency for voting purposes in the State;

(d) has not, within the period of required residency, claimed residency in another State; and

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(e) shows by all attending circumstances that that person's intent is to make Alaska his or her permanent residence.

ARTICLE XVII

APPLICABLE LAW

17.1 Alaska Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Alaska, excluding any conflict-of-law rule or principle which might refer such construction to the laws of another state or country.

17.2 Submission to Jurisdiction. Any legal action or proceeding arising out of or relating to this Agreement or for the enforcement of the covenants or obligation of either party must be instituted in a State court of general jurisdiction sitting in the State of Alaska, and Purchaser hereby irrevocably submits to the jurisdiction of that court in any such action or proceeding.

ARTICLE XVIII

WARRANTIES

18.1 No Warranties. The purchase and sale of Royalty Oil under this Agreement is subject only to the warranties of Seller expressly set forth in this Agreement and Seller disclaims and Purchaser waives all other warranties, express or implied in law, whatsoever.

ARTICLE XIX

AMENDMENT

19.1 Amendment. This Agreement may be supplemented, amended or modified at any time, but only by written instrument duly executed by the parties to this Agreement. In addition, material amendments to this Agreement which appreciably reduce the consideration to Seller must be approved by the Legislature of the State of Alaska.

ARTICLE XX

SUCCESSORS AND ASSIGNS

20.1 General Prohibition. No assignment, pledge or encumbrance of this Agreement shall be made by either party without first obtaining the written consent of the other party. The Commissioner may grant such consent on behalf of the Seller. The Commissioner shall have sole and complete discretion in granting or denying a proposed assignment, pledge or encumbrance. Subject to the above requirements in this Article, this Agreement will be binding upon and inure to the benefit of each of the parties and its successors and permitted assigns. In addition, if Purchaser gains or acquires a controlling interest in an entity which has an agreement with Seller for the sale of Royalty Oil ("Other Agreement"), then upon at least one year's notice Seller, at its option may require Purchaser to terminate either this Agreement or the Other Agreement. The choice of which Agreement to terminate will be Purchaser's. Purchaser may

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request that Seller waive this option in advance of Purchaser gaining a controlling interest in an entity which has an agreement with Seller for the sale of Royalty Oil. The Commissioner has sole and complete discretion in granting or denying the requested waiver.

ARTICLE XXI

HEADINGS

21.1 Headings. Headings used in this Agreement are for convenience only and shall not affect the construction of this Agreement.

ARTICLE XXII

RECORDS

22.1 Preservation of Records. Purchaser will preserve and maintain all books, accounts, and records relating to or arising out of the performance of this Agreement, including but not limited to the purchase or sale of Royalty Oil and its refined products, for a period of six (6) years. Purchaser will also maintain and preserve all similar books, accounts, and records of which it has possession belonging to those third parties with whom it contracts for the performance of various parts of this Agreement. Neither Purchaser nor Seller shall be required to retain any records for more than six (6) years unless retention of such records is specifically required by applicable law or regulation. Purchaser shall either maintain its records within

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the State of Alaska or make such records available to Seller at Purchaser's principal office in the State of Alaska within thirty (30) days after written request by Seller.

22.2 Inspection of Records of Parties. Purchaser and Seller will accord to each other and to their authorized agents, attorneys, and auditors during reasonable business hours access to any and all property, records, books, documents, and indexes directly relating to the Purchaser's or Seller's performance of this Agreement and which are under the control of the party from which access is desired so that the other party may inspect, photograph and make copies of that property, records, books, documents and indexes. In no event, however, shall Seller be required to disclose any information, data, or records which are required to be held confidential by state law or regulation. If the information obtained by Seller may be held confidential under state or federal law or regulation, Purchaser may request that that information be held confidential by Seller.

ARTICLE XXIII

INTERPRETATION OF TERMS AND CONDITIONS

23.1 Commissioner Finding and Review. In the event that there is a disagreement about the meaning or application of a word, term, or condition in this Agreement, Purchaser will present the arguments supporting its view in writing to the Commissioner for his consideration. The Commissioner will subsequently, within a reasonable time, issue a finding on the meaning or application

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of such disputed word, term, or condition, and setting forth the basis for his conclusions. Purchaser agrees to accept findings by the Commissioner under this Article as long as there is substantial evidence supporting the Commissioner's findings. None of the above shall empower the Commissioner to determine the price of the crude oil, should such price become subject to renegotiation pursuant to Section 2.3.

DATED this 22 day of February, 1983.

SELLER: THE STATE OF ALASKA

Esther C. Wunnicke
Commissioner,
Department of Natural Resources

PURCHASER: TESORO ALASKA PETROLEUM COMPANY

By James F. Smith
James F. Smith,
President

WKW
LAW

AGO 786696

Tesoro Alaska Petroleum Company

March 15, 1983

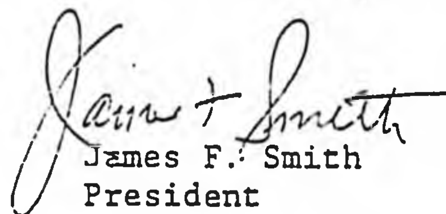
Ms. Esther C. Wunnicke,
Commissioner
State of Alaska
Department of Natural Resources
Pouch M
Juneau, Alaska 99811

Dear Commissioner Wunnicke:

Please find enclosed a fully executed original of the Letter Agreement between the State of Alaska and Tesoro Alaska Petroleum Company concerning third party control of Tesoro.

A copy of this letter has been retained for our records.

Yours very truly,



James F. Smith
President

JFS:pw

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STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

POUCH M
JUNEAU, ALASKA 99811
PHONE: (907) 465-2400

March 12, 1983

Mr. James F. Smith
President
Tesoro Alaska Petroleum
 Company
8700 Tesoro Drive
San Antonio, Texas 78286

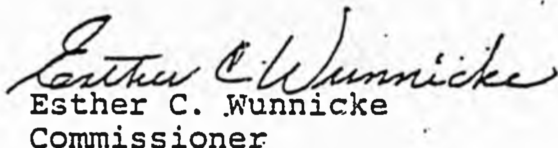
Dear Mr. Smith:

On March 12, 1983, the State of Alaska and Tesoro Alaska Petroleum Company ("Tesoro Alaska") entered into an Agreement for the Sale and Purchase of Royalty Oil (the "Agreement"). Article 7.5 of the Agreement provides that the State may elect to terminate the Agreement in the event that a "third party" obtains "control" (as such terms are defined therein) of Tesoro Alaska or its parent, Tesoro Petroleum Corporation ("Tesoro").

During the negotiations which led to the execution of the Agreement, you informed the State that, on January 26, 1983, two Charter Security Life Insurance Companies, subsidiaries of The Charter Company ("Charter"), had entered into a Purchase Agreement, a Stockholders Agreement, a Registration Rights Agreement and a Certificate of Designation Establishing A Series of $2.20 Cumulative Covertible Preferred Stock (the "agreements") with Tesoro to purchase 2,875,000 shares of a new series of Cumulative Convertible Preferred Stock of Tesoro. Furthermore, those agreements contemplate that the Charter Security Life Insurance Companies or other companies affiliated with The Charter Company may purchase additional shares of Tesoro so that The Charter Company and companies affiliated with The Charter Company may own up to 30 percent of the voting interest in Tesoro. You also informed us that the Charter Security Life Insurance Companies will be entitled to up to three seats on Tesoro's Board of Directors, depending upon the size of Tesoro's Board.

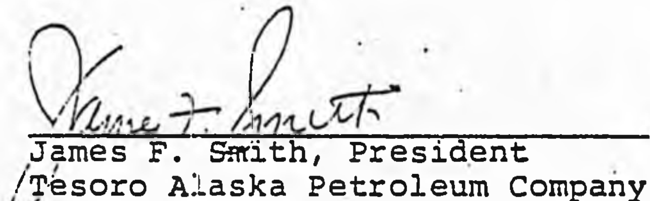
The purpose of this letter is to set forth the understanding and intent of the State and Tesoro Alaska with respect to the application of Article 7.5 of the Agreement to the contemplated relationship between Charter and Tesoro. If the arrangements described in the preceding paragraph are effected, it is the understanding and intent of the parties that Charter and/or its affiliates will not control Tesoro or Tesoro Alaska within the meaning of Article 7.5 of the Agreement. If, however, Charter and/or its affiliates materially increases its or their ability to direct or cause direction of the management and policies of Tesoro or Tesoro Alaska over that contemplated in the agreements, Article 7.5 will be applicable.

Sincerely,



Esther C. Wunnicke
Commissioner

ACCEPTED AND AGREED TO:



WRW
LAW

James F. Smith, President
Tesoro Alaska Petroleum Company

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CONTENTS OF FILE
ON
ROYALTY OIL CONTRACTS

A) COPY OF REMARKS BY TESORO REPRESENTATIVE

B) COPY OF REMARKS BY CHEVRON REPRESENTATIVE

C) MEMO OF EXPLANATION ON CONTRACTS

D) COPY OF LETTER OF AGREEMENT FROM TESORO

E) COPY OF HB 320 WITH FISCAL NOTE AND GOVERNOR'S TRANSMITTAL LETTER

F) COPY OF HB 370 WITH FISCAL NOTE AND GOVERNOR'S TRANSMITTAL LETTER

G) COPY OF HB 371 WITH FISCAL NOTE AND GOVERNOR'S TRANSMITTAL LETTER

H) COPY OF STOCKHOLDERS AGREEMENT BETWEEN CHARTER AND TESORO

I) COPY OF CONTRACTS, WITH COMMISSIONER WUNNICKE'S COVER LETTER

J) RESOLUTIONS FROM ROYALTY OIL BOARD

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MEMORANDUM State of Alaska

TO: Esther Wunnicke
Commissioner
Department of Natural Resources

DATE: May 5, 1983

FILE NO:

TELEPHONE NO: 465-3600

FROM: Norman C. Gorsuch
Attorney General

SUBJECT: Overview of royalty oil contract terms

By: Robert M. Maynard RMM
Assistant Attorney General
Oil and Gas-Juneau

The state's royalty oil contracts are unique. Normally, oil sales contracts are for cash or equal amounts of oil, are for a relatively short term (three months to one year), and are very short documents (usually no more than three or four pages). In fact, large sales of oil are often accomplished merely by exchanging telex's, with industry custom filling in all non-expressed terms of the agreement. The flexibility of each company to respond to changes and conditions and the concern solely with price and quality of the oil sold allows these contracts to be generally sufficient. In addition, even the longer term contracts (up to five years) have clauses that allow either party to get out the contract, usually after each quarter, if they cannot continue to agree on the price of the oil sold.

The state's contracts, on the other hand, are unique in that not only are they long term (11 to 25 years), but also they have extensive and detailed provisions. The reason for the general difference is that the state is not in the oil market with the same goals as private companies. Nor does the state have a private company's flexibility.

Also, the state is much more risk adverse than the normal oil company. About 40 percent of total state revenues derive from the money the state gets for its royalty oil. Whereas a private company is often willing to "gamble" on making greater profit, the state interest is often more conservative.

Without taking "in-kind", the state would receive what the producers receive when they market their own oil. These companies, primarily Exxon, Sohio, and Arco, have large and expert marketing staffs and are generally able to approach or exceed the values the state could receive over the long term by a

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similar marketing effort. Therefore, if the state decides to take its oil in kind it is making a decision that it can get greater consideration for its oil when it sells than the companies as a whole receive when they market their oil. Under certain circumstances this can occur, but it must occur either through unusual circumstances or through the offering of a benefit for the sale of royalty oil that the companies do not offer when they sell their oil in the normal commercial transaction.

In any event, the state is otherwise guaranteed a certain level of revenues from royalty oil when it leaves it with the producers. Taking the oil in kind not only puts an element of risk upon the state that the state should try to minimize, but also entails other problems that make the sale of the royalty oil a more complicated transaction. One of these considerations is that the state as a government has procedures for the sale of oil that bind its flexibility much more than that of a private oil company. For example, the constitution gives the legislature the power to set the terms and conditions of royalty oil sales. The legislature in the past has not given (and there are strong arguments why it should not give) complete discretion and flexibility to one state official in daily transactions for the sale of 40 percent of the state treasury. The delegation of that much control and authority in such a high risk area has been viewed by the legislature as too much of a gamble. Consequently, the statutes set forth a very detailed and, to a private company, cumbersome procedure before the state can commit any significant quantities of royalty oil.

Another practical problem is that it would be extremely difficult for the state to duplicate the marketing expertise of the individual oil companies. First, large staffs would have to be manned with experts in the area. It is doubtful that the state could be able to hire those expert traders on a state salary system. The only alternative would be to hire those experts by contract or to give them a percentage of the transaction.

Even so, the state also doesn't have the backup facilities or expertise in the other aspects of oil transportation and sale that the majors have acquired. The state does not have the ability to instantaneously take oil from or give oil back to the producers -- instead, the state must give six months notice before it can force the producers to either give the state oil or take oil back in case of a problem. Consequently, the state must be prepared to arrange for or invest

in tankers, storage facilities, or other backup systems that would be necessary to handle oil on any emergency basis.

Because of these and other considerations, the state has not attempted to enter the day to day oil marketing business in the same manner as the rest of the industry. Not only would it be difficult to consistently outperform the majors in that type of business transaction, but also there are practical and political barriers to the state attempting to run its royalty oil business in that manner.

Instead, the state has attempted to take advantage of unique conditions for the sale of oil or has attempted to offer a unique advantage to the purchaser of royalty oil that that purchaser could not receive in a normal commercial oil transaction. The occurance of conditions for the short term sale of royalty oil for greater cash consideration are few and far between -- they usually depend upon holes in the market created by government regulation (e.g., government price controls and entitlements). And, those short term sales are only available for relatively small volumes (20 to 50 thousand barrels a day) of oil. Examples of the state taking advantage of unique conditions for a sale are the 1979 sale back to the producers of royalty oil for the ceiling price (which netted the state approximately three to four hundred million dollars) or the auction of state royalty oil in 1980, which ultimately netted the state approximately 60 to 70 million dollars (even with the various bankruptcies and some companies walking on the state contracts).

Otherwise, there is only one unique advantage the state can offer in the world oil market -- a long-term royalty oil contract. The state is the only place in the world where a purchaser can receive a long-term guaranteed supply of oil from a secure source of supply. That guarantee of a long-term supply has some, often unquantifiable, worth which the state can lever into additional consideration above the market value of the oil itself (since market value is determined by the relatively short-term sales of Prudhoe Bay oil).

In offering long-term contracts, however, the state entered into an area for which there was no real precedent. There were no form contracts or proven provisions for long-term oil contracts. As has been seen in the last decade in the oil markets, there are many unknown changes in world circumstances which will occur over the term of the contract. Thus the contract would have to anticipate possible problems and protect the state in the event that an unknown danger arose. Not knowing the exact nature of that unknown condition made the task much

more difficult. In addition, because of the relatively cumbersome procedures for disposing of royalty oil, the state has much less flexibility in amending a contract when problems arise in the future.

One example of this problem is the determination of a price for the oil over the long-term. The price of world oil has gyrated wildly just in the past six years. Negotiating a price term without the benefit of price reopeners over the long-term is a difficult task -- no outside referent (such as OPEC postings, product worth, etc.) has proved to be a reliable guide for the value of Prudhoe Bay oil from year to year. Thus in negotiating for the additional consideration for the long-term nature of the contract, the state must first identify the base consideration that it would otherwise have received for those years. In other words, whether or not the state wishes that additional consideration be in cash or in non-monetary benefits (e.g., in-state processing or in-state supply), a key term is the underlying base consideration representing the short-term value of royalty oil for any particular year. An additional, and extremely important consideration here is that the monetary income for the base price of the royalty oil is a large component of total state revenues. Thus the price term that must be picked should not carry with it the risk of the state receiving less for its oil than it would have if it never entered into a royalty contract at all.

The only price term which accomplishes these purposes is tying the base of the royalty oil to that which the state would have received from the producers if it had continued to take the oil in value rather than in kind. This term would rise and fall over time in proportion to the other sales of North Slope crude oil, and thus be in line with the short-term value of that royalty oil. At the same time it would leave the state in the exact same position as if it had never taken the oil in kind at all.

Therefore the base price for the royalty oil contracts is the "in-value" price term. If the state wishes to take the additional consideration for the long-term nature of the contract in cash, the state would ask for a premium above the in-value price (for example, the in-value price plus thirty cents). If the state wanted non-monetary consideration, it would simply ask for the in-value price and then provide for that non-monetary consideration in other parts of the contract (for example, requiring that the oil be processed in state).

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As a general matter, the bulk of the royalty oil contract, and all of the terms of the contract which are unique to the state's sale of oil, revolve around the long-term nature of that contract. On the one hand are those terms which deal with the additional consideration be given to the state because of the long term nature of the contract.

On the other hand are those terms which protect the state from potential adverse consequences of entering into a long-term royalty oil contract. These derive not only from the unknowns which would arise from entering into a contact over a number of years, but also the problems that the state faces from its lack of flexibility if an emergency should arise.

These terms in effect shift the risk of unknown conditions or adverse consequences from the state to the purchaser. It must be emphasized that these terms also represent "consideration" to the state for entering into a long-term contract. As an example, if the benefit of a long-term contract to purchaser is equal to one dollar, terms protecting the state from adverse consequences over the long-term might be worth 40 cents of that dollar (like paying for insurance), leaving the additional consideration available for the cash portion of the price term to be only 60 cents. In other words, every time the state insists on being protected from adverse consequences, it reduces the state's ability to demand greater benefits for in-state benefits or cash from the purchaser.

And, as a matter of policy, the state has decided that if it is to make concessions in the negotiation process, it would make no concessions on those provisions which protect the state from adverse consequences. Consequently, the state, if necessary, would make some concessions in the area of guaranteeing the additional benefits, and make many more concessions on those relatively minor benefits that might be added to the contract. For example, the state would not budge from the strigent guarantees that would require the purchaser to pay the in-value price or guarantee its payment (e.g., a letter of credit for 60 days worth of oil which would require no documentation whatsoever to be submitted for instant payment except for the signature of the Attorney General and the Commissioner of Natural Resources). On the other hand, for in-state processing requirements the state was willing to give a little bit and make those provisions protections against abuse by the purchaser rather than absolute guarantees that certain goals would always be reached. In other words, the in-state processing and in-state supply provisions provide for minimum benchmarks that must be met, and rely upon market conditions in Alaska to

extract the greater benefits that may be realized. In the Tesoro ANS contract, for instance, the contract provides that all oil sold must be run through the plant, and at least 32% of that oil be converted to products marketed in Alaska. The proposed Tesoro plant, however, could produce a much higher percentage of product if Alaska demand required. The contract does not demand that higher percentage; rather, it relies on the market to realize that additional in-state use. It should be emphasized that these concessions were made in exchange for concessions by the purchaser to give the state protection against adverse consequences.

Specifically, there are four general types of provisions that the state has considered essential to protect its long-term interest. First, there are terms that insure that the state will be paid the amount that it would have received from the producers if it had not taken the royalty oil in kind, but instead had left the oil in value (the "in-value price). These include provisions that insure that in-value is the price paid, and assure the payment of that amount in case adverse circumstances arise. Provisions of the standard contract which implement these principles include Article 2.3 (price of royalty oil); Article 2.8 (absolute obligations); Article 5 (payments and accounting); Article 8.2 (inability to receive oil); Article 14 (sovereign power of the state); Article 12 (disposal of oil upon default or termination); Article 15 (security); Article 19 (amendment); and Article 23 (interpretations of terms and conditions).

Second, there are a group of terms which are designed to assure that the state is never in physical custody of the oil, or is otherwise left without someone to pick up the oil at Pump Station Number 1. First, such a situation might result in the state having to sell the oil at distressed prices without the hopes of ultimate recovery from a credit worthy party. Second, the state is simply not equipped, both legally and practically, to make instaneous dispositions of oil on the spot market. Third, because of the limited storage capacity for oil at Valdez, it would not take very long for unlifted oil to back up at Valdez and potentially shut down the pipeline. Such an event would have disastrous consequences on all state revenues. In addition, this catagory of terms also provides that the state is never in physical custody of the oil: that the transfer of oil from the producers to the state and the state to its purchaser is an instanteous transaction and that all risk passes to the purchaser at the time and point the state receives delivery of the oil. Thus these provisions provide that the purchaser must instaneously accept delivery, that the state can force the

purchaser to take delivery under all imaginable circumstances, or that in an emergency the state can take the oil from a purchaser and sell to a third party without interference from the original purchaser (this is to prevent the purchaser from tying the disposition of oil during a disagreement). Examples of these provisions are Article 7 (default), Article 8 (disposition of oil upon default or termination), and Article 11 (force majeure).

A third category of provisions are those provisions that protect the state from the purchaser using an excuse or other legal argument to attempt to get out of their obligation to pick up the royalty oil and pay for it. Thus the state insisted on strigent conditions concerning default, force majeure, and provisions which would provide that the state would not warrant anything except that it had title to the oil. Examples of these provisions are Article 2.1 (quantity); Article 2.2 (quality); Article 2.4 through 2.6 (point and time of deliverly, risk,); Article 4.1 (measurement); Article 18 (disclaimer of warranties); Article 7 (default or termination); Article 8 (disposition of oil); Article 2.8 (absolute obligation); Article 5.7 (late payment); and Article 5.3 (payment).

These provisions provide as close to complete protection as the state could reasonably devise by a contract. In addition, to cover the situation where the purchaser may argue that the contract might be ambiguous or vague when it attempted to be applied to some presently unforeseen event, the state insisted in Article 23 that such disagreements would first be resolved by the commissioner, and that the commissioner would make the initial determination of what the word, term, or application of that word, term or condition would be. In addition, the purchaser contracts to agree to accept that interpretation along as there is substantial evidence supporting the commissioner's findings, which is a standard of review similar to the limited review a court gives a finding of fact by a state agency when it is in its regulatory capacity. In addition, the state inserted some terms and conditions which would allow the state to monitor the purchaser's actions to see if there is any indication that the purchaser might be considering abandoning its obligations under the contract. Such provisions include Article 2.7 (transportation arrangements); Article 3.2 -- 3.3 (financial condition); and Article 22 (records).

In these areas the state insisted on extremely stringent conditions, and for the most part refused to consider any alteration even though it was recognized that these conditions would put burdens on the purchaser not matched any

where in the world under other oil contracts. These provisions were born from the experiences the state has undergone over the past seven years, including the present price dispute with the Alaska Oil Company, a previous bankruptcy of one of the state's purchasers (Energy Cooperative, Inc.), and the abandonment of the royalty oil contract by Alaska Petroleum Company. These terms were reviewed by outside counsel, who also suggested a number of the terms inserted in these contracts.

Although it is impossible to totally protect the state under all conceivable circumstances simply by a contract, there is little question that overall the state has the tightest oil contract in the world. Although this is a little like saying a person has the best sight in a room full of blind people (given the loose and flexible nature of almost all other oil contracts), it does provide a quantum level of increased protection for the state over any other oil contract known.

Like money spent for insurance, however, some premium must be paid by the insistence of the state upon such stringent conditions. Again, since the state was not willing to grant any concessions on terms it considered vital to protect it against risk, the state was not in a position to require as stringent provisions in the other terms of the contract dealing with the additional consideration. Thus in the in-state processing and in-state supply portions of the contract (the non-monetary consideration) the state was not able to insist upon stringent performance guarantees or other provisions which would require the purchaser to produce products in Alaska at a loss or break even point. Nor was the state in a position to insist upon levels of production or in-state processing which were above those reasonably required by Alaska market demand.

Instead, the in-state processing and supply provisions provided "sideboards" or minimum provisions that would protect the state against abuses by the purchaser from the intent of the contract. In other words, the state insisted that the oil be processed in an in-state refinery, that that refinery actually produce significant amounts of products, and that the purchaser otherwise exercise its best efforts to produce and market in Alaska some minimum quantity of oil products. The state left to the local demand the other economic decisions of the local refiner to increase production above that minimum quantity to either meet demand or increase market share.

Therefore, there are provisions in the contract which are designed to assure that to the extent the market in Alaska would support the economic processing and marketing of oil

products within the state, the oil sold to the purchaser would be processed and marketed in the state. Examples of these articles are Articles 2.9 (date of first delivery -- in the Tesoro ANS contract); Article 2.10 (performance guarantee and reservation fee); Article 2.11 (in-state processing); Article 2.12 (best efforts); Article 3.5 (option to purchase resid). As a subsidiary matter, there are also provisions which are designed to assure that the purchaser is not asking or taking more oil than their in-state needs would require (and thus be actually used for some out of state benefit). Article 2.1 (quantity) and Article 2.10 (performance guarantee) are examples of those types of articles which are designed to assist in that goal.

Finally, the state negotiated for some additional benefits, but did not insist upon many guarantees of those benefits. These additional minor benefits could someday be very valuable, but were not considered the primary consideration for the long-term contract. Examples of these provisions are Article 3.4 (expansion); Article 3.6 (petroleum coke); and Article 16 (local hire).

RMM:jf

Cost of Oil to Western Alaska
similar costs of gasoline

AGO 786710

Alaska State Legislature

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STATE OF AFFAIRS—(VICE-CHAIR)
LABOR & COMMERCE
RESOURCES

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June 15, 1983

The Honorable Bill Sheffield
Governor
State of Alaska
Juneau, Alaska 99811

Dear Governor Sheffield:

I am seriously concerned by your recent statements regarding the proposed royalty oil contracts for Tesoro and Chevron. I note that, at your cabinet meeting this week, you accused several "large oil companies" of interfering with your attempts to seek legislative approval of the royalty oil contract legislation. Yet you declined to mention any of these "interferers" by name.

In a free enterprise system it seems quite appropriate to me that competition be allowed to flourish. You evidently disagree as evidenced by your statements. Further, if you intend to make such accusations, I would think you would have the courtesy to specifically name your detractors rather than brand the oil industry wholesale for what you perceive to be improper actions. I would request that you name the "large oil companies" which you are accusing so that the public will not be led to believe that the State's Chief Executive is dealing in rumor spreading or plain gossip.

I also am concerned that you are urging legislative ratification of these contracts and that you feel they deserve to be voted on. Yet, much of the information requested of Tesoro and Chevron by the House and Senate committees has not been forthcoming. Am I to assume by your statements that you wish the Legislature to vote on these contracts while many important questions about the financial feasibility of these long term contracts remain unanswered? I certainly hope not. You recently forced some legislators to vote on another matter without allowing questions to be answered via the committee process, and we have seen the less than ideal results of that debacle.

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Governor Bill Sheffield
June 15, 1983
Page 2

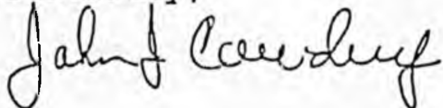
The committee process is in place to ask the questions that, perhaps, your Administration would rather not ask. We owe that obligation to Alaskans. The people of Alaska trust that their representatives will vote only after they are properly informed on the issues. Some of us respect the Constitutional duties we have been elected to uphold.

The contracts before us deserve critical and prolonged examination. I, personally, do not believe, at this time, they should be entered into. If the questions I have asked of the oil companies are satisfactorily answered, I might change that opinion.

Finally, I would note that House and Senate priorities were agreed upon during the time you were out of state attending a zoo opening in Oregon. If these contracts were so vital to you, it seems to me you would have been present in Juneau during the critical negotiations between the House and Senate to bring this session to a close.

I urge that you give greater consideration to these contracts and the unanswered questions. I further urge that you refrain from negatively branding the oil industry on which this state depends so greatly without adequate justification.

Sincerely,



Representative John Cowdery
Chairman
Joint Legislative Committee on Oil and Gas

AGO 786712

THE ALLIANCE

P.O. Box 100100 / Anchorage, Alaska 99510 / (907) 562-0100

RESOLUTION IN SUPPORT OF
ENACTMENT OF MEASURES
WHICH ALLOW THE STATE TO
PROCEED WITH THE SALE OF
ROYALTY OIL TO BOTH TESORO
ALASKA PETROLEUM CO. AND
CHEVRON U.S.A.

Whereas, the Alaska Support Industry Alliance has reviewed the complicated issues attendant to the contracts between the State of Alaska and the Tesoro Alaska Petroleum Co. and Chevron U.S.A. and,

Whereas, after such review, it appears to be in the best interest of the State to proceed to enter into these agreements.

Now Therefore Be It Resolved that the Alaska Support Industry Alliance hereby does call upon the Legislature of the State of Alaska to expeditiously proceed with passage of those bills which are required to ratify both of the agreements executed by the Commissioner of Natural Resources and the in-state refiners.

Dated this 2nd day of June, 1983

Milton Byrd
Milton Byrd, President

Alaska Support Industry Alliance...for responsible economic development

Milton Byrd – President
Frontier Companies of Alaska
Ann Curtis — Vice President
Crowley Maritime
Paul Harding — Secretary
Universal Services, Inc., Int'l
e Mathis — Treasurer
Universal Services, Inc., Int'l
Virgil Gillespie
Alaska International
Construction, Inc
Len Kelley
Greyhound Support Services, Inc
John Martin
Dresser Atlas
Val Molyneux
VECO
Roger Spencer
Alaska Bussell Electric, Inc
Bill Webb
Arctic Hosts, Inc
Chuck Becker
Executive Director

AGO 786713