HOUSE
COMMITTEE REPORT

(11)

Date referred: 3/19/86

FURTHER REFERRALS:

DATE: 3-25-86

The FINANCE Committee has considered HB 559

"An Act approving the sale of Kuparuk River Unit royalty oil by the State of Alaska to Petro Star, Inc. and Chevron U.S.A., Inc.; and providing for an effective date."

and recommends:

[X] do pass
[ ] do not pass
[ ] do pass with attached amendment(s)
[ ] no recommendation
[ ] replace with ______ [ ] same title
[ ] new title

and recommends ______

[ ] further referral to the ______ Committee

and attaches:
[ ] letter of intent
[ ] first fiscal note
[X] ~~new~~ fiscal note 2-26-86 1.151.1 Rev
[ ] zero fiscal note

SIGNING DO PASS:

Albert P. Adams
Sam Cotten
John Sturgulewski
[illegible]
Mike Szymanski
[illegible]
Ronald L. Larsen
Pat Pourchot
[illegible]

SIGNING OTHER RECOMMENDATIONS:

Albert P. Adams
Chairman

STATE OF ALASKA 1986 LEGISLATIVE SESSION
FISCAL NOTE

Revision Date : 2-26-86

REQUEST

Bill/Resolution No. : HB 559
Title : Kuparuk Royalty Oil Sale to Petrostar/Chevron

Sponsor : Governor
Requestor : Oil & Gas
Date of Request : 02-25-86

FISCAL DETAIL

Agency Affected : Natural Resources
BRU : Petroleum Management

Components :

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0
CAPITAL	0	0	0	0	0	0
REVENUE	0	1,151.1	1,067.4	1,067.4	907.3	771.5

FUNDING : (Thousands of Dollars)

	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS :

	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : Attach a separate page if necessary

Note: Revenue computations by calendar year instead of fiscal year.

See attached

Prepared by : Jim Eason [signature]
Division : Oil & Gas
Phone : 762-4246
Date : 2-26-86

Approved by Commissioner : [signature] Deputy
Agency : Natural Resources
Date : 2/26/86

Distribution (by Agency preparing fiscal note) :
- Legislative Finance
- Legislative Sponsor
- Requestor
- Office of Management and Budget
- Impacted Agency(ies)

10/25/85

ANALYSIS
Fiscal Note HB 559

Approval of the proposed Petrostar/Chevron will result in the state's receipt of approximately $7.5 million in premium payments over the term of the contract. Approximately 16,756,670 barrels of oil will be delivered under the contract, with Chevron's respective share being 11,171,002 barrels, and Petrostar's share being 5,585,668 barrels. Chevron will pay a premium above the "in value" amount of $.50 per barrel, while Petrostar's premium will be $.35 per barrel for its net barrels. Chevron's share of this premium will total $5,585,501 over the life of the contract (contract ends September 30, 1996), and Petrostar's respective contribution will be $1,954,984. All amounts calculated are expressed in "nominal"dollars, and the analysis assumes contract deliveries commence December 1, 1986 and ends September 30, 1996.

Revenue Projects

Calendar Year	
92	655.5
93	592.0
94	528.8
95	475.4
96	323.0
Total	7,539.4

Introduced: 2/10/86
Referred: House Special Committee on
Oil & Gas, Resources and Finance

1 IN THE HOUSE BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

2 HOUSE BILL NO. 559

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FOURTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act approving the sale of Kuparuk River Unit
7 royalty oil by the State of Alaska to Petro Star,
8 Inc. and Chevron U.S.A., Inc.; and providing for an
9 effective date."

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

11 * Section 1. The "Agreement for the Sale and Purchase of State Royalty
12 Oil" between the State of Alaska and Petro Star, Inc. and Chevron U.S.A.,
13 Inc., dated December 9, 1985, is approved and ratified.

14 * Sec. 2. This Act takes effect immediately in accordance with AS 01.-
15 10.070(c).

RECEIVED
Department of Law
JAN - 3 1986
Office of the Attorney General
Anchorage Branch
Anchorage, Alaska

The Alaska Royalty Oil and Gas Development Advisory Board

Resolution 85-2

On or about October 23, 1985, the director of the division of oil and gas ("director") provided the Alaska Royalty Oil and Gas Development Advisory Board with the preliminary notice of sale, preliminary findings, and proposed contract for a long-term sale of up to about 6500 barrels per day of Kuparuk River Unit royalty oil to Petrostar, Inc. and Chevron U.S.A. Inc.

This proposed sale has been discussed at several public meetings held by the board during 1985. At the February 20 meeting, Petrostar representatives testified in support of a royalty oil sale. On March 26, staff of the Alaska Department of Natural Resources (DNR) reported to the board on the status of a solicitation for purchasers of state royalty oil. At the April 12 meeting, DNR presented a status report on the solicitation, which was released April 1. On July 25, DNR presented to the board a recapitulation of the responses to the solicitation. At the meetings of the board held September 26-27 and October 7, the board received public testimony on a proposed sale of Kuparuk royalty oil to Petrostar and Chevron. On October 30, the director made a presentation to the board on the Petrostar-Chevron contract proposed in DNR's October 23 preliminary findings; the board also received public testimony on the proposed contract. The last two meetings were held by teleconference in Anchorage, Fairbanks, Valdez, and Juneau.

DNR's final findings on the proposed sale and the contract were sent to the board on December 9, 1985. On December 19, the board met to develop and vote on its recommendations to the legislature on the proposed sale.

Based on the board's review of the agreement for the sale and purchase of royalty oil between the State of Alaska and Petrostar and Chevron, DNR's findings and determinations regarding the proposed sale, and the testimony received at public meetings of the board, the board is of the opinion that the proposed disposition of Kuparuk River Unit royalty oil to Petrostar and Chevron meets the requirements of AS 38.06 and 3 AAC 56. The board recommends that the Fifteenth Alaska Legislature approve the agreement for the sale and purchase of royalty oil from the Kuparuk River Unit to Petrostar and Chevron, dated December 9, 1985.

Dated: December 19, 1985

[signature]　　　　Laurie D. Cunningham

[signature]　　　　[signature]

____

BILL SHEFFIELD
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

The Honorable Ben Grussendorf
Speaker of the House
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Representative Grussendorf:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill that provides for legislative approval of a royalty oil contract between the state, Petro Star, Inc. and Chevron U.S.A., Inc. for the sale of Kuparuk River royalty oil. Also transmitted with this bill is a copy of the resolution of the Alaska Royalty Oil and Gas Development Advisory Board recommending approval of that contract, along with a letter from the Department of Law forwarding the resolution to you. This resolution is being transmitted in accordance with AS 38.06.040(a)(3) and AS 38.06.070(c).

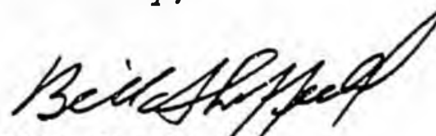
The contract is also described in the findings issued by the Department of Natural Resources on December 9, 1985. Copies of these findings have been made available to the legislature and the public for review.

A bill approving the contract is being introduced for legislative approval for two reasons. First, as a matter of comity, I respect the legislature's desire to have a direct voice in major disposals of royalty oil. Therefore, although this and the previous administration have consistently taken the position that the statutory requirement of legislative approval of royalty oil contracts (AS 38.06.055) is unconstitutional, the contract itself contains provisions requiring approval by the legislature before it takes effect.

Second, this legislation would ratify the royalty oil contract. 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, the statutes provide that the legislature is to approve a royalty oil contract only by "enacting legislation" (AS 38.06.055(a)), but also refer to a Royalty Board recommendation to be submitted to the legislature at the time a "resolution approving the proposed sale ... is introduced in the legislature" (AS 38.06.070(c)). Since legislative approval by enactment of legislation is required as a matter of contract, I believe that it is prudent to present this contract for legislative approval and ratification.

Sincerely,



Bill Sheffield
Governor

FINAL FINDINGS AND DETERMINATION
TO SELL KUPARUK RIVER UNIT ROYALTY OIL
TO PETRO STAR, INC. AND CHEVRON U.S.A., INC.

December 9, 1985

INTRODUCTION

On September 16, 1985 the Department of Natural Resources issued a document entitled Analysis and Recommendations for Disposition of State Royalty Oil (Analysis). The Analysis reviewed the state's competitive royalty oil sale of December 11, 1984 (1984 Competitive Sale) and evaluated negotiated royalty oil disposal options resulting from the department's Solicitation for Proposals(s) to Purchase Prudhoe Bay and/or Kuparuk River Unit Royalty Oil of April 1, 1985 (Solicitation). After considering comments from the Alaska Royalty Oil and Gas Development Advisory Board (Royalty Board), legislators and many members of the public, the Commissioner of Natural Resources determined that the state's interests would be best served by a negotiated long-term sale to Petro Star, Inc. (Petro Star) and Chevron U.S.A., Inc. (Chevron), and additional short-term competitive sales.

A preliminary finding and public notice for a competitive sale of Prudhoe Bay Unit Royalty Oil was published October 17, 1985. The document entitled Preliminary Findings and Determination to sell Kuparuk River Unit Royalty Oil to Petro Star, Inc. and Chevron U.S.A., Inc. (Preliminary Findings) was published with a preliminary notice on October 23, 1985.

The department proposes to sell approximately 6,500 barrels per day (bpd) of royalty oil from the Kuparuk River Unit. A maximum of 2,500 bpd will be sold to Petro Star and about 4,000 bpd will be sold to Chevron, with both sales occurring under a single long-term, noncompetitive contract. In accordance with AS 38, the Department of Natural Resources must determine whether this disposal serves the state's best interest and make other findings before the sale may take place. This final finding describes the proposed sale and analyzes its potential effects.

BACKGROUND

A long-term royalty oil disposal to Petro Star (an in-state refiner located in North Pole) has been discussed at several public meetings held by the Royalty Board during 1985. At the February 20 meeting, Petro Star representatives testified in support of a royalty oil sale. On March 26, the department reported to the Royalty Board on the status of the state's planned Solicitation. At the April 12 meeting, the department presented a status report on the Solicitation, which was released April 1. A recapitulatic- . the responses to the Solicitation was presented at the Royalty Board meeting of July 25.

In its response to the department's Solicitation, Petro Star originally requested an 11-year contract for 4.266% of Prudhoe Bay Unit royalty oil production, or about 8,000 bpd. At the time the department's Analysis was released (September 13, 1985), tentative agreement had been reached for a long-term contract with Petro Star on terms similar to Petro Star's original proposal. However, that tentative agreement was subject to Petro Star making a satisfactory disposition of the return oil barrels.

Oil which has been processed through a refinery, but is not retained as refined product, is known as residual oil. Residual oil can be injected i--- the Trans Alaska Pipeline System (TAPS), where it becomes commingled with . TAPS crude stream. Residual oil added to the TAPS crude stream is called "return oil". The department was aware that a substantial volume of return oil would result from a long-term disposal to Petro Star.

At a September 16, 1985 meeting of the House Special Committee on Oil and Gas, several legislators encouraged the department to pursue a "net sale" to Petro Star that would relieve it of the obligations related to the return oil barrels. The department investigated this possibility, and concluded that it would be feasible to make a "net sale" to Petro Star if satisfactory arrangements could be made by the department for the return oil barrels.

It was suggested that Petro Star's return oil could be offered in future short-term competitive sales. The department determined that it was preferable to dispose of the return oil barrels in a long-term contract running in tandem with the Petro Star contract, rather than leaving those barrels uncommitted. There is presently too much uncertainty regarding future competitive sales to ensure satisfactory disposal through that mechanism.

The department then asked Chevron whether it would be willing to purchase Petro Star's return oil barrels under the same terms that Chevron had offered in response to the department's Solicitation. Chevron was selected because it offered the highest premium (50¢/barrel) of any company responding to the Solicitation and was willing to meet the standard financial and security terms requested by the department in the Solicitation. Chevron indicated its tentative agreement with this proposal, and the royalty board was advised of this development at its meeting September 26.

At the Royalty Board meetings of September 26-27 and October 7, the Royalty Board received public testimony on the proposed sale of royalty oil to Petro Star and Chevron. On October 30, the Director of the department's Division of Oil and Gas made a presentation to the Royalty Board on the Petro Star-Chevron contract proposed in the Preliminary Findings; the Royalty Board also received public testimony on the proposed contract.

Under the contract, a maximum of approximately 6,500 bpd of Kuparuk River Unit royalty oil will be sold to Petro Star and Chevron. Chevron will have a maximum quantity of approximately 4,000 bpd, and Petro Star a maximum quantity of approximately 2,[illegible] bpd. These volumes will be expressed and sold as a percentage of unit production. The exact percentages will be determined after approval of the contract next year since production from the Kuparuk River Unit is fluctuating at this time. Petro Star initially will take approximately 2,000 bpd, and will have the option to increase its take by November 1, 1987 to the maximum quantity of approximately 2,500 bpd. Chevron

will sell its royalty oil volume from this contract to Petro Star at Pump Station 1, and Petro Star will sell its return oil to Chevron at Valdez.

The differences between the contract form which accompanies this finding and the proposed contract form presented with the Preliminary Findings reflect a consideration of the comments received and the issues raised both by the department and board members at the Royalty Board meeting of October 30, 1985.

SUMMARY OF PROPOSED CONTRACT TERMS

1. Price: The total price per barrel to be received by the state in this negotiated disposal is the sum of the following components:

   (a) The amount the state would have received for a barrel of Prudhoe Bay royalty oil taken at that time in value (in money);

   (b) a premium of 35¢ per barrel for Petro Star and 50¢ per barrel for Chevron;

   (c) Kuparuk field costs;

   (d) additional sums upon the resolution of 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);

   (e) less, the tariff charge for the Kuparuk Pipeline and the applicable TAPS quality bank adjustment.

2. Term: Delivery of oil will commence the first day of the first month seven (7) months after the contract is approved by the Legislature and the Governor. The contract terminates September 30, 1996.

3. Quantity and Source: The contract allows for a maximum volume of approximately 6,500 barrels per day (bpd), expressed as a percentage of daily royalty oil from the Kuparuk River Unit. Petro Star will purchase a maximum of approximately 2,500 bpd and Chevron will purchase approximately 4,000 bpd.

4. Point of Delivery: Purchasers will take delivery at the Central Production Facility meter into the Kuparuk Pipeline.

5. In-State Processing and Best Efforts: Petro Star will process not less than 85% of the total royalty oil sold under the agreement. Petro Star also agrees to use its "best efforts" to produce and market in Alaska an amount of refined petroleum products from its refinery near North Pole, Alaska not less in volume than 23% of the total royalty oil sold under the agreement.

6. Security: Petro Star will provide a letter of credit worth sixty (60) days of oil, and Chevron will provide a letter of credit worth ninety (90) days of oil. In the event of default by Petro Star, Chevron agrees to purchase Petro Star's volume on five days notice. In addition, Petro Star will execute an escrow agreement to cover future payments of additional amounts that may be owed upon final resolution of the Amerada Hess litigation. Petro Star has agreed to escrow $1.12 per barrel to be credited against future Amerada Hess adjustments.

7. Relationship between Petro Star and Chevron: Petro Star will use as refinery charge Chevron's volume of royalty oil sold under the contract. After Petro Star processes the oil there will remain a portion of oil or oil products which will be shipped through TAPS, and sold by Petro Star to Chevron at Valdez. The quantity will approximate Chevron's purchase volume under the royalty oil contract.

IN-STATE BENEFIT ANALYSIS

Petro Star was incorporated during October of 1984 by a group of private Alaska investors. The company was formed to produce refined petroleum products for marketing within the Interior and on the North Slope of Alaska. Since incorporation, Petro Star has received additional financial backing from the Arctic Slope Regional Corporation in exchange for an ownership interest of 30 percent in the company.

At the time of Petro Star's response to the department's Solicitation, Petro Star had exercised an option to purchase a 6,000 bpd topping plant and two 1,000 bpd topping plants. The 6,000 bpd plant is located adjacent to TAPS at North Pole, and commenced refining heating oils on September 5, 1985 using North Slope crude purchased from Sohio. Eventually, aviation gasoline is also to be refined. Petro Star is its own distributor of refined products, and plans to emphasize rural markets.

On October 20, 1985, a fire at the Petro Star refinery idled the plant. The refinery commenced operations again on November 23, 1985. The department does not anticipate any impact on the proposed disposal as a result of that event.

The primary bases for this long-term negotiated sale are: 1) to receive a market price for royalty oil; and 2) to encourage in-state processing of royalty oil and the attendant benefits (primarily jobs, increased tax base, and competition from refined product suppliers that may lead to lower product prices for consumers). An in-state benefit analysis of the Petro Star proposal (and of the other responses to the Solicitation which proposed to process royalty oil in-state) was provided in the Analysis, and is updated here.

The prospective in-state benefits of the disposal to Petro Star arise from reduced refined product prices and the primary and secondary economic effects of the refinery operation. Since the publication of the Analysis, Petro Star

and others have made the department aware of MAPCO's substantial shipments of jet fuels to Anchorage in recent years, and the department acknowledges that a new Fairbanks refinery need not lead to excess capacity in the region. However, the conclusion of the Analysis with respect to price impacts remains valid. For the reasons discussed in the Analysis, the Department anticipates no more than modest favorable impacts on the price of refined products as a result of a sale to Petro Star.

However, Mr. Steve Lewis of Petro Star indicated at the Royalty Board meeting of October 7, 1985 that significant price competition has occurred since the construction of the Petro Star refinery. Petro Star officials say the company is marketing much of its present refinery production (about 1,000 bpd) at prices lower than those charged by MAPCO. Examples cited include heating oil sales to five rural villages and to construction companies operating on the North Slope. According to Mr. Lewis, Petro Star currently serves the total fuel needs of the Anaktuvuk Pass area at favorable prices. Petro Star officials also believe that recent favorable changes in MAPCO's product prices, which are said to be at a three-year low, were influenced by their company's prospective and present operations. While the price discounts mentioned by Petro Star are only on the order of pennies per gallon, a one cent decrease in the price of a gallon of refined product that could be made from 1,000 bpd translates to an annual consumer savings of about $153,000. However, the extent to which a royalty oil disposal to Petro Star may maintain or extend these price reductions cannot be readily determined.

The second area of prospective in-state benefits resulting from a disposal of royalty oil to Petro Star relates to the spinoff effects of the refinery operation. The direct benefits would stem from payroll, property taxes, state corporate taxes, and profits if held in-state. All Petro Star profits are expected to be held in state. These cash infusions in turn lead to multiplier effects. Actual project-specific multiplier estimates for other projects, such as Beluga coal development or the Dow-Shell petrochemical proposal examined in 1981, vary from 0.6 to 3.0. Actual project-specific multiplier effects can only be ascertained by extensive surveys or actual development.

The Analysis indicates that the in-state benefits presented there are overstated because of the displacement effects of excess capacity. However this statement may not be applicable in light of the earlier mentioned acknowledgement that a new Fairbanks refinery need not lead to excess capacity in the region. The table below provides some in-state benefit measures for the Petro Star refinery. The table reflects clarifications provided by Petro Star since the publication of the Analysis. A 1.5 capital investment multiplier is used for discussion purposes, as it falls within the expected range for this type of project.

CONSTRUCTION BENEFITS

Capital Investment	Capital Investment in Alaska	Capital Investment Multiplier at 1.5	Total Construction Benefits
initially $6.9 million	$5.7 million	$8.5 million	$14.2 million

ANNUAL POST-CONSTRUCTION BENEFITS

Payroll	Property Taxes	Profits	State Corporate Profits Tax	Known Total	1.5 Multiplier	Total Known B[illegible]fit
$600,000 (11 persons)	$36,000	Unknown but in-state	undetermined	$636,000	$954,000	$[illegible]0,000

The benefits estimated above for the construction of the refinery itself, which cannot be ascribed to a prospective long-term royalty oil contract, are shown for information purposes only. The annual post-construction benefits reflect the effect of the refinery's continued operation. These benefits are not entirely traceable to a long-term royalty oil contract with Petro Star, since continued operation of the refinery does not depend on royalty oil. Nevertheless, this sale to Petro Star would help ensure the continuation of spinoff benefits resulting from operation of the Petro Star refinery. Those benefits would include the 15-member work force of the distribution company

North Pole Fuel, which has been purchased by Petro Star.Further, refinery projects offering more substantial in-state benefits frequently depend on royalty oil for construction as well as operation. All of the spinoff benefits identified above could have been attributable to a long-term disposal had Petro Star been dependent on royalty oil to begin construction and operations. The department's preference for new refinery proposals which are not dependent on royalty oil was made known to Petro Star prior to the construction of the Petro Star refinery. Consequently, the qualifiers to the spinoff benefits shown above are largely a result of that preference. Petro Star is the only proposal for new in-state refining that has proven by actually building and operating a refinery that is not dependent on royalty oil. The department regards this evidence of economic viability more highly than the tentative nature of spinoff benefits arising from speculative projects which are dependent on royalty oil.

COMMENTS RECEIVED

The department received only one written comment in response to the Preliminary Notice and Findings. In a letter dated November 8, 1985, the Tesoro Alaska Petroleum Company (Tesoro) expressed concern to the Commissioner about the effect of this long-term disposal on the future availability of royalty oil to meet the needs of in-state refiners. Tesoro said that in eight years, the state's total volume of royalty oil will be less than its current sales to in-state refiners. Consequently, Tesoro stated that "any additional long term-commitments by the state will mean deeper cutbacks in future crude supply to present Alaska refineries" and that "there is already refining capacity in Alaska which exceeds the state-wide demand for petroleum products." Tesoro also believed that the disposal could set a precedent that would make it difficult for the state to deny similar awards to "anyone who can secure a simple, inexpensive plant, buy a few barrels of crude, and declare himself an in-state refiner." Tesoro concluded that regularly scheduled competitive royalty oil sales would serve the best interests of Alaskans while maximizing state oil revenues. While the department

appreciates and shares Tesoro's concern about the future availability of royalty oil to meet the needs of in-state refiners, and has addressed this topic in the Analysis, the Commissioner has nonetheless concluded that the disposal will best serve the state's interests. That conclusion is based on the need to foster regional competition among in-state refiners and provide additional in-state benefits that result from in-state refining, and to provide equity of access to royalty oil among existing refiners.

DISCUSSION OF SPECIFIC CONTRACT PROVISIONS

Because the contract entails the sale of state royalty oil to two parties it contains several provisions different from other long-term state contracts. Those provisions and other changes are discussed below.

QUANTITY OPTIONS

The quantity of oil to be sold under the long-term contract is expressed as a percentage of daily Kuparuk River Unit royalty oil production. The sales quantity will initially be about 6,000 bpd. Chevron will purchase about 4,000 bpd and Petro Star will purchase about 2,000 bpd.

The royalty oil contract gives Petro Star the option to increase its purchase amount from about 2,000 bpd to 2,500 bpd. The total quantity sold under the contract will be about 6,500 bpd if Petro Star purchases its maximum. Should Petro Star not exercise this option by November 1, 1987, the total quantity could be reduced to either the maximum daily quantity purchased by Petro Star prior to November 1, 1987 or the Petro Star refinery's maximum thruput capacity at that time, provided it does not exceed 6,500 bpd.

Petro Star and Chevron may each accept less than their contractual maximum quantities by giving a nine-month notice to the state. Petro Star and Chevron may also permanently reduce their contractual maximum quantities by giving a similar nine-month notice to the state. If either Petro Star or Chevron give notice that it wishes to accept delivery of less than its maximum quantity without permanently reducing its maximum quantity, a penalty will be assessed against it based on the difference between the maximum quantity and the actual volume it accepts. Also, if either of the purchasers permanently decreases its maximum quantity by 50 percent or more, the department may, subject to certain conditions, terminate the sale of royalty oil to the other purchaser.

Several circumstances, including the standard provisions covering default, could lead to the termination of royalty oil sales to one of the purchasers. The royalty oil agreement, as it relates to the remaining purchaser, may continue under specific conditions. Petro Star could continue its portion of the agreement or increase its take to include all or part of the Chevron volume upon agreement with the Commissioner to meet specified requirements. Continuation of the disposal to Chevron would be in the Commissioner's discretion and would be contingent on Chevron's agreement to process the oil at its Nikiski refinery. The contract provisions for these eventualities are more fully described in a following section entitled "Price Reopener".

PETRO STAR/CHEVRON AGREEMENT

Chevron has agreed to sell the royalty oil it purchases under the contract to Petro Star at TAPS Pump Station #1, and to repurchase the oil at the TAPS terminus in Valdez. This will enable Petro Star to run its refinery at full capacity and retain its purchase volume in the form of refined products. Once processed, the oil not retained by Petro Star (return oil) is expected to equal the approximately 4,000 bpd initially purchased by Chevron. That volume will be reinjected into TAPS at the Petro Star refinery site. Return oil shipped through TAPS becomes intermingled with unprocessed crude oil so that when the return oil emerges at Valdez it is identical to the TAPS common

stream crude oil. Petro Star, as the shipper, will be liable for the payment of the TAPS quality bank differential based on the resulting degradation of the common-stream crude oil.

Chevron and Petro Star have entered into a separate contract between themselves which covers the details of their buy-sell agreement. That contract has been added as an attachment to the state royalty oil contract (Exhibit A).

Return oil, on which the state might otherwise retain an option, would not result from the proposed disposal due to the arrangements contemplated under the contract. Should there be any change in the arrangement between Petro Star and Chevron, all affected parties will negotiate toward agreement upon a market price option for the state on whatever return oil may exist under any new arrangement. The state may terminate the royalty oil agreement if a material change in the terms of the arrangement between Petro Star and Chevron precludes Petro Star from economically using Chevron's volume as refinery charge.

At the Royalty Board meeting of October 30, 1985, the fact that residual oil rather than return oil would result from a termination of Petro Star's portion of the agreement was raised. This would occur since Chevron's Nikiski refinery is not positioned to inject residual oil into TAPS. Consequently, the section of the contract form which addresses the state's market price option over return oil (2.13) has been amended to include residual oil. This alteration includes the insertion of a phrase in section 2.14 which explicitly grants the state a market price option over Chevron's residual oil should Petro Star's portion of the agreement be terminated.

IN-STATE PROCESSING REQUIREMENTS

The contract contains a number of in state processing requirements for Petro Star. Petro Star agrees to process not less than 85 percent of the total

volume of royalty oil sold under the contract. Petro Star also agrees to retain at least 20 percent of that volume in the form of refined products. These percentage requirements are less stringent than those contained in royalty contracts held by other in-state refiners. The lower percentages are necessary to accommodate Petro Star's small refinery and its recent commencement of operations and marketing.

In addition, Petro Star agrees under the contract to use its "best efforts" to produce and market a volume of refined products in Alaska equal to not less than 23 percent of the total volume of royalty oil sold. To monitor that effort, Petro Star will be required to provide the department a quarterly statement showing the quantity of refined products it produced and marketed in Alaska over that period.

These provisions are similar to the in-state processing requirements contained in the long-term royalty oil contracts with Tesoro Alaska Petroleum Company and Chevron.

PRICE

The contract contains a unique price term. Although the contract will sell Kuparuk River Unit royalty oil, the price term will be based on Prudhoe Bay Unit oil as adjusted for the differences between the two fields. This price term is possible since Kuparuk River Unit and Prudhoe Bay Unit oil are intermingled in TAPS, creating a single royalty crude stream available for disposal by the state. The TAPS quality bank adjustment compensates for the difference in quality between Prudhoe Bay and Kuparuk River crude oils. The Kuparuk pipeline tariff compensates for the locational differences between the sources of these crude oils.

The price of the Kuparuk royalty oil to be sold under the contract will be equal to the amount that the state would receive from its Prudhoe Bay lessees for a like volume of Prudhoe Bay royalty oil taken in value at that time, plus

the Kuparuk River Unit field cost allowance which the state is billed when taking Kuparuk royalty oil in kind, plus a per barrel premium of 35¢ from Petro Star and 50¢ from Chevron. To properly compensate the purchasers for the quality and transportation cost differential between Kuparuk royalty oil and the Prudhoe Bay-based price, two deductions will be made to that price. These are the Kuparuk Pipeline tariff and the TAPS quality bank adjustment charge for injecting Kuparuk oil into the TAPS crude oil stream.

In addition, Petro Star and Chevron will be liable to the state for retroactive adjustments to the Prudhoe Bay in value price resulting from resolution of the Amerada Hess litigation. Those retroactive price adjustments will apply to all royalty oil purchased under the agreement. To assure the purchasers a limit to their liability for Amerada Hess retroactive price adjustments, the department has agreed to a ceiling retroactive price adjustment of $2.50 per barrel of royalty oil purchased. This sum represents a negotiated ceiling, and is not any party's estimate of litigation results.

At the Royalty Board meeting of October 30, 1985, the department announced a possible alteration to the interest rates specified in the Amerada Hess provision of the proposed long-term royalty contract with Petro Star and Chevron. This issue arose from Chevron's desire to renegotiate the provision which specifies the interest rate that would be applied to additional amounts that may be owed by the purchaser upon final resolution of the Amerada Hess litigation. Originally this term specified that the applicable interest rate would be the higher of the prime rate plus 3 percent or the rate of return realized on the State general fund. Under the alteration proposed by Chevron and agreed to by the department, the purchaser would pay the interest rate which will be explicitly or implicitly included in the resolution of the Amerada Hess litigation.

This alteration was found acceptable to the department in light of Chevron's concerns, which arose from the fact that the interest rates expected to emerge from a settlement of the Amerada Hess litigation will likely differ from the interest rate originally specified in the proposed long-term contract. Depending on when a resolution to the Amerada Hess litigation occurs, this

situation could lead to settlement amounts which are substantially different than the settlement amount arising from a resolution of that litigation. This amendment appears in section 2.3 (Price of the Royalty Oil) of the contract.

SECURITY

The department ordinarily requires from royalty oil purchasers an irrevocable letter of credit equal to 90 days' worth of oil. This requirement has been a feature of all royalty oil disposals since the competitive sale of December 11, 1984, with the exception of the Prudhoe Bay royalty oil offered at that sale. The exception occurred because the department devised a "put call" option which enabled the letter of credit requirement for that oil to be reduced to 60 days. The Findings and Determination to Conduct a Competitive Sale of Prudhoe Bay and Kuparuk River Unit Royalty Oil, of October 17, 1984 discusses both the put call option and the eventualities which necessitate the requirement for a letter of credit.

The contract requires the standard 90-day letter of credit from Chevron for the quantity to be purchased by the company. Chevron also has agreed to a "backup" arrangement with the state under the contract. Under that provision, Chevron will accept delivery of any volume of royalty oil upon which Petro Star may default, with only a five day notice required from the state. The purchase price for that volume would be the Petro Star purchase price. The backup sale would continue only until the Commissioner returned the oil to in value.

The additional security provided by the backup arrangement with Chevron has allowed for the letter of credit requirement for Petro Star to be reduced to 60 days. The Petro Star letter of credit will provide financial protection for the state beyond the date the department may become aware of any possible performance failure on the part of Petro Star. The backup arrangement with Chevron, which would be activated in that event, replaces the additional 30 days of coverage ordinarily required by the department.

AMERADA HESS ESCROW ACCOUNT

Upon a review of the responses to the department's Solicitation, the department became concerned with the ability of some respondents to pay the state retroactive price adjustments stemming from resolution of the Amerada Hess litigation. The amounts which may be entailed by those retroactive price adjustments (to be determined at an unknown time) over a long-term royalty oil disposal could be substantial. Consequently, the department suggested escrow arrangements with some respondents, including Petro Star, during the first review of the responses to the Solicitation. During the later negotiations with Petro Star, an escrow amount of $1.12 per royalty oil barrel purchased was found acceptable by the department. Under the contract, Petro Star will establish an interest-bearing escrow account in that amount for the purpose of making payments to the state for any retroactive price adjustments resulting from a resolution of the Amerada Hess litigation.

PRICE REOPENER

Any time after two years from the date of first delivery of royalty oil to Petro Star and Chevron, the state or either of the purchasers may exercise the price reopener clause contained in the contract by giving a one month written notice. If a new purchase price is agreed to by the state and the affected purchaser within three months of the notice to reopen, the new purchase price will become effective one month after that agreement. Two years after a new purchase price becomes effective, that price will be subject to renegotiation under the price reopener provision of the contract. If a new purchase price is not agreed to by the state and the affected purchaser within three months of the notice to reopen, that purchasers' portion of the agreement may be terminated by either the state or the purchaser upon nine months written notice.

The requirements to continue the remaining purchaser's portion of the agreement differ for Petro Star or Chevron. Were the agreement to be

terminated with respect to Petro Star, the state may, upon nine months written notice, terminate the agreement with Chevron. Should the department elect to continue the sale of royalty oil to Chevron under the proposed contract, the volume sold, which would not exceed approximately 4,000 bpd, must be processed at the Chevron refinery in Nikiski.

If Chevron's portion of the agreement were terminated, the sale of royalty oil to Petro Star could continue under the contract only under the following conditions. The sales volume could remain the same or could be expanded to include all or part of the quantity formerly purchased by Chevron. The price to Petro Star for any expanded quantity of oil will be Chevron's purchase price, including the per barrel premium of 50¢. Petro Star must also agree to expand its security and in-state processing obligations to correspond to the new total daily volume to be purchased. This would include an increased letter of credit, equal to 90 days' worth of the new daily volume to be purchased, and Amerada Hess escrow account payments corresponding to that volume. Further, Petro Star and the department must successfully complete negotiations for an amendment to the contract which provides the state an option to repurchase Petro Star's return oil at a market-based price.

Should the exercise of any of the options described in this section result in an appreciable reduction of the consideration received by the state for the continued sale of royalty oil, the approval of the Alaska State Legislature will be required.

For more information, see Article VII (Default or Termination) of the proposed contract.

LOCAL HIRE

Like the state's other long-term royalty oil contracts with in-state refiners, the contract contains a provision concerning local hire. The preferential hiring clause states in part, "Purchaser agrees to hire and employ Alaska

residents and Alaska companies to the extent they are available, willing and qualified for all work performed in Alaska under or in connection with this Agreement, including but not limited to construction and operation of facilities to refine or otherwise use the Royalty Oil." "Alaska resident" is defined as an individual who has lived in the state for one year at the time of hiring. It is understood under the arrangements initially comtemplated, that Chevron will not be performing work in Alaska in connection with this contract. If this provision is determined to be unconstitutional, then, by signing the contract Petro Star agrees to hire and employ Alaskan residents and Alaska companies to the extent such preferential hiring is determined to be constitutional.

The issue of local hire with respect to Petro Star was raised at the Royalty Board meeting of September 26, 1985 by Mr. Kevin Dougherty, who represented the Alaska AFL-CIO and the Alaska State District Council of Laborers. Mr. Dougherty remarked that approximately one half of the employees contracted to construct the Petro Star refinery were from out of state. Mr. Dougherty also noted that the annual employee salary indicated in the Analysis for Petro Star was much lower than the corresponding figures shown for the proposed Arctic Energy refinery.

Mr. Steve Lewis of Petro Star did not agree to the payroll figures implied in the Analysis. Mr. Lewis further stated that the issue of local hire should not be confused with union hire and that all Petro Star employees were Alaska residents. Mr. Lewis also disputed the assertion that only one half of the refinery's construction work force was comprised of Alaska residents.

In a letter to the Royalty Board dated September 27, 1985, Mr. Dougherty stated that his comment with respect to Petro Star's construction work force was based on information provided by the workers on that project. Mr. Dougherty also added that his payroll figures were taken directly from the Analysis. The latter discrepancy was traced to the number of employees shown for Petro Star in the Analysis, which has been corrected in this document.

PRELIMINARY FINDINGS AND DETERMINATIONS

1. Competitive bidding is waived.

   I have determined in accordance with AS 38.05.183(a) and 11 AAC 03.030 that the best interest of the state does not require competitive bidding for this disposal. Petro Star is the only existing in-state refiner which does not purchase state royalty oil under negotiated, long-term contract(s). In order to realize the objectives implied by many of the considerations listed in AS 38.05.182-183 and AS 38.06.070 and to obtain the benefits for Alaska consumers that accrue from in-state refining, the department has waived competitive bidding for this disposal, which is partially based on factors other than the cash value offered. The contract for a long-term royalty oil sale to Petro Star and Chevron follows a formal "Solicitation for Proposals", to which eleven firms responded, and a six-month public review and comment process.

2. The sale to Petro Star and Chevron is in the best interest of the State.

   Under AS 38.05.183(e), a noncompetitive sale, exchange, or other disposal of royalty oil or gas taken in kind by the state may be awarded by the commissioner to the prospective buyer whose proposal offers maximum benefits to the citizens of the state.

   In accordance with AS 38.05.183(a),(c) and (e), and 11 AAC 03.010(b) and (d), I find that taking royalty oil in kind and selling that oil to Petro Star and Chevron for use in-state is in the best interests of the state and that it will maximize benefits to state citizens. Applicable statutory criteria are discussed below.

(a) The state is now highly dependent on oil revenues and will continue to depend on oil revenues in the future. The price term of the sale protects the state's interest by ensuring that revenues from this sale will exceed the in value alternative. AS 38.05.183(e)(1) and AS 38.06.070(a)(1).

(b) The projected effects of this sale are brought about by the continued assurance of supply under a long-term existing contract. Petro Star has made an initial investment of more than $6.9 million in its Alaska operations. The company has created 11 new jobs. The benefits related to local payrolls and to the purchase of local goods, services and supplies is more than $1.6 million annually. AS 38.05.183(e)(2)-(3).

(c) The local and regional needs of the Fairbanks area for petroleum products will be satisfied and local competition among refineries will be created. A one cent decrease in the price of each gallon of refined product that could be made from 1,000 bpd translates to an annual consumer saving of about $153,000. On the conservative assumption that Petro Star would reduce its per gallon product price by one penny, the annual savings to the consumer would exceed $380,000 at the refinery's expected capacity. AS 38.05.183(e)(4) and AS 38.06.070(a)(2).

(d) The continued operation of Petro Star, with the attendant payroll and secondary benefits, will have a positive and desired effect on the citizens of the state. While this disposal likely will not result in new capital investment or development, it will enable the efficient use of existing investment and development. AS 38.06.070(a)(3).

(e) The projected social impacts of a disposal to Petro Star are anticipated to be favorable. The benefits presently received from the operation of the Petro Star Refinery plus the supply of products through Petro Star's distribution system would continue. AS 38.06.070(a)(4).

(f) Since most of the essential provisions of the proposed disposal to Petro Star 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. AS 38.06.070(a)(5).

(g) Local and regional consumption of refined petroleum products will be directly and favorably affected by the Petro Star/ Chevron disposal. Local labor markets will continue to benefit through employment opportunities at the Petro Star refinery. AS 38.06.070(a)(6).

(h) Environmental effects resulting from the disposal will be negligible, if any, since the facility is already in existence. AS 38.06.070(a)(7).

(i) The sale will help existing commercial private enterprise and patterns of investments by assisting in the continued operation of Petro Star. Further, Petro Star is the sole in-state refinery owned by Alaskans and Alaska companies. AS 38.06.070(a)(8).

In accordance with 11 AAC 03.060(b), the weight given to the applicable criteria in determining the maximum benefit to Alaska citizens must be addressed. In making this finding the Department first assured itself that the state would not lose money by making a disposal to Petro Star/Chevron. Once so assured, other benefits attendant to the disposal were examined. If the price offered did not assure the state at least what it would have received had it left the

oil in value then the sale would not, in the Department's view, serve the state's best interests. Petro Star matched the highest premium offered by any existing in-state refiner, and Chevron offered the highest premium for export purchase. Therefore great weight in this disposal was placed on AS 38.05.183(e)(1), the cash value offered. In addition to the cash value offered, great weight was given to the projected benefits of Petro Star using the oil in the state to directly benefit Alaska citizens.

3. The contract prices are acceptable.

Under 11 AAC 03.091(b) I find that in establishing the price of this royalty oil contract, the department has obtained a price at least equal to the volume weighted average of the current reported netback prices filed by the lessees for royalty purposes for those filing periods applicable to the term of the disposition, plus field costs incurred by the royalty share.

Petro Star will pay a $.35 premium over the amount the state would receive from its Prudhoe Bay lessees for that amount of Prudhoe Bay royalty oil taken at that time in money (in value), plus Kuparuk field costs, less the Kuparuk Pipeline tariff charge and less the applicable TAPS quality bank adjustment. Chevron will purchase what would otherwise be Petro Star's return oil and will pay the state a $.50 premium over the amount the state will receive from its Prudhoe Bay lessees for that amount of Prudhoe Bay royalty oil taken at that time in money (in value), plus Kuparuk field costs, less the Kuparuk Pipeline tariff charge and less the applicable TAPS quality bank adjustment. The in value component of the in value price bases for both Petro Star and Chevron will be retroactively adjusted upon resolution of the *Amerada Hess* litigation.

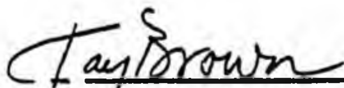
4. The Royalty Oil to be sold to Chevron is available for export.

In view of the department's most recent annual (1985) Historical and Projected Oil and Gas Consumption report, and the department's Findings and Determination documents for recent short-term royalty oil disposals, including the Supplemental Findings for the Competitive Royalty Oil Sale (November 28, 1984), I find under AS 38.05.183(d) and 11 AAC 03.010(e) that the volume of royalty oil to be sold to Chevron is surplus to the present and projected intrastate domestic and industrial needs for oil and is available for disposal and possible export from the state.

CONCLUSION

Under the terms of the proposed contract, the state would receive a market (litigation-adjusted) price for the royalty oil, while fostering in-state processing and attendant benefits. The satisfactory price terms, coupled with associated direct and secondary benefits for Alaska citizens, supports the decision to waive competitive bidding.

The foregoing facts and analysis support my preliminary finding that this disposal is in the best interests of the state and that it maximizes benefits to Alaska citizens.



Kay Brown, Director
for Esther C. Wunnicke
Commissioner

December 6, 1985
Date

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DIVISION OF OIL & GAS
ANCHORAGE, ALASKA

AGREEMENT FOR THE SALE AND PURCHASE

OF

STATE ROYALTY OIL

PETRO STAR, INC.

CHEVRON U.S.A.

THE STATE OF ALASKA
Department of Natural Resources

December 9, 1985

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DOG 9-85
(PETRO STAR & CHEVRON/KUPARUK)
(Revised 11-85)
(DNR # 10-4017)

AGREEMENT FOR THE SALE AND
PURCHASE OF ROYALTY OIL

THIS AGREEMENT, entered into as of December 9, 1985 by and between THE STATE OF ALASKA ("Seller") PETRO STAR, INC., an Alaska corporation, ("Purchaser Petro Star"), and CHEVRON U.S.A. INC., a Pennsylvania corporation, ("Purchaser Chevron").

ARTICLE I
DEFINITIONS

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

1.1 "Commissioner" means the Commissioner of the Alaska Department of Natural Resources or her designee.

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 Section 2.5.

1.8 "Purchaser" means either Petro Star, Inc., or Chevron U.S.A. Inc., or both, unless one particular Purchaser is designated.

1.9 "Prudhoe Bay Lessees" means the lessees of the oil and gas leases subject to the Prudhoe Bay Unit Agreement effective April 1, 1977, as amended from time to time.

1.10 "Prudhoe Bay Royalty Oil" means Royalty Oil received from the Prudhoe Bay Lessees.

1.11 "Royalty Oil" means the oil which 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.

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

1.13 "Settlement Agreement" means the Agreement for Settlement of Cleaning, Dehydration and Transporation Charges Applicable to Royalty Oil Taken From the Kuparuk River Unit, effective as of December 13, 1981, and attached to the Unit Agreement as Appendix I.

1.14 "TAPS" means the Trans Alaska Pipeline System.

1.15 "Unit Agreement" means the Kuparuk River Unit Agreement effective as of December 1, 1981, by and between Seller and the Lessees, as amended from time to time.

ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity. Seller agrees to sell to Purchaser Petro Star, and Purchaser Petro Star agrees to buy from Seller, that amount of oil equal to __________ % of the Daily Royalty Oil ("Maximum Quantity"). Seller agrees to sell to Purchaser Chevron, and Purchaser Chevron agrees to buy from Seller, that amount of oil equal to _________ % of the Daily Royalty Oil ("Maximum Quantity"). Promptly after the effective date of this Agreement, Seller will determine the actual percentages, which will be the percentages that on the date of initial nomination would result in a Maximum Quantity for Purchaser Petro Star that on the Date of First Delivery would approximate 2500 bpd and a Maximum Quantity for Purchaser Chevron that on the Date of First Delivery will approximate 4000 bpd. However, unless Purchaser Petro Star notifies Seller in writing within five (5) days after the effective date of this Agreement, Seller will initially nominate for Purchaser Petro Star the percentage that Seller estimates will on the Date of First Delivery approximate 2000 bpd.

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. If by November 1, 1987 Purchaser Petro Star has not begun to take the Maximum Quantity of oil, Seller, at its option and discretion, may permanently decrease the Purchaser Petro Star's Maximum Quantity to either (1) the greatest percentage of Daily Royalty Oil tendered by Seller to it before that time or, (2) the maximum amount of oil that can be processed at Purchaser Petro Star's refinery, located at North Pole, Alaska. Purchaser may permanently decrease its Maximum Quantity under this Agreement upon nine (9) months' written notice to Seller.

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 Oil to be sold or tendered under this Agreement. Seller shall hold Purchaser harmless from all liens, encumbrances and valid adverse claims that may affect the Oil at the time the Oil is tendered to Purchaser.

If Seller stores Royalty Oil pursuant to the Kuparuk River Unit Emergency Storage Agreement dated December 15, 1981, and attached as Appendix II to the Unit Agreement, (the "Storage Agreement"), or otherwise, or if Seller recovers stored Royalty Oil, the quantity of Oil to be sold and purchased under this Agreement shall be calculated as if no Royalty Oil was stored or recovered.

2.2 Quality. The Oil sold shall be the same quality as the Royalty Oil delivered by the Lessees to Seller at the Point of Delivery. It is understood and agreed that the quality of the Oil sold may vary from time to time. Seller disclaims, and Purchaser waives, any guarantee, representation, or warranty, either express 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 Oil to be sold or tendered under this Agreement.

2.3 Price of the Royalty Oil. The price payable by Purchaser Petro Star for Oil tendered under this Agreement ("Petro Star Purchase Price") shall be equal to the amount that Seller actually would receive from its Prudhoe Bay Lessees for that amount of Prudhoe Bay Royalty Oil taken at that time in money (in value), plus 35¢ per barrel and plus the Kuparuk Field Cost Allowance incurred by the Oil as determined under the Settlement Agreement, less the tariff charge for the Kuparuk Pipeline and less the applicable TAPS quality barrel adjustment.

The price payable by Purchaser Chevron for Oil tendered under this Agreement ("Chevron Purchase Price") shall be equal to the amount that Seller actually would receive from its Prudhoe Bay Lessees for that amount of Prudhoe Bay Royalty Oil taken at that time in money (in value), plus 50¢ per barrel and plus the Kuparuk Field Cost Allowance incurred by the oil as determined under the Settlement Agreement, less the tariff charge for the Kuparuk Pipeline and less the applicable TAPS quality bank adjustment.

The in value component of each Purchase Price shall be determined by Seller based upon the reports submitted by the Prudhoe Bay Lessees for royalty purposes or, when those reports are unavailable, incomplete or inaccurate, upon information submitted by the Prudhoe Bay Lessees for production tax or other tax purposes as may be adjusted from time to time as provided in this Agreement. Purchaser shall be entitled only to review or request such 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 Prudhoe Bay Royalty Oil in value from its Prudhoe Bay Lessees is presently the subject of litigation 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"). 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 Prudhoe Bay Lessees to Seller for royalty purposes or, when the royalty reports are unavailable, incomplete, or inaccurate, upon information submitted by the Prudhoe Bay Lessees for production tax or other tax purposes, plus $0.35 per barrel for Purchaser Petro Star and $0.50 for Purchaser Chevron, and plus the Kuparuk Field Cost Allowance as determined under the Settlement Agreement, less the Kuparuk Pipeline tariff and less the applicable TAPS quality bank adjustment. 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. However, Seller and Purchaser agree that any Amerada Hess adjustments in excess of $2.50 per barrel will not be made. This sum represents a negotiated ceiling, and is not any party's estimate of litigation results.

If additional amounts are owed by Purchaser to Seller or by Seller to Purchaser under a final judgement or settlement resolving all or part of the issues in Amerada Hess which separately specifies principal and interest, interest will be paid on the principal component of the additional amounts in the manner and at the interest rate or rates specified in the judgement or settlement resolving each issue. If no interest rate is specified in the judgement or settlement or if interest is expressly included within a lump sum amount in the judgement or settlement, an interest component will be presumed to already comprise a portion of the additional amounts, and no separate interest will be paid.

Purchaser Petro Star 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 Purchaser whether or not Purchaser 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, Purchaser'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 Purchase Price Reopener. Seller and each Purchaser shall have the right to reopen this Agreement with respect to each Purchaser's own volume, as to purchase price only. At any time after Purchaser receives Oil for two (2) years from the Date of First Delivery (as defined in Section 2.10), Seller or Purchaser may exercise the right to reopen by giving to the other party one (1) month prior written notice. Upon issuance and receipt of a notice to reopen, that Purchaser and Seller will promptly commence good faith negotiations in an attempt to establish a new purchase price. In the event that a new purchase price is not agreed to by that Purchaser and Seller within three (3) months after giving the notice to reopen, that Purchaser or Seller may terminate that Purchaser's portion of this Agreement upon nine (9) months written notice to the other. The purchase price for Oil tendered during any period pending termination shall be the price in effect immediately prior to giving the notice of intent to reopen. If a new purchase price is agreed to by that Purchaser and Seller, the new purchase price shall become effective for Oil tendered in the month following the Agreement on the new purchase price. Not less than two (2) years after the conclusion of the purchase price reopener process described above, that Purchaser or Seller may reopen that Purchaser's portion of this Agreement, as to purchase price only, by giving notice of intent to exercise the right to reopen. At that time, the purchase price reopener process described above will again be applicable.

2.5 Point and Time of Delivery. Simultaneously 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 Section 2.3 of the Settlement Agreement is the Central Production Facility Meter into the Kuparuk Pipeline.

2.6 Passage of Title and Risk of Loss. Title and risk of loss to the 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 arising from or in connection with 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, including satisfaction of line fill obligations and storage tank bottom requirements of the Kuparuk Pipeline and Trans Alaska Pipeline System, if any. If and as requested by Seller, and at the time or times requested by Seller, Purchaser shall submit specific information concerning the arrangements it has made for transportation of the Oil sold under this Agreement through and away from Kuparuk Pipeline and the Trans Alaska Pipeline System and for the resale or other disposal of the Oil. Such information may include the specific tenders of Oil made to the Kuparuk Pipeline and Trans Alaska Pipeline System and identification of tankers which will transport the Oil. In addition, Purchaser will provide Seller, if and as requested by Seller, with satisfactory evidence or reasonable assurances of the existence and continuing validity of adequate arrangements for the transportation or disposal of the 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.

2.9 Absolute Obligations. The obligations of Purchaser to accept, pay for, and arrange for the transportation of the 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.

2.10 Date of First Delivery. The Date of First Delivery will be on the first day of the first month seven (7) months after the effective date specified in Article VI, unless Seller, in its sole discretion at the request of both Purchasers, sets an earlier date.

2.11 In-State Processing. Purchaser Petro Star agrees that not less than 85% of the Royalty Oil sold under this Agreement, averaged on a quarterly basis, shall be processed through Purchaser Petro Star's refinery near North Pole, Alaska, except as provided below. "Process" means producing refined petroleum products from the crude oil in significant quantities, but which quantities may not be less than 20% of the volume of Royalty Oil run through Purchaser Petro Star's refinery pursuant to this Agreement.

Purchaser Petro Star'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.

Seller may, at its option, waive the in-state processing requirement in whole or in part, if Seller is satisfied that Purchaser Petro Star is using its best efforts to process the Royalty Oil sold under this Agreement at Purchaser Petro Star'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 Petro Star agrees to use its "best efforts" to produce and market in Alaska an amount of refined petroleum products from its refinery near North Pole, Alaska not less in volume than 23% of the Royalty Oil sold under this Agreement. Those refined petroleum products shall be comprised of at least LAGO and Kerosene. After each three (3) months of deliveries under this Agreement, Purchaser Petro Star shall promptly provide to the Seller an affidavit certified by Purchaser Petro Star stating the quantity of refined petroleum products produced and marketed in the State of Alaska from in-state processing of the Daily Royalty Oil sold under this Agreement for that period.

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

2.13 Option to Purchase Return Oil. After Purchaser Petro Star processes Royalty Oil, there will remain a portion of Oil or Oil products which may be shipped through TAPS ("Return Oil"). Return Oil shipped through TAPS becomes intermingled with unprocessed crude oil so that when the Return Oil is picked up in Valdez it is identical to the common stream crude oil shipped through TAPS. A shipper of Return Oil presently is, and may continue to be, liable for the payment of a quality bank adjustment differential based upon the resulting degradation of TAPS common-stream crude ("quality bank adjustment").

The total daily volume of Royalty Oil sold under this Agreement approximates Purchaser Petro Star's daily refinery throughput. Purchaser Petro Star's daily Maximum Quantity approximates its maximum retained product and Purchaser Chevron's daily Maximum Quantity approximates what would otherwise be Purchaser Petro Star's return oil. Thus, under the arrangements contemplated under this Agreement, no return oil would exist upon which the state could retain an option. Should the arrangements contemplated under this Agreement cease to exist, Purchaser and Seller agree to negotiate in good faith towards agreement upon a market price option for Seller on whatever return oil or residual oil may exist under the new arrangements.

2.14 Arrangements between Purchasers. Purchaser Chevron and Purchaser Petro Star have entered into an arrangement under which Purchaser Petro Star will use as refinery charge Purchaser Chevron's volume of Royalty Oil under this Agreement. The arrangement includes the purchase of Royalty Oil taken by Purchaser Chevron under this Agreement by Purchaser Petro Star at TAPS Pump Station No. 1, and resale of the Royalty Oil to Purchaser Chevron at Valdez. A copy of the document which specifies the terms of the arrangement is attached as Exhibit A. Should the terms of the arrangement change materially so that Purchaser Petro Star is precluded from economically using Purchaser Chevron's volume as refinery charge, Seller shall have the right at the Commissioner's discretion to terminate this Agreement on nine (9) months notice.

Should Purchaser materially reduce its Maximum Quantity under Section 2.1 or terminate its portion of this Agreement under Section 2.4, or should termination occur due to an Event of Default under Article VII, either Seller or the other Purchaser may terminate the remaining portion of this Agreement by giving nine (9) months written notice, except as provided below. In this section a material reduction means a reduction of 50% or more from the original Maximum Quantity.

Upon termination of Purchaser Petro Star's portion of this Agreement for any reason or material reduction of Purchaser Petro Star's Maximum Quantity under Section 2.1, Seller shall exercise its right to terminate Purchaser Chevron's portion of this Agreement. However, if Purchaser Chevron agrees to process in its refinery at Nikiski, Alaska the Royalty Oil to be sold under this Agreement after that time, and if Purchaser Chevron successfully completes negotiations with the commissioner for an amendment to this Agreement which grants Seller a market price option on Purchaser Chevron's residual oil resulting from the processing of that oil, the Commissioner shall have the discretion to not terminate Purchaser Chevron's portion of this Agreement.

Upon termination of Purchaser Chevron's portion of this Agreement for any reason or material reduction of Purchaser Chevron's Maximum Quantity under Section 2.1, Purchaser Petro Star shall have the option to continue purchasing up to its Maximum Quantity, or to increase its Maximum Quantity to include all or part of the volume formerly purchased by Purchaser Chevron under this Agreement. Purchaser Petro Star shall exercise this option in writing within one month of the termination of Purchaser Chevron's portion of this Agreement. Purchaser Petro Star's option shall be conditioned on Purchaser Petro Star (1) agreeing for any increased quantity to pay the Purchase Price that Purchaser Chevron would pay under this Agreement, (2) agreeing to increase its Section 15.2 letter of credit to ninety (90) days for all volumes it would purchase under this Agreement, (3) agreeing to pay its Section 15.3 Amerada Hess escrow amount for all volumes it would purchase under this Agreement, (4) agreeing to increase its Section 2.11 and Section 2.12 in-state processing and best efforts obligations to include all volumes it would purchase under this Agreement, and (5) successfully completing negotiations with the Commissioner for an amendment to this Agreement which grants Seller a market price option on Purchaser Petro Star's return oil from all volumes it would purchase under this Agreement. The Commissioner shall have the discretion to accept other or additional security arrangements as part of Purchaser Petro Star's option as she, in her sole discretion, considers adequate to protect Seller. In accordance with Article XIX of this Agreement, the exercise of any option described in this section that would appreciably reduce the consideration received by Seller requires prior approval of the Alaska Legislature.

2.15. 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 Purchaser 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 Section 2.15 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.

ARTICLE III
REPRESENTATIONS 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) a natural person who has reached the age of majority and who is a citizen of the United States; or (b) a corporation organized and existing under and by virtue of the laws of the United States or of any state, territory or the District of Columbia and qualified to do business in Alaska; or (c) any association of the foregoing. If a corporation, Purchaser has all necessary corporate power to enter into this Agreement and to perform its covenants and obligations under this Agreement, and 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 ability to perform under this Agreement. Purchaser, in addition, will immediately inform Seller of any significant change in ownership of either 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, 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 section, Purchaser Chevron may submit, and Seller will accept, the annual report and supplement of Chevron Corporation.

ARTICLE IV
MEASUREMENTS AND TESTS

The quantity and quality of the 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 the Point of Delivery specified under Section 2.5.

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 the month of delivery of Oil, an invoice statement of account of all Oil estimated to have been measured at the Central Production Facility Meter into the Kuparuk Pipeline and tendered to Purchaser under this Agreement during the immediately preceding Month according to the best information available to Seller, the estimated Purchase Price(s) 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 shall thereafter adjust its initial billing under this section as soon as more accurate information concerning the quantity and Purchase Price(s) of 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 first monthly invoice under Section 5.1, each subsequent monthly invoice will also state Seller's initial adjustments to be made, if any, to the invoice rendered in the immediately preceding 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 Section 5.5.

5.3 Payment. Purchaser will make payment of each amount billed under this section within ten (10) Days after receipt of the invoice statement of account. Payment shall be made without any deduction, set off, or withholding by wire transfer of immediately available funds to Seller's account at the following address:

First Pennsylvania Bank Philadelphia
ABA No. 031000024
For Credit to State of Alaska
Account No. 07/089250/00
Attn: Catherine Hess

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. Buyer will only be permitted to review material or information that is not confidential. If a dispute concerning a bill arises, Purchaser agrees to pay the full amount billed by Seller, except for obvious clerical mistakes, pending final resolution of the dispute.

5.4 Payment to Lessee(s). 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 the amount due to Seller 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 Section 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 payments for subsequent months, shall be made in accordance with Section 5.3.

5.5 Subsequent Adjustments. Purchaser acknowledges that more accurate information concerning the quantity of or Purchase Price for 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, 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, unless the adjustment concerns an amount last invoiced more than sixty (60) Days before the corrected invoice. In that 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 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. Adjustments due to regulatory or court proceedings may be made at any time and shall bear interest at the rate stated in Section 5.6 from the date of payment of the invoice upon which an adjustment is subsequently made pursuant to this section. The provisions of this Section 5.5 will survive any termination of this Agreement.

5.6 Interest. Except for adjustments made upon resolution of Amerada Hess under Section 2.3, all sums which are not paid when due under this Agreement or which are subsequently determined to be due under an adjustment under Section 5.5, 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 to Seller 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 Purchaser if, in Seller's sole discretion, the payment to the third party will assist Seller in monitoring or enforcing this Agreement.

ARTICLE VI
TERM

This Agreement shall become effective upon execution by the parties and enactment of legislation by the State of Alaska (including approval by the Governor) approving this Agreement. This Agreement shall be null and voi if it is not so approved by September 30, 1986. 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 specified in Section 2.10, and shall end September 30, 1996. As used in this section, "enactment of legislation" is as defined in AS 01.10.070(f)(4).

ARTICLE VII
DEFAULT OR TERMINATION

7.1 Default. If any one or more of the follc events ("Events of Default") occur, then at Seller's option, Seller may t. nate or suspend its obligation to tender and sell Oil and proceed to exerc 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 invoiced under this Agreement at the time when payment is due; or

(ii) Purchaser fails to observe or perf any of its other covenants and obligations under Artic 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 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 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 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 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 Oil under this Agreement is terminated or suspended under Sections 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. Seller, upon occurrence of any Event of Default, in its sole discretion, may arrange for any disposition to third parties of Oil to be tendered and sold under this Agreement. Upon the occurrence of any Event of Default, Purchaser is released from the obligations set forth in Sections 2.11 (In-State Processing) and 2.12 (Best Efforts) until the Event of Default no longer exists or the obligation of Purchaser to take Royalty Oil under this Agreement expires. If upon occurrence of any Event of Default Seller makes arrangement for disposition to third parties of Oil 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 Oil in excess 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, losses and expenses (including reasonable attorneys fees and disbursements) 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 Oil which is the subject of this Agreement.

ARTICLE VIII
DISPOSITION OF OIL

8.1 Inability to Receive Oil. 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 thirty (30) days advance written notice to return up to 2500 barrels 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' prior notice, or to attempt to secure a waiver of any condition or requirement, is at Seller's sole and complete discretion. If for any reason Purchaser is unable or refuses to accept or receive any Oil tendered under this Agreement, Purchaser shall nevertheless be and remain responsible for the disposal of that Oil and for paying 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. In order to secure the obligations of Purchaser under this Section 8.1 and under Section 2.8, Purchaser shall, if and as Seller may request from time to time, assign to Seller all right, title and interest of Purchaser under any nominations, leases, agreements, contracts, charter parties and other arrangements for the transportation of the Oil sold under this Agreement through and away from the Kuparuk Pipeline and the Trans Alaska Pipeline System; provided, that Seller shall not have any liability or obligations under any such nominations, leases, agreements, contracts, charter parties or other arrangements unless, and to the extent that, Seller shall actually exercise its rights to succeed to Purchaser's interest thereunder and shall obtain the benefits thereof.

8.2 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, Storage Agreement, or any other agreement. However, Purchaser shall use due diligence and make its best efforts to act in a manner that enables Seller to adhere to the notice requirements and other obligations provided in the Storage Agreement. Purchaser agrees that when it executes this Agreement, it will also immediately execute the release attached as Exhibit B to this Agreement.

ARTICLE IX
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 stop the other party from complaining of a later breach similar in nature.

ARTICLE X
SEVERABILITY

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 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, Seller will have the right to terminate this Agreement. Prior to Seller exercising its right to terminate this Agreement Seller and Purchaser shall enter into good faith negotiations to restore, to the fullest extent possible, 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 Oil tendered

under this Agreement and except for Purchaser's obligation to dispose of 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 to the party by registered or certified United States mail, postage prepaid, with a return receipt requested of the 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 Oil and Gas
Pouch 7-034
Anchorage, Alaska 99510

Telephone:

Telex:

If to Purchaser Petro Star:

Telephone:

Telex:

If to Purchaser Chevron:

Telephone:

Telex:

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

ARTICLE XIII

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

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 of, and pay for Oil tendered under this Agreement.

ARTICLE XV

SECURITY

15.1 Purchaser Chevron Letter of Credit. Sixty (60) days prior to Date of First Delivery, Purchaser Chevron shall cause to be issued and delivered to Seller an irrevocable stand-by letter of credit, with an effective date no later than the Date of First Delivery, issued for the benefit of Seller by a state or national banking institution of the United States ("Issuer"), which is insured by 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 principal face amount of such letter of credit shall be a sum estimated by the Commissioner to be equal to the aggregate Purchase Price for the approximate total amount of Oil to be tendered by Seller to Purchaser Chevron during the first ninety (90) days following the Date of First Delivery, calculated at the Purchase Price. 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 her designee and the Attorney General of the State of Alaska or his designee that Purchaser Chevron 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 Chevron 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 Chevron shall upon Seller's request (whether or not Purchaser Chevron may deny, reject or otherwise resist such claims) cause the [illegible]al face amount of the letter of credit to be increased by an amount e[illegible] to the excess. The principal face amount of the letter of credit shall also be automatically increased by Purchaser Chevron without request from Seller whenever the face amount is less than the expected Purchase Price of ninety (90) days of Oil tenders to Purchaser Chevron under this Agreement, to an amount equal to the expected Purchase Price of ninety (90) days of Oil tenders to Purchaser Chevron. The principal face amount of the letter of credit may be decreased by Purchaser Chevron upon approval of Seller if the face amount is more than the expected Purchase Price of ninety (90) days of Oil tenders to Purchaser Chevron under this Agreement, to an amount equal to the expected Purchase Price of ninety (90) days of Oil tenders to Purchaser Chevron.

The letter of credit must allow drafts to be drawn and presented to the Issuer up to and including the 90th day after the last delivery of Royalty Oil to Purchaser Chevron under this contract. The Commissioner may accept such other or additional security as she, in her sole discretion, considers adequate to protect Seller.

15.2 Purchaser Petro Star Letter of Credit. Sixty (60) days prior to the Date of First Delivery, Purchaser Petro Star shall cause to be issued and delivered to Seller an irrevocable stand-by letter of credit, with an effective date no later than the Date of First Delivery, issued for the benefit of Seller by a state or national banking institution of the United States ("Issuer"), which is insured by 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 principal face amount of such letter of credit shall be a sum estimated by the Commissioner to be equal to the aggregate Purchase Price for the approximate total amount of Oil to be tendered by Seller to Purchaser Petro Star during the first sixty (60) days following the Date of First Delivery, calculated at the Purchase Price. 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 her designee and the Attorney General of the State of Alaska or his designee that Purchaser Petro Star 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 Petro Star 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 Petro Star shall upon Seller's request (whether or not Purchaser Petro Star 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 Petro Star without request from Seller whenever the face amount is less than the expected Purchase Price of sixty (60) days of Oil tenders to Purchaser Petro Star under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Oil tenders to Purchaser Petro Star. The principal face amount of the letter of credit may be decreased by Purchaser

Petro Star upon approval of Seller if the face amount is more than the expected Purchase Price of sixty (60) days of Oil tenders to Purchaser Petro Star under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Oil tenders to Purchaser Petro Star.

The letter of credit must allow drafts to be drawn and presented to the Issuer up to and including the 60th day after the last delivery of Royalty Oil to Purchaser Petro Star under this contract. The Commissioner may accept such other or additional security as she, in her sole discretion, considers adequate to protect Seller;

15.3 Purchaser Petro Star Amerada Hess Escrow. Sixty (60) days prior to the Date of First Delivery, Purchaser Petro Star shall cause to be executed and delivered to Seller an executed escrow agreement with a state or national banking institution of the United States ("Escrow Bank"), which is insured by the Federal Deposit Insurance Corporation, and which has a aggregate capital and surplus of not less than One Hundred Million Dollars ($100,000,000), or other banking institution acceptable to the Seller in its sole discretion. The escrow agreement shall be in a form satisfactory to the Commissioner. The escrow agreement shall provide for payment of escrowed amounts only after final resolution of the *Amerada Hess* litigation, including any appeals, and upon tender of a certified statement, signed by the Commissioner of Natural Resources and the Attorney General of the State of Alaska. The certified statement shall specify the disposition of the principal and accrued interest of the escrow as calculated under the provisions of Articles II and V of this Agreement, with the full adjusted Purchase Price and interest payable to Seller, and any escrow balance payable to Purchaser Petro Star. Before requesting escrow payment, Seller will give Purchaser Petro Star at least twenty (20) days written notice of its calculations for the escrow disposition.

Purchaser Petro Star agrees to make monthly deposits into the escrow of the sum equal to $1.12 per barrel of Royalty Oil purchased by Purchaser Petro Star from Seller under this Agreement during the previous month. This sum represents a negotiated escrow amount, and is not any party's estimate of litigation results. The amount of this escrow shall be an element of the "Purchase Price" under this Agreement, and shall be subject to periodic renegotiation as specified in the purchase price reopener provision of Section 2.4.

Purchaser Petro Star shall make payments to the escrow at the same time as it pays Seller under Article V of this Agreement, including increased payments necessitated by quantity adjustments under that Article. Purchaser Petro Star shall bear all expenses of the escrow, and shall arrange for the Escrow Bank to send to Seller monthly statements showing the escrow balance.

15.4 Chevron Backup. Purchaser Chevron agrees that, after receiving at least five (5) days notice from Seller, it will accept delivery of any volumes of Royalty Oil upon which Purchaser Petro Star has defaulted under this Agreement. The notice referenced above shall be given by telephone and by telex to the telephone number and address provided in Section 12.1. Purchaser Chevron agrees to take those volumes subject to all the terms of this Agreement, except that the price for those volumes shall be the Petro Star Purchase Price. Purchaser Chevron will promptly increase its letter of credit to include the increased volume. The Commissioner will return the defaulted volumes to in value as soon as possible, and will promptly notify Purchaser Chevron of the date on which deliveries to it under this section will cease.

ARTICLE XVI
PREFERENTIAL HIRING

Purchaser agrees to hire and employ Alaska residents and Alaska companies to the extent they are available, willing and qualified for all work performed in Alaska under or in connection with this Agreement, including but not limited to construction and operation of facilities to refine or otherwise use the Royalty Oil. As used in this Agreement "Alaska resident" means an individual who has resided in the State for one year at the time of hiring or employment and "Alaska companies" means those companies who are incorporated in the State of Alaska or whose principal place of business is in Alaska. Seller acknowledges that under the arrangements initially contemplated under this Agreement, Purchaser Chevron will not be performing work in Alaska under or in connection with this Agreement.

If this provision is determined to be unconstitutional by a court of competent jurisdiction, then Purchaser agrees to hire and employ Alaska residents and Alaska companies to the extent such preferential hiring is determined to be constitutional.

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

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

This Agreement may be supplemented, amended or modified at any time, but only by written instrument duly executed by the parties to this Agreement. Any material amendment to this contract that appreciably reduces the consideration received by the state requires prior approval of the legislature.

ARTICLE XX

SUCCESSORS AND ASSIGNS

No assignment, pledge or encumbrance of this Agreement shall be made by either Purchaser without first obtaining the written consent of Seller, or by Seller without obtaining the written consent of both Purchasers. The Commissioner may grant such consent on behalf of 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 Oil ("Other Agreement"), then Seller, at its option and on thirty Days' prior notice, may require Purchaser to terminate either this Agreement or the Other Agreement. The choice of which

Agreement to terminate will be Seller's. Purchaser may request that Seller waive this provision in advance of Purchaser gaining a controlling interest in an entity which has an agreement with Seller for the sale of Oil. The Commissioner has sole and complete discretion in granting or denying the requested waiver.

ARTICLE XXI

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 directly relating to the performance of this Agrecment, including but not limited to the purchase or sale of Oil and its refined products, for a period of six (6) years. Purchaser will also maintain and preserve all similar bocks, 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 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

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 her consideration. The Commissioner will subsequently, within a reasonable time, issue a finding on the meaning or application of the disputed word, term, or condition, setting forth the basis for her 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 9th day of December, 1985

SELLER: THE STATE OF ALASKA

by Jay Brown, Director

~~Commissioner~~

Department of Natural Resources

PURCHASER PETRO STAR, INC.: PETRO STAR, INC.

By [signature]

President

PURCHASER CHEVRON: CHEVRON U.S.A. INC.

By A.M. Caccamo

3928s

EXHIBIT B

RELEASE

For a valuable consideration, the receipt and adequacy of which are acknowledged, the undersigned does hereby release and forever discharge ARCO Alaska, Inc., BP Alaska Exploration Inc., Chevron U.S.A. Inc., Exxon Corporation, Mobil Oil Corporation, Phillips Petroleum Company, Sohio Alaska Petroleum Company, Union Oil Company of California, Amoco Production Company, individually and collectively, and each of their predecessors, successors, assigns, and all persons acting by, through, under or in concert with them, or any of them (the "Releasees"), of and from any and all claims, demands or causes of action of any nature whatsoever, known or unknown, fixed or contingent, hereinafter made against the Releasees, or any of them arising out of, based upon, or relating to the purported storage rights of the State of Alaska with respect to royalty oil produced from the land as to which the Kuparuk River Unit Agreement is now effective on to which it may be extended.

The undersigned represents and warrants that there has been no assignment or other transfer of any interest in any claim which agrees to indemnify and hold Releasees, and each of them, harmless from any liability, claims, demands, damages, costs, expenses and attorney's fees incurred by Releasees, or any of them, as a result of any person asserting assignment or transfer or any rights or claims under that assignment or transfer. It is the intention of the parties that this indemnity does not require payment as a condition precedent to recovery by the Releasees against the undersigned under this indemnity.

The undersigned agrees that if after execution of this Release the undersigned commences, joins in, or in any manner seeks relief through any suit arising out of, based upon, or relating to any of the claims released under this Release or in any manner asserts against Releasees, or any of them, any of the claims released under this Release, then the undersigned will pay to Releasees, and each of them, in addition to any other damages caused to Releasees by that action or claim all attorney's fees incurred by Releasees in defending or otherwise responding to the action or claim.

The undersigned further understands and agrees that the execution of this Release shall neither consitute nor be construed as an admission by the Releasees, or any of them, that they have any storage obligation with respect to the State's royalty oil.

[signature] 5 December 1985

PETRO STAR, INC. DATE

[signature] 6 December 1985

CHEVRON U.S.A. DATE

Introduced: 2/10/86
Referred: House Special Committee on
Oil & Gas, Resources and Finance

1 IN THE HOUSE — BY THE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

2 HOUSE BILL NO. 559

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FOURTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act approving the sale of Kuparuk River Unit
7 royalty oil by the State of Alaska to Petro Star,
8 Inc. and Chevron U.S.A., Inc.; and providing for an
9 effective date."

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

11 * Section 1. The "Agreement for the Sale and Purchase of State Royalty
12 Oil" between the State of Alaska and Petro Star, Inc. and Chevron U.S.A.,
13 Inc., dated December 9, 1985, is approved and ratified.

14 * Sec. 2. This Act takes effect immediately in accordance with AS 01.-
15 10.070(c).