

**SB**

**318**

**(File 1)**

# FISCAL NOTE

STATE OF ALASKA

BILL NO. SB318

1996 LEGISLATIVE SESSION

Revision Date: Original Dept Affected: Natural Resources  
 Title: An Act authorizing, approving, and ratifying BRU: Resource Development  
the amendment of Northstar Unit oil and gas leases ... Component: Oil & Gas Development  
 Sponsor: Senate Rules Committee  
 Requestor: Senate Resources Component Serial No. 439

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY97	FY98	FY99	FY00	FY01	FY02
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
<b>TOTAL OPERATING</b>	0.0	0.0	0.0	0.0	0.0	0.0
<b>CAPITAL EXPENDITURES</b>	0.0	0.0	0.0	0.0	0.0	0.0
<b>CHANGE IN REVENUES (1004)</b>	0.0	3,857.1	37,952.1	38,700.6	34,975.4	(3,686.3)

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
<b>TOTAL</b>	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY96) cost: \$ none

**POSITIONS**

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

**ANALYSIS:** (Attach a separate page if necessary)

The state will likely realize a significant increase in revenues from royalties and taxes from the Northstar Unit development over the next six years if this bill passes. Without the bill, the Department of Revenue predicts in its Fall 1995 Base Price forecast that the Northstar Unit will not commence full production until 2002. Assuming full production in 2002 (and some preliminary production starting in 4th quarter 2001), DNR predicts that the state will receive only \$5.5 million in tax revenues over the next six years, mostly from property taxes.

With passage of this bill, early development of the Northstar field is possible. Full oil production is anticipated by 1999. Within this same six-year period, state revenues will likely be an additional \$180 million over the \$5.5 million amount. These revenues will be in the form of royalties and "supplemental royalties," and severance, conservation, property, and corporate income taxes. The state will also receive nearly \$7 million as its share of federal royalties from the federal lease tracts in the Northstar Unit. **SEE ATTACHED TABLE FOR FULL FINANCIAL ANALYSIS...**

Prepared by: Ken Boyd, Director Phone: 269-8800  
 Division: Oil & Gas Date: 28-Mar-96  
 Approved by Commissioner: [Signature] Date: 28-Mar-96  
 Agency: Natural Resources

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**State Revenues (without Northstar Lease Amendments)**

State	State Royalty	State Supplemental Royalty	State Share of Federal Royalty	Severance Tax	Spill & Conserv. Tax	Property Tax*	Corporate Income Tax	Total State Revenues
(Thousands of 1996 Dollars)								
1996	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
1997	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1998	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
1999	0.0	0.0	0.0	0.0	0.0	0.0	(477.1)	(477.1)
2000	0.0	0.0	0.0	0.0	0.0	828.3	(835.9)	(7.6)
2001	3,868.9	0.0	247.4	0.0	45.6	2,547.2	(1,173.8)	5,535.3
2002	35,778.5	0.0	2,287.7	16,171.7	407.2	4,245.3	2,784.3	61,674.6
	<u>\$39,647.4</u>	<u>\$0.0</u>	<u>\$2,535.1</u>	<u>\$16,171.7</u>	<u>\$452.8</u>	<u>\$7,620.8</u>	<u>\$297.5</u>	<u>\$66,725.2</u>

**State Revenues (with Northstar Lease Amendments)**

State	State Royalty	State Supplemental Royalty	State Share of Federal Royalty	Severance Tax	Spill & Conserv. Tax	Property Tax*	Corporate Income Tax	Total State Revenues
(Thousands of 1996 Dollars)								
1996	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	(\$477.1)	(\$477.1)
1997	0.0	0.0	0.0	0.0	0.0	761.4	(834.1)	(72.7)
1998	3,625.3	0.0	231.8	0.0	50.1	2,343.9	(1,213.4)	5,037.7
1999	35,631.3	42.5	2,278.2	16,101.5	447.4	3,914.3	2,767.6	61,182.8
2000	35,735.8	680.0	2,284.9	13,487.8	432.1	4,771.2	2,994.3	60,386.1
2001	34,891.8	1,969.0	2,231.0	12,682.7	406.5	4,586.5	3,440.7	60,208.2
2002	29,599.9	2,887.4	1,892.6	7,949.5	330.6	4,293.8	3,234.1	50,187.9
	<u>\$139,484.1</u>	<u>\$5,578.9</u>	<u>\$8,918.5</u>	<u>\$50,221.5</u>	<u>\$1,666.7</u>	<u>\$20,671.1</u>	<u>\$9,912.1</u>	<u>\$236,452.9</u>

**Change in State Revenues (with Northstar Lease Amendments)**

State	State Royalty	State Supplemental Royalty	State Share of Federal Royalty	Severance Tax	Spill & Conserv. Tax	Property Tax*	Corporate Income Tax	Total State Revenues
(Thousands of 1996 Dollars)								
1996	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	(\$477.1)	(\$477.1)
1997	0.0	0.0	0.0	0.0	0.0	761.4	(834.1)	(72.7)
1998	3,625.3	0.0	231.8	0.0	50.1	2,343.9	(1,213.4)	5,037.7
1999	35,631.3	42.5	2,278.2	16,101.5	447.4	3,914.3	3,244.7	61,659.9
2000	35,735.8	680.0	2,284.9	13,487.8	432.1	3,942.9	3,830.2	60,393.7
2001	31,022.9	1,969.0	1,983.6	12,682.7	361.0	2,039.3	4,614.5	54,673.0
2002	(6,178.6)	2,887.4	(395.1)	(8,222.2)	(76.5)	48.5	449.9	(11,486.7)
	<u>\$99,836.7</u>	<u>\$5,578.9</u>	<u>\$6,383.4</u>	<u>\$34,049.8</u>	<u>\$1,214.1</u>	<u>\$13,050.3</u>	<u>\$9,614.7</u>	<u>\$169,727.8</u>

\*Approximately 75 percent of this amount may go to the North Slope Borough.

# FISCAL NOTE

STATE OF ALASKA

BILL NO. SB318

1996 LEGISLATIVE SESSION

Revision Date: Original Dept Affected Natural Resources  
 Title: An Act authorizing, approving, and ratifying BRU: Resource Development  
the amendment of Northstar Unit oil and gas leases ... Component: Pipeline Coordinator  
 Sponsor: Senate Rules Committee  
 Requestor: Senate Resources Component Serial No. 1191

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY97	FY98	FY99	FY00	FY01	FY02
PERSONAL SERVICES	147.3	147.3	125.0			
TRAVEL	25.0	25.0	25.0			
CONTRACTUAL	243.3	243.3	75.0			
SUPPLIES	12.0	12.0	6.0			
EQUIPMENT	3.5	3.5				
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
<b>TOTAL OPERATING</b>	<b>431.1</b>	<b>431.1</b>	<b>231.0</b>	****	****	****

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
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CHANGE IN REVENUES ( )						
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FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
1091 Designated Program Rcpts	431.1	431.1	231.0			
<b>TOTAL</b>	<b>431.1</b>	<b>431.1</b>	<b>231.0</b>	****	****	****

Estimate of any current year (FY96) cost: \$ none

POSITIONS

FULL-TIME	0	0	0	0	0	0
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

**ANALYSIS:** (Attach a separate page if necessary)

This request is an industry funded project under AS 38.35.140(b) for the development of a common carrier pipeline for the Northstar project near Prudhoe Bay.

The budget is based on the Lease Application moving forward from mid-April 1996 through September 1997 and construction beginning in November 1997. The Leasing Process and Statute require that the Commissioner of DNR make a decision that the Applicant is financially and technically FIT, WILLING and ABLE to construct, operate, maintain and terminate the pipeline. The funds for FY97 and some of the funds for FY98 will be expended on determining if the applicant has proposed a project that meets this requirement. The remainder of the funding will be expended for oversight of the construction of the pipeline by ADNDR, ADEC, ADF&G and ADLabor. The FY99 funds will be used for conformation and oversight of the operational aspects of the project, such as Quality Assurance, Quality Control, and operational processes. *Continued on next page...*

Prepared by: Jerry Brossia, State Pipeline Coordinator Phone: 271-3601  
 Division: State Pipeline Coordinator's Office Date: 29-Mar-95  
 Approved by Commissioner: [Signature] Date: 29-Mar-95  
 Agency: Natural Resources

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Fiscal Analysis Continued...

\*\*\*\* Beyond FY99 there will be a request for additional funds for the administration and oversight of the Leases that cannot be determined at this time. These funds will be based on the outcome of the previous years activities and findings. The State Pipeline Coordinator's Office will promptly notify the Governor's Office should this project schedule change.

Adopted 4-24-96 (Med.)

WORK DRAFT

WORK DRAFT

WORK DRAFT

9-GS2065VF  
Chenoweth  
Alternative 1  
4/24/96

**CS FOR SENATE BILL NO. 318(RES)**

**IN THE LEGISLATURE OF THE STATE OF ALASKA**

**NINETEENTH LEGISLATURE - SECOND SESSION**

**BY THE SENATE RESOURCES COMMITTEE**

**Offered:**

**Referred:**

**Sponsor(s): SENATE RULES COMMITTEE BY REQUEST OF THE GOVERNOR**

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act authorizing, approving, and ratifying the amendment of Northstar Unit  
2 oil and gas leases between the State of Alaska and BP Exploration (Alaska)  
3 Inc.; and providing for an effective date."

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

5 \* Section 1. LEGISLATIVE FINDINGS AND POLICY. Based upon the findings of fact  
6 set out in the "Findings of Fact of the Senate Resources Committee Regarding SB 318," dated  
7 April 24, 1996, the legislature finds

8 (1) the production of oil and gas from state land is a matter of statewide  
9 interest and effect because it is the principal source of revenue to the state and provides  
10 important job opportunities for the people of the state;

11 (2) BP Exploration (Alaska) Inc. holds certain state oil and gas leases in the  
12 Northstar Unit that include net profit share provisions;

13 (3) BP Exploration (Alaska) Inc. has refused to develop the Northstar Unit  
14 leases unless the leases are amended to eliminate the net profit share provisions;

1 (4) unless the net profit share provisions of the Northstar Unit are amended,  
2 production of oil and gas from the unit is highly unlikely to begin before the year 2002;

3 (5) because of the development account provisions of the net profit share  
4 leases, the later that these leases are developed, the less "net profits" the state receives;

5 (6) if the net profit share provisions of the Northstar Unit leases are amended,  
6 full production of oil and gas from the unit may begin as early as the year 1999;

7 (7) amending the net profit share provisions of the Northstar Unit leases to  
8 provide for a supplemental royalty, instead of a share of net profits, will provide economic  
9 benefits of oil and gas production to the people of the state by encouraging production from  
10 the Northstar Unit earlier than it might otherwise occur under the terms of the Northstar Unit  
11 Agreement and the unit's approved Plan of Development;

12 (8) the development of the unit and the associated construction of unit facilities  
13 within the state will provide additional revenue to the state and increased job opportunities;

14 (9) the expedited development of the unit may result in increased state revenue  
15 from future oil and gas lease sales;

16 (10) the expedited development of the unit may result in technological  
17 breakthroughs and other cost savings that may make other development opportunities in the  
18 state economically feasible;

19 (11) notwithstanding the anticipated benefits that may result from the  
20 amendment of the Northstar Unit's net profit share lease terms, the legislature reaffirms that  
21 it is the policy of the state to enforce the competitively bid terms of its oil and gas leases and  
22 that the commissioner of natural resources should assure that the state's oil and gas resources  
23 are being diligently and timely developed;

24 (12) the public's confidence that the terms of the state's oil and gas leases are  
25 being fairly and uniformly administered must be maintained;

26 (13) it is important to assure that there is no appearance of favoritism in the  
27 state's administration of its oil and leases; and therefore

28 (14) except as provided under sec. 2 of this Act, the commissioner of natural  
29 resources is directed not to negotiate the amendment of the competitively bid terms of any  
30 state oil and gas lease without prior explicit authorization by the legislature through the  
31 passage of a general act granting the authority to do so.

1 \* Sec. 2. (a) The State of Alaska and BP Exploration (Alaska) Inc. are parties to the  
2 following leases in the Northstar Unit:

- 3 (1) ADL 312798, effective February 1, 1980;
- 4 (2) ADL 312799, effective February 1, 1980;
- 5 (3) ADL 312808, effective February 1, 1980;
- 6 (4) ADL 312809, effective February 1, 1980; and
- 7 (5) ADL 355001, effective August 1, 1983.

8 (b) The commissioner of natural resources may amend the Northstar Unit leases  
9 described in (a) of this section as set out below:

10 AMENDMENT TO THE NORTHSTAR UNIT LEASES  
11 BETWEEN THE STATE OF ALASKA AND  
12 BP EXPLORATION (ALASKA) INC.

13 The State of Alaska ("State") and BP Exploration (Alaska) Inc.  
14 ("BPXA") are parties to the following leases in the Northstar Unit: ADL  
15 312798, effective February 1, 1980; ADL 312799, effective February 1, 1980;  
16 ADL 312808, effective February 1, 1980; and ADL 312809, effective  
17 February 1, 1980 (collectively the "1980 Leases"); as well as ADL 355001,  
18 effective August 1, 1983 (the "1983 Lease"). The parties agree to amend the  
19 1980 Leases and the 1983 Lease as set forth in this amendment to the Northstar  
20 Unit leases.

21 1980 Leases

22 (1) Paragraph 6(b) is replaced in its entirety as follows:

23 (b) Annual rental paid in advance is a credit on the royalty or  
24 supplemental royalty due under this lease for that year.

25 (2) Paragraph 7 is replaced in its entirety as follows:

26 7. SUPPLEMENTAL ROYALTY. (a) In addition to the  
27 royalty paid and computed under paragraphs 8, 10, and 11 below,  
28 Lessee shall pay to the State a supplemental royalty ("supplemental  
29 royalty"). Lessee shall pay the supplemental royalty, if owed, upon the  
30 same production volume for which royalty is paid ("production  
31 volume"). The supplemental royalty payment for a given month equals

1 the supplemental royalty value times the supplemental royalty  
2 percentage rate ("percentage rate") times the production volume for that  
3 month. The percentage rate shall be calculated monthly by reference  
4 to: (1) an ANS West Coast spot price ("spot price"); and (2) a  
5 supplemental royalty trigger price ("trigger price"). If the spot price is  
6 equal to or less than the trigger price, then the percentage rate equals  
7 zero. If the spot price is greater than the trigger price, then the  
8 percentage rate equals [the spot price per barrel minus the trigger price  
9 per barrel] times 1.5 percent per dollar per barrel. The percentage rate  
10 may never exceed 7.5 percent.

11 (b) The spot price is the price per barrel calculated in Article  
12 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement  
13 Agreement ("ANS Agreement"), dated December 31, 1991, between the  
14 State and BPXA, for the crude oil referred to as "ANS (USWC)" in the  
15 ANS Agreement. The trigger price is \$17.35 per barrel through  
16 April 30, 1997. On May 1, 1997, and each May 1 thereafter, the  
17 trigger price shall be adjusted by an inflation factor equal to fifty  
18 percent of the "inflation rate" defined as the Producer Price Index for  
19 Industrial Commodities ("PPI") for December of the previous year, as  
20 reported by April 30 of the current year, divided by the PPI for  
21 December of 1995, as reported by April 30, 1996. The supplemental  
22 royalty value for oil, gas, natural gas liquids and associated substances  
23 is defined in paragraphs 10 and 11 below. Exhibit B is a sample  
24 calculation to demonstrate the method of calculating supplemental  
25 royalty for oil.

26 (3) Paragraph 9 is replaced in its entirety as follows:

27 9. REDUCTION OF ROYALTY. Except as provided in  
28 paragraph 7 above, Lessee shall not be entitled to any reduction of  
29 royalty paid under paragraph 8 above or supplemental royalty paid  
30 under paragraph 7 above based on any current or future agreement,  
31 State statute, or State regulation.

1 (4) Paragraph 10 is replaced in its entirety as follows:

2 10. ROYALTY IN VALUE. Unless the State elects to receive  
3 all or a portion of its royalty or supplemental royalty in kind as  
4 provided in paragraph 12 below, Lessee shall pay to the State the value  
5 of all royalty and supplemental royalty oil, gas and associated  
6 substances as determined under paragraph 11 below. Royalty and  
7 supplemental royalty paid in value shall be free and clear of all lease  
8 expenses (and any portion of such expenses which is incurred away  
9 from the leased area), including, but not limited to, expenses for  
10 separation, cleaning, dehydration, gathering, saltwater disposal, and  
11 preparing the oil, gas or associated substances for transportation off the  
12 leased area. All royalty and supplemental royalty that may become  
13 payable in money to the State shall be paid on or before the last day of  
14 the calendar month following the month in which the oil, gas or  
15 associated substances are produced. Royalty and supplemental royalty  
16 payments shall be accompanied by copies of run tickets or such other  
17 information relating to valuation of royalty and supplemental royalty as  
18 the State may require, which may include, but is not limited to,  
19 evidence of sales, shipments, and amounts of gross oil, gas and  
20 associated substances produced.

21 (5) Paragraph 11 is replaced in its entirety as follows:

22 11. VALUE. For purposes of computing supplemental royalty  
23 due under this lease, the value of supplemental royalty oil, gas, natural  
24 gas liquids and associated substances shall be the value used in  
25 computing royalty on said substances.

26 (a) To compute the value of oil for royalty and supplemental  
27 royalty purposes, this lease shall be deemed an "ANS Lease" under the  
28 terms of the ANS Agreement, irrespective of any provision(s) of such  
29 agreement which would otherwise exclude this lease therefrom.

30 (b) To compute the value of gas and natural gas liquids for  
31 royalty and supplemental royalty purposes, this lease shall be deemed

1 a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation  
2 Settlement Agreement between BPXA and the State dated as of April 1,  
3 1995, irrespective of any provision(s) of such agreement which would  
4 otherwise exclude this lease therefrom.

5 (c) To compute the value of associated substances (which shall  
6 be deemed to exclude oil, gas, and natural gas liquids) for royalty and  
7 supplemental royalty purposes, the value of such associated substances  
8 shall not be less than the highest of:

9 (1) the field price actually received by Lessee for such  
10 associated substances;

11 (2) Lessee's posted price in the field for such associated  
12 substances;

13 (3) the volume weighted average field price actually  
14 received by other producers in the same field or area for associated  
15 substances of like kind and quality at the time such associated  
16 substances are removed from the leased or unit area; or

17 (4) the volume weighted average posted price in the  
18 field of other producers in the same field or area for associated  
19 substances of like kind and quality at the time such associated  
20 substances are removed from the leased or unit area.

21 If associated substances are sold away from the leased or unit  
22 area, the term "field price" above shall be the actual price for such  
23 associated substances received from the purchaser thereof less the actual  
24 cost of transportation away from the leased or unit area to the point of  
25 delivery.

26 **Minimum Value Determinations.** The State may establish  
27 minimum values for purposes of computing royalties on associated  
28 substances obtained from this lease, with consideration being given to  
29 the price actually received by Lessee, to the price or prices paid in the  
30 same field or area for production of like quality, to posted prices, to  
31 prices received by Lessee and/or other producers from sales occurring

1 away from the leased area, and to other relevant matters. Each such  
2 determination will be made only after Lessee has been given notice and  
3 a reasonable opportunity to be heard. Under this provision, it is  
4 expressly agreed that the minimum value of royalty associated  
5 substances under this lease may not necessarily equal the price of such  
6 associated substances.

7 (6) The following provision shall be added to the end of paragraph 12:

8 (e) Supplemental royalty under paragraph 7 above may be taken  
9 in kind under the same terms and conditions as royalty may be taken  
10 in kind under this paragraph 12.

11 (7) Paragraph 14 is replaced in its entirety as follows:

12 14. APPORTIONMENT OF ROYALTY FROM APPROVED  
13 UNIT. The landowner's royalty and supplemental royalty share of the  
14 unit production allocated to each separately owned tract shall be  
15 regarded as royalty to be distributed to and among, or the proceeds of  
16 it paid to, the landowners, free and clear of all unit expense and free of  
17 any lien for it. Under this provision, the State's royalty and  
18 supplemental royalty share of any unit production allocated to the  
19 leased area shall be regarded as royalty to be distributed to, or the  
20 proceeds of it paid to, the State, free and clear of all unit expenses (and  
21 any portion of such expenses which is incurred away from the unit  
22 area), including, but not limited to, expenses for separation, cleaning,  
23 dehydration, gathering, saltwater disposal, and preparing oil, gas or  
24 associated substances for transportation off the unit area, and free of  
25 any lien for it.

26 (8) Paragraph 28 (c) is added as follows:

27 (c) Notwithstanding any other provisions of this lease, the  
28 Northstar Unit Agreement, State statute, or State regulation, this lease  
29 shall terminate automatically without notice, an opportunity to be heard,  
30 or judicial proceeding, if the Lessee fails to comply with the sanction  
31 schedule set forth in Exhibit C ("sanction schedule"), attached and

1 incorporated by reference. Automatic termination shall occur whether  
2 or not there is a well on the leased area capable of producing oil or gas  
3 in paying quantities, the lease is committed to a unit agreement, or the  
4 Lessee is drilling or conducting reworking operations, on the date  
5 performance under the schedule is due. Furthermore, upon termination  
6 BPXA shall promptly file of record appropriate lease relinquishments.  
7 The automatic termination shall occur at 11:59 P.M., Alaska Time, on  
8 the day performance of the obligation under the sanction schedule is  
9 due.

10 (9) Paragraph 32 is replaced in its entirety as follows:

11 32. FORCE MAJEURE. If the State determines that Lessee has  
12 been prevented, after diligent efforts made in good faith, from  
13 complying with any express or implied promise, term, condition or  
14 covenant of this lease (other than the obligation to provide project  
15 sanction within twelve (12) months of the passage by the legislature of  
16 an Act authorizing an Amendment to the Northstar Unit leases for the  
17 project), from conducting drilling operations, or from producing or  
18 marketing oil or gas from the leased area, by reason of war, riots, acts  
19 of God, unusually severe weather, or any other cause beyond Lessee's  
20 reasonable ability to foresee or control (including delays caused by  
21 judicial decision or lack thereof or inability to obtain local, State, or  
22 federal permits or environmental impact statements), whether similar to  
23 those enumerated or not, Lessee's obligation to comply with such  
24 provision shall be suspended, but not voided, and Lessee shall not be  
25 liable for damages for failure to comply therewith. If Lessee's  
26 obligations to conduct drilling or reworking operations are suspended  
27 under this paragraph and the continuation of such operations without  
28 suspension would have had the effect of preventing the expiration or  
29 termination of this lease, this lease shall not terminate during the period  
30 which the obligation to perform such operations is suspended. Nothing  
31 in this paragraph shall be construed to suspend the obligation to pay

1 rentals, or to suspend the obligation to pay royalties, supplemental  
2 royalties or other production payments from operations on the lease area  
3 which are not suspended or from operations which are not affected by  
4 any such suspension, to the State.

5 (10) Paragraph 41 is replaced in its entirety as follows:

6 41. FABRICATION OF PRODUCTION AND PROCESSING  
7 MODULES WITHIN ALASKA AND EMPLOYMENT OF ALASKAN  
8 RESIDENTS. Lessee agrees to utilize on-site production and  
9 processing modules for development of the Northstar oil field, and  
10 agrees to fabricate those modules within Alaska. BP Exploration  
11 (Alaska) Inc. will reimburse the State for any public funds expended to  
12 prepare, develop or operate any sites or facilities necessary for the  
13 fabrication, transportation or installation of the Northstar Unit  
14 production and processing modules. All expenses associated with the  
15 design, fabrication, transportation and installation of production and  
16 processing modules required for the development of the Northstar oil  
17 field will be the sole responsibility of BP Exploration (Alaska) Inc. and  
18 its contractors.

19 Lessee shall comply with all valid federal, State and local laws  
20 in hiring Alaska residents and contractors and shall not discriminate  
21 against Alaska residents or contractors. Within the constraints of law,  
22 Lessee shall employ Alaska residents and contractors to the extent they  
23 are available and qualified. Subject to the foregoing:

24 Lessee voluntarily agrees to hire residents of Alaska. Lessee  
25 shall advertise for available positions locally and use Alaska job service  
26 organizations to notify the Alaskan public. For work in connection with  
27 this lease, Lessee shall purchase materials and services from Alaska  
28 vendors, suppliers, and consultants and shall contract with Alaska firms  
29 for fabricating the modules for on-site production and processing  
30 facilities in Alaska. Lessee shall require its contractors to employ and  
31 train, when necessary, residents of Alaska. Lessee shall submit

1 annually to the Director, Division of Oil and Gas, for transmission to  
2 the President of the Senate and the Speaker of the House of  
3 Representatives, a report that details the specific measures Lessee and  
4 its contractors and subcontractors have taken or are planning to take to  
5 recruit qualified Alaska residents for available jobs, describes on-the-job  
6 training opportunities, and describes Lessee's efforts to hire Alaska  
7 firms for work in connection with this lease. Lessee shall furnish the  
8 Department of Labor, for transmission to the President of the Senate  
9 and the Speaker of the House of Representatives, a quarterly report  
10 regarding the employment of Alaska residents on the lease area in  
11 compliance with regulations by the Department of Labor. The report  
12 must also include statistical data concerning the number of resident  
13 personnel hired within the past year for this lease.

14 1983 Lease

- 15 (1) Paragraph 4(f) and paragraph 34(7) are deleted and replaced in their  
16 entirety with the following paragraph 4(f):

17 (f) FORCE MAJEURE. If the State determines that lessee has  
18 been prevented, after diligent efforts made in good faith, from  
19 complying with any express or implied promise, term, condition or  
20 covenant of this lease (other than the obligation to provide project  
21 sanction within twelve (12) months of the passage by the legislature of  
22 an Act authorizing an Amendment to the Northstar Unit leases for the  
23 project), from conducting drilling operations, or from producing or  
24 marketing oil or gas from the leased area, by reason of war, riots, acts  
25 of God, unusually severe weather, or any other cause beyond lessee's  
26 reasonable ability to foresee or control (including delays caused by  
27 judicial decision or lack thereof or inability to obtain local, State, or  
28 federal permits or environmental impact statements), whether similar to  
29 those enumerated or not, lessee's obligation to comply with such  
30 provision shall be suspended, but not voided, and lessee shall not be  
31 liable for damages for failure to comply therewith. If lessee's

1 obligations to conduct drilling or reworking operations are suspended  
2 under this paragraph and the continuation of such operations without  
3 suspension would have had the effect of preventing the expiration or  
4 termination of this lease, this lease shall not terminate during the period  
5 which the obligation to perform such operations is suspended. Nothing  
6 in this paragraph shall be construed to suspend the obligation to pay  
7 rentals, or to suspend the obligation to pay royalties, supplemental  
8 royalties or other production payments from operations on the lease area  
9 which are not suspended or from operations which are not affected by  
10 any such suspension, to the State.

11 (2) Paragraph 5(b) is replaced in its entirety as follows:

12 (b) Annual rental paid in advance is a credit on the royalty or  
13 supplemental royalty due under this lease for that year.

14 (3) Paragraph 7 is replaced in its entirety as follows:

15 7. APPORTIONMENT OF ROYALTY FROM APPROVED  
16 UNIT. The State's royalty and supplemental royalty share of the unit  
17 production allocated to each separately owned tract must be regarded  
18 as royalty to be distributed to or among, or the proceeds of it paid to,  
19 the State, free and clear of all unit expenses and free of any lien for  
20 them. Under this provision, the State's royalty and supplemental  
21 royalty share of any unit production allocated to the leased area will be  
22 regarded as royalty to be distributed to, or the proceeds of it paid to, the  
23 State, free and clear of all unit expenses (and any portion of those  
24 expenses incurred away from the unit area), including, but not limited  
25 to, expenses for separating, cleaning, dehydration, gathering, saltwater  
26 disposal, and preparing oil, gas, or associated substances for  
27 transportation off the unit area, and free of any lien for them.

28 (4) A new paragraph 20(c) is added as follows:

29 (c) Notwithstanding any other provisions of this lease, the  
30 Northstar Unit Agreement, State statute, or State regulation, this lease  
31 shall terminate automatically without notice, an opportunity to be heard.

1 or judicial proceeding, if the lessee fails to comply with the sanction  
2 schedule set forth in Exhibit C ("sanction schedule"), attached and  
3 incorporated by reference. Automatic termination shall occur whether  
4 or not there is a well on the leased area capable of producing oil or gas  
5 in paying quantities, the lease is committed to a unit agreement, or the  
6 lessee is drilling or conducting reworking operations, on the date  
7 performance under the schedule is due. Furthermore, upon termination  
8 BPXA shall promptly file of record appropriate lease relinquishments.  
9 The automatic termination shall occur at 11:59 P.M., Alaska Time, on  
10 the day performance of an obligation under the sanction schedule is  
11 due.

12 (5) Paragraph 31 is replaced in its entirety as follows:

13 31. FABRICATION OF PRODUCTION AND PROCESSING  
14 MODULES WITHIN ALASKA AND EMPLOYMENT OF ALASKAN  
15 RESIDENTS. Lessee agrees to utilize on-site production and  
16 processing modules for development of the Northstar oil field, and  
17 agrees to fabricate those modules within Alaska. BP Exploration  
18 (Alaska) Inc. will reimburse the state for any public funds expended to  
19 prepare, develop or operate any sites or facilities necessary for the  
20 fabrication, transportation or installation of the Northstar Unit  
21 production and processing modules. All expenses associated with the  
22 design, fabrication, transportation and installation of production and  
23 processing modules required for the development of the Northstar oil  
24 field will be the sole responsibility of BP Exploration (Alaska) Inc. and  
25 its contractors.

26 Lessee shall comply with all valid federal, State and local laws  
27 in hiring Alaska residents and contractors and shall not discriminate  
28 against Alaska residents or contractors. Within the constraints of law,  
29 Lessee shall employ Alaska residents and contractors to the extent they  
30 are available and qualified. Subject to the foregoing:

31 Lessee voluntarily agrees to hire residents of Alaska. Lessee

1 shall advertise for available positions locally and use Alaska job service  
2 organizations to notify the Alaskan public. For work in connection with  
3 this lease, Lessee shall purchase materials and services from Alaska  
4 vendors, suppliers, and consultants and shall contract with Alaska firms  
5 for fabricating the modules for on-site production and processing  
6 facilities in Alaska. Lessee shall require its contractors to employ and  
7 train, when necessary, residents of Alaska. Lessee shall submit  
8 annually to the Director, Division of Oil and Gas, for transmission to  
9 the President of the Senate and the Speaker of the House of  
10 Representatives, a report that details the specific measures Lessee and  
11 its contractors and subcontractors have taken or are planning to take to  
12 recruit qualified Alaska residents for available jobs, describes on-the-job  
13 training opportunities, and describes Lessee's efforts to hire Alaska  
14 firms for work in connection with this lease. Lessee shall furnish the  
15 Department of Labor, for transmission to the President of the Senate  
16 and the Speaker of the House of Representatives, a quarterly report  
17 regarding the employment of Alaska residents on the lease area in  
18 compliance with regulations by the Department of Labor. The report  
19 must also include statistical data concerning the number of resident  
20 personnel hired within the past year for this lease.

21 (6) Paragraph 35 is replaced in its entirety as follows:

22 35. ROYALTY ON PRODUCTION. Except for oil, gas, and  
23 associated substances used on the leased area for development and  
24 production or unavoidably lost, the lessee shall pay to the State as a  
25 royalty 20 percent in amount or value of the oil, gas, and associated  
26 substances saved, removed, or sold from the leased area and of the gas  
27 used on the leased area for extraction of natural gasoline or other  
28 products from the leased area.

29 (7) Paragraph 36 is replaced in its entirety as follows:

30 36. VALUE. For purposes of computing supplemental royalty  
31 due under this lease, the value of supplemental royalty oil, gas, natural

1 gas liquids, and associated substances shall be the value used in  
2 computing royalty on said substances.

3 (a) To compute the value of oil for royalty and supplemental  
4 royalty purposes, this lease shall be deemed an "ANS Lease" under the  
5 terms of the ANS Agreement, irrespective of any provision(s) of such  
6 agreement which would otherwise exclude this lease therefrom.

7 (b) To compute value of gas and natural gas liquids for royalty  
8 and supplemental royalty purposes, this lease shall be deemed a "Lease"  
9 under the terms of the 1995 ANS Gas Royalty Litigation Settlement  
10 Agreement between BPXA and the State dated as of April 1, 1995,  
11 irrespective of any provision(s) of such agreement which would  
12 otherwise exclude this lease therefrom.

13 (c) To compute the value of associated substances (which shall  
14 be deemed to exclude oil, gas, and natural gas liquids) for royalty and  
15 supplemental royalty purposes, the value of such associated substances  
16 shall not be less than the highest of:

17 (1) the field price actually received by lessee for such  
18 associated substances;

19 (2) Lessee's posted price in the field for such associated  
20 substances;

21 (3) the volume weighted average field price actually  
22 received by other producers in the same field or area for associated  
23 substances of like kind and quality at the time such associated  
24 substances are removed from the leased or unit area; or

25 (4) the volume weighted average posted price in the  
26 field of other producers in the same field or area for associated  
27 substances of like kind and quality at the time such associated  
28 substances are removed from the leased or unit area.

29 If associated substances are sold away from the leased or unit  
30 area, the term "field price" above shall be the actual price for such  
31 associated substances received from the purchaser thereof less the actual

1 cost of transportation away from the leased or unit area to the point of  
2 delivery.

3 Minimum Value Determinations. The State may establish  
4 minimum values for purposes of computing royalties on associated  
5 substances obtained from this lease, with consideration being given to  
6 the price actually received by lessee, to the price or prices paid in the  
7 same field or area for production of like quality, to posted prices, to  
8 prices received by lessee and/or other producers from sales occurring  
9 away from the leased area, and to other relevant matters. Each such  
10 determination will be made only after lessee has been given notice and  
11 a reasonable opportunity to be heard. Under this provision, it is  
12 expressly agreed that the minimum value of royalty associated  
13 substances under this lease may not necessarily equal the price of such  
14 associated substances.

15 (8) Paragraph 37 is replaced in its entirety as follows:

16 37. ROYALTY IN VALUE. Unless the State elects to receive  
17 all or a portion of its royalty or supplemental royalty in kind as  
18 provided in paragraph 38, lessee shall pay to the State the value of all  
19 royalty and supplemental royalty oil, gas and associated substances as  
20 determined under paragraph 36. Royalty and supplemental royalty paid  
21 in value shall be free and clear of all lease expenses (and any portion  
22 of such expenses which is incurred away from the leased area),  
23 including, but not limited to, expenses for separation, cleaning,  
24 dehydration, gathering, saltwater disposal, and preparing the oil, gas or  
25 associated substances for transportation off the leased area. All royalty  
26 and supplemental royalty that may become payable in money to the  
27 State shall be paid on or before the last day of the calendar month  
28 following the month in which the oil, gas or associated substances are  
29 produced. Royalty and supplemental royalty payments shall be  
30 accompanied by copies of run tickets or such other information relating  
31 to valuation of royalty and supplemental royalty as the State may

1 require, which may include, but is not limited to, evidence of sales,  
2 shipments, and amounts of gross oil, gas and associated substances  
3 produced.

4 (9) The following provisions shall be added to the end of paragraph 38:

5 (f) Supplemental royalty under this lease may be taken in kind  
6 under the same terms and conditions as royalty may be taken in kind  
7 under this paragraph 38.

8 (10) Paragraph 39 is replaced in its entirety as follows:

9 39. REDUCTION OF ROYALTY. Except as provided in  
10 paragraph 40 below, lessee shall not be entitled to any reduction of  
11 royalty paid under paragraph 35 above or supplemental royalty paid  
12 under paragraph 40 below based on any current or future agreement,  
13 State statute, or State regulation.

14 (11) Paragraph 40 is replaced in its entirety as follows

15 40. SUPPLEMENTAL ROYALTY. (a) In addition to the  
16 royalty paid and computed under paragraphs 35, 36, 37 above, lessee  
17 shall pay to the State a supplemental royalty ("supplemental royalty").  
18 Lessee shall pay the supplemental royalty, if owed, upon the same  
19 production volume for which royalty is paid ("production volume").  
20 The supplemental royalty payment for a given month equals the  
21 supplemental royalty value times the supplemental royalty percentage  
22 rate ("percentage rate") times the production volume for that month.  
23 The percentage rate shall be calculated monthly by reference to: (1) an  
24 ANS West Coast spot price ("spot price"); and (2) a supplemental  
25 royalty trigger price ("trigger price"). If the spot price is equal to or  
26 less than the trigger price, then the percentage rate equals zero. If the  
27 spot price is greater than the trigger price, then the percentage rate  
28 equals [the spot price per barrel minus the trigger price per barrel] times  
29 1.5 percent per dollar per barrel. The percentage rate may never exceed  
30 7.5 percent.

31 (b) The spot price is the price per barrel calculated in Article

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3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement Agreement ("ANS Agreement"), dated December 31, 1991, between the State and BP Exploration (Alaska) Inc. for the crude oil referred to as "ANS (USWC)" in the ANS Agreement. The trigger price is \$17.35 per barrel through April 30, 1997. On May 1, 1997, and each May 1 thereafter, the trigger price shall be adjusted by an inflation factor equal to fifty percent of the "inflation rate" defined as the Producer Price Index for Industrial Commodities ("PPI") for December of the previous year, as reported by April 30 of the current year, divided by the PPI for December of 1995, as reported by April 30, 1996. The supplemental royalty value for oil, gas, natural gas liquids and associated substances is defined in paragraphs 36 and 37 above. Exhibit B is a sample calculation to demonstrate the method of calculating supplemental royalty for oil.

These amendments do not affect: (1) any future agreements which may be reached for the handling of outside substances as that term is used in the Northstar Unit Agreement effective January 24, 1990, or (2) the current valuation methodology for royalty for any other Alaska Net Profit Share leases between the State and BP Exploration (Alaska) Inc. or any affiliates or any future agreements which may be reached regarding a future valuation methodology for Alaska Net Profit Share leases. These amendments take effect on the first day following delivery of a letter from the commissioner of the Department of Natural Resources to the Revisor of Statutes, with copies to the President of the Senate and the Speaker of the House of Representatives, confirming that BP Exploration (Alaska) Inc. or its parent entity has made an irrevocable commitment of full funding (project sanction) to develop the North Star Oil Field. This amendment is dated for reference purposes as of \_\_\_\_\_ (Date).

LESSEE: LESSOR:  
BP EXPLORATION (ALASKA), INC. STATE OF ALASKA  
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\_\_\_\_\_, Vice President \_\_\_\_\_, Commissioner  
Department of Natural Resources

STATE OF ALASKA )

) ss.

Third Judicial District )

On \_\_\_\_\_, 1996, before me appeared \_\_\_\_\_,  
Commissioner, State of Alaska, Department of Natural Resources, and who  
executed this lease and acknowledged voluntarily signing it on behalf of the  
State of Alaska, as lessor.

\_\_\_\_\_

Notary Public in and for the State of Alaska

My Commission expires: \_\_\_\_\_

STATE OF ALASKA )

) ss.

Third Judicial District )

On \_\_\_\_\_, 1996, before me appeared \_\_\_\_\_,  
Vice President of BP Exploration (Alaska), Inc. and who executed this lease  
and acknowledged voluntarily signing it on behalf of the BP Exploration  
(Alaska), Inc. as lessee.

\_\_\_\_\_

Notary Public in and for the State of Alaska

My Commission expires: \_\_\_\_\_

Exhibit B

Calculation of the Supplemental Royalty Payment for Oil

(1) The calculation of the ANS West Coast spot price is derived  
from Platt's "Oilgram Price Report" Spot Crude Price Assessments:

Platt's Reported Daily

Assessment (\$/barrel)

Date	ANSWC Low	ANSWC High	ANSWC Daily Average	ANSWC Daily Average
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WORK DRAFT

WORK DRAFT

WORK DRAFT

					(After Rounding) <sup>1</sup>
1					
2	01/02/96	\$17.97	\$18.06	\$18.015	\$18.02
3	01/03/96	\$17.94	\$18.03	\$17.985	\$17.98
4	01/04/96	\$17.96	\$18.03	\$17.995	\$18.00
5	01/05/96	\$18.60	\$18.64	\$18.620	\$18.62
6	01/09/96	\$18.23	\$18.29	\$18.260	\$18.26
7	01/10/96	\$17.99	\$18.05	\$18.020	\$18.02
8	01/11/96	\$17.10	\$17.17	\$18.135	\$17.14
9	01/12/96	\$16.64	\$16.71	\$18.675	\$16.68
10	01/15/96	\$16.75	\$16.83	\$16.690	\$16.79
11	01/16/96	\$16.60	\$16.66	\$16.730	\$16.63
12	01/17/96	\$16.91	\$16.97	\$16.940	\$16.94
13	01/18/96	\$17.46	\$17.54	\$17.500	\$17.50
14	01/19/96	\$17.28	\$17.37	\$17.325	\$17.32
15	01/22/96	\$17.02	\$17.08	\$17.050	\$17.05
16	01/23/96	\$17.10	\$17.16	\$17.150	\$17.13
17	01/24/96	\$17.35	\$17.41	\$17.380	\$17.38
18	01/25/96	\$16.76	\$16.81	\$17.785	\$16.78
19	01/26/96	\$16.43	\$16.53	\$17.480	\$16.48
20	01/29/96	\$16.16	\$16.24	\$16.200	\$16.20
21	01/30/96	\$16.30	\$16.38	\$16.340	\$16.34
22	01/31/96	\$16.46	\$16.56	\$16.510	\$16.51

23 Monthly Average calculated from ANSWC Daily  
24 Average (After Rounding) = \$17.2271 per barrel  
25 ANS West Coast spot price for the January 1996  
26 month of production = \$17.23 per barrel  
27 (2) The inflation factor shall be calculated as follows: Assume  
28 that by April 30, 1996, the U.S. Department of Labor reports a PPI for  
29 December 1995 as 126.2. Assume that by April 30, 1998, the PPI for

<sup>1</sup> All source and calculated numbers shall be rounded as required in the ANS Agreement.

1 December 1997 is 134.2. The inflation factor for 1998 is calculated according  
2 to the following formula:

3 Inflation Factor for May 1, 1998, through April 30, 1999

$$4 = [(PPI \text{ December of the previous year} \div PPI \text{ December 1995}) - 1] \times 0.5$$
$$5 = [(134.2 \div 126.2) - 1] \times 0.5 = 0.0317 = 3.17 \text{ percent}$$

6 (3) The trigger price for May 1, 1998, through April 30, 1999,  
7 is calculated by adjusting \$17.35 per barrel by the inflation factor as follows:

$$8 \text{ Trigger price for the current year} = \$17.35 \text{ per barrel} \times (1 + \text{inflation factor})$$
$$9 = \$17.35 \text{ per barrel} \times (1 - 3.17 \text{ percent})$$
$$10 = \$17.35 \times 1.0317$$
$$11 = \$17.90 \text{ per barrel}$$

12 (4) Assuming the current month ANSWC spot price is \$21.40,  
13 the supplemental royalty percentage rate is calculated as:

$$14 \text{ Supplemental royalty percentage rate} = (\text{ANSWC spot price} - \text{trigger price for the}$$
$$15 \text{ current year}) \times (1.5 \text{ percent per dollar per barrel})$$
$$16 = (\$21.40 \text{ per barrel} - \$17.90 \text{ per barrel}) \times 1.5 \text{ percent per dollar per barrel}$$
$$17 = (21.40 - 17.90) \times 0.015$$
$$18 = 0.05250 = 5.25 \text{ percent}$$

19 (5) The calculation of the supplemental royalty payment for the  
20 current month is the product of the production volume times the royalty value  
21 and the supplemental royalty percentage rate. Assume that 1,550,000 barrels  
22 of oil were produced in the Northstar unit in the current month and that the  
23 royalty value is \$17.71. The supplemental royalty is:

$$24 \text{ Supplemental royalty payment} = \text{production volume} \times \text{royalty value} \times \text{supplemental}$$
$$25 \text{ royalty percentage rate}$$
$$26 = 1,550,000 \text{ barrels} \times \$17.71 \text{ per barrel} \times 5.25 \text{ percent}$$
$$27 = \$1,441,151.25$$

## 28 EXHIBIT C

### 29 SANCTION SCHEDULE

30 The Northstar Development Project ("the Project") is described in the  
31 document titled "Northstar Development Project, Conceptual Engineering

1 Report" dated February 1996. BPXA shall comply with the following sanction  
2 schedule for the Project and shall provide satisfactory evidence of compliance  
3 within fifteen (15) days of the date performance is due under the schedule:

4 BPXA shall receive Project sanction within twelve (12) months after  
5 passage by the legislature of an Act approving the Amendment to the Northstar  
6 Unit Leases for the Project. "Project sanction" means approval in writing by  
7 the highest appropriate authority in BPXA or its parent entity necessary for the  
8 total amount of expenditures required for the Project. Satisfactory evidence of  
9 receipt of sanction shall be tendered to the State in the form of the sanctioning  
10 entity's documents approving the expenditure of funds for the Project. If  
11 project sanction is withdrawn for any reason whatsoever, BPXA shall notify the  
12 State within three working days by letter from an authorized officer and BPXA  
13 shall be deemed to have failed to comply with this schedule.

14 (c) Notwithstanding any other provision of law, the "Amendment to the Northstar Unit  
15 Leases Between the State of Alaska and BP Exploration (Alaska) Inc." as described in (b) of  
16 this section, if voluntarily agreed to by the commissioner of natural resources and BP  
17 Exploration (Alaska) Inc., is approved and ratified.

18 \* Sec. 3. This Act takes effect on the first day following delivery of a letter from the  
19 commissioner of natural resources to the revisor of statutes, with copies to the president of the  
20 senate and the speaker of the house of representatives, confirming that BP Exploration  
21 (Alaska) Inc. or its parent entity has made a commitment of full funding (projection sanction)  
22 to develop the Northstar Oil Field.

Adopted 4-29-96

9-LS7000S  
Chenoweth  
4/24/96

1 FINDINGS OF FACT OF THE SENATE RESOURCES COMMITTEE REGARDING  
2 SB 318, DATED APRIL 24, 1996. Based upon extensive public testimony, as well as the  
3 review of the written documents and presentations made by BP Exploration (Alaska) Inc.  
4 (BPXA), the Department of Law, and the Department of Natural Resources related to the  
5 proposal of BP Exploration (Alaska) Inc. and the Department of Natural Resources to amend  
6 certain of the lease terms of State of Alaska oil and gas leases within the Northstar Unit  
7 (NSU), the Senate Resources Committee makes the following findings of fact:

8 ARTICLE 1. THE STATE'S NET PROFIT SHARE AND HISTORY OF THE  
9 NORTHSTAR LEASES BEFORE UNITIZATION.

10 (1) The net profit share provision of four of the five state leases now included  
11 in the Northstar Unit was the competitively bid variable when the leases were originally  
12 offered for lease. The leases were offered with a fixed per acre cash bonus and a fixed  
13 royalty of 20 percent, and bidders were asked to submit sealed competitive bids based upon  
14 the percentage of net profits that the bidder would share with the state. According to the  
15 Department of Natural Resources, the average of the winning net profit share bids for these  
16 leases was "about 89 percent." As to the fifth state lease, the net profit share and royalty were  
17 fixed by the Department of Natural Resources at 40 percent and 12 1/2 percent, respectively,  
18 and the competitively bid variable was the amount of bonus offered by the bidders.

19 (2) The leases for which the net profit share was the bid variable, ADL Nos.  
20 312798, 312799, 312808, and 312809, were offered for lease in State of Alaska Competitive  
21 Oil and Gas Lease Sale 30, that was held in December 1979. These four leases were issued  
22 in 1980 for a primary term of 10 years. The fifth lease, ADL 355001, was offered in State  
23 of Alaska Competitive Oil and Gas Lease Sale 39 in May 1983, and was issued in June 1983.  
24 The primary term of ADL 355001 was also 10 years.

25 (3) The original lessees of the Northstar leases included Amerada Hess Co.,  
26 Shell Oil Co. (Shell), Enterprise Oil Co. (Enterprise), and Murphy Oil Co. In 1990, Amerada

1 Hess Co. bought Enterprise's interest in the leases for \$2,000,000.

2 (4) Three years after the initial four state leases were issued, Shell Oil Co.  
3 discovered the Northstar oil field while drilling the Seal Island No. 1 Well. Thereafter, during  
4 the period 1984 - 1986 additional wells were drilled to delineate the Northstar field. Those  
5 wells included Shell Seal Island No. 2 (1984); Shell Seal Island No. 3 (1985); Shell Seal  
6 Island No. 4 (1985); Amerada Hess Co. Northstar No. 1 (1985); and Amerada Hess Co.  
7 Northstar No. 2 (1986).

8 (5) Near the end of the 10-year primary term for the initial four state leases  
9 and the two Outer Continental Shelf (OCS) leases that later came to be included in the  
10 Northstar Unit, Amerada Hess Co. and its partners approached the Department of Natural  
11 Resources and the federal Minerals Management Service with a proposal to form the Northstar  
12 Unit.

13 ARTICLE 2. FORMATION OF THE NORTHSTAR UNIT AND  
14 ACTIVITIES UNDER THE INITIAL PLAN OF DEVELOPMENT.

15 (1) Instead of attempting to take back the four leases that were due to expire  
16 so that they could be competitively leased again, division director James Eason of the  
17 Department of Natural Resources along with the Minerals Management Service approved  
18 formation of the Northstar Unit and its initial Plan of Development, thereby extending the  
19 ten-year primary term of the leases committed to the unit. The Department of Natural  
20 Resources' action in approving this exploratory unit which effectively extended all four state  
21 leases beyond their primary term (and effectively precluding competitively releasing them)  
22 without any certainty of production was consistent with the department's actions on a  
23 multitude of units including: Prudhoe Bay/Niakuk deferral, Prudhoe Bay/Pt. McIntyre  
24 deferral, Milne Point formation, Milne Point expansion, Duck Island, Point Thomson, Point  
25 Thomson expansion, Thetis Island, Hemi Springs, Big River, Astosch, Badami, Kuukpuk,  
26 Northstar formation, North Fork, Nicolai Creek, Kavik, Jones Island, Falls Creek, West  
27 McArthur River, and Gwydyr Bay. There has been no evidence that the Department of  
28 Natural Resources sought the Department of Law's advice about taking back the leases without  
29 certified wells and forcing the leases with certified wells into production in connection with  
30 its 1990 decision.

31 (2) The term of the Northstar Unit was five years, from January 24, 1990, until

1 January 23, 1995.

2 (3) According to the Department of Natural Resources, as a condition of its  
3 approval of the initial five-year Plan of Development for the unit, "[t]he state lessees were  
4 permitted to make progressively larger annual payments to the state in lieu of drilling a well  
5 in the Plan of Development. The extension fee payments were to be paid by the State lessees  
6 to the State under the following schedule: January 31, 1991—\$1 million; January 31,  
7 1992—\$2 million; January 31, 1993—\$2 million; January 31, 1994—\$3 million and  
8 January 31, 1995—\$4 million, unless the fee obligation was extinguished by the drilling of  
9 a well in the unit area." As further conditions of its approval, the Department of Natural  
10 Resources also required Amerada Hess Co. and its partners to conduct certain petrological and  
11 petrophysical analyses, to gather an additional 250 line-miles of geophysical (seismic) data  
12 over the unit area, and to complete facilities design and reservoir engineering studies  
13 (pre-production studies) during the initial Plan of Development. The Plan of Development did  
14 not require Amerada Hess and its partners to begin production during the five-year initial  
15 term.

16 (4) Amerada Hess Co. and its partners made the scheduled "in lieu of drilling"  
17 payments for the first three years of the five-year Plan of Development period, with payments  
18 totaling \$5 million. Amerada Hess Co. then elected to drill the Amerada Hess Co. Northstar  
19 No. 3 Well in 1994, extinguishing its remaining financial obligations to the state under the  
20 terms of the Plan of Development for the Northstar Unit. Amerada Hess Co. and its partners  
21 also timely complied fully with each of the other conditions set out by the Department of  
22 Natural Resources in its approval of the initial Plan of Development. The Plan of  
23 Development had succeeded in getting one well drilled and in Amerada Hess Co. and its  
24 partners' completing certain other work commitments including petrological/petrophysical  
25 studies, production facilities design, seismic surveys, seismic analysis and interpretation, and  
26 reservoir engineering studies. However, no production from the unit occurred during the five-  
27 year period of the initial Plan of Development.

28 (5) Following the drilling of the Amerada Hess Co. Northstar No. 3 Well  
29 earlier in 1994, Amerada Hess Co. met with representatives of the Department of Natural  
30 Resources and the Minerals Management Service in June 1994, to inform the agencies of its  
31 decision not to proceed with development of the Northstar Unit. The Department of Natural

1 Resources has indicated that Amerada Hess Co. believed that the development costs for the  
2 Northstar Unit leases would exceed \$1,400,000,000. Assuming that the state could have  
3 gotten the leases back, because of their \$1,400,000,000 development cost, the Department of  
4 Natural Resources believes that the leases would have had little value and would most likely  
5 have been re-leased for a nominal bonus bid.

6 (6) Under the terms of the Northstar Unit Agreement, Amerada Hess Co. and  
7 its partners were required to submit a proposed Plan of Development to the Department of  
8 Natural Resources late in October 1994, 90 days before the expiration of the first Plan of  
9 Development, or the unit, which had already extended the Northstar Unit leases five years  
10 beyond their initial primary term, would terminate.

11 (7) Having made the decision not to proceed with development of the unit,  
12 Amerada Hess Co. did not submit a proposed second Plan of Development, and under the  
13 terms of the unit agreement and the department's regulations, the Department of Natural  
14 Resources issued a Notice of Default to Amerada Hess Co. and its partners on November 3,  
15 1994

16 (8) By subsequent letter dated December 12, 1994, the Department of Natural  
17 Resources amended its November 3, 1994, Notice of Default to provide that Amerada Hess  
18 Co. could cure the default either by providing an updated Plan of Development within 90 days  
19 or by voluntarily agreeing to terminate the Northstar Unit Agreement. The Department of  
20 Natural Resources' December 12, 1994, letter concluded "[f]inally, if the NSU terminates,  
21 three State of Alaska leases will continue beyond their primary term pursuant to paragraph  
22 5(d) of the lease. The three leases are ADLs 312798, 312799 and 312809. This is further  
23 notice that within 90 days of termination of the NSU the lessees shall file a Plan of  
24 Development in compliance with the requirements set forth in paragraph 17 of the lease."

25 (9) Amerada Hess Co. and Shell began efforts to sell their respective interests  
26 in the Northstar Unit leases. Neither the exact timing nor the details of Amerada Hess Co.'s  
27 and Shell's efforts to market the leases are a matter of public record.

28 (10) Amerada Hess Co. and Shell subsequently sold their interests in the  
29 Northstar Unit leases to BP Exploration (Alaska) Inc. early in 1995. BP Exploration (Alaska)  
30 Inc. has characterized the terms of its purchase of the Northstar Unit lease interests as a  
31 "competitive process." However, BP Exploration (Alaska) Inc. has declined to make public

1 the terms of its purchase or the identity of its competitors for the purchase of Amerada Hess  
2 Co.'s and Shell's interest in the Northstar Unit leases, citing a confidentiality agreement  
3 between the parties that prohibits its doing so. The state played no role in the offering or  
4 selling of Amerada Hess Co.'s and Shell's interest in the Northstar Unit leases to BP  
5 Exploration (Alaska) Inc. Lessees commonly sell interests in leases without the state's  
6 involvement other than approving assignments resulting from the sale.

7 (11) In its purchase of the Northstar Unit leases from Amerada Hess Co. and  
8 its partners, BP Exploration (Alaska) Inc. acquired the net profit share development accounts  
9 for those leases. The amount of accrued costs in the Northstar Unit net profit share  
10 development accounts has been estimated by BP Exploration (Alaska) Inc. to be \$262,000,000.  
11 Under the terms of the leases and the Department of Natural Resources' regulations, although  
12 BP Exploration (Alaska) Inc. did not actually spend the \$262,000,000 in the development  
13 accounts, it would be entitled to recover those costs, plus its actual future costs of  
14 development, with interest, before it would be obligated to pay the state a share of net profits  
15 from the development of the Northstar Unit leases.

16 (12) Department of Natural Resources Commissioner Shively has testified that  
17 "[T]he implications for the state in that is the longer the development is delayed, the less  
18 money the state is going to get in net profits leasing. And so timing was critical to me as we  
19 negotiated this deal with BP."

20 (13) BP Exploration (Alaska) Inc.'s president, Mr. John Morgan, has testified  
21 "[I]n making that acquisition (purchase of the Northstar leases) we did understand and it was  
22 clear to us that the issue of net profit leases represented a problem, and a problem that would  
23 need to be overcome with the state, if development was to proceed."

24 (14) BP Exploration (Alaska) Inc.'s president, Mr. Morgan, also has testified  
25 that "... part of the risk we took when we acquired the leases was that the State of Alaska  
26 may not agree to a modification of the terms that would allow us to go forward with  
27 development, and we did that knowingly and clearly."

28 **ARTICLE 3. BP EXPLORATION (ALASKA) INC.'S SUCCESSION**  
29 **AS NORTHSTAR UNIT OPERATOR AND THE DEPARTMENT OF**  
30 **NATURAL RESOURCES' APPROVAL OF THE 2ND PLAN OF**  
31 **DEVELOPMENT FOR THE NORTHSTAR UNIT.**

1 (1) On January 13, 1995, BP Exploration (Alaska) Inc. wrote the Department  
2 of Natural Resources and the Minerals Management Service to request that the agencies  
3 approve a 90-day extension to the Department of Natural Resources' earlier Notice of Default  
4 for the Northstar Unit.

5 (2) Effective January 19, 1995, then-director Eason approved assignment of  
6 the state Northstar Unit leases to BP Exploration (Alaska) Inc. as had been requested earlier,  
7 and on January 20, 1995, both then-director Eason of the Department of Natural Resources  
8 and the Minerals Management Service approved BP Exploration (Alaska) Inc. as the successor  
9 operator of the Northstar Unit.

10 (3) On January 23, 1995, the day the Northstar Unit was scheduled to  
11 terminate under the Department of Natural Resources' Notice of Default for failure of the  
12 operator to provide a proposed Plan of Development, BP Exploration (Alaska) Inc., in its  
13 capacity as the new unit operator, submitted a proposed two-year Plan of Development for the  
14 Northstar Unit. According to documents in the Department of Natural Resources' unit files,  
15 BP Exploration (Alaska) Inc. indicated "that with more time it could submit a more detailed  
16 and decisive plan."

17 (4) The following day, on January 24, 1995, then-director Eason of the  
18 Department of Natural Resources approved BP Exploration (Alaska) Inc.'s request for a 90-day  
19 extension to submit a new plan of development because, according to director Eason, it was  
20 "in everyone's best interest to allow BP additional time to conclude its acquisition and to  
21 formulate a new Plan of Development." On January 24, 1995, the Minerals Management  
22 Service also approved BP Exploration (Alaska) Inc.'s request for an extension to file a more  
23 detailed Plan of Development until April 30, 1995.

24 (5) On March 30, 1995, BP Exploration (Alaska) Inc. submitted a revised and  
25 more comprehensive Plan of Development and a request to extend the Northstar Unit  
26 Agreement for a three-year term coincident with its revised Plan of Development.  
27 Importantly, the revised plan included sanction within the last year. The plan included the  
28 following specific activities: (A) data gathering and project development including  
29 environmental data gathering and studies, promulgation of marine mammal incidental take  
30 regulations, and a cooperative agreement with the Alaska Eskimo Whaling Commission; (B)  
31 3-D seismic acquisition, including the appropriate government permits and seismic processing.

1 pipeline and facility engineering and reservoir descriptions; (C) project sanction including  
2 project construction permits, integrated 3-D seismic and reservoir descriptions, permit  
3 approvals, and finally, sanction by BP Exploration (Alaska) Inc.'s headquarters. The revised  
4 Plan of Development added the steps required by BP Exploration (Alaska) Inc. to take the  
5 Northstar development to project sanction. The estimated cost of these activities was  
6 \$12,000,000. In the two-year plan, the estimated cost was \$10,000,000.

7 (6) The term of the second Plan of Development was increased from the  
8 originally proposed two-year term to a three-year term because of increased commitments by  
9 BP Exploration (Alaska) Inc.

10 (7) On May 1, 1995, the Minerals Management Service approved the revised  
11 plan concluding that the "new schedule of activities are deemed necessary to bring the unit  
12 into production." On June 2, 1995, the Department of Natural Resources "conditionally"  
13 approved BP Exploration (Alaska) Inc.'s revised three-year Plan of Development. Division  
14 director Ken Boyd approved the plan because, "in his judgment, it was a reasonable one that  
15 allowed the new operator, BP Exploration (Alaska) Inc., adequate time to interpret the existing  
16 geological, geophysical, and engineering data, shoot what he considered important 3-D seismic  
17 data, begin work on development options, define the scope of reservoir/conceptual engineering,  
18 and submit permits with the ultimate goal of getting internal BP Exploration (Alaska) Inc.  
19 sanction in the fourth quarter of 1997." It was director Boyd's belief that "[t]he plan was  
20 tailored to the shortest deadline that an operator could reasonably be expected to meet." The  
21 plan explicitly stated that sanction would "depend on economic competitiveness of the project  
22 compared to other BP Exploration (Alaska) Inc. projects worldwide, the business climate (oil  
23 price, etc.), and the status of the external permitting processes." It also noted that the risks  
24 included "[d]evelopment and production economics."

25 (8) According to the Department of Natural Resources, "[a]s part of the  
26 conditional approval, BPXA was required to submit annual program reports and a final report  
27 to the agencies that synthesizes the data and studies performed by BPXA during the extension  
28 period and BPXA's conclusions and recommendations regarding the development of the NSU.  
29 The POD does not require BPXA to start production during the three year term. Assuming  
30 BPXA complies with the conditions of the second POD, the unit will not expire until April 30,  
31 1998."

1                   ARTICLE 4. BP EXPLORATION (ALASKA) INC.'S  
2                   INITIAL EFFORTS TO AMEND THE NET PROFIT  
3                   SHARE LEASE TERMS.

4                   (1) Both BP Exploration (Alaska) Inc.'s President, Mr. Morgan, and  
5 Department of Natural Resources Commissioner Shively have testified that at sometime  
6 between January and April 1995, before the Department of Natural Resources' approval of BP  
7 Exploration (Alaska) Inc.'s revised Plan of Development and extension for the Northstar Unit,  
8 BP Exploration (Alaska) Inc. approached the administration, asking that it support the  
9 incorporation of provisions that would allow the commissioner of the Department of Natural  
10 Resources to modify net profit share terms of oil and gas leases in the royalty modification  
11 legislation that the administration requested last session (HB 207). Mr. Patrick Coughlin,  
12 petroleum investment manager for the division of oil and gas, testified that BP Exploration  
13 (Alaska) Inc. requested incorporation of the net profit provisions sometime in late January or  
14 early March (1995) during the drafting of the original version of HB 207.

15                   (2) Testimony before the committee by both BP Exploration (Alaska) Inc. and  
16 the Department of Natural Resources reflects that the parties decided, however, not to pursue  
17 authority to amend the terms of net profit share leases in that legislation. According to  
18 Commissioner Shively, ". . . I felt, and ultimately I think BP felt, that adding another issue  
19 to the mix was probably not appropriate."

20                   (3) Commissioner Shively testified that, after having decided not to pursue  
21 incorporation of the net profit share amendment provisions within the framework of HB 207,  
22 "he committed to BP at the time to discuss Northstar, but under the conditions that I believed,  
23 at the time, that I probably did not have the legal authority to make a deal with them on  
24 Northstar. And so therefore, that the individual deal itself would have to come to the  
25 legislature. That was always part of the discussions."

26                   (4) Based upon testimony by both Commissioner Shively and BP Exploration  
27 (Alaska) Inc.'s Mr. Morgan, it is clear that even had HB 207 been amended to include explicit  
28 authority for the commissioner to reduce the state's net profit share under the same  
29 circumstances as the commissioner was ultimately authorized to reduce the state's royalty  
30 share under the terms of HB 207, to encourage production that otherwise would not be  
31 economically feasible, the commissioner could not have done so in this instance because

1 production from the Northstar Unit is forecast to be economic without amendments to the net  
2 profit share provisions.

3 ARTICLE 5. THE ECONOMICS OF DEVELOPING THE  
4 NORTHSTAR LEASES UNDER THEIR  
5 EXISTING TERMS.

6 (1) The director of the division of oil and gas, Ken Boyd, has testified that  
7 "BPXA currently estimates that 76.8% of the recoverable reserves underlie the state leases in  
8 the Northstar Unit (NSU). The Division's Resource Evaluation Group has reviewed this  
9 estimate and other confidential estimates, and believes the 75 to 80% is a reasonable range.  
10 This range could be slightly higher if BPXA develops the known reserves to the Northwest."

11 (2) Both the Department of Natural Resources and BP Exploration (Alaska)  
12 Inc., have testified that BP Exploration (Alaska) Inc.'s development of the Northstar Unit  
13 leases under the original lease terms would be economic. According to BP Exploration  
14 (Alaska) Inc.'s President, Mr. Morgan, "[W]e have never argued that the development of  
15 Northstar could not be profitable under the terms including the net profit arrangements. In  
16 profitability in terms of return on capital, this would be possible. This is not a marginal oil  
17 field."

18 (3) The Department of Natural Resources' independent analysis of the  
19 Northstar Unit economics comes to a similar conclusion. Commissioner Shively has testified  
20 "[t]oday both we, and I think British Petroleum, estimate that around 135 mm barrels of oil  
21 could be recovered from this field. It is not a marginal field; it is not the kind of field we  
22 talked about last year with HB 207. It is a field fully capable of carrying its own under the  
23 appropriate economic conditions."

24 (4) BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified ". . .  
25 that with the net profit arrangement in place, at the level that it exists, BP would not be  
26 prepared to go ahead with the development of a Northstar project, even though, if you run the  
27 economics, you can show that the return on investment for the project is a sound sort of return  
28 on investment."

29 (5) Based upon BP Exploration (Alaska) Inc.'s own analysis, development of  
30 the Northstar project "would have an estimated BP Net Revenue of approximately \$485  
31 million and a full project Rate of Return (ROR) of around 21%."

1 (6) BP Exploration (Alaska) Inc. has testified that its rate of return for a  
2 "hypothetical incremental investment" later in field life (2007) would be 21 percent without  
3 the net profit share lease terms versus 10 percent with the net profit share lease terms.

4 (7) In its September 1995 report to the Governor's Oil and Gas Policy Council  
5 entitled "Review of International Competitiveness of Alaska's Fiscal System" (Little Report),  
6 the Arthur D. Little Co. concluded "[Oil] companies generally look for a rate of return of  
7 about 15% . . . Projects with lower returns usually do not generate enough profits to encourage  
8 companies to commit time and resources to their development."

9 (8) Commissioner Shively testified "I do not believe that no oil company in  
10 the world could develop this field under the current provisions. When we did the economic  
11 analysis, we believe the rate of return is sufficient for somebody to want to do it. On the  
12 other hand, BP has told us that they would not do it, and therefore, I cannot make a finding  
13 that under the current situation the development of the field is not economically feasible. It,  
14 in my mind, is economically feasible under both considerations. Both of the considerations  
15 of the net profits and using the supplemental royalty. BP has said for them it is not  
16 developable under the net profit conditions."

17 (9) Based upon BP Exploration (Alaska) Inc.'s estimates of the recoverable  
18 reserves and project development costs, the Northstar Unit has a per barrel development cost  
19 of \$2.90. For comparison, other North Slope projects which BP Exploration (Alaska) Inc. has  
20 sanctioned (approved and committed the funding to develop), the year in which the  
21 developments were sanctioned and BP Exploration (Alaska) Inc.'s estimated per barrel cost  
22 of developing each are: Kuparuk (1982) - \$6.65 per barrel; Endicott (1985) - \$5.40 per barrel;  
23 Prudhoe Bay Unit: GHX-2 (1992) - \$4.45 per barrel; Pt. McIntyre (1992) - \$2.30 per barrel;  
24 and Niakuk (1992) - \$2.50 per barrel.

25 (10) BP Exploration (Alaska) Inc. estimates the per barrel development costs  
26 for both the Milne Point Unit - Schrader Bluff development and the Northstar project, neither  
27 of which have yet been sanctioned by BP Exploration (Alaska) Inc. management, to be \$1.80  
28 per barrel, and \$2.90 per barrel, respectively.

29 ARTICLE 6. REVENUE TRADE-OFFS FROM  
30 THE LEASING OF THE NORTHSTAR LEASES  
31 WITH THE NET PROFIT SHARE AS THE

## COMPETITIVE BID VARIABLE.

(1) The decision by the commissioner of natural resources to offer the Northstar Unit leases with the net profit share as the competitive bid variable in 1979 resulted in a trade-off of larger immediate bonus payments for the speculative potential to receive a share of the lessees' net profits from the development of any field subsequently discovered. Since oil and gas exploration is inherently risky, with commercial discoveries occurring far less frequently than dry holes, the commissioner's bid strategy entailed risk sharing with the lessees. Compared to other bidding terms available to the commissioner, the selection of net profit share terms allowed successful bidders to obtain the leases for less cash than would otherwise have been required.

(2) Interpolating revenue received for the federal leases within the Northstar Unit, which were leased with a 16 2/3 percent sliding scale royalty and the bonus as the bid variable and making many speculative assumptions, the Department of Natural Resources estimates the state's Northstar Unit leases could have brought \$268,406,052, as opposed to the \$15,469,000 actually received, had the leases been offered with a 12 1/2 percent royalty, no net-profit share and with the bonus as the bid variable.

(3) Assuming the Department of Natural Resources' estimate of bonuses is correct and based upon the annual realized rate of returns reported by the Alaska Permanent Fund Corporation in its 1995 report, the balance of the 50 percent of the \$268,406,052 that would have been deposited to the permanent fund would have been \$704,588,494 at year-end 1995.

(4) The Department of Natural Resources has provided estimates of the expected mean value to a bidder of the Northstar Unit leases. If the Northstar Unit leases were returned at one time to the state for reoffering in a competitive sale with bonus as the bid variable, with royalty set at 12 1/2 percent or 20 percent, with no net profit share and with estimated recoverable reserves, capital and operating costs as estimated in its economic modeling of the agreement with BP Exploration (Alaska) Inc., the estimated expected mean value, in the view of the Department of Natural Resources, would represent the most a bidder would bid. The Department of Natural Resources further qualifies its estimates by noting that the bidder would have had to make the same economic assumptions about the Northstar Unit leases as were used by BP Exploration (Alaska) Inc. Further, the division of oil and gas has

1 testified that "if a sale of the Northstar Unit leases were conducted in the future, the division  
2 would expect bonus bids to range from a nominal amount to something less than  
3 \$225,000,000, depending upon the royalty rate and the discount rate." For a 12 1/2 percent  
4 royalty and at discount rates of 10 percent and 15 percent, the Department of Natural  
5 Resources estimates that the expected mean value to a bidder would be \$225,000,000 and  
6 \$130,000,000, respectively. For a 20 percent royalty and at discount rates of 10 percent and  
7 15 percent, the Department of Natural Resources estimates the mean value of anticipated  
8 bonuses would be \$182,000,000 and \$98,000,000, respectively.

9                   ARTICLE 7. BP EXPLORATION (ALASKA) INC.'S  
10                   REFUSAL TO DEVELOP THE NORTHSTAR  
11                   UNIT LEASES UNLESS THE NET PROFIT  
12                   SHARE PROVISIONS ARE AMENDED.

13                   (1) Notwithstanding the acknowledged forecasted profitability of developing  
14 the Northstar field under its existing lease terms, BP Exploration (Alaska) Inc.'s President, Mr.  
15 Morgan, has testified that BP Exploration (Alaska) Inc. will not develop the Northstar Unit  
16 leases unless the State of Alaska agrees to eliminate the net profit share provisions of the  
17 leases.

18                   (2) There is no precedent, nor is there explicit legislative authority for the  
19 commissioner of natural resources to retroactively change the competitively bid variable of  
20 a state oil and gas lease.

21                   (3) The Department of Natural Resources has testified that BP Exploration  
22 (Alaska) Inc. did not inform the state of its unwillingness to develop the Northstar Unit leases  
23 without amendment of the net profit share terms until some time after the department had  
24 approved the current Plan of Development and the three-year extension of the unit term.

25                   (4) The Department of Natural Resources has testified that there is an implied  
26 covenant for lessees of Alaska's oil and gas leases to diligently explore and develop their  
27 leases. The Department of Natural Resources also has testified, however, that since the  
28 department has approved a three-year Plan of Development for the Northstar Unit leases that  
29 does not explicitly require development of the field, it believes that so long as BP Exploration  
30 (Alaska) Inc. meets the requirements of that plan, it would be seen as fulfilling its obligation  
31 to develop, and cannot be forced to proceed with production during the term of the current

1 plan which does not expire until April 30, 1998.

2 (5) The Department of Natural Resources has testified that BP Exploration  
3 (Alaska) Inc.'s refusal to develop the Northstar Unit leases represents the first occasion in  
4 which a state oil and gas lessee has confirmed that it could develop an oil field economically,  
5 but that it is unwilling to do so unless the state renegotiates the competitively bid terms of the  
6 leases.

7 (6) The Department of Natural Resources has testified that if the department  
8 had not approved a further three-year extension for the Northstar Unit in June 1995, the two  
9 leases within the unit that did not have wells upon them certified to be capable of production  
10 in paying quantities would have reverted to the state, becoming available for releasing. Under  
11 the lease provisions and the regulations, the department could then have given notice to BP  
12 Exploration (Alaska) Inc. to begin production from the three leases that did have wells  
13 certified as capable of production in paying quantities within a reasonable time to do so, that  
14 could not have been less than six months. The department has indicated that it has never  
15 previously given such a notice to any lessee and there could be litigation over what constitutes  
16 "reasonable time" on the North Slope to put a well into production. Furthermore, the leases  
17 provide that the leases with certified wells cannot be terminated without "an appropriate  
18 judicial proceeding."

19 (7) As to why the Department of Natural Resources did not insist on a firm  
20 commitment from BP Exploration (Alaska) Inc. last year that it would develop the Northstar  
21 Unit leases before the department agreed to extend the Northstar Unit for three years,  
22 Commissioner Shivley has testified ". . . [I]f we had all the information in the spring of last  
23 year that we had today, we might have made another decision; we did not have that  
24 information."

25 (8) The Department of Natural Resources' approval of the second Plan of  
26 Development, and the resulting three-year extension, effectively eliminated any short-term  
27 leverage the department might have had otherwise to expedite BP Exploration (Alaska) Inc.'s  
28 development of the Northstar Unit leases without amendment of the leases. The Department  
29 of Natural Resources believes its approval was in keeping with the department's approval of  
30 other Plans of Development in the recent past.

31 (9) Both the Department of Natural Resources and the Department of Law

1 have testified that the Department of Natural Resources did not consult with the Department  
2 of Law regarding whether the state might have any legal basis for moving earlier than 1998  
3 to force production under the lease terms. The Department of Natural Resources has indicated  
4 that it saw nothing unique about this case that would have justified consulting the Department  
5 of Law.

6 ARTICLE 8. THE DEPARTMENT OF NATURAL RESOURCES' AND  
7 BP EXPLORATION (ALASKA) INC.'S NEGOTIATIONS TO AMEND  
8 THE NORTHSTAR UNIT LEASES.

9 (1) Based upon BP Exploration (Alaska) Inc.'s representation that it would not  
10 develop the Northstar Unit leases under their existing terms, the Department of Natural  
11 Resources entered into confidential negotiations with BP Exploration (Alaska) Inc. in the fall  
12 of 1995 to amend the state's oil and gas lease terms.

13 (2) As its principal reason for proceeding with the negotiations to amend the  
14 leases, the Department of Natural Resources cited its desire to assure that production begins  
15 earlier than it otherwise would under the timeline estimated by the Department of Revenue.  
16 The Department of Natural Resources maintains that, if the legislature does not pass SB 318,  
17 the department could not force BP Exploration (Alaska) Inc. to develop the field until after  
18 the expiration of the current Plan of Development.

19 (3) Department of Natural Resources' Commissioner Shively has testified that,  
20 "[t]he negotiations were long--longer than I had hoped. I had hoped to have this agreement  
21 to the legislature earlier; they were at times very difficult, but I believe that we have  
22 negotiated a deal that is in t'ie best interests of the state."

23 (4) BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified that "  
24 . . . I can't stress enough, that from BP's perspective, this was a long and very formal  
25 negotiating process, that I don't see the agreement contained in this bill as in any way being  
26 an incentive to BP; I see it as a very balanced agreement coming out of that negotiation."

27 (5) Under the terms of the agreement negotiated by BP Exploration (Alaska)  
28 Inc. and the Department of Natural Resources, the state agrees to waive its net profit interest  
29 in the leases, and in return is to receive an increased royalty rate on one of the five leases,  
30 from 12 1/2 percent to 20 percent, as well as the potential to receive a "supplemental royalty"  
31 on all of the leases, depending upon whether oil prices rise sufficiently in the future beyond

1 a specified threshold (trigger) price. In addition, BP Exploration (Alaska) Inc. has made  
2 certain nonbinding commitments to increases in state employment, conditional commitments  
3 to construct certain undefined modules, and facilities necessary to develop the Northstar Unit  
4 within Alaska and has agreed to relinquish the Northstar Unit leases if BP Exploration  
5 (Alaska) Inc.'s management does not sanction the project within one year after the effective  
6 date of legislation ratifying amendment of the leases.

7 **ARTICLE 9. LEGAL ANALYSIS BY THE DEPARTMENT OF LAW.**

8 (1) As to whether the commissioner has the authority to amend the state's net  
9 profit share lease terms in a situation where those terms were the competitive bid variable in  
10 a sale, the Attorney General has testified that "Clearly what we are faced here is with a  
11 diminution of revenues that would come to the state . . . and that would require the  
12 commissioner in order to make the changes to make a finding that this project otherwise  
13 would not be economically feasible. And that was a conclusion which the commissioner  
14 would not and could not make. And once again, whether 180 (AS 38.05.180) would apply,  
15 in this instance it could not apply. And again, our reasoning supports the need to put this  
16 matter before the legislature."

17 (2) As to whether legislative ratification of a negotiated agreement between the  
18 commissioner of the Department of Natural Resources and BP Exploration (Alaska) Inc. to  
19 modify the terms of the Northstar Unit leases would violate the Constitution of the State of  
20 Alaska's prohibition against local or special legislation, the Department of Law representative  
21 has testified that "[I]t will be the department's responsibility to carefully articulate the state's  
22 interest during legislative hearings on the bill proposing the net profit share reduction. This  
23 must be done with the goal in mind of establishing a detailed legislative history supporting  
24 the interests of the state. The legislative history will be important because the ultimate  
25 decision 'whether a general act can be made applicable' rests with the Alaska Supreme Court."

26 (3) The Department of Law representative has testified that "[i]f there is  
27 valuable consideration received by both the state and the leaseholder, the benefit to the state  
28 may be characterized as direct."

29 (4) The Department of Law representative has also testified that "[b]ecause the  
30 State leased the oil rights at the Northstar field pursuant to the constitutional mandate to obtain  
31 the maximum public benefit, an effort to expedite production vitally affects the public

1 interest."

2 (5) The Department of Law has also testified "[w]e believe that a compelling  
3 case can be made that there is adequate consideration to support a finding of a direct and  
4 substantial public benefit flowing from the reduction of the net profit share."

5 (6) As to whether the promises of local manufacture and assembly of facilities  
6 must be binding terms of the Northstar Agreement in order to meet the "statewide  
7 significance" test, the Department of Law representative has testified "[t]hat there needs to be  
8 a record made here in the legislature of the State interests that are behind this very narrowly  
9 focused piece of legislation. As far as the promises to be binding I think it is enough that  
10 there's some good and sound reason for this kind of legislation."

11 (7) The Department of Law representative has testified that "[w]hether the  
12 agreement bears fruit I don't think is as important as the fact that you are doing it in good  
13 faith belief that it will happen. I don't know if I can tell you that it has to be binding. That's  
14 not a consideration of our opinion. It's merely a fact that there must be some sound  
15 reasonable basis for making this legislation as narrow as it is."

16 (8) The Department of Law representative has testified "[w]e think this  
17 transaction has state-wide significance because of the amount of revenue that's involved, the  
18 fact the major population center of the railbelt area would be the beneficiary of some of the  
19 economic activity connected with the development of the Northstar Unit, that fact that  
20 petroleum revenues form such a large percentage of the total revenues to the State. It makes  
21 this a very good case for being a matter of state-wide significance."

22 (9) As to whether the expenditures (loss of state revenues) under the Northstar  
23 Agreement meet the "public purposes" test under art. IX, sec. 6, of the Alaska Constitution,  
24 the Department of Law representative has testified "[i]t's been our opinion in the past that the  
25 courts will generally find a public purpose if the legislature declares it to be a public purpose.  
26 That's been the reasoning of the courts. From our side, analyzing it even further than that,  
27 because we don't like to stop there sometimes being the executive branch. We also analyze  
28 it as this mutually of consideration that there has to be some equal exchange in order for there  
29 to be a public purpose."

30 (10) As to the consideration which the state must receive under the Northstar  
31 Agreement, the Department of Law representative has testified "[t]here has to be, in order to

1 satisfy the public purpose doctrine, a direct public benefit and not an indirect public benefit--  
2 when you're giving up public revenues or foregoing some debt that's owed you by some third  
3 party. There has to be a direct public benefit and not an indirect benefit. The direct benefit  
4 cannot only flow to the other interest and there appears to be direct public benefit here in  
5 connection with the way this agreement is structured."

6 (11) As to whether the consideration which the State expects to receive under  
7 the Northstar Agreement actually must be received, the Department of Law representative has  
8 testified "[n]o, I don't think so, not under the public purpose doctrine. The public purpose  
9 doctrine is the one legal issue that worries me the least. I think this transaction easily passes  
10 the public purpose doctrine test. The courts have been very deferential to legislative  
11 determinations of what is in the best interests of the State to expend its money on or to forego  
12 its revenues on or to receive additional revenues on. The courts have been very deferential  
13 in that regard and I don't see that as being a major factor influencing the validity of this  
14 particular transaction."

15 (12) As to whether an aggrieved bidder may have standing to challenge the  
16 Department of Natural Resources' negotiated amendments to the competitively bid lease terms,  
17 the Department of Law representative has testified "We note that the issue is present, that  
18 someone can raise this as a means of attacking the validity of the lease amendments. What  
19 we conclude is that if the legislature were to enact specific authorization, both ratifying and  
20 approving the contract, and authorizing the department to undertake the lease change, that, we  
21 think, would overcome the competitive bidding argument."

22 (13) The Department of Law representative has testified that "[o]ther persons  
23 who competed for the leases may claim that since the net profit share was the sole variable  
24 in the lease sale, it is such a material term that a change cannot be made without violating the  
25 competitive bidding statute. Uncertainty concerning the state's prospects for prevailing on any  
26 litigation on this issue gives an additional basis for our advice that the department seek  
27 independent statutory authority for the Northstar transaction."

28 (14) As to whether the legislature's passage of SB 318 will effectively shield  
29 the Department of Natural Resources' negotiated amendments to the Northstar Unit leases  
30 from legal challenge, the attorney general has testified "I guess my own judgment on this . . .  
31 we can't give you the certainty that absent this kind legislation, we would prevail on the

1 argument. That's precisely, again, I think one of the reasons we brought this to the  
2 legislature, and Jim's (Assistant Attorney General Jim Baldwin) comments earlier about seeing  
3 legislative action as being an effective vaccination, as it were, against that kind of challenge."

4 (15) The attorney general has testified that "[w]ith legislative action, I think  
5 we have a high degree of confidence that we would prevail on this issue."

6 ARTICLE 10. THE DEPARTMENT OF NATURAL RESOURCES' AND  
7 BP EXPLORATION (ALASKA) INC.'S VIEW OF THE LEGISLATURE'S ROLE  
8 IN RATIFICATION AND PASSAGE OF SB 318.

9 (1) Although both BP Exploration (Alaska) Inc.'s President, Mr. Morgan, and  
10 Commissioner Shively have testified that they believe legislative approval of the amendments  
11 is necessary, both have confirmed their intent that the legislature's role in reviewing the  
12 negotiated amendments should be limited to voting for or against ratification of the agreement  
13 that they have negotiated, and should not include amending the terms of the agreement.  
14 Commissioner Shively testified "[w]ell, Mr. Chairman, as John Morgan just said, we have  
15 presented this as an up or down vote. And we did it for a variety of reasons. One, the  
16 negotiations we went through were long and complex. It is late in the session. On the other  
17 hand, if there are things that BP believes that they would like to agree to, we will certainly  
18 look at them."

19 (2) BP Exploration (Alaska) Inc.'s President, Mr. Morgan, testified "I have to  
20 say that from our perspective, we have in good faith reached a negotiated agreement with the  
21 administration, and I believe that any variation of those terms would cast that whole  
22 negotiating process into doubt. So it's both my belief that that was the intent of the  
23 administration in introducing the bill, and it would certainly be my very strong preference that  
24 this should be handled essentially on an approval or disapproval basis, without the introduction  
25 of any significant or material changes."

26 ARTICLE 11. THE EFFECTS OF THE AMENDMENTS ON THE STATE'S SHARE  
27 OF REVENUE FROM THE DEVELOPMENT OF THE NORTHSTAR UNIT.

28 (1) The Department of Natural Resources cannot precisely define the state's  
29 future revenue losses. Commissioner Shively noted that "the only thing we know about all  
30 these numbers (the DNR's economic modeling of the effects of amending the NSU leases),  
31 is since they are projections, is that they are wrong, we just don't know how wrong."

1           (2) The Department of Natural Resources' Mr. Coughlin has testified regarding  
2 potential state revenue loss that "[i]f you look at it as if they (BP Exploration (Alaska) Inc.)  
3 would go ahead and develop it because it's, they say, an economic field, the state loses, in  
4 essence, \$48 million by trading a net profit share for the supplemental royalty." Mr. Coughlin  
5 has noted on the other hand, if full production does not begin until after 2002, the state could  
6 lose money if the amendments are not accepted.

7           (3) The Department of Natural Resources' representative has testified that its  
8 evaluation of the economic consequences to the state of amending the Northstar Unit leases  
9 to remove the net profit provisions is based upon the assumption that the "mean" recoverable  
10 oil reserves from the Northstar Unit are likely to be 1,000,000 barrels, and that there is a  
11 90 percent probability that recoverable reserves will be greater than 105,000,000 barrels and  
12 a 90 percent probability that recoverable reserves will be less than 160,000,000 barrels."

13           (4) The Department of Natural Resources has testified that its analysis of the  
14 economic consequences to the state of amending the Northstar Unit lease terms to remove the  
15 net profit provisions is based upon an assumed peak production rate from the field of 50,000  
16 barrels per day.

17           (5) As to whether the Department of Natural Resources, in the course of its  
18 negotiations with BP Exploration (Alaska) Inc. had considered whether to add some sort of  
19 corrective factor to the agreement to compensate if the reserves ultimately prove to be  
20 considerably larger than estimated, Commissioner Shively has testified "(w)e did have a  
21 proposal at one time on the table that would have taken that into account. That's not where  
22 we ended up. It was part of a more complicated formula that was developed by our division  
23 of oil and gas that was part of one of our counter-offers."

24           (6) The Department of Natural Resources' petroleum economist, Mr. Kevin  
25 Banks, who was responsible for evaluating the economic effects of the Northstar Unit lease  
26 amendments, has testified that the negotiated agreement is an "okay" deal rather than a "good"  
27 deal for the state. In response to the question of why he characterized the deal as "okay"  
28 rather than "good", Mr. Banks, testified "I think it has to do with the fact that the net profit  
29 share has considerable up-side for the state. If there's any change in the economics of the  
30 field that improves, if prices are considerably higher, for example, or if production is any  
31 higher. As some of the materials we sent over to you earlier would indicate, the net profit

1 share really pours in. By the same token, it's exactly the problem that BP has with it: that  
2 for any increase in the "benefits" that might be associated with the higher production rates or  
3 higher prices, or some other economic feature, the state gets all of it, virtually all of it. And  
4 it has a fairly serious impact on the economics and the incentives for incremental kinds of  
5 projects for the company. And that's why I say it's "okay." There is a high side to this that  
6 I think we can't ignore." Additionally, Mr. Banks has provided the committee with  
7 information that under low side cases, the state's revenues from the net profit share are  
8 substantially reduced while the supplemental royalty may still pay something, and the longer  
9 the project is delayed, the more likely the payout from the net profit share will be reduced.

10 ARTICLE 12. THE NONMONETARY TERMS OF THE DEPARTMENT OF  
11 NATURAL RESOURCES/BP EXPLORATION (ALASKA) INC. NEGOTIATED  
12 AMENDMENTS TO THE NORTHSTAR UNIT LEASES AND THE  
13 ENFORCEABILITY OF THOSE TERMS.

14 (1) As to whether the terms in the negotiated agreement between the  
15 Department of Natural Resources and BP Exploration (Alaska) Inc. regarding local hire and  
16 local contracting are enforceable. Commissioner Shively has testified "I do not believe we  
17 could--that that language allows us to enforce to the extent BP is morally committed to do,  
18 and I don't think you can write language to do that."

19 (2) Although the agreement to amend the Northstar Unit leases purportedly  
20 provides for automatic termination of the leases, making them available for releasing under  
21 the state's competitive oil and gas leasing program, should BP Exploration (Alaska) Inc. not  
22 sanction the project within 12 months. Commissioner Shively has testified that the agreement  
23 contains a provision that allows the state to waive the obligation by prior written consent.

24 (3) The Department of Law has testified that any waiver of BP Exploration  
25 (Alaska) Inc.'s commitment to perform under the sanction schedule would have to be done  
26 "reasonably and not arbitrarily," and Commissioner Shively has testified "I have no intention  
27 of waiving that. I mean that's a very important part of the arrangement, and I mean. I think  
28 that if we cannot get this project going, then we need to reassess those leases and get them  
29 back out onto the public market."

30 (4) In response to the question of how would the administration, or a court if  
31 the need should arise, measure compliance given the number of disclaimers and qualifiers, and

1 the lack of any specific performance measures in the agreement, Commissioner Shively has  
2 testified "I think we have stated this before. What we are asking BP to do, and what they  
3 have committed to do, I do not believe is enforceable by law."

4 ARTICLE 13. POLICY IMPLICATIONS OF THE PASSAGE OF SB 318.

5 (1) As to where the state ultimately ends up if, as a matter of precedent, it has  
6 to negotiate against itself in other instances to encourage its existing lessees to honor the terms  
7 of their competitively bid contracts, Commissioner Shively has testified "[A]ny of these things  
8 puts the state in a difficult position. We've, on the other hand, there have been provisions that  
9 allow the state to modify lease terms in the law and in the lease since Statehood. This is not  
10 a new concept. I was actually just reading an article the other day about the recent leases or  
11 arrangements that were made between the Venezuelan government and a number of private  
12 companies, and one of the conclusions of that article was that the first thing the companies  
13 were going to do down there was go back in and renegotiate their terms. And so, it does put  
14 the government in a difficult position. It's why I think in things like this and also like heavy  
15 oil, we need to do some economic and other analyses, which we did. But I think in this day  
16 and age this is part of how the government manages its resources. But it is not new. We've  
17 made changes to the leases before. We have not made changes in this particular way, but we  
18 have done these before, and once you start down that road, which we started down years ago,  
19 yes, the state does put itself in a difficult position, but not an impossible position."

20 (2) In response to the question of how the commissioner can test whether, and  
21 to what extent the state must give up public resources to promote the development of the  
22 state's resources, if, as here, there are no standards and no rules, Commissioner Shively has  
23 testified "When you make these decisions, it's like anything else, you have to use your best  
24 judgment. I happen to believe that one of the problems with government is that we try to set  
25 all of these sorts of rules and guidelines, and it's what makes government unworkable. What  
26 you need is people that can make judgments, that can look at difficult situations, assess the  
27 information, and say this is a good idea or a bad idea. I see nothing wrong with that. I think  
28 that's better government, but this idea that we have now that if you just have enough rules and  
29 enough regulations, everything is going to be perfect is nuts. I mean, even the bidding  
30 process doesn't necessarily guarantee the state that you get your full value for your resources.  
31 You get the most somebody wants to pay for it. That may or may not be full value."

By: Senator - Georgianna Lincoln.  
adopted 4-24-96

### Letter of Intent for SB318

The legislature sets forth its intent regarding the meaning of certain words and phrases used in the "Amendment to the Northstar Unit Leases between the State of Alaska and BP Exploration (Alaska) Inc. ("Amendment")". Specifically, the legislature sets forth its intent regarding Paragraph 41 of the 1980 Leases entitled "Employment of Alaskan Residents" and Paragraph 31 of the 1983 Lease entitled "Employment of Alaskan Residents" in the Amendment (collectively "Employment Paragraphs"). The legislature intends that the Alaska residents and contractors discussed in the Employment Paragraphs are truly Alaskan and that Alaska residents throughout the state be given an opportunity to obtain employment on the Northstar project.

The legislature believes that its findings made in AS 36.10.005(a)(1)(c)(i), (c), and (d), regarding an employment preference for Alaska residents on state construction projects are equally applicable to the Amendment. The legislature believes that the state has a compelling interest in reducing the level of unemployment among its residents.

For purposes of Employment Paragraphs, the legislature intends that the phrases "Alaska resident," "residents of Alaska," and "resident personnel" mean an individual who is physically present in the state with the intent to remain in the state indefinitely and to make a home in the state. An individual demonstrates that intent by maintaining a residence in the state for one year before the date of hire. Other acceptable proof of that intent includes evidence that the individual: (1) was registered to vote in Alaska for the year previous to the date of hire; (2) attended school in Alaska within the year previous to the date of hire; (3) possessed an Alaska driver's, fishing, trapping, or hunting license for at least one year before the date of hire; or (4) received an Alaska permanent fund dividend for the year previous to the date of hire. The hiring entity may also require that the individual state under oath that the individual is not claiming residency outside of the state or obtaining benefits under a claim of residency outside of the state.

For purposes of the Employment Paragraphs, the legislature intends that the word "available" means Alaska residents who are located anywhere in the state, not just residents located in the area of the state where the work is to be performed. The legislature further intends that the word "qualified" means an individual who either currently possesses the requisite education, training, skills, or experience to perform the work necessary for a particular position or is capable of performing such skills after completing one of the job training programs that are contemplated in the Employment Paragraphs.

The legislature understands that nonresidents will be hired only if there is no available and qualified Alaska resident to perform the work. For purposes of the Employment Paragraphs, the legislature intends that the requirement to "advertise for available positions locally" includes advertising in newspapers and other publications located throughout the state, including rural areas, not just in the location where the work is to be performed. The legislature further intends that the requirement to "use Alaska job service organizations" includes those offices maintained by the Department of Labor whose functions are to aid the unemployed in finding employment and any job service organization located throughout the state, not just the location where the work is to be performed.

For purposes of the Employment Paragraphs, the legislature intends that the phrases "Alaska contractors" and "Alaska firms" mean a firm or contractor that:

(1) has held an Alaska business license for one year before performing any work in connection with the Northstar leases; and

(2) has maintained for one year a place of business within the state that deals in the supplies, services or construction of the nature required for the project before performing any work in connection with the Northstar leases; and;

(3) is

(a) a sole proprietorship and the proprietor is an Alaska resident;

(b) a partnership and more than fifty percent of the partners are Alaska residents;

(c) a corporation that has been incorporated in the state; or

(d) is a joint venture composed entirely of ventures that qualify under ~~(1) or (2) (a) or (c)~~ above.  
(1), (b) and (2) (a), (b) or (c)

For purposes of the Employment Paragraphs, the legislature intends that the requirements that the lessee "furnish the Department of Labor a quarterly report regarding the Alaska residents on the leased area in compliance with regulations by the Commissioner of Labor" and "the report must also include statistical data concerning the number of resident personnel hired within the past year for this lease" comply with the reporting requirements of 5 AAC 30.062 and shall include information regarding the number of nonresidents hired within the past year, and the number of Alaska contractors and non-Alaska contractors hired within the past year. The legislature intends that the provisions of the Employment Paragraphs be enforced to the greatest extent permissible under the constitutions of the United States and the State of Alaska.

4-18/96

Senator Georgianna  
Lincoln

Letter of Intent for SB318

The legislature ~~wishes to set forth~~ <sup>the</sup> its intent regarding ~~the~~ meaning of certain words and phrases used in the "~~First~~ Amendment to the Northstar Unit Leases between the State of Alaska and BP Exploration (Alaska) Inc. ("~~First~~ Amendment")", ~~that is authorized, approved, and ratified by SB 318.~~ Specifically, the legislature ~~wishes to set forth~~ its intent regarding Paragraph 41 of the 1980 Leases titled "Employment of Alaskan Residents" and Paragraph 31 of the 1983 Lease titled "Employment of Alaskan Residents" in the ~~First~~ Amendment (collectively "Employment Paragraphs"). The legislature intends that the Alaska residents and contractors discussed in the Employment Paragraphs are truly Alaskan and that Alaska residents throughout the state be given an opportunity to obtain employment on the Northstar project.

The legislature believes that ~~its~~ findings made by ~~the legislature~~ in AS 36.10.005(a)(1)c(8) and (11)c(18), (c), and (d), regarding an employment preference for Alaska residents on state construction projects are equally applicable to the ~~First~~ Amendment. The legislature believes that the state has a compelling interest in reducing the level of unemployment among its residents.

For purposes of Employment Paragraphs, the legislature intends that the phrases "Alaska resident," "residents of Alaska," and "resident personnel" mean an individual who is physically present in the state with the intent to remain in the state indefinitely and to make a home in the state. An individual demonstrates that intent by maintaining a residence in the state for one year before the date of hire. Other acceptable proof of that intent includes evidence that the individual: (1) was registered to vote in Alaska for the year previous to the date of hire; (2) attended school in Alaska within the year previous to the date of hire; (3) possessed an Alaska driver's <sup>(1)</sup> fishing, trapping, or hunting license for at least one year before the date of hire; or (4) received an Alaska permanent fund dividend for the year previous to the date of hire. The hiring entity may also require that the individual state under oath that the individual is not claiming residency outside of the state or obtaining benefits under a claim of residency outside of the state.

For purposes of the Employment Paragraphs, the legislature intends that the word "available" means Alaska residents who are located anywhere in the state, not just residents located in the area of the state where the work is to be performed. The legislature further intends that the word "qualified" means an individual who either currently possesses the requisite education, training, skills, or experience to perform the work necessary for a particular position or is capable of performing such skills after completing one of the job training programs that are contemplated in the Employment Paragraphs.

The legislature understands that nonresidents will be hired only if there is no available and qualified Alaska resident to perform the work. For purposes of the Employment Paragraphs, the legislature intends that the requirement to "advertise for available positions locally" includes advertising in newspapers and other publications located throughout the state, including rural areas, not just in the location where the work is to be performed. The legislature further intends that the requirement to "use Alaska job service organizations" includes those offices maintained by the Department of Labor whose functions are to aid the unemployed in finding employment and any job service organization located throughout the state, not just the location where the work is to be performed.

For purposes of the Employment Paragraphs, the legislature intends that the phrases "Alaska contractors" and "Alaska firms" mean a firm or contractor that:

(1) has held an Alaska business license for one year before performing any work in connection with the Northstar leases; and

(2) has maintained <sup>for one year a</sup> ~~its principal~~ place of business within the state ~~for one year~~ before performing any work in connection with the Northstar leases; and;

(3) is *that deals in the supplies, services or construction of the nature required for the project*

(a) a sole proprietorship and the proprietor is an Alaska resident;

(b) a partnership and more than fifty percent of the partners are Alaska residents;

(c) a corporation that has been incorporated in the state; or

(d) is a joint venture composed entirely of venturers that qualify under (1) cc(3)(a)c(c) above.

For purposes of the Employment Paragraphs, the legislature intends that the requirements that the lessee "furnish the Department of Labor a quarterly report regarding the Alaska residents on the leased areas in compliance with regulations by the Commissioner of Labor" and "[t]he report must also include statistical data concerning the number of resident personnel hired within the past year for this lease" comply with the reporting requirements of 8 AAC 30.062 and shall include information regarding the number of nonresidents hired within the past year, and the number of Alaska contractors and non-Alaska contractors hired within the past year. The legislature intends that the provisions of the Employment Paragraphs be enforced to the greatest extent permissible under the constitutions of the United States and the State of Alaska.

4-24-96

moved,  
Not adopted

3-3  
Failed

9-GS2065(G)  
Chenoweth  
Alternative 2  
4/24/96

**CS FOR SENATE BILL NO. 318(RES)**

**IN THE LEGISLATURE OF THE STATE OF ALASKA**

**NINETEENTH LEGISLATURE - SECOND SESSION**

**BY THE SENATE RESOURCES COMMITTEE**

Offered:  
Referred:

Sponsor(s): **SENATE RULES COMMITTEE BY REQUEST OF THE GOVERNOR**

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act relating to the amendment of Northstar Unit oil and gas leases  
2 between the State of Alaska and BP Exploration (Alaska) Inc.; and providing  
3 for an effective date."

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

5 \* **Section 1. LEGISLATIVE FINDINGS AND POLICY.** Based upon the findings of fact  
6 set out in the "Findings of Fact of the Senate Resources Committee Regarding SB 318," dated  
7 April 24, 1996, the legislature finds

8 (1) the production of oil and gas from state land is a matter of statewide  
9 interest and effect because it is the principal source of revenue to the state and provides  
10 important job opportunities for the people of the state;

11 (2) BP Exploration (Alaska) Inc. holds certain state oil and gas leases in the  
12 Northstar Unit that include net profit share provisions;

13 (3) BP Exploration (Alaska) Inc. has refused to develop the Northstar Unit  
14 leases unless the leases are amended to eliminate the net profit share provisions;

1 (4) the Department of Natural Resources has testified that, unless the net profit  
2 share provisions of the Northstar Unit are amended, production of oil and gas from the unit  
3 is highly unlikely to begin before the year 2002;

4 (5) because of the development account provisions of the net profit share  
5 leases, the later that these leases are developed, the less "net profits" the state receives;

6 (6) the Department of Natural Resources has testified that, if the net profit  
7 share provisions of the Northstar Unit leases are amended, full production of oil and gas from  
8 the unit may begin as early as the year 1999;

9 (7) amending the net profit share provisions of the Northstar Unit leases to  
10 provide for a supplemental royalty, instead of a share of net profits, will provide economic  
11 benefits of oil and gas production to the people of the state by encouraging production from  
12 the Northstar Unit earlier than it might otherwise occur under the terms of the Northstar Unit  
13 Agreement and the unit's approved Plan of Development;

14 (8) the development of the unit and the associated construction of unit facilities  
15 within the state will provide additional revenue to the state and increased job opportunities;

16 (9) the expedited development of the unit may result in increased state revenue  
17 from future oil and gas lease sales;

18 (10) the expedited development of the unit may result in technological  
19 breakthroughs and other cost savings that may make other development opportunities in the  
20 state economically feasible;

21 (11) notwithstanding the anticipated benefits that may result from the  
22 amendment of the Northstar Unit's net profit share lease terms, the legislature reaffirms that  
23 it is the policy of the state to enforce the competitively bid terms of its oil and gas leases and  
24 that the commissioner of natural resources should assure that the state's oil and gas resources  
25 are being diligently and timely developed;

26 (12) the public's confidence that the terms of the state's oil and gas leases are  
27 being fairly and uniformly administered must be maintained; and

28 (13) it is important to assure that there is no appearance of favoritism in the  
29 state's administration of its oil and leases.

30 \* Sec. 2. (a) The State of Alaska and BP Exploration (Alaska) Inc. are parties to the  
31 following leases in the Northstar Unit:

- 1 (1) ADL 312798, effective February 1, 1980;  
2 (2) ADL 312799, effective February 1, 1980;  
3 (3) ADL 312808, effective February 1, 1980;  
4 (4) ADL 312809, effective February 1, 1980; and  
5 (5) ADL 355001, effective August 1, 1983.

6 (b) The commissioner of natural resources has entered into an agreement to amend  
7 the Northstar Unit leases entitled "First Amendment to the Northstar Unit Leases Between the  
8 State of Alaska and BP Exploration (Alaska) Inc." dated March 22, 1996, for which the  
9 commissioner does not have legislative authorization.

10 (c) The legislature does not approve or disapprove, nor ratify the amendments to the  
11 Northstar Unit leases that have been negotiated between the commissioner of natural resources  
12 and BP Exploration (Alaska) Inc. and that are embodied in the agreement entitled the "First  
13 Amendment to the Northstar Unit Leases Between the State of Alaska and BP Exploration  
14 (Alaska) Inc." dated March 22, 1996.

15 \* Sec. 3. This Act takes effect immediately under AS 01.10.070(c).




# Alaska State Legislature

Official Business

State Capitol  
Juneau AK 99801

## MEMO

*ATTN: TAME OIL - 141000000000*  
TO: Legal Services  
via fax: 9 pages including this one

FROM: Annette Kreitzer, Aide to   
Senate Resources Committee

DATE: April 23, 1996

RE: CS SB 318: Northstar Oil and Gas Lease Amendment

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Please draft two alternative Resources Committee substitutes for SB 318 using Work Draft 9-GS2065\C. In the case of each alternative, remove Sec. 1 from the bill, and create a new stand-alone document entitled "Findings of Facts of the Senate Resources Committee Regarding SB 318 dated April 24, 1996" using the text of Sec. 1, but as amended below.

- 1) Page 1, line 10, delete [LEGISLATURE] and insert senate resources committee
- 2) Page 1, line 13, after "four of the" insert five
- 3) Page 2, line 30, delete [FOLLOWING LENGTHY NEGOTIATIONS BETWEEN THE AMERADA HESS CO., THE DEPARTMENT OF NATURAL RESOURCES, AND THE MINERALS MANAGEMENT SERVICE,] and insert Instead of attempting to take back the four leases which were due to expire so that they could be competitively released, then director Eason of the
- 4) Page 2, line 31, after "Department of Natural Resources" delete [AND] and insert along with

5) Page 3, line 3, after "leases committed to the unit" insert the following text: The Department of Natural Resources' action in approving this exploratory unit which effectively extended all four state leases beyond their primary term (and effectively precluding competitively releasing them) without any certainty of production was consistent with the department's actions on a multitude of units including: Prudhoe Bay/Niakuk deferral, Prudhoe Bay/Pt. McIntyre deferral, Milne Point formation, Milne Pt. expansion, Duck Island, Point Thomson, Point Thomson expansion, Thetis Island, Hemi Springs, Big River, Astosch, Badami, Kuukpuk, Northstar formation, North Fork, Nicolai Creek, Kavik, Jones Island, Falls Creek, West McArthur River, and Gwydyr Bay. There has been no evidence that the department of natural resources sought the department of law's advice about taking back the leases without certified wells and forcing the leases with certified wells into production in connection with its 1990 decision.

6) Page 3, line 4, after "Northstar Unit was" delete [LIMITED INITIALLY TO]

7) Page 3, line 4, after "to five years" delete [HOWEVER]

8) Page 3, line 5, after "until January 23, 1995," delete [AND THE PLAN OF DEVELOPMENT REQUIRED BY THE DEPARTMENT OF NATURAL RESOURCES PROVIDED SPECIFIC AND DETAILED CONDITIONS DESIGNED TO ENCOURAGE EXPEDITED EVALUATION AND DEVELOPMENT OF THE FIELD]

9) Page 3, line 19, after "Plan of Development." add The Plan of Development did not require Amerada Hess and its partners to begin production during the five year initial term.

10) Page 3, line 26, after "Plan of Development" add The Plan of Development had succeeded in getting one well drilled and in Amerada Hess Co. and its partners' completing certain other work commitments including, petrological/petrophysical studies, production facilities design, seismic surveys, seismic analysis and interpretation, and reservoir engineering studies. However, no production from the unit occurred during the five year period of the initial Plan of Development.

11) Page 3, line 30, after "of the Northstar Unit." add The department of natural resources has indicated that Amerada Hess Co. believed that the development costs for the Northstar Unit leases would exceed \$1.4 billion. Assuming that the state could have gotten the leases back, because of their

\$1.4 billion development cost, the department of natural resources believes that the leases would have had little value, and would most likely have been re-leased for a nominal bonus bid.

12) Page 4, line 20, after "Northstar Unit leases" delete [SOMETIME DURING 1994]

13) Page 4, line 30, delete [, NOR WAS IT OFFERED THE OPPORTUNITY TO COMPETE FOR THE LEASES] and insert Lessees commonly sell interests in leases without the state's involvement other than approving assignments resulting from the sale.

14) Page 5, line 1, after "BP Exploration (Alaska) Inc." delete [INHERITED] and insert acquired

15) Page 5, line 3, after "has been estimated by" delete [THE DEPARTMENT OF NATURAL RESOURCES] and insert BP Exploration (Alaska) Inc.

16) Page 5, line 29, after "Effective January 19, 1995," delete [THE DNR] and add then director Eason

17) Page 5, line 31, after ", and on January 20, 1995, both" add then director Eason of

18) Page 6, line 9, after "on January 24, 1995," add then director Eason of

19) Page 6, line 10, after "Resources" delete [AND] and add approved BP Exploration (Alaska) Inc.'s request for a 90 day extension to submit a new plan of development because, according to director Eason, it was "in everyone's best interest to allow BP additional time to conclude its acquisition and to formulate a new plan of development". On January 24, 1995,

20) Page 6, line 10, after "Minerals Management Service" add also

21) Page 6, line 12, after "submitted a revised" add and more comprehensive

22) Page 6, line 14, after "Plan of Development" add Importantly, the revised plan included sanction within the last year. The plan included the following specific activities: 1) data gathering and project development, including environmental data gathering and studies, promulgation of

marine mammal incidental take regulations, and a cooperative agreement with the Alaska Eskimo Whaling Commission; 2) 3-D seismic acquisition, including the appropriate government permits and seismic processing, pipeline and facility engineering and reservoir descriptions; 3) project sanction including project construction permits, integrated 3-D seismic and reservoir descriptions, permit approvals, and finally, sanction by BP Exploration (Alaska) Inc.'s headquarters. The revised Plan of Development added the steps required by BP Exploration (Alaska) Inc. to take the Northstar development to project sanction. The estimated cost of these activities was \$12 million. In the two year plan, the estimated cost was \$10 million.

23) Page 6, line 15, delete [IT IS UNCLEAR FROM THE RECORD WHY T] and insert T

24) Page 6, line 17, delete [THUS EXTENDING THE TIME DURING WHICH THE DEPARTMENT OF NATURAL RESOURCES CANNOT MOVE TO FORCE PRODUCTION FROM THE NORTHSTAR UNIT LEASES.] and add because of increased commitments by BP Exploration (Alaska) Inc.

25) Page 6, line 19, before "On June 2" add On May 1, 1995, the Minerals Management Service approved the revised plan concluding that the "new schedule of activities are deemed necessary to bring the unit into production.

26) Page 6, line 20, after "three-year Plan of Development" add Director Boyd approved the plan because, "in his judgment, it was a reasonable one that allowed the new operator, BP Exploration (Alaska) Inc., adequate time to interpret the existing geological, geophysical and engineering data, shoot what he considered important 3-D seismic data, begin work on development options, define the scope of reservoir/conceptual engineering, and submit permits with the ultimate goal of getting internal BP Exploration (Alaska) Inc. sanction in the fourth quarter of 1997." It was director Boyd's belief that "the plan was tailored to the shortest deadlines that an operator could reasonably be expected to meet." The plan explicitly stated that sanction would "depend on economic competitiveness of the project compared to other BP Exploration (Alaska) Inc. projects worldwide, the business climate (oil price, etc.), and the status of the external permitting processes." It also noted that the risks included "development and production economics."

- 27) Page 7, line 28, after "Northstar Unit" delete [WOULD] and add is forecasted to
- 28) Page 9, line 29, after "The" delete [DEPARTMENT OF NATURAL RESOURCES] and after "decision" add by the commissioner of the department of natural resources
- 29) Page 9, line 30, after "variable in 1979" delete [REPRESENTED A CONSCIOUS] and add resulted in a
- 30) Page 9, line 31, after "for the" add speculative
- 31) Page 10, line 3, after "than dry holes, the" delete [DEPARTMENT OF NATURAL RESOURCES] and add commissioner's
- 32) Page 10, line 4, after "available to the" delete [DEPARTMENT OF NATURAL RESOURCES] and add commissioner
- 33) Page 10, line 7, delete [BASED UPON ITS REVIEW OF THE BONUS] and add Interpolating
- 34) Page 10, line 9, after "as the bid variable," add and making many speculative assumptions
- 35) Page 10, line 18, after "has provided estimates" delete [OF THE BONUS REVENUES THAT THE STATE WOULD RECEIVE TODAY] and add of the expected mean value to a bidder of the Northstar Unit leases.
- 36) Page 10, line 19, capitalize the "i" in "if the Northstar Unit" and after "were returned" add at one time
- 37) Page 10, line 23, after "Exploration (Alaska) Inc." add . the estimated expected mean. value. in the view of the department of natural resources, would represent the most a bidder would bid. The department of natural resources further qualifies its estimates by noting that the bidder would have had to make the same economic assumptions about the Northstar Unit leases as were used by BP Exploration (Alaska) Inc. Further, the division of oil and gas has testified that "if a sale of the Northstar Unit leases were conducted in the future, the division would expect bonus bids to range from a nominal amount to something less than \$225 million, depending upon the royalty rate and the discount rate."

- 38) Page 10, line 24, after "estimates that the" add expected and after "mean value" delete [OF ANTICIPATED BONUSES] and add to a bidder
- 39) Page 11, line 1, after "the acknowledged" add forecasted
- 40) Page 11, line 19, after "expire until" delete [JUNE] and add April 30.
- 41) Page 11, line 26, after "June, 1995, the" add two
- 42) Page 11, line 30, after "begin production from" delete [THOSE] and add the three
- 43) Page 12, line 1, after "less than six months." add The department has indicated that it has never previously given such a notice to any lessee and there could be litigation over what constitutes "reasonable time" on the North Slope to put a well into production. Furthermore, the leases provide that the leases with certified wells cannot be terminated without "an appropriate judicial proceeding."
- 44) Page 12, line 9, after "effectively eliminated any" add short term
- 45) Page 12, line 11 after "of the leases." add The department of natural resources believes its approval was in keeping with the department's approval of other Plans of Development in the recent past.
- 46) Page 12, line 15, after "under the lease terms" delete [,] and add . Then, delete [GIVEN THE UNIQUE FACTS IN THE CASE.] and add The department of natural resources has indicated that it saw nothing unique about this case which would have justified consulting the department of law.
- 47) Page 12, line 27, delete [THE EARLIEST THAT]; after "the department now" delete [NOW] and insert not
- 48) Page 12, line 28, delete [WOULD BE 2002] and add until after the expiration of the current Plan of Development.
- 49) Page 17, line 7, delete [BASED UPON THE DEPARTMENT OF NATURAL RESOURCES' ANALYSIS, THE NEGOTIATED AMENDMENTS TO THE NORTHSTAR UNIT LEASES WILL REDUCE EXPECTED STATE REVENUE FROM THE DEVELOPMENT OF THE NORTHSTAR UNIT.]

50) Page 17, line 9, after "Northstar Unit." delete [HOWEVER,] and capitalize the "t" in the word "the" which follows.

51) Page 17, line 17, after "for the supplemental royalty." add Mr. Coughlin has noted on the other hand, if full production does not begin until after 2002, the state could lose money if the amendments are not accepted.

52) Page 17, line 22, after the words from line 21 "and that there is a" delete [10] and add 90

53) Page 18, line 17, after "I think we can't ignore." add Additionally, Mr. Banks has provided the committee with information that under low side cases the state's revenues from the net profit share are substantially reduced while the supplemental royalty may still pay something, and the longer the project is delayed, the more likely the payout from the net profit share will be reduced.

—END OF AMENDMENTS TO FINDINGS OF FACTS—

For Alternative 1, continue with the following amendments after renumbering the sections:

54) Page 20, line 9, after "Based upon the findings of facts" delete [SET OUT ABOVE] and add set forth in the "Findings of Facts of the Senate Resources Committee Regarding SB 318 dated April 24, 1996

55) Page 27, line 27, delete [THE STATE OF ALASKA WILL NOT BE RESPONSIBLE FOR CONTRIBUTING TO ANY CAPITAL EXPENDITURES REQUIRED] and add BP Exploration (Alaska) Inc. will reimburse the State of Alaska for any public funds expended

56) Page 28, line 13, after "Lessee shall" add purchase materials and services from Alaska vendors, suppliers, and consultants and

57) Page 28, line 13, after "Alaska firms" delete [AND]

58) Page 31, line 2, delete [THE STATE OF ALASKA WILL NOT BE RESPONSIBLE FOR CONTRIBUTING TO ANY CAPITAL EXPENDITURES REQUIRED] and add BP Exploration (Alaska) Inc. will reimburse the State of Alaska for any public funds expended

59) Page 39, line 24, delete [PROJECT SANCTION BY BPXA OR ITS PARENT ENTITY SHALL BE IRREVOCABLE.]

60) Page 40, line 5, after "has made" delete [AN IRREVOCABLE] and add a

For Alternative 2, make the following amendments and renumber the bill sections:

61) Page 20, line 9, after "Based upon the findings of facts" delete [SET OUT ABOVE] and add set forth in the "Findings of Facts of the Senate Resources Committee Regarding SB 318 dated April 24, 1996

62) Page 20, line 18, before "unless the net profit" add The department of natural resources has testified that

63) Page 20, line 22, before "if the net profit share" add The department of natural resources has testified that

64) Page 21, line 11, after "must be maintained;" add and

65) Page 21, line 13, after "leases" delete [; AND THEREFORE] and add ,

66) Page 21, line 14 delete [(14) EXCEPT AS PROVIDED UNDER SECTION 3 OF THIS ACT, THE COMMISSIONER OF NATURAL RESOURCES IS DIRECTED NOT TO AMEND THE COMPETITIVELY BID TERMS OF ANY STATE OIL AND GAS LEASE WITHOUT PRIOR EXPLICIT AUTHORIZATION BY THE LEGISLATURE THROUGH THE PASSAGE OF A GENERAL ACT GRANTING AUTHORITY TO DO SO.]

67) Page 21, line 25, after "natural resources" delete [MAY AMEND THE NORTHSTAR UNIT LEASES DESCRIBED IN (a) OF THIS SECTION AS SET OUT BELOW:] and add has entered into an agreement to amend the Northstar Unit leases entitled "First Amendment to the Northstar Unit Leases Between the State of Alaska and BP Exploration (Alaska) Inc." for which he does not have legislative authorization.

68) Page 21, line 27 through Page 39, line 28, delete all text

69) Page 39, line 29, delete [NOTWITHSTANDING ANY OTHER PROVISION OF LAW, THE "AMENDMENT TO THE NORTHSTAR

UNIT LEASES BETWEEN THE STATE OF ALASKA AND BP EXPLORATION (ALASKA) INC." AS DESCRIBED IN (b) OF THIS SECTION, IF VOLUNTARILY AGREED TO BY THE COMMISSIONER OF NATURAL RESOURCES AND BP EXPLORATION (ALASKA) INC., IS APPROVED AN RATIFIED.] and add The legislature does not approve or disapprove, nor ratify the amendments to the Northstar Unit leases which have been negotiated between the commissioner of natural resources and BP Exploration (Alaska) Inc., and which are embodied in the agreement entitled the "First Amendment to the Northstar Unit Leases Between the State of Alaska and BP Exploration (Alaska) Inc.", dated March 22, 1996.

Page 40, line 2, delete all text and add This Act takes effect immediately under AS 01.10.070.(c).

9-GS2065\C  
Cook  
4/17/96

FINDINGS OF FACT - SECTION 1  
... 2

**CS FOR SENATE BILL NO. 318(RES)**

**IN THE LEGISLATURE OF THE STATE OF ALASKA**

**NINETEENTH LEGISLATURE - SECOND SESSION**

**BY THE SENATE RESOURCES COMMITTEE**

Offered:  
Referred:

Sponsor(s): **SENATE RULES COMMITTEE BY REQUEST OF THE GOVERNOR**

**A BILL**

**FOR AN ACT ENTITLED**

1 "An Act authorizing, approving, and ratifying the amendment of Northstar Unit  
2 oil and gas leases between the State of Alaska and BP Exploration (Alaska)  
3 Inc.; and providing for an effective date."

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

5 \* Section 1. **FINDINGS OF FACT.** Based upon extensive public testimony, as well as the  
6 review of the written documents and presentations made by BP Exploration (Alaska) Inc.  
7 (BPXA), the Department of Law, and the Department of Natural Resources related to the  
8 proposal of BP Exploration (Alaska) Inc. and the Department of Natural Resources to amend  
9 certain of the lease terms of State of Alaska oil and gas leases within the Northstar Unit  
10 (NSU), the legislature makes the following findings of fact:

11 **ARTICLE 1. THE STATE'S NET PROFIT SHARE AND HISTORY OF THE**  
12 **NORTHSTAR LEASES BEFORE UNITIZATION.**

13 (1) The net profit share provision of four of the state leases now included in  
14 the Northstar Unit was the competitively bid variable when the leases were originally offered

1 for lease. The leases were offered with a fixed per acre cash bonus and a fixed royalty of 20  
2 percent, and bidders were asked to submit sealed competitive bids based upon the percentage  
3 of net profits that the bidder would share with the state. According to the Department of  
4 Natural Resources, the average of the winning net profit share bids for these leases was "about  
5 89 percent." As to the fifth state lease, the net profit share and royalty were fixed by the  
6 Department of Natural Resources at 40 percent and 12 1/2 percent, respectively, and the  
7 competitively bid variable was the amount of bonus offered by the bidders.

8 (2) The leases for which the net profit share was the bid variable, ADL Nos.  
9 312798, 312799, 312808, and 312809, were offered for lease in State of Alaska Competitive  
10 Oil and Gas Lease Sale 30, that was held in December 1979. These four leases were issued  
11 in 1980 for a primary term of 10 years. The fifth lease, ADL 355001, was offered in State  
12 of Alaska Competitive Oil and Gas Lease Sale 39 in May 1983, and was issued in June 1983.  
13 The primary term of ADL 355001 was also 10 years.

14 (3) The original lessees of the Northstar leases included Amerada Hess Co.,  
15 Shell Oil Co. (Shell), Enterprise Oil Co. (Enterprise), and Murphy Oil Co. In 1990, Amerada  
16 Hess Co. bought Enterprise's interest in the leases for \$2,000,000.

17 (4) Three years after the initial four state leases were issued, Shell Oil Co.  
18 discovered the Northstar oil field while drilling the Seal Island No. 1 Well. Thereafter, during  
19 the period 1984 - 1986 additional wells were drilled to delineate the Northstar field. Those  
20 wells included Shell Seal Island No. 2 (1984); Shell Seal Island No. 3 (1985); Shell Seal  
21 Island No. 4 (1985); Amerada Hess Co. Northstar No. 1 (1985); and Amerada Hess Co.  
22 Northstar No. 2 (1986).

23 (5) Near the end of the 10-year primary term for the initial four state leases  
24 and the two Outer Continental Shelf (OCS) leases that later came to be included in the  
25 Northstar Unit, Amerada Hess Co. and its partners approached the Department of Natural  
26 Resources and the federal Minerals Management Service with a proposal to form the Northstar  
27 Unit.

28 ARTICLE 2. FORMATION OF THE NORTHSTAR UNIT AND  
29 ACTIVITIES UNDER THE INITIAL PLAN OF DEVELOPMENT.

30 (1) Following lengthy negotiations between the Amerada Hess Co., the  
31 Department of Natural Resources, and the Minerals Management Service, the Department of

1 Natural Resources and the Minerals Management Service approved formation of the Northstar  
2 Unit and its initial Plan of Development, thereby extending the ten-year primary term of the  
3 leases committed to the unit.

4 (2) The term of the Northstar Unit was limited initially to five years however,  
5 from January 24, 1990, until January 23, 1995, and the Plan of Development required by the  
6 Department of Natural Resources provided specific and detailed conditions designed to  
7 encourage expedited evaluation and development of the field.

8 (3) According to the Department of Natural Resources, as a condition of its  
9 approval of the initial five-year Plan of Development for the unit, "[t]he state lessees were  
10 permitted to make progressively larger annual payments to the state in lieu of drilling a well  
11 in the Plan of Development. The extension fee payments were to be paid by the State lessees  
12 to the State under the following schedule: January 31, 1991—\$1 million; January 31,  
13 1992—\$2 million; January 31, 1993—\$2 million; January 31, 1994—\$3 million and  
14 January 31, 1995—\$4 million, unless the fee obligation was extinguished by the drilling of  
15 a well in the unit area." As further conditions of its approval, the Department of Natural  
16 Resources also required Amerada Hess Co. and its partners to conduct certain petrological and  
17 petrophysical analyses, to gather an additional 250 line-miles of geophysical (seismic) data  
18 over the unit area, and to complete facilities design and reservoir engineering studies  
19 (pre-production studies) during the initial Plan of Development.

20 (4) Amerada Hess Co. and its partners made the scheduled "in lieu of drilling"  
21 payments for the first three years of the five-year Plan of Development period, with payments  
22 totaling \$5 million. Amerada Hess Co. then elected to drill the Amerada Hess Co. Northstar  
23 No. 3 Well in 1994, extinguishing its remaining financial obligations to the state under the  
24 terms of the Plan of Development for the Northstar Unit. Amerada Hess Co. and its partners  
25 also timely complied fully with each of the other conditions set out by the Department of  
26 Natural Resources in its approval of the initial Plan of Development.

27 (5) Following the drilling of the Amerada Hess Co. Northstar No. 3 Well  
28 earlier in 1994, Amerada Hess Co. met with representatives of the Department of Natural  
29 Resources and the Minerals Management Service in June 1994, to inform the agencies of its  
30 decision not to proceed with development of the Northstar Unit.

31 (6) Under the terms of the Northstar Unit Agreement, Amerada Hess Co. and

1 its partners were required to submit a proposed Plan of Development to the Department of  
2 Natural Resources late in October 1994, 90 days before the expiration of the first Plan of  
3 Development, or the unit, which had already extended the Northstar Unit leases five years  
4 beyond their initial primary term, would terminate.

5 (7) Having made the decision not to proceed with development of the unit,  
6 Amerada Hess Co. did not submit a proposed second Plan of Development, and under the  
7 terms of the unit agreement and the department's regulations, the Department of Natural  
8 Resources issued a Notice of Default to Amerada Hess Co. and its partners on November 3,  
9 1994.

10 (8) By subsequent letter dated December 12, 1994, the Department of Natural  
11 Resources amended its November 3, 1994, Notice of Default to provide that Amerada Hess  
12 Co. could cure the default either by providing an updated Plan of Development within 90 days  
13 or by voluntarily agreeing to terminate the Northstar Unit Agreement. The Department of  
14 Natural Resources' December 12, 1994, letter concluded "[f]inally, if the NSU terminates,  
15 three State of Alaska leases will continue beyond their primary term pursuant to paragraph  
16 5(d) of the lease. The three leases are ADLs 312798, 312799 and 312809. This is further  
17 notice that within 90 days of termination of the NSU the lessees shall file a Plan of  
18 Development in compliance with the requirements set forth in paragraph 17 of the lease."

19 (9) Amerada Hess Co. and Shell began efforts to sell their respective interests  
20 in the Northstar Unit leases some time during 1994. Neither the exact timing nor the details  
21 of Amerada Hess Co.'s and Shell's efforts to market the leases are a matter of public record.

22 (10) Amerada Hess Co. and Shell subsequently sold their interests in the  
23 Northstar leases to BP Exploration (Alaska) Inc. early in 1995. BP Exploration (Alaska) Inc.  
24 has characterized the terms of its purchase of the Northstar Unit lease interests as a  
25 "competitive process." However, BP Exploration (Alaska) Inc. has declined to make public  
26 the terms of its purchase or the identity of its competitors for the purchase of Amerada Hess  
27 Co.'s and Shell's interest in the Northstar Unit leases, citing a confidentiality agreement  
28 between the parties that prohibits its doing so. The state played no role in the offering or  
29 selling of Amerada Hess Co.'s and Shell's interest in the Northstar Unit leases to BP  
30 Exploration (Alaska) Inc. nor was it offered the opportunity to compete for the leases.

31 (11) In its purchase of the Northstar Unit leases from Amerada Hess Co. and

1 its partners, BP Exploration (Alaska) Inc. <sup>assigned</sup> inherited the net profit share development accounts  
 2 for those leases. The amount of accrued costs in the Northstar Unit net profit share  
 3 development accounts has been estimated by <sup>BP (Alaska) Inc.</sup> the Department of Natural Resources to be  
 4 \$262,000,000. Under the terms of the leases and the Department of Natural Resources'  
 5 regulations, although BP Exploration (Alaska) Inc. did not actually spend the \$262,000,000  
 6 in the development account, it would be entitled to recover those costs, plus its actual future  
 7 costs of development, with interest, before it would be obligated to pay the state a share of  
 8 net profits from the development of the Northstar Unit leases.

9 (12) Department of Natural Resources Commissioner Shively has testified that  
 10 "[T]he implications for the state in that is the longer the development is delayed, the less  
 11 money the state is going to get in net profits leasing. And so timing was critical to me as we  
 12 negotiated this deal with BP."

13 (13) BP Exploration (Alaska) Inc.'s president, Mr. John Morgan, has testified  
 14 "[I]n making that acquisition (purchase of the Northstar leases) we did understand and it was  
 15 clear to us that the issue of net profit leases represented a problem, and a problem that would  
 16 need to be overcome with the state, if development was to proceed."

17 (14) BP Exploration (Alaska) Inc.'s president, Mr. Morgan, also has testified  
 18 that ". . . part of the risk we took when we acquired the leases was that the State of Alaska  
 19 may not agree to a modification of the terms that would allow us to go forward with  
 20 development, and we did that knowingly and clearly."

21 **ARTICLE 3. BP EXPLORATION (ALASKA) INC.'S SUCCESSION**  
 22 **AS NORTHSTAR UNIT OPERATOR AND THE DEPARTMENT OF**  
 23 **NATURAL RESOURCES' APPROVAL OF THE 2ND PLAN OF**  
 24 **DEVELOPMENT FOR THE NORTHSTAR UNIT.**

25 (1) On January 13, 1995, BP Exploration (Alaska) Inc. wrote the Department  
 26 of Natural Resources and the Minerals Management Service to request that the agencies  
 27 approve a 90-day extension to the Department of Natural Resources' earlier Notice of Default  
 28 for the Northstar Unit.

29 (2) Effective January 19, 1995, <sup>the DNR</sup> the DNR approved assignment of the state  
 30 Northstar Unit leases to BP Exploration (Alaska) Inc. as had been requested earlier, and on  
 31 January 20, 1995, both the Department of Natural Resources and the Minerals Management

1 Service approved BP Exploration (Alaska) Inc. as the successor operator of the Northstar Unit;

2 (3) On January 23, 1995, the day the Northstar Unit was scheduled to  
3 terminate under the Department of Natural Resources' Notice of Default for failure of the  
4 operator to provide a proposed Plan of Development, BP Exploration (Alaska) Inc., in its  
5 capacity as the new unit operator, submitted a proposed two-year Plan of Development for the  
6 Northstar Unit. According to documents in the Department of Natural Resources' unit files,  
7 BP Exploration (Alaska) Inc. indicated "that with more time it could submit a more detailed  
8 and decisive plan."

9 (4) The following day, on January 24, 1995, the Department of Natural  
10 Resources and the Minerals Management Service approved BP Exploration (Alaska) Inc.'s  
11 request for an extension to file a more detailed Plan of Development until April 30, 1995.

12 (5) On March 30, 1995, BP Exploration (Alaska) Inc. submitted a revised Plan  
13 of Development and a request to extend the Northstar Unit Agreement for a three-year term  
14 coincident with its revised Plan of Development.

15 (6) It is unclear from the record why the term of the second Plan of  
16 Development was increased from the originally proposed two-year term to a three-year term,  
17 thus extending the time during which the Department of Natural Resources cannot move to  
18 force production from the Northstar Unit leases.

19 (7) On June 2, 1995, the Department of Natural Resources "conditionally"  
20 approved BP Exploration (Alaska) Inc.'s revised three-year Plan of Development.

21 (8) According to the Department of Natural Resources, "[a]s part of the  
22 conditional approval, BPXA was required to submit annual program reports and a final report  
23 to the agencies that synthesizes the data and studies performed by BPXA during the extension  
24 period and BPXA's conclusions and recommendations regarding the development of the NSU.  
25 The POD does not require BPXA to start production during the three year term. Assuming  
26 BPXA complies with the conditions of the second POD, the unit will not expire until April 30,  
27 1998."

28 ARTICLE 4. BP EXPLORATION (ALASKA) INC.'S  
29 INITIAL EFFORTS TO AMEND THE NET PROFIT  
30 SHARE LEASE TERMS.

31 (1) Both BP Exploration (Alaska) Inc.'s President, Mr. Morgan, and

1 Department of Natural Resources Commissioner Shively have testified that at sometime  
2 between January and April 1995, before the Department of Natural Resources' approval of BP  
3 Exploration (Alaska) Inc.'s revised Plan of Development and extension for the Northstar Unit,  
4 BP Exploration (Alaska) Inc. approached the administration, asking that it support the  
5 incorporation of provisions that would allow the commissioner of the Department of Natural  
6 Resources to modify net profit share terms of oil and gas leases in the royalty modification  
7 legislation that the administration requested last session (HB 207). Mr. Patrick Coughlin,  
8 petroleum investment manager for the division of oil and gas, testified that BP Exploration  
9 (Alaska) Inc. requested incorporation of the net profit provisions sometime in late January or  
10 early March (1995) during the drafting of the original version of HB 207.

11 (2) Testimony before the committee by both BP Exploration (Alaska) Inc. and  
12 the Department of Natural Resources reflects that the parties decided, however, not to pursue  
13 authority to amend the terms of net profit share leases in that legislation. According to  
14 Commissioner Shively, ". . . I felt, and ultimately I think BP felt, that adding another issue  
15 to the mix was probably not appropriate."

16 (3) Commissioner Shively testified that, after having decided not to pursue  
17 incorporation of the net profit share amendment provisions within the framework of HB 207,  
18 "he committed to BP at the time to discuss Northstar, but under the conditions that I believed,  
19 at the time, that I probably did not have the legal authority to make a deal with them on  
20 Northstar. And so therefore, that the individual deal itself would have to come to the  
21 legislature. That was always part of the discussions."

22 (4) Based upon testimony by both Commissioner Shively and BP Exploration  
23 (Alaska) Inc.'s Mr. Morgan, it is clear that even had HB 207 been amended to include explicit  
24 authority for the commissioner to reduce the state's net profit share under the same  
25 circumstances as the commissioner was ultimately authorized to reduce the state's royalty  
26 share under the terms of HB 207, to encourage production that otherwise would not be  
27 economically feasible, the commissioner could not have done so in this instance because  
28 production from the Northstar Unit ~~would~~ be economic without amendments to the net profit  
29 share provisions.

30 ARTICLE 5. THE ECONOMICS OF DEVELOPING THE  
31 NORTHSTAR LEASES UNDER THEIR

## EXISTING TERMS.

1  
2 (1) The director of the division of oil and gas, Mr. Ken Boyd, has testified that  
3 "BPXA currently estimates that 76.8% of the recoverable reserves underlie the state leases in  
4 the Northstar Unit (NSU). The Division's Resource Evaluation Group has reviewed this  
5 estimate and other confidential estimates, and believes the 75 to 80% is a reasonable range.  
6 This range could be slightly higher if BPXA develops the known reserves to the Northwest."

7 (2) Both the Department of Natural Resources and BP Exploration (Alaska)  
8 Inc. have testified that BP Exploration (Alaska) Inc.'s development of the Northstar Unit  
9 leases under the original lease terms would be economic. According to BP Exploration  
10 (Alaska) Inc.'s President, Mr. Morgan, "[W]e have never argued that the development of  
11 Northstar could not be profitable under the terms including the net profit arrangements. In  
12 profitability in terms of return on capital, this would be possible. This is not a marginal oil  
13 field."

14 (3) The Department of Natural Resources' independent analysis of the  
15 Northstar Unit economics comes to a similar conclusion. Commissioner Shively has testified  
16 "[t]oday both we, and I think British Petroleum, estimate that around 135 mm barrels of oil  
17 could be recovered from this field. It is not a marginal field; it is not the kind of field we  
18 talked about last year with HB 207. It is a field fully capable of carrying its own under the  
19 appropriate economic conditions."

20 (4) BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified "...  
21 that with the net profit arrangement in place, at the level that it exists, BP would not be  
22 prepared to go ahead with the development of a Northstar project, even though, if you run the  
23 economics, you can show that the return on investment for the project is a sound sort of return  
24 on investment."

25 (5) Based upon BP Exploration (Alaska) Inc.'s own analysis, development of  
26 the Northstar project "would have an estimated BP Net Revenue of approximately \$485  
27 million and a full project Rate of Return (ROR) of around 21%."

28 (6) BP Exploration (Alaska) Inc. has testified that its rate of return for a  
29 "hypothetical incremental investment" later in field life (2007) would be 21 percent without  
30 the net profit share lease terms versus 10 percent with the net profit share lease terms.

31 (7) In its September 1995 report to the Governor's Oil and Gas Policy Council

1 entitled "Review of International Competitiveness of Alaska's Fiscal System" (Little Report),  
2 the Arthur D. Little Co. concluded "[Oil] companies generally look for a rate of return of  
3 about 15% . . . Projects with lower returns usually do not generate enough profits to encourage  
4 companies to commit time and resources to their development."

5 (8) Commissioner Shively testified "I do not believe that no oil company in  
6 the world could develop this field under the current provisions. When we did the economic  
7 analysis, we believe the rate of return is sufficient for somebody to want to do it. On the  
8 other hand, BP has told us that they would not do it, and therefore, I cannot make a finding  
9 that under the current situation the development of the field is not economically feasible. It,  
10 in my mind, is economically feasible under both considerations. Both of the considerations  
11 of the net profits and using the supplemental royalty. BP has said for them it is not  
12 developable under the net profit conditions."

13 (9) Based upon BP Exploration (Alaska) Inc.'s estimates of the recoverable  
14 reserves and project development costs, the Northstar Unit has a per barrel development cost  
15 of \$2.90. For comparison, other North Slope projects which BP Exploration (Alaska) Inc. has  
16 sanctioned (approved and committed the funding to develop), the year in which the  
17 developments were sanctioned and BP Exploration (Alaska) Inc.'s estimated per barrel cost  
18 of developing each are: Kuparuk (1982) - \$6.65 per barrel; Endicott (1985) - \$5.40 per barrel;  
19 Prudhoe Bay Unit: GHX-2 (1992) - \$4.45 per barrel; Pt. McIntyre (1992) - \$2.30 per barrel;  
20 and Niakuk (1992) - \$2.50 per barrel.

21 (10) BP Exploration (Alaska) Inc. estimates the per barrel development costs  
22 for both the Milne Point Unit - Schrader Bluff development and the Northstar project, neither  
23 of which have yet been sanctioned by BP Exploration (Alaska) Inc. management, to be \$1.80  
24 per barrel, and \$2.90 per barrel, respectively.

25 ARTICLE 6. REVENUE TRADE-OFFS FROM  
26 THE LEASING OF THE NORTHSTAR LEASES  
27 WITH THE NET PROFIT SHARE AS THE  
28 COMPETITIVE BID VARIABLE.

29 (1) The Department of Natural Resources' decision to offer the Northstar leases  
30 with the net profit share as the competitive bid variable in 1979 represented a conscious  
31 trade-off of larger immediate bonus payments for the potential to receive a share of the

1 lessees' net profits from the development of any field subsequently discovered. Since oil and  
2 gas exploration is inherently risky, with commercial discoveries occurring far less frequently  
3 than dry holes, the Department of Natural Resources' bid strategy entailed risk sharing with  
4 the lessees. Compared to other bidding terms available to the Department of Natural  
5 Resources, the selection of net profit share terms allowed successful bidders to obtain the  
6 leases for less cash than would otherwise have been required.

7 (2) Based upon its review of the bonus revenue received for the federal leases  
8 within the Northstar Unit, which were leased with a 16 2/3 percent sliding scale royalty and  
9 the bonus as the bid variable, the Department of Natural Resources estimates the state's  
10 Northstar Unit leases could have brought \$268,406,052, as opposed to the \$15,469,000  
11 actually received, had the leases been offered with a 12 1/2 percent royalty, no net-profit share  
12 and with the bonus as the bid variable.

13 (3) Assuming the Department of Natural Resources' estimate of bonuses is  
14 correct and based upon the annual realized rate of returns reported by the Alaska Permanent  
15 Fund Corporation in its 1995 report, the balance of the 50 percent of the \$268,406,052 that  
16 would have been deposited to the permanent fund would have been \$704,588,494 at year-end  
17 1995.

18 (4) The Department of Natural Resources has provided estimates of the bonus  
19 revenues that the state would receive today if the Northstar Unit leases were returned to the  
20 state for reoffering in a competitive sale with bonus as the bid variable, with royalty set at 12  
21 1/2 percent or 20 percent, with no net profit share and with estimated recoverable reserves,  
22 capital and operating costs as estimated in its economic modeling of the agreement with BP  
23 Exploration (Alaska) Inc. For a 12 1/2 percent royalty and at discount rates of 10 percent and  
24 15 percent, the Department of Natural Resources estimates that the mean value of anticipated  
25 bonuses would be \$225,000,000 and \$130,000,000, respectively. For a 20 percent royalty and  
26 at discount rates of 10 percent and 15 percent, the Department of Natural Resources estimates  
27 the mean value of anticipated bonuses would be \$182,000,000 and \$98,000,000, respectively.

28 **ARTICLE 7. BP EXPLORATION (ALASKA) INC.'S**  
29 **REFUSAL TO DEVELOP THE NORTHSTAR**  
30 **UNIT LEASES UNLESS THE NET PROFIT**  
31 **SHARE PROVISIONS ARE AMENDED.**

1 (1) Notwithstanding the acknowledged profitability of developing the Northstar  
2 field under its existing lease terms, BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has  
3 testified that BP Exploration (Alaska) Inc. will not develop the Northstar Unit leases unless  
4 the State of Alaska agrees to eliminate the net profit share provisions of the leases.

5 (2) There is no precedent, nor is there explicit legislative authority for the  
6 commissioner of natural resources to retroactively change the competitively bid variable of  
7 a state oil and gas lease.

8 (3) The Department of Natural Resources has testified that BP Exploration  
9 (Alaska) Inc. did not inform the state of its unwillingness to develop the Northstar Unit leases  
10 without amendment of the net profit share terms until some time after the department had  
11 approved the current Plan of Development and the three-year extension of the unit term.

12 (4) The Department of Natural Resources has testified that there is an implied  
13 covenant for lessees of Alaska's oil and gas leases to diligently explore and develop their  
14 leases. The Department of Natural Resources also has testified, however, that since the  
15 department has approved a three-year Plan of Development for the Northstar Unit leases that  
16 does not explicitly require development of the field, it believes that so long as BP Exploration  
17 (Alaska) Inc. meets the requirements of that plan, it would be seen as fulfilling its obligation  
18 to develop, and cannot be forced to proceed with production during the term of the current  
19 plan which does not expire until June 1998.

20 (5) The Department of Natural Resources has testified that BP Exploration  
21 (Alaska) Inc.'s refusal to develop the Northstar Unit leases represents the first occasion in  
22 which a state oil and gas lessee has confirmed that it could develop an oil field economically,  
23 but that it is unwilling to do so unless the state renegotiates the competitively bid terms of the  
24 leases.

25 (6) The Department of Natural Resources has testified that if the department  
26 had not approved a further three-year extension for the Northstar Unit in June 1995, the leases  
27 within the unit that did not have wells upon them certified to be capable of production in  
28 paying quantities would have reverted to the state, becoming available for releasing. Under  
29 the lease provisions and the regulations, the department could then have given notice to BP  
30 Exploration (Alaska) Inc. to begin production from those leases that did have wells certified  
31 as capable of production in paying quantities within a reasonable time to do so, that could not

1 have been less than six months. ^

2 (7) As to why the Department of Natural Resources did not insist on a firm  
3 commitment from BP Exploration (Alaska) Inc. last year that it would develop the Northstar  
4 Unit leases before the department agreed to extend the Northstar Unit for three years,  
5 Commissioner Shivley has testified ". . . [I]f we had all the information in the spring of last  
6 year that we had today, we might have made another decision; we did not have that  
7 information."

8 (8) The Department of Natural Resources' approval of the second Plan of  
9 Development, and the resulting three-year extension, effectively eliminated any <sup>staff term</sup> leverage the  
10 department might have had otherwise to expedite BP Exploration (Alaska) Inc.'s development  
11 of the Northstar Unit leases without amendment of the leases. ^

12 (9) Both the Department of Natural Resources and the Department of Law  
13 have testified that the Department of Natural Resources did not consult with the Department  
14 of Law regarding whether the state might have any legal basis for moving earlier than 1998  
15 to force production under the lease terms, given the unique facts in this case. ^

16 ARTICLE 8. THE DEPARTMENT OF NATURAL RESOURCES' AND  
17 BP EXPLORATION (ALASKA) INC.'S NEGOTIATIONS TO AMEND  
18 THE NORTHSTAR UNIT LEASES.

19 (1) Based upon BP Exploration (Alaska) Inc.'s representation that it would not  
20 develop the Northstar Unit leases under their existing terms, the Department of Natural  
21 Resources entered into confidential negotiations with BP Exploration (Alaska) Inc. in the fall  
22 of 1995 to amend the state's oil and gas lease terms.

23 (2) As its principal reason for proceeding with the negotiations to amend the  
24 leases, the Department of Natural Resources cited its desire to assure that production begins  
25 earlier than it otherwise would under the timeline estimated by the Department of Revenue.  
26 The Department of Natural Resources maintains that, if the legislature does not pass SB 318,  
27 the earliest that the department could <sup>now</sup> force BP Exploration (Alaska) Inc. to develop the  
28 field would be 2002;

29 (3) Department of Natural Resources' Commissioner Shively has testified that,  
30 "[t]he negotiations were long--longer than I had hoped. I had hoped to have this agreement  
31 to the legislature earlier; they were at times very difficult, but I believe that we have

1 negotiated a deal that is in the best interests of the state."

2 (4) BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified that "  
3 . . . I can't stress enough, that from BP's perspective, this was a long and very formal  
4 negotiating process, that I don't see the agreement contained in this bill as in any way being  
5 an incentive to BP; I see it as a very balanced agreement coming out of that negotiation."

6 (5) Under the terms of the agreement negotiated by BP Exploration (Alaska)  
7 Inc. and the Department of Natural Resources, the state agrees to waive its net profit interest  
8 in the leases, and in return is to receive an increased royalty rate on one of the five leases,  
9 from 12 1/2 percent to 20 percent, as well as the potential to receive a "supplemental royalty"  
10 on all of the leases, depending upon whether oil prices rise sufficiently in the future beyond  
11 a specified threshold (trigger) price. In addition, BP Exploration (Alaska) Inc. has made  
12 certain nonbinding commitments to increases in state employment, conditional commitments  
13 to construct certain undefined modules, and facilities necessary to develop the Northstar Unit  
14 within Alaska and has agreed to relinquish the Northstar Unit leases if BP Exploration  
15 (Alaska) Inc.'s management does not sanction the project within one year after the effective  
16 date of legislation ratifying amendment of the leases.

17 ARTICLE 9. LEGAL ANALYSIS BY THE DEPARTMENT OF LAW.

18 (1) As to whether the commissioner has the authority to amend the state's net  
19 profit share lease terms in a situation where those terms were the competitive bid variable in  
20 a sale, the Attorney General has testified that "Clearly what we are faced here is with a  
21 diminution of revenues that would come to the state . . . and that would require the  
22 commissioner in order to make the changes to make a finding that this project otherwise  
23 would not be economically feasible. And that was a conclusion which the commissioner  
24 would not and could not make. And once again, whether 180 (AS 38.05.180) would apply,  
25 in this instance it could not apply. And again, our reasoning supports the need to put this  
26 matter before the legislature."

27 (2) As to whether legislative ratification of a negotiated agreement between the  
28 commissioner of the Department of Natural Resources and BP Exploration (Alaska) Inc. to  
29 modify the terms of the Northstar Unit leases would violate the Constitution of the State of  
30 Alaska's prohibition against local or special legislation, the Department of Law representative  
31 has testified that "[I]t will be the department's responsibility to carefully articulate the state's

1 interest during legislative hearings on the bill proposing the net profit share reduction. This  
2 must be done with the goal in mind of establishing a detailed legislative history supporting  
3 the interests of the state. The legislative history will be important because the ultimate  
4 decision 'whether a general act can be made applicable' rests with the Alaska Supreme Court."

5 (3) The Department of Law representative has testified that "[i]f there is  
6 valuable consideration received by both the state and the leaseholder, the benefit to the state  
7 may be characterized as direct."

8 (4) The Department of Law representative has also testified that "[b]ecause the  
9 State leased the oil rights at the Northstar field pursuant to the constitutional mandate to obtain  
10 the maximum public benefit, an effort to expedite production vitally affects the public  
11 interest."

12 (5) The Department of Law has also testified "[w]e believe that a compelling  
13 case can be made that there is adequate consideration to support a finding of a direct and  
14 substantial public benefit flowing from the reduction of the net profit share."

15 (6) As to whether the promises of local manufacture and assembly of facilities  
16 must be binding terms of the Northstar Agreement in order to meet the "statewide  
17 significance" test, the Department of Law representative has testified "[t]hat there needs to be  
18 a record made here in the legislature of the State interests that are behind this very narrowly  
19 focused piece of legislation. As far as the promises to be binding I think it is enough that  
20 there's some good and sound reason for this kind of legislation."

21 (7) The Department of Law representative has testified that "[w]hether the  
22 agreement bears fruit I don't think is as important as the fact that you are doing it in good  
23 faith belief that it will happen. I don't know if I can tell you that it has to be binding. That's  
24 not a consideration of our opinion. It's merely a fact that there must be some sound  
25 reasonable basis for making this legislation as narrow as it is."

26 (8) The Department of Law representative has testified "[w]e think this  
27 transaction has state-wide significance because of the amount of revenue that's involved, the  
28 fact the major population center of the railbelt area would be the beneficiary of some of the  
29 economic activity connected with the development of the Northstar Unit, that fact that  
30 petroleum revenues form such a large percentage of the total revenues to the State. It makes  
31 this a very good case for being a matter of state-wide significance."

1 (9) As to whether the expenditures (loss of state revenues) under the Northstar  
2 Agreement meet the "public purposes" test under art. IX, sec. 6, of the Alaska Constitution,  
3 the Department of Law representative has testified "[i]t's been our opinion in the past that the  
4 courts will generally find a public purpose if the legislature declares it to be a public purpose.  
5 That's been the reasoning of the courts. From our side, analyzing it even further than that,  
6 because we don't like to stop there sometimes being the executive branch. We also analyze  
7 it as this mutually of consideration that there has to be some equal exchange in order for there  
8 to be a public purpose."

9 (10) As to the consideration which the state must receive under the Northstar  
10 Agreement, the Department of Law representative has testified "[t]here has to be, in order to  
11 satisfy the public purpose doctrine, a direct public benefit and not an indirect public benefit--  
12 when you're giving up public revenues or foregoing some debt that's owed you by some third  
13 party. There has to be a direct public benefit and not an indirect benefit. The direct benefit  
14 cannot only flow to the other interest and there appears to be direct public benefit here in  
15 connection with the way this agreement is structured."

16 (11) As to whether the consideration which the State expects to receive under  
17 the Northstar Agreement actually must be received, the Department of Law representative has  
18 testified "[n]o, I don't think so, not under the public purpose doctrine. The public purpose  
19 doctrine is the one legal issue that worries me the least. I think this transaction easily passes  
20 the public purpose doctrine test. The courts have been very deferential to legislative  
21 determinations of what is in the best interests of the State to expend its money on or to forego  
22 its revenues on or to receive additional revenues on. The courts have been very deferential  
23 in that regard and I don't see that as being a major factor influencing the validity of this  
24 particular transaction."

25 (12) As to whether an aggrieved bidder may have standing to challenge the  
26 Department of Natural Resources' negotiated amendments to the competitively bid lease terms,  
27 the Department of Law representative has testified "We note that the issue is present, that  
28 someone can raise this as a means of attacking the validity of the lease amendments. What  
29 we conclude is that if the legislature were to enact specific authorization, both ratifying and  
30 approving the contract, and authorizing the department to undertake the lease change, that, we  
31 think, would overcome the competitive bidding argument."

1 (13) The Department of Law representative has testified that "[o]ther persons  
2 who competed for the leases may claim that since the net profit share was the sole variable  
3 in the lease sale, it is such a material term that a change cannot be made without violating the  
4 competitive bidding statute. Uncertainty concerning the state's prospects for prevailing on any  
5 litigation on this issue gives an additional basis for our advice that the department seek  
6 independent statutory authority for the Northstar transaction."

7 (14) As to whether the legislature's passage of SB 318 will effectively shield  
8 the Department of Natural Resources' negotiated amendments to the Northstar Unit leases from  
9 legal challenge, the attorney general has testified "I guess my own judgment on this . . . we  
10 can't give you the certainty that absent this kind legislation, we would prevail on the argument.  
11 That's precisely, again, I think one of the reasons we brought this to the legislature, and Jim's  
12 (Assistant Attorney General Jim Baldwin) comments earlier about seeing legislative action as  
13 being an effective vaccination, as it were, against that kind of challenge."

14 (15) The attorney general has testified that "[w]ith legislative action, I think  
15 we have a high degree of confidence that we would prevail on this issue."

16 ARTICLE 10. THE DEPARTMENT OF NATURAL RESOURCES' AND  
17 BP EXPLORATION (ALASKA) INC.'S VIEW OF THE LEGISLATURE'S ROLE  
18 IN RATIFICATION AND PASSAGE OF SB 318.

19 (1) Although both BP Exploration (Alaska) Inc.'s President, Mr. Morgan, and  
20 Commissioner Shively have testified that they believe legislative approval of the amendments  
21 is necessary, both have confirmed their intent that the legislature's role in reviewing the  
22 negotiated amendments should be limited to voting for or against ratification of the agreement  
23 that they have negotiated, and should not include amending the terms of the agreement.  
24 Commissioner Shively testified "[w]ell, Mr. Chairman, as John Morgan just said, we have  
25 presented this as an up or down vote. And we did it for a variety of reasons. One, the  
26 negotiations we went through were long and complex. It is late in the session. On the other  
27 hand, if there are things that BP believes that they would like to agree to, we will certainly  
28 look at them."

29 (2) BP Exploration (Alaska) Inc.'s President, Mr. Morgan, testified "I have to  
30 say that from our perspective, we have in good faith reached a negotiated agreement with the  
31 administration, and I believe that any variation of those terms would cast that whole

1 negotiating process into doubt. So it's both my belief that that was the intent of the  
2 administration in introducing the bill, and it would certainly be my very strong preference that  
3 this should be handled essentially on an approval or disapproval basis, without the introduction  
4 of any significant or material changes."

5 ARTICLE 11. THE EFFECTS OF THE AMENDMENTS ON THE STATE'S SHARE  
6 OF REVENUE FROM THE DEVELOPMENT OF THE NORTHSTAR UNIT.

7 (1) Based upon the Department of Natural Resources' analyses, the negotiated  
8 amendments to the Northstar Unit leases will reduce expected state revenue from the  
9 development of the Northstar Unit. However, the Department of Natural Resources cannot  
10 precisely define the state's future revenue losses. Commissioner Shively noted that "the only  
11 thing we know about all these numbers (the DNR's economic modeling of the effects of  
12 amending the NSU leases), is since they are projections, is that they are wrong, we just don't  
13 know how wrong."

14 (2) The Department of Natural Resources' Mr. Coughlin has testified regarding  
15 potential state revenue loss that "[i]f you look at it as if they (BP Exploration (Alaska) Inc.)  
16 would go ahead and develop it because it's, they say, an economic field, the state loses, in  
17 essence, \$48 million by trading a net profit share for the supplemental royalty." ^

18 (3) The Department of Natural Resources' representative has testified that its  
19 evaluation of the economic consequences to the state of amending the Northstar Unit leases  
20 to remove the net profit provisions is based upon the assumption that the "mean" recoverable  
21 oil reserves from the Northstar Unit are likely to be 130,000,000 barrels, and that there is a  
22 10 percent probability that recoverable reserves will be greater than 105,000,000 barrels and  
23 a 90 percent probability that recoverable reserves will be less than 160,000,000 barrels."

24 (4) The Department of Natural Resources has testified that its analysis of the  
25 economic consequences to the state of amending the Northstar Unit lease terms to remove the  
26 net profit provisions is based upon an assumed peak production rate from the field of 50,000  
27 barrels per day.

28 (5) As to whether the Department of Natural Resources, in the course of its  
29 negotiations with BP Exploration (Alaska) Inc. had considered whether to add some sort of  
30 corrective factor to the agreement to compensate if the reserves ultimately prove to be  
31 considerably larger than estimated. Commissioner Shively has testified "[w]e did have a

1 proposal at one time on the table that would have taken that into account. That's not where  
2 we ended up. It was part of a more complicated formula that was developed by our division  
3 of oil and gas that was part of one of our counter-offers."

4 (6) The Department of Natural Resources' petroleum economist, Mr. Kevin  
5 Banks, who was responsible for evaluating the economic effects of the Northstar Unit lease  
6 amendments, has testified that the negotiated agreement is an "okay" deal rather than a "good"  
7 deal for the state. In response to the question of why he characterized the deal as "okay"  
8 rather than "good", Mr. Banks, testified "I think it has to do with the fact that the net profit  
9 share has considerable up-side for the state. If there's any change in the economics of the  
10 field that improves, if prices are considerably higher, for example, or if production is any  
11 higher. As some of the materials we sent over to you earlier would indicate, the net profit  
12 share really pours in. By the same token, it's exactly the problem that BP has with it: that  
13 for any increase in the "benefits" that might be associated with the higher production rates or  
14 higher prices, or some other economic feature, the state gets all of it, virtually all of it. And  
15 it has a fairly serious impact on the economics and the incentives for incremental kinds of  
16 projects for the company. And that's why I say it's "okay." There is a high side to this that  
17 I think we can't ignore."

18 ARTICLE 12. THE NONMONETARY TERMS OF THE DEPARTMENT OF  
19 NATURAL RESOURCES/BP EXPLORATION (ALASKA) INC. NEGOTIATED  
20 AMENDMENTS TO THE NORTHSTAR UNIT LEASES AND THE  
21 ENFORCEABILITY OF THOSE TERMS.

22 (1) As to whether the terms in the negotiated agreement between the  
23 Department of Natural Resources and BP Exploration (Alaska) Inc. regarding local hire and  
24 local contracting are enforceable, Commissioner Shively has testified "I do not believe we  
25 could--that that language allows us to enforce to the extent BP is morally committed to do,  
26 and I don't think you can write language to do that."

27 (2) Although the agreement to amend the Northstar Unit leases purportedly  
28 provides for automatic termination of the leases, making them available for releasing under  
29 the state's competitive oil and gas leasing program, should BP Exploration (Alaska) Inc. not  
30 sanction the project within 12 months, Commissioner Shively has testified that the agreement  
31 contains a provision that allows the state to waive the obligation by prior written consent.

1 (3) The Department of Law has testified that any waiver of BP Exploration  
2 (Alaska) Inc.'s commitment to perform under the sanction schedule would have to be done  
3 "reasonably and not arbitrarily," and Commissioner Shively has testified "I have no intention  
4 of waiving that. I mean that's a very important part of the arrangement, and I mean, I think  
5 that if we cannot get this project going, then we need to reassess those leases and get them  
6 back out onto the public market."

7 (4) In response to the question of how would the administration, or a court if  
8 the need should arise, measure compliance given the number of disclaimers and qualifiers, and  
9 the lack of any specific performance measures in the agreement, Commissioner Shively has  
10 testified "I think we have stated this before. What we are asking BP to do, and what they  
11 have committed to do, I do not believe is enforceable by law."

#### 12 ARTICLE 13. POLICY IMPLICATIONS OF THE PASSAGE OF SB 318.

13 (1) As to where the state ultimately ends up if, as a matter of precedent, it has  
14 to negotiate against itself in other instances to encourage its existing lessees to honor the terms  
15 of their competitively bid contracts, Commissioner Shively has testified "[A]ny of these things  
16 puts the state in a difficult position. We've, on the other hand, there have been provisions that  
17 allow the state to modify lease terms in the law and in the lease since Statehood. This is not  
18 a new concept. I was actually just reading an article the other day about the recent leases or  
19 arrangements that were made between the Venezuelan government and a number of private  
20 companies, and one of the conclusions of that article was that the first thing the companies  
21 were going to do down there was go back in and renegotiate their terms. And so, it does put  
22 the government in a difficult position. It's why I think in things like this and also like heavy  
23 oil, we need to do some economic and other analyses, which we did. But I think in this day  
24 and age this is part of how the government manages its resources. But it is not new. We've  
25 made changes to the leases before. We have not made changes in this particular way, but we  
26 have done these before, and once you start down that road, which we started down years ago,  
27 yes, the state does put itself in a difficult position, but not an impossible position."

28 (2) In response to the question of how the commissioner can test whether, and  
29 to what extent the state must give up public resources to promote the development of the  
30 state's resources, if, as here, there are no standards and no rules, Commissioner Shively has  
31 testified "When you make these decisions, it's like anything else, you have to use your best

1 judge it. I happen to believe that one of the problems with government is that we try to set  
2 all of these sorts of rules and guidelines, and it's what makes government unworkable. What  
3 you need is people that can make judgments, that can look at difficult situations, assess the  
4 information, and say this is a good idea or a bad idea. I see nothing wrong with that. I think  
5 that's better government, but this idea that we have now that if you just have enough rules and  
6 enough regulations, everything is going to be perfect is nuts. I mean, even the bidding  
7 process doesn't necessarily guarantee the state that you get your full value for your resources.  
8 You get the most somebody wants to pay for it. That may or may not be full value."

9 \* Sec. 2. ADDITIONAL FINDINGS AND POLICY. Based upon the findings of facts ~~set~~  
10 out above, the legislature finds:

11 (1) the production of oil and gas from state land is a matter of statewide  
12 interest and effect because it is the principal source of revenue to the state and provides  
13 important job opportunities for the people of the state;

14 (2) BP Exploration (Alaska) Inc. holds certain state oil and gas leases in the  
15 Northstar Unit that include net profit share provisions;

16 (3) BP Exploration (Alaska) Inc. has refused to develop the Northstar Unit  
17 leases unless the leases are amended to eliminate the net profit share provisions;

18 (4) unless the net profit share provisions of the Northstar Unit are amended,  
19 production of oil and gas from the unit is highly unlikely to begin before the year 2002;

20 (5) because of the development account provisions of the net profit share  
21 leases, the later that these leases are developed, the less "net profits" the state receives;

22 (6) if the net profit share provisions of the Northstar Unit leases are amended,  
23 full production of oil and gas from the unit may begin as early as the year 1999;

24 (7) amending the net profit share provisions of the Northstar Unit leases to  
25 provide for a supplemental royalty, instead of a share of net profits, will provide economic  
26 benefits of oil and gas production to the people of the state by encouraging production from  
27 the Northstar Unit earlier than it might otherwise occur under the terms of the Northstar Unit  
28 Agreement and the unit's approved Plan of Development;

29 (8) the development of the unit and the associated construction of unit facilities  
30 within the state will provide additional revenue to the state and increased job opportunities;

31 (9) the expedited development of the unit may result in increased state revenue

1 from future oil and gas lease sales;

2 (10) the expedited development of the unit may result in technological  
3 breakthroughs and other cost savings that may make other development opportunities in the  
4 state economically feasible;

5 (11) notwithstanding the anticipated benefits that may result from the  
6 amendment of the Northstar Unit's net profit share lease terms, the legislature reaffirms that  
7 it is the policy of the state to enforce the competitively bid terms of its oil and gas leases and  
8 that the commissioner of natural resources should assure that the state's oil and gas resources  
9 are being diligently and timely developed;

10 (12) the public's confidence that the terms of the state's oil and gas leases are  
11 being fairly and uniformly administered must be maintained;

12 (13) it is important to assure that there is no appearance of favoritism in the  
13 state's administration of its oil and leases; and therefore

14 (14) except as provided under sec. 3 of this Act, the commissioner of natural  
15 resources is directed not to negotiate the amendment of the competitively bid terms of any  
16 state oil and gas lease without prior explicit authorization by the legislature through the  
17 passage of a general act granting the authority to do so.

18 \* Sec. 3. (a) The State of Alaska and BP Exploration (Alaska) Inc. are parties to the  
19 following leases in the Northstar Unit:

20 (1) ADL 312798, effective February 1, 1980;

21 (2) ADL 312799, effective February 1, 1980;

22 (3) ADL 312808, effective February 1, 1980;

23 (4) ADL 312809, effective February 1, 1980; and

24 (5) ADL 355001, effective August 1, 1983.

25 (b) The commissioner of natural resources may amend the Northstar Unit leases  
26 described in (a) of this section as set out below:

27 **AMENDMENT TO THE NORTHSTAR UNIT LEASES**

28 **BETWEEN THE STATE OF ALASKA AND**

29 **BP EXPLORATION (ALASKA) INC.**

30 The State of Alaska ("State") and BP Exploration (Alaska) Inc.  
31 ("BPXA") are parties to the following leases in the Northstar Unit: ADL

1 312798, effective February 1, 1980; ADL 312799, effective February 1, 1980;  
2 ADL 312808, effective February 1, 1980; and ADL 312809, effective  
3 February 1, 1980 (collectively the "1980 Leases"); as well as ADL 355001,  
4 effective August 1, 1983 (the "1983 Lease"). The parties agree to amend the  
5 1980 Leases and the 1983 Lease as set forth in this amendment to the Northstar  
6 Unit leases.

#### 7 1980 Leases

8 (1) Paragraph 6(b) is replaced in its entirety as follows:

9 (b) Annual rental paid in advance is a credit on the royalty or  
10 supplemental royalty due under this lease for that year.

11 (2) Paragraph 7 is replaced in its entirety as follows:

12 7. SUPPLEMENTAL ROYALTY. (a) In addition to the  
13 royalty paid and computed under paragraphs 8, 10, and 11 below,  
14 Lessee shall pay to the State a supplemental royalty ("supplemental  
15 royalty"). Lessee shall pay the supplemental royalty, if owed, upon the  
16 same production volume for which royalty is paid ("production  
17 volume"). The supplemental royalty payment for a given month equals  
18 the supplemental royalty value times the supplemental royalty  
19 percentage rate ("percentage rate") times the production volume for that  
20 month. The percentage rate shall be calculated monthly by reference  
21 to: (1) an ANS West Coast spot price ("spot price"); and (2) a  
22 supplemental royalty trigger price ("trigger price"). If the spot price is  
23 equal to or less than the trigger price, then the percentage rate equals  
24 zero. If the spot price is greater than the trigger price, then the  
25 percentage rate equals [the spot price per barrel minus the trigger price  
26 per barrel] times 1.5 percent per dollar per barrel. The percentage rate  
27 may never exceed 7.5 percent.

28 (b) The spot price is the price per barrel calculated in Article  
29 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement  
30 Agreement ("ANS Agreement"), dated December 31, 1991, between the  
31 State and ANS, for the crude oil referred to as "ANS (USWC)" in the

1           ANS Agreement. The trigger price is \$17.35 per barrel through  
2           April 30, 1997. On May 1, 1997, and each May 1 thereafter, the  
3           trigger price shall be adjusted by an inflation factor equal to fifty  
4           percent of the "inflation rate" defined as the Producer Price Index for  
5           Industrial Commodities ("PPI") for December of the previous year, as  
6           reported by April 30 of the current year, divided by the PPI for  
7           December of 1995, as reported by April 30, 1996. The supplemental  
8           royalty value for oil, gas, natural gas liquids and associated substances  
9           is defined in paragraphs 10 and 11 below. Exhibit B is a sample  
10          calculation to demonstrate the method of calculating supplemental  
11          royalty for oil.

12          (3) Paragraph 9 is replaced in its entirety as follows:

13                 9. REDUCTION OF ROYALTY. Except as provided in  
14                 paragraph 7 above, Lessee shall not be entitled to any reduction of  
15                 royalty paid under paragraph 8 above or supplemental royalty paid  
16                 under paragraph 7 above based on any current or future agreement,  
17                 State statute, or State regulation.

18          (4) Paragraph 10 is replaced in its entirety as follows:

19                 10. ROYALTY IN VALUE. Unless the State elects to receive  
20                 all or a portion of its royalty or supplemental royalty in kind as  
21                 provided in paragraph 12 below, Lessee shall pay to the State the value  
22                 of all royalty and supplemental royalty oil, gas and associated  
23                 substances as determined under paragraph 11 below. Royalty and  
24                 supplemental royalty paid in value shall be free and clear of all lease  
25                 expenses (and any portion of such expenses which is incurred away  
26                 from the leased area), including, but not limited to, expenses for  
27                 separation, cleaning, dehydration, gathering, saltwater disposal, and  
28                 preparing the oil, gas or associated substances for transportation off the  
29                 leased area. All royalty and supplemental royalty that may become  
30                 payable in money to the State shall be paid on or before the last day of  
31                 the calendar month following the month in which the oil, gas or

1 associated substances are produced. Royalty and supplemental royalty  
2 payments shall be accompanied by copies of run tickets or such other  
3 information relating to valuation of royalty and supplemental royalty as  
4 the State may require, which may include, but is not limited to,  
5 evidence of sales, shipments, and amounts of gross oil, gas and  
6 associated substances produced.

7 (5) Paragraph 11 is replaced in its entirety as follows:

8 11. VALUE. For purposes of computing supplemental royalty  
9 due under this lease, the value of supplemental royalty oil, gas, natural  
10 gas liquids and associated substances shall be the value used in  
11 computing royalty on said substances.

12 (a) To compute the value of oil for royalty and supplemental  
13 royalty purposes, this lease shall be deemed an "ANS Lease" under the  
14 terms of the ANS Agreement, irrespective of any provision(s) of such  
15 agreement which would otherwise exclude this lease therefrom.

16 (b) To compute the value of gas and natural gas liquids for  
17 royalty and supplemental royalty purposes, this lease shall be deemed  
18 a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation  
19 Settlement Agreement between BPXA and the State dated as of April 1,  
20 1995, irrespective of any provision(s) of such agreement which would  
21 otherwise exclude this lease therefrom.

22 (c) To compute the value of associated substances (which shall  
23 be deemed to exclude oil, gas, and natural gas liquids) for royalty and  
24 supplemental royalty purposes, the value of such associated substances  
25 shall not be less than the highest of:

26 (1) the field price actually received by Lessee for such  
27 associated substances;

28 (2) Lessee's posted price in the field for such associated  
29 substances;

30 (3) the volume weighted average field price actually  
31 received by other producers in the same field or area for associated

1 substances of like kind and quality at the time such associated  
2 substances are removed from the leased or unit area; or

3 (4) the volume weighted average posted price in the  
4 field of other producers in the same field or area for associated  
5 substances of like kind and quality at the time such associated  
6 substances are removed from the leased or unit area.

7 If associated substances are sold away from the leased or unit  
8 area, the term "field price" above shall be the actual price for such  
9 associated substances received from the purchaser thereof less the actual  
10 cost of transportation away from the leased or unit area to the point of  
11 delivery.

12 Minimum Value Determinations. The State may establish  
13 minimum values for purposes of computing royalties on associated  
14 substances obtained from this lease, with consideration being given to  
15 the price actually received by Lessee, to the price or prices paid in the  
16 same field or area for production of like quality, to posted prices, to  
17 prices received by Lessee and/or other producers from sales occurring  
18 away from the leased area, and to other relevant matters. Each such  
19 determination will be made only after Lessee has been given notice and  
20 a reasonable opportunity to be heard. Under this provision, it is  
21 expressly agreed that the minimum value of royalty associated  
22 substances under this lease may not necessarily equal the price of such  
23 associated substances.

24 (6) The following provision shall be added to the end of paragraph 12:

25 (c) Supplemental royalty under paragraph 7 above may be taken  
26 in kind under the same terms and conditions as royalty may be taken  
27 in kind under this paragraph 12.

28 (7) Paragraph 14 is replaced in its entirety as follows:

29 14. APPORTIONMENT OF ROYALTY FROM APPROVED  
30 UNIT. The landowner's royalty and supplemental royalty share of the  
31 unit production allocated to each separately owned tract shall be

1           regarded as royalty to be distributed to and among, or the proceeds of  
2           it paid to, the landowners, free and clear of all unit expense and free of  
3           any lien for it. Under this provision, the State's royalty and  
4           supplemental royalty share of any unit production allocated to the  
5           leased area shall be regarded as royalty to be distributed to, or the  
6           proceeds of it paid to, the State, free and clear of all unit expenses (and  
7           any portion of such expenses which is incurred away from the unit  
8           area), including, but not limited to, expenses for separation, cleaning,  
9           dehydration, gathering, saltwater disposal, and preparing oil, gas or  
10          associated substances for transportation off the unit area, and free of  
11          any lien for it.

12          (8) Paragraph 28 (c) is added as follows:

13                 (c) Notwithstanding any other provisions of this lease, the  
14                 Northstar Unit Agreement, State statute, or State regulation, this lease  
15                 shall terminate automatically without notice, an opportunity to be heard,  
16                 or judicial proceeding, if the Lessee fails to comply with the sanction  
17                 schedule set forth in Exhibit C ("sanction schedule"), attached and  
18                 incorporated by reference. Automatic termination shall occur whether  
19                 or not there is a well on the leased area capable of producing oil or gas  
20                 in paying quantities, the lease is committed to a unit agreement, or the  
21                 Lessee is drilling or conducting reworking operations, on the date  
22                 performance under the schedule is due. Furthermore, upon termination  
23                 BPXA shall promptly file of record appropriate lease relinquishments.  
24                 The automatic termination shall occur at 11:59 P.M., Alaska Time, on  
25                 the day performance of the obligation under the sanction schedule is  
26                 due.

27          (9) Paragraph 32 is replaced in its entirety as follows:

28                 32. FORCE MAJEURE. If the State determines that Lessee has  
29                 been prevented, after diligent efforts made in good faith, from  
30                 complying with any express or implied promise, term, condition or  
31                 covenant of this lease (other than the obligation to provide project

1 sanction within twelve (12) months of the passage by the legislature of  
2 an Act authorizing an Amendment to the Northstar Unit leases for the  
3 project), from conducting drilling operations, or from producing or  
4 marketing oil or gas from the leased area, by reason of war, riots, acts  
5 of God, unusually severe weather, or any other cause beyond Lessee's  
6 reasonable ability to foresee or control (including delays caused by  
7 judicial decision or lack thereof or inability to obtain local, State, or  
8 federal permits or environmental impact statements), whether similar to  
9 those enumerated or not, Lessee's obligation to comply with such  
10 provision shall be suspended, but not voided, and Lessee shall not be  
11 liable for damages for failure to comply therewith. If Lessee's  
12 obligations to conduct drilling or reworking operations are suspended  
13 under this paragraph and the continuation of such operations without  
14 suspension would have had the effect of preventing the expiration or  
15 termination of this lease, this lease shall not terminate during the period  
16 which the obligation to perform such operations is suspended. Nothing  
17 in this paragraph shall be construed to suspend the obligation to pay  
18 rentals, or to suspend the obligation to pay royalties, supplemental  
19 royalties or other production payments from operations on the lease area  
20 which are not suspended or from operations which are not affected by  
21 any such suspension, to the State.

22 (10) Paragraph 41 is replaced in its entirety as follows:

23 41. FABRICATION OF PRODUCTION AND PROCESSING  
24 MODULES WITHIN ALASKA AND EMPLOYMENT OF ALASKAN  
25 RESIDENTS. Lessee agrees to utilize on-site production and  
26 processing modules for development of the Northstar oil field, and  
27 agrees to fabricate those modules within Alaska. The State of Alaska  
28 will not be responsible for contributing to any capital expenditures  
29 required to prepare, develop or operate any sites or facilities necessary  
30 for the fabrication, transportation or installation of the Northstar Unit  
31 production and processing modules. All expenses associated with the

1 design, fabrication, transportation and installation of production and  
 2 processing modules required for the development of the Northstar oil  
 3 field will be the sole responsibility of BP Exploration (Alaska) Inc. and  
 4 its contractors.

5 Lessee shall comply with all valid federal, State and local laws  
 6 in hiring Alaska residents and contractors and shall not discriminate  
 7 against Alaska residents or contractors. Within the constraints of law,  
 8 Lessee shall employ Alaska residents and contractors to the extent they  
 9 are available and qualified. Subject to the foregoing:

10 Lessee voluntarily agrees to hire residents of Alaska. Lessee  
 11 shall advertise for available positions locally and use Alaska job service  
 12 organizations to notify the Alaskan public. For work in connection with  
 13 this lease, Lessee shall <sup>purchase materials and services from</sup> contract with Alaska firms <sup>Alaska vendors, suppliers and consultants and</sup> and fabricate  
 14 the modules for on-site production and processing facilities in Alaska.  
 15 Lessee shall require its contractors to employ and train, when necessary,  
 16 residents of Alaska. Lessee shall submit annually to the Director,  
 17 Division of Oil and Gas, for transmission to the President of the Senate  
 18 and the Speaker of the House of Representatives, a report that details  
 19 the specific measures Lessee and its contractors and subcontractors have  
 20 taken or are planning to take to recruit qualified Alaska residents for  
 21 available jobs, describes on-the-job training opportunities, and describes  
 22 Lessee's efforts to hire Alaska firms for work in connection with this  
 23 lease. Lessee shall furnish the Department of Labor, for transmission  
 24 to the President of the Senate and the Speaker of the House of  
 25 Representatives, a quarterly report regarding the employment of Alaska  
 26 residents on the lease area in compliance with regulations by the  
 27 Department of Labor. The report must also include statistical data  
 28 concerning the number of resident personnel hired within the past year  
 29 for this lease.

#### 30 1983 Lease

31 (1) Paragraph 4(f) and paragraph 34(7) are deleted and replaced in their

1 entirety with the following paragraph 4(f):

2 (f) FORCE MAJEURE. If the State determines that lessee has  
3 been prevented, after diligent efforts made in good faith, from  
4 complying with any express or implied promise, term, condition or  
5 covenant of this lease (other than the obligation to provide project  
6 sanction within twelve (12) months of the passage by the legislature of  
7 an Act authorizing an Amendment to the Northstar Unit leases for the  
8 project), from conducting drilling operations, or from producing or  
9 marketing oil or gas from the leased area, by reason of war, riots, acts  
10 of God, unusually severe weather, or any other cause beyond lessee's  
11 reasonable ability to foresee or control (including delays caused by  
12 judicial decision or lack thereof or inability to obtain local, State, or  
13 federal permits or environmental impact statements), whether similar to  
14 those enumerated or not, lessee's obligation to comply with such  
15 provision shall be suspended, but not voided, and lessee shall not be  
16 liable for damages for failure to comply therewith. If lessee's  
17 obligations to conduct drilling or reworking operations are suspended  
18 under this paragraph and the continuation of such operations without  
19 suspension would have had the effect of preventing the expiration or  
20 termination of this lease, this lease shall not terminate during the period  
21 which the obligation to perform such operations is suspended. Nothing  
22 in this paragraph shall be construed to suspend the obligation to pay  
23 rentals, or to suspend the obligation to pay royalties, supplemental  
24 royalties or other production payments from operations on the lease area  
25 which are not suspended or from operations which are not affected by  
26 any such suspension, to the State.

27 (2) Paragraph 5(b) is replaced in its entirety as follows:

28 (b) Annual rental paid in advance is a credit on the royalty or  
29 supplemental royalty due under this lease for that year.

30 (3) Paragraph 7 is replaced in its entirety as follows:

31 7. APPORTIONMENT OF ROYALTY FROM APPROVED

1 UNIT. The State's royalty and supplemental royalty share of the unit  
2 production allocated to each separately owned tract must be regarded  
3 as royalty to be distributed to or among, or the proceeds of it paid to,  
4 the State, free and clear of all unit expenses and free of any lien for  
5 them. Under this provision, the State's royalty and supplemental royalty  
6 share of any unit production allocated to the leased area will be  
7 regarded as royalty to be distributed to, or the proceeds of it paid to, the  
8 State, free and clear of all unit expenses (and any portion of those  
9 expenses incurred away from the unit area), including, but not limited  
10 to, expenses for separating, cleaning, dehydration, gathering, saltwater  
11 disposal, and preparing oil, gas, or associated substances for  
12 transportation off the unit area, and free of any lien for them.

13 (4) A new paragraph 20(c) is added as follows:

14 (c) Notwithstanding any other provisions of this lease, the  
15 Northstar Unit Agreement, State statute, or State regulation, this lease  
16 shall terminate automatically without notice, an opportunity to be heard,  
17 or judicial proceeding, if the lessee fails to comply with the sanction  
18 schedule set forth in Exhibit C ("sanction schedule"), attached and  
19 incorporated by reference. Automatic termination shall occur whether  
20 or not there is a well on the leased area capable of producing oil or gas  
21 in paying quantities, the lease is committed to a unit agreement, or the  
22 lessee is drilling or conducting reworking operations, on the date  
23 performance under the schedule is due. Furthermore, upon termination  
24 BPXA shall promptly file of record appropriate lease relinquishments.  
25 The automatic termination shall occur at 11:59 P.M., Alaska Time, on  
26 the day performance of an obligation under the sanction schedule is  
27 due.

28 (5) Paragraph 31 is replaced in its entirety as follows:

29 31. FABRICATION OF PRODUCTION AND PROCESSING  
30 MODULES WITHIN ALASKA AND EMPLOYMENT OF ALASKAN  
31 RESIDENTS. Lessee agrees to utilize on-site production and

1 processing modules for development of the Northstar oil field, and  
2 agrees to fabricate those modules within Alaska. ~~The State of Alaska~~  
3 will not be responsible for contributing to any capital expenditures  
4 required to prepare, develop or operate any sites or facilities necessary  
5 for the fabrication, transportation or installation of the Northstar Unit  
6 production and processing modules. All expenses associated with the  
7 design, fabrication, transportation and installation of production and  
8 processing modules required for the development of the Northstar oil  
9 field will be the sole responsibility of BP Exploration (Alaska) Inc. and  
10 its contractors.

11 Lessee shall comply with all valid federal, State and local laws  
12 in hiring Alaska residents and contractors and shall not discriminate  
13 against Alaska residents or contractors. Within the constraints of law,  
14 Lessee shall employ Alaska residents and contractors to the extent they  
15 are available and qualified. Subject to the foregoing:

16 Lessee voluntarily agrees to hire residents of Alaska. Lessee  
17 shall advertise for available positions locally and use Alaska job service  
18 organizations to notify the Alaskan public. For work in connection with  
19 this lease, Lessee shall contract with Alaska firms and fabricate the  
20 modules for on-site production and processing facilities in Alaska.  
21 Lessee shall require its contractors to employ and train, when necessary,  
22 residents of Alaska. Lessee shall submit annually to the Director,  
23 Division of Oil and Gas, for transmission to the President of the Senate  
24 and the Speaker of the House of Representatives, a report that details  
25 the specific measures Lessee and its contractors and subcontractors have  
26 taken or are planning to take to recruit qualified Alaska residents for  
27 available jobs, describes on-the-job training opportunities, and describes  
28 Lessee's efforts to hire Alaska firms for work in connection with this  
29 lease. Lessee shall furnish the Department of Labor, for transmission  
30 to the President of the Senate and the Speaker of the House of  
31 Representatives, a quarterly report regarding the employment of Alaska

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residents on the lease area in compliance with regulations by the Department of Labor. The report must also include statistical data concerning the number of resident personnel hired within the past year for this lease.

(6) Paragraph 35 is replaced in its entirety as follows:

35. ROYALTY ON PRODUCTION. Except for oil, gas, and associated substances used on the leased area for development and production or unavoidably lost, the lessee shall pay to the State as a royalty 20 percent in amount or value of the oil, gas, and associated substances saved, removed, or sold from the leased area and of the gas used on the leased area for extraction of natural gasoline or other products from the leased area.

(7) Paragraph 36 is replaced in its entirety as follows:

36. VALUE. For purposes of computing supplemental royalty due under this lease, the value of supplemental royalty oil, gas, natural gas liquids, and associated substances shall be the value used in computing royalty on said substances.

(a) To compute the value of oil for royalty and supplemental royalty purposes, this lease shall be deemed an "ANS Lease" under the terms of the ANS Agreement, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(b) To compute value of gas and natural gas liquids for royalty and supplemental royalty purposes, this lease shall be deemed a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation Settlement Agreement between BPXA and the State dated as of April 1, 1995, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(c) To compute the value of associated substances (which shall be deemed to exclude oil, gas, and natural gas liquids) for royalty and supplemental royalty purposes, the value of such associated substances shall not be less than the highest of:

1 (1) the field price actually received by lessee for such  
2 associated substances;

3 (2) Lessee's posted price in the field for such associated  
4 substances;

5 (3) the volume weighted average field price actually  
6 received by other producers in the same field or area for associated  
7 substances of like kind and quality at the time such associated  
8 substances are removed from the leased or unit area; or

9 (4) the volume weighted average posted price in the  
10 field of other producers in the same field or area for associated  
11 substances of like kind and quality at the time such associated  
12 substances are removed from the leased or unit area.

13 If associated substances are sold away from the leased or unit  
14 area, the term "field price" above shall be the actual price for such  
15 associated substances received from the purchaser thereof less the actual  
16 cost of transportation away from the leased or unit area to the point of  
17 delivery.

18 Minimum Value Determination: The State may establish  
19 minimum values for purposes of computing royalties on associated  
20 substances obtained from this lease, with consideration being given to  
21 the price actually received by lessee, to the price or prices paid in the  
22 same field or area for production of like quality, to posted prices, to  
23 prices received by lessee and/or other producers from sales occurring  
24 away from the leased area, and to other relevant matters. Each such  
25 determination will be made only after lessee has been given notice and  
26 a reasonable opportunity to be heard. Under this provision, it is  
27 expressly agreed that the minimum value of royalty associated  
28 substances under this lease may not necessarily equal the price of such  
29 associated substances.

30 (8) Paragraph 37 is replaced in its entirety as follows:

31 37. ROYALTY IN VALUE. Unless the State elects to receive

1 all or a portion of its royalty or supplemental royalty in kind as  
2 provided in paragraph 38, lessee shall pay to the State the value of all  
3 royalty and supplemental royalty oil, gas and associated substances as  
4 determined under paragraph 36. Royalty and supplemental royalty paid  
5 in value shall be free and clear of all lease expenses (and any portion  
6 of such expenses which is incurred away from the leased area),  
7 including, but not limited to, expenses for separation, cleaning,  
8 dehydration, gathering, saltwater disposal, and preparing the oil, gas or  
9 associated substances for transportation off the leased area. All royalty  
10 and supplemental royalty that may become payable in money to the  
11 State shall be paid on or before the last day of the calendar month  
12 following the month in which the oil, gas or associated substances are  
13 produced. Royalty and supplemental royalty payments shall be  
14 accompanied by copies of run tickets or such other information relating  
15 to valuation of royalty and supplemental royalty as the State may  
16 require, which may include, but is not limited to, evidence of sales,  
17 shipments, and amounts of gross oil, gas and associated substances  
18 produced.

19 (9) The following provisions shall be added to the end of paragraph 38:

20 (f) Supplemental royalty under this lease may be taken in kind  
21 under the same terms and conditions as royalty may be taken in kind  
22 under this paragraph 38.

23 (10) Paragraph 39 is replaced in its entirety as follows:

24 39. REDUCTION OF ROYALTY. Except as provided in  
25 paragraph 40 below, lessee shall not be entitled to any reduction of  
26 royalty paid under paragraph 35 above or supplemental royalty paid  
27 under paragraph 40 below based on any current or future agreement,  
28 State statute, or State regulation.

29 (11) Paragraph 40 is replaced in its entirety as follows:

30 40. SUPPLEMENTAL ROYALTY. (a) In addition to the  
31 royalty paid and computed under paragraphs 35, 36, 37 above, lessee

1 shall pay to the State a supplemental royalty ("supplemental royalty").  
2 Lessee shall pay the supplemental royalty, if owed, upon the same  
3 production volume for which royalty is paid ("production volume").  
4 The supplemental royalty payment for a given month equals the  
5 supplemental royalty value times the supplemental royalty percentage  
6 rate ("percentage rate") times the production volume for that month.  
7 The percentage rate shall be calculated monthly by reference to: (1) an  
8 ANS West Coast spot price ("spot price"); and (2) a supplemental  
9 royalty trigger price ("trigger price"). If the spot price is equal to or  
10 less than the trigger price, then the percentage rate equals zero. If the  
11 spot price is greater than the trigger price, then the percentage rate  
12 equals [the spot price per barrel minus the trigger price per barrel] times  
13 1.5 percent per dollar per barrel. The percentage rate may never exceed  
14 7.5 percent.

15 (b) The spot price is the price per barrel calculated in Article  
16 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement  
17 Agreement ("ANS Agreement"), dated December 31, 1991, between the  
18 State and BP Exploration (Alaska) Inc. for the crude oil referred to as  
19 "ANS (USWC)" in the ANS Agreement. The trigger price is \$17.35  
20 per barrel through April 30, 1997. On May 1, 1997, and each May 1  
21 thereafter, the trigger price shall be adjusted by an inflation factor equal  
22 to fifty percent of the "inflation rate" defined as the Producer Price  
23 Index for Industrial Commodities ("PPI") for December of the previous  
24 year, as reported by April 30 of the current year, divided by the PPI for  
25 December of 1995, as reported by April 30, 1996. The supplemental  
26 royalty value for oil, gas, natural gas liquids and associated substances  
27 is defined in paragraphs 36 and 37 above. Exhibit B is a sample  
28 calculation to demonstrate the method of calculating supplemental  
29 royalty for oil.

30 These amendments do not affect: (1) any future agreements which may  
31 be reached for the handling of outside substances as that term is used in the

1 Northstar Unit Agreement effective January 24, 1990, or (2) the current  
 2 valuation methodology for royalty for any other Alaska Net Profit Share leases  
 3 between the State and BP Exploration (Alaska) Inc. or any affiliates or any  
 4 future agreements which may be reached regarding a future valuation  
 5 methodology for Alaska Net Profit Share leases. These amendments take effect  
 6 on the first day following delivery of a letter from the commissioner of the  
 7 Department of Natural Resources to the Revisor of Statutes, with copies to the  
 8 President of the Senate and the Speaker of the House of Representatives,  
 9 confirming that BP Exploration (Alaska) Inc. or its parent entity has made an  
 10 irrevocable commitment of full funding (project sanction) to develop the North  
 11 Star Oil Field. This amendment is dated for reference purposes as of \_\_\_\_\_  
 12 \_\_\_\_\_ (Date).

13 LESSEE: LESSOR:  
 14 BP EXPLORATION (ALASKA), INC. STATE OF ALASKA  
 15 \_\_\_\_\_  
 16 \_\_\_\_\_, Vice President \_\_\_\_\_, Commissioner  
 17 Department of Natural Resources

18 STATE OF ALASKA )  
 19 ) ss.  
 20 Third Judicial District )  
 21 On \_\_\_\_\_, 1996, before me appeared \_\_\_\_\_,  
 22 Commissioner, State of Alaska, Department of Natural Resources, and who  
 23 executed this lease and acknowledged voluntarily signing it on behalf of the  
 24 State of Alaska, as lessor.

25 \_\_\_\_\_  
 26 Notary Public in and for the State of Alaska  
 27 My Commission expires: \_\_\_\_\_  
 28 STATE OF ALASKA )  
 29 ) ss.  
 30 Third Judicial District )  
 31 On \_\_\_\_\_, 1996, before me appeared \_\_\_\_\_

1 Vice President of BP Exploration (Alaska), Inc. and who executed this lease  
 2 and acknowledged voluntarily signing it on behalf of the BP Exploration  
 3 (Alaska), Inc. as lessee.

4 \_\_\_\_\_  
 5 Notary Public in and for the State of Alaska

6 My Commission expires: \_\_\_\_\_

7 Exhibit B

8 Calculation of the Supplemental Royalty Payment for Oil

9 (1) The calculation of the ANS West Coast spot price is derived  
 10 from Platt's "Oilgram Price Report" Spot Crude Price Assessments:

11 Platt's Reported Daily

12 Assessment (\$/barrel)

13 Date	14 ANSWC Low	15 ANSWC High	16 ANSWC Daily Average	17 ANSWC Daily Average (After Rounding) <sup>1</sup>
18 01/02/96	\$17.97	\$18.06	\$18.015	\$18.02
19 01/03/96	\$17.94	\$18.03	\$17.985	\$17.98
20 01/04/96	\$17.96	\$18.03	\$17.995	\$18.00
21 01/05/96	\$18.60	\$18.64	\$18.620	\$18.62
22 01/09/96	\$18.23	\$18.29	\$18.260	\$18.26
23 01/10/96	\$17.99	\$18.05	\$18.020	\$18.02
24 01/11/96	\$17.10	\$17.17	\$18.135	\$17.14
25 01/12/96	\$16.64	\$16.71	\$18.675	\$16.68
26 01/15/96	\$16.75	\$16.83	\$16.690	\$16.79
27 01/16/96	\$16.60	\$16.66	\$16.730	\$16.63
28 01/17/96	\$16.91	\$16.97	\$16.940	\$16.94
29 01/18/96	\$17.46	\$17.54	\$17.500	\$17.50
	\$17.28	\$17.37	\$17.325	\$17.32
	\$17.02	\$17.08	\$17.050	\$17.05

1 \_\_\_\_\_  
 2 All source and calculated numbers shall be rounded as required in the ANS  
 3 Agreement.

1	01/23/96	\$17.10	\$17.16	\$17.150	\$17.13
2	01/24/96	\$17.35	\$17.41	\$17.380	\$17.38
3	01/25/96	\$16.76	\$16.81	\$17.785	\$16.78
4	01/26/96	\$16.43	\$16.53	\$17.480	\$16.48
5	01/29/96	\$16.16	\$16.24	\$16.200	\$16.20
6	01/30/96	\$16.30	\$16.38	\$16.340	\$16.34
7	01/31/96	\$16.46	\$16.56	\$16.510	\$16.51

8 Monthly Average calculated from ANSWC Daily

9 Average (After Rounding) = \$17.2271 per barrel

10 ANS West Coast spot price for the January 1996

11 month of production = \$17.23 per barrel

12 (2) The inflation factor shall be calculated as follows: Assume  
13 that by April 30, 1996, the U.S. Department of Labor reports a PPI for  
14 December 1995 as 126.2. Assume that by April 30, 1998, the PPI for  
15 December 1997 is 134.2. The inflation factor for 1998 is calculated according  
16 to the following formula:

17 Inflation Factor for May 1, 1998, through April 30, 1999

18 = [(PPI December of the previous year ÷ PPI December 1995) - 1] x 0.5

19 = [(134.2 ÷ 126.2) - 1] x 0.5 = 0.0317 = 3.17 percent

20 (3) The trigger price for May 1, 1998, through April 30, 1999,  
21 is calculated by adjusting \$17.35 per barrel by the inflation factor as follows:

22 Trigger price for the current year = \$17.35 per barrel x (1 + inflation factor)

23 = \$17.35 per barrel x (1 + 3.17 percent)

24 = \$17.35 x 1.0317

25 = \$17.90 per barrel

26 (4) Assuming the current month ANSWC spot price is \$21.40,  
27 the supplemental royalty percentage rate is calculated as:

28 Supplemental royalty percentage rate = (ANSWC spot price - trigger price for the  
29 current year) x (1.5 percent per dollar per barrel)

30 = (\$21.40 per barrel - \$17.90 per barrel) x 1.5 percent per dollar per barrel

31 = (21.40 - 17.90) x 0.015

1 = 0.05250 = 5.25 percent

2 (5) The calculation of the supplemental royalty payment for the  
3 current month is the product of the production volume times the royalty value  
4 and the supplemental royalty percentage rate. Assume that 1,550,000 barrels  
5 of oil were produced in the Northstar unit in the current month and that the  
6 royalty value is \$17.71. The supplemental royalty is:

7 Supplemental royalty payment = production volume x royalty value x supplemental  
8 royalty percentage rate

9 = 1,550,000 barrels x \$17.71 per barrel x 5.25 percent

10 = \$1,441,151.25

### 11 EXHIBIT C

#### 12 SANCTION SCHEDULE

13 The Northstar Development Project ("the Project") is described in the  
14 document titled "Northstar Development Project, Conceptual Engineering  
15 Report" dated February 1996. BPXA shall comply with the following sanction  
16 schedule for the Project and shall provide satisfactory evidence of compliance  
17 within fifteen (15) days of the date performance is due under the schedule:

18 BPXA shall receive Project sanction within twelve (12) months after  
19 passage by the legislature of an Act approving the Amendment to the Northstar  
20 Unit Leases for the Project. "Project sanction" means approval in writing by  
21 the highest appropriate authority in BPXA or its parent entity necessary for the  
22 total amount of expenditures required for the Project. Satisfactory evidence of  
23 receipt of sanction shall be tendered to the State in the form of the sanctioning  
24 entity's documents approving the expenditure of funds for the Project. Project  
25 sanction by BPXA or its parent entity shall be irrevocable. If project sanction  
26 is withdrawn for any reason whatsoever, BPXA shall notify the State within  
27 three working days by letter from an authorized officer and BPXA shall be  
28 deemed to have failed to comply with this schedule.

29 (c) ~~Notwithstanding any other provision of law, the "Amendment to the Northstar Unit~~  
30 ~~Leases Between the State of Alaska and BP Exploration (Alaska) Inc."~~ as described in (b) of  
31 this section, if voluntarily agreed to by the commissioner of natural resources and BP

- 1 Exploration (Alaska) Inc., is approved and ratified.
- 2 \* Sec. 4. This Act takes effect on the first day following delivery of a letter from the
- 3 commissioner of natural resources to the revisor of statutes, with copies to the president of the
- 4 senate and the speaker of the house of representatives, confirming that BP Exploration
- 5 (Alaska) Inc. or its parent entity has made an irrevocable commitment of full funding
- 6 (projection sanction) to develop the Northstar Oil Field.



E. M. Luttrell  
Vice President  
Exploration, Alaska

**BP EXPLORATION**

BP Exploration (Alaska) Inc  
600 East Benson Boulevard  
P.O. Box 198812  
Anchorage, Alaska 99519-8812  
(907) 564-4892

April 18, 1996

Senator Loren Leman  
Alaska State Legislature  
State Capitol (MS 3100)  
Juneau, Alaska 99801-1182

Subject: BP position on the CS for Senate Bill 318

Dear Senator Leman:

BP has reached a negotiated agreement with the State of Alaska to amend the Northstar unit leases. The Legislature has been asked to consider and ratify that agreement. Ratification will lead to the early development of Northstar to the mutual benefit of both Alaska and BP.

The CS (Committee Substitute) has altered the agreement, attempting to reopen the negotiation. All of the areas of the original agreement which have been amended in the CS version are areas which were carefully discussed and negotiated to arrive at a balanced agreement. Both we and the DNR have sought to explain to your committee the reason for these conclusions. BP will not reopen the negotiations and can not agree to the changes.

To be clear, BP and its contractors have heard the concern of the Legislature over local hire and we reaffirm our public commitment to maximize the job opportunities for Alaskans and Alaskan contractors represented by Northstar development.

Sincerely,



Eric M. Luttrell

EML/dd

cc: President Drue Pearce  
Speaker Gail Phillips  
Commissioner John Shively

State of Alaska  
 Department of Natural Resources  
*Division of Oil and Gas - Director's Office*

3601 C Street, Suite 1380, Anchorage, Alaska 99503  
 Phone 907-269-8784 Fax 907-562-3852

*Fax transmittal*



To: Lenston Loren Loren

Fax Number: 907-465-3810

From: Ken Boyd

Date & Time: 4/23/96 10:05 am

Number of Pages (including cover sheet): 27

Comments:

TONY KNOWLES, GOVERNOR

## DEPARTMENT OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

3601 C STREET, SUITE 1380  
ANCHORAGE, ALASKA 99503-5848  
PHONE: (907) 762-2549

April 23, 1996

The Honorable Loren Leman  
Chairman, Senate Resources Committee  
Alaska State Legislature  
State Capitol Building, Room 113  
Juneau, Alaska 99801-1182  
MAIL STOP 3100

Dear Senator Leman:

The Division believes that the "so-called" findings of fact in Section 1 of CS for SB 318 (RES.) should be dropped. The findings are replete with opinion rather than facts, and for the most part add little to the debate. If the committee is intent on leaving them in the bill, the Division has drafted suggested changes. The Division believes that the findings are unsatisfactory in two principal areas. For the most part, the Division's suggestions are directed at these two areas.

First, the findings unfairly suggest that the Division's extension of the NSU and the approval of the revised three-year plan of development (POD) in 1995 was somehow out of the ordinary and was not designed to encourage early exploration and development. In essence by allowing the unit to continue in effect, the Division continued two leases that would have otherwise expired. Also the Division did not take the drastic step of ordering production from the certified wells on the other three leases. The decision was consistent with over twenty previous decisions, which the Division has identified after just a perusal of in-house records, that have extended leases without mandating production.

To illustrate the findings' skewed approach, let us examine the 1990 decision by Director Eason, now the committee's advisor, to approve the NSU. The findings claim that the POD which Director Eason approved was "designed to encourage expedited evaluation and development" of the NSU. Initially, the Division notes that there has been no testimony supporting this opinion. While the Division does not necessarily disagree with the statement, it does disagree with the implication that the 1990 decision was designed to encourage expedited evaluation and development, but the 1995 was not. In 1990, four of the five leases were due to expire. Instead of approving the unit, the Division could have caused the one lease without a certified well to automatically revert back to the state and it could have ordered the three leases with certified wells into production. It could have competitively rebid the one lease and, if the others were not placed into production, it could have terminated them and released them. The Division did not. There is no evidence that it consulted the DOL about these possibilities. It was unnecessary, just as it was unnecessary in 1995, because as

The Honorable Loren Leman

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April 23, 1996

a matter of consistent policy since at least 1977, the Division has believed that it is better to work with the current lessees to get a mutually acceptable POD that hopefully encourages early exploration and production rather than require the return of leases or force production.

In 1990, the Division settled for a POD that, while giving the state some fee obligation payments, did not even require the drilling of one well. There was no requirement that Amerada Hess drive down development costs. There was no requirement that Amerada Hess be in production before the 5 year term ended. (For your information, there was nothing unique about the five year term as suggested by the findings.) Indeed, the POD contemplated a further extension if during the five-year term Amerada Hess could show the field was economic. Although the intent of the POD might have been expedited exploration and development, the POD did not deliver it. At the end of the term, Amerada Hess had drilled only one more well, had a development plan that was totally uneconomic, and had not produced a drop of oil. The current three-year POD at least provides for project sanction by the end of the three-year plan.

The extension of leases by putting them into units could be argued to violate the competitive bid process. The leases were bid for a set primary term. What the state wants is production. If the current lessee has not delivered, why not take the leases back? The consistent answer is that if the current lessee and the Division can agree to a POD, the Division believes that the state is better off than trying to take the leases back. In all situations, the POD is negotiated with the Division typically wanting more, sooner; and the lessee wanting less, later. Ultimately, the Division's goal has been to obtain development as soon as reasonably possible. Rentals or payments in lieu of drilling obligations provide minimal revenue in comparison to what the state receives if a lease is put into production.

If the Senate is critical of the 1995 decision, then it should be critical of all these past decisions. This lease extension issue has been previously visited by the legislature when it considered whether the Division should have authority to form exploratory units. Previous legislatures did not take this authority away from the Division. If the Senate believes that the Division should not have the authority, then it should mandate a change in that policy by changing the law. The Division suspects that there would be a cry of anguish from industry for virtually every company drilling wells in Alaska has at one time or another asked the Division to extend leases by putting them into exploratory units or deferring the contraction of leases from a unit. The result would not be partnering or trying to get reasonable exploration and development. It would be slavish attention to the competitive bidding process.

The second principal objection is the slant of the findings on the economic issues. Initially, the findings overstate the likely economic benefits the Division believes could be obtained if the leases were relet. Next, in comparing the benefits of supplemental royalty against the net profit share, the findings emphasize the effects of the upside cases while ignoring the downside cases. Finally, the findings improperly focus on whether the deal is a "good" deal or an "OK" deal. When was the last time anyone of us can say we got a "good" deal. If the Division were to say that the state got a good

The Honorable Loren Leman

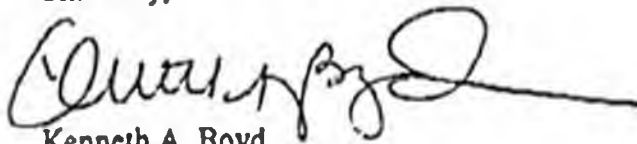
3

April 23, 1996

deal, doesn't that imply that BP got a bad deal? In most negotiations, each party will give up things that it would rather not. The Division's position is that even without any Alaska Hire, this deal would be a reasonable deal for the state, no more or no less. If BP honors its commitment to Alaska Hire, and the fabrication industry in this state is able to expand and become competitive on a world wide basis, then the deal could be characterized as a good deal or maybe even a great deal.

Again, the Division believes that the committee should drop the findings in Section 1 altogether. If the committee chooses to do otherwise, then the Division has enclosed its proposed amendments.

Sincerely,



Kenneth A. Boyd  
Director

Enclosures

**MEMORANDUM**  
DEPARTMENT OF NATURAL RESOURCES**State of Alaska**  
DIVISION OF OIL AND GASTO: Patrick Coughlin  
Deputy Director/Petroleum Investments  
Manager

DATE: April 23, 1996

TELEPHONE NO: 269-8812

FROM: Mike Kotowski ~~MDK~~  
Units ManagerSUBJECT: Unit Decisions  
Extending Leases

Per your request, attached is a list of units and unit expansions approved by the DNR which extended leases beyond their primary term. The list includes the date of application for the unit agreement or unit expansion, the date the application was approved, the date the unit terminated (if terminated), and the director of the Division of Oil and Gas or commissioner of the DNR approving the application.

Attachment

Unit	Operator	Date of Application	Date of Approval	Date of Termination	Director	Commissioner	
Astoch	Conoco	7/30/90	11/16/90	10/8/92	James E. Eason	Glenn Olds	
Budoni	BP	11/18/84	3/13/86			Mary Patherford, Dep. Co.	
Big Flyer	ARCO	8/24/84	8/21/90	4/8/91	James E. Eason	Rod Swape	
Deck Island	Esxon to BP	2/3/78	8/21/78			Fred Bonema, Dep. Co.	
Falls Creek	Chevron to ARCO	8/30/88	12/21/80		Leo Petersen, Acting Dir, DOI	Rosecoe E. Bell	
Gaydyr Bay	Conoco	4/28/78	10/23/78	10/1/82		R. LaRoché	
Hemi Springs	ARCO	11/14/83	1/17/84	10/1/82	Key Brown	Eather Winnick	
Jensen Island	AMCO to Amerasia Hess	8/27/82	12/18/82	8/8/84	James E. Eason	Glenn Olds	
Kavli	ARCO	8/27/72	3/23/73			Charles F. Herbert	
Kukpik	ARCO	4/10/82	8/10/82		James E. Eason	Glenn Olds	
Mine Point	Conoco	4/27/78	10/29/78			R. LaRoché	
MPU Expansion	Conoco	10/23/91	3/2/92		James E. Eason	Harold G. Heliza	
Nicola Creek	Texaco	3/11/84	3/15/88			Thomas Kelley	
North Fort	Chevron	5/4/85	5/25/85			Rosecoe E. Bell	
Northstar	Amerasia Hess to BP	10/12/88	1/24/90		James E. Eason	Lennie Gorsuch	
Point Thomson	Esxon	10/21/78	8/1/77		J.P. Green, DNEM	R. LaRoché	
Point Thomson Expansion	Esxon	1/13/84	3/28/84		Key Brown	Eather Winnick	
Prudhoe Bay/Nizak*	BP/ARCO	10/27/86	2/25/87		James E. Eason	Judith Brady	
Prudhoe Bay/Pt. McIntyre*	BP/ARCO	10/27/86	2/25/87		James E. Eason	Judith Brady	
		* Involved deferral of PBU contract for 4 leases					
Thesis Island	Esxon	11/13/82	2/12/93	5/15/82	James E. Eason	Glenn Olds	
W McArthur River	Stewart Petroleum	4/18/80	7/27/80		James E. Eason	Rod Swape	

Amendment to Page 1, Line 13, Paragraph 1

Replace with...

(1) The net profit share provision of four of the five state leases now included in the Northstar Unit was the competitively bid variable when the leases were originally offered for lease. The leases were offered with a fixed per acre cash bonus and a fixed royalty of 20 percent, and bidders were asked to submit sealed competitive bids based upon the percentage of net profits that the bidder would share with the state. According to the Department of Natural Resources, the average of the winning net profit share bids for these leases was "about 89 percent." As to the fifth state lease, the net profit share and royalty were fixed by the Department of Natural Resources at 40 percent and 12 1/2 percent, respectively, and the competitively bid variable was the amount of bonus offered by the bidders.

Amendment to Page 2, Line 30, Paragraph 1

Replace with...

(1) [ FOLLOWING LENGTHY NEGOTIATIONS BETWEEN THE AMERADA HESS CO., THE DEPARTMENT OF NATURAL RESOURCES, AND THE MINERALS MANAGEMENT SERVICE,] Instead of attempting to take back the four leases which were due to expire so that they could be competitively released, then Director Eason of the Department of Natural Resources along with [AND] the Minerals Management Service approved formation of the Northstar Unit and its initial

Plan of Development, thereby extending the ten-year primary term of the leases committed to the unit. The Department of Natural Resources' action in approving this exploratory unit which effectively extended all four state leases beyond their primary term (and effectively precluding competitively releasing them) without any certainty of production was consistent with the department's actions on a multitude of units including: Prudhoe Bay/Niakuk deferral, Prudhoe Bay/Point McIntyre deferral, Milne Point formation, Milne Point Expansion, Duck Island, Point Thomson, Point Thomson Expansion, Thetis Island, Heml Springs, Big River, Astoch, Badami, Kuuknik, Northstar formation, Northfork, Nicolai Creek, Kavik, Jones Island, Falls Creek, West McAurthur River, and Gwydyr Bay. There has been no evidence that the Department of Natural Resources sought the Department of Law's advice in connection with his 1990 decision about taking back the leases without certified wells and forcing the leases with certified wells into production.

Amendment to Page 3, Line 4, Paragraph 2

Replace with...

(2) The term of the Northstar Unit was [LIMITED INITIALLY TO] five years [HOWEVER.] from January 24, 1990, until January 23, 1995. [AND THE PLAN OF DEVELOPMENT REQUIRED BY THE DEPARTMENT OF NATURAL RESOURCES PROVIDED SPECIFIC AND DETAILED CONDITIONS DESIGNED TO ENCOURAGE EXPEDITED EVALUATION AND DEVELOPMENT OF THE FIELD.]

Amendment to Page 3, Line 20, Paragraph 4

Replace with...

(4) Amerada Hess Co. and its partners made the scheduled "in lieu of drilling" payments for the first three years of the five-year Plan of Development period, with payments totaling \$5 million. Amerada Hess Co. then elected to drill the Amerada Hess Co. Northstar No. 3 Well in 1994, extinguishing its remaining financial obligations to the state under the terms of the Plan of Development for the Northstar Unit. Amerada Hess Co. and its partners also timely complied fully with each of the other conditions set out by the Department of Natural Resources in its approval of the initial Plan of Development. The Plan of Development had succeeded in getting only one well drilled, no production, and an inefficient development plan in the five year term.

Amendment to Page 3, Line 27, Paragraph 5

Replace with...

(5) Following the drilling of the Amerada Hess Co. Northstar Unit No. 3 Well earlier in 1994, Amerada Hess Co. met with representatives of the Department of Natural Resources and the Minerals Management Service in June 1994, to inform the agencies of its decision not to proceed with development of the Northstar Unit. Amerada

Hess Co. stated that the development costs for the Northstar Unit leases would exceed \$1.4 billion. Assuming that the state could get them back, the leases had little value, and would most likely be released for a nominal bonus bid.

Amendment to Page 4, Line 19, Paragraph 9

Replace with...

(9) Amerada Hess Co. and Shell began efforts to sell their respective interests in the Northstar Unit leases, [SOMETIME DURING 1994.] Neither the exact timing nor the details of Amerada Hess Co.'s and Shell's efforts to market the leases are a matter of public record.

Amendment to Page 4, Line 22, Paragraph 10

Replace with...

(10) Amerada Hess Co. and Shell subsequently sold their interests in the Northstar leases to BP Exploration (Alaska) Inc. early in 1995. BP Exploration (Alaska) Inc. has characterized the terms of its purchase of the Northstar Unit lease interests as a "competitive process." However, BP Exploration (Alaska) Inc. has declined to make public the terms of its purchase or the identity of its competitors for the purchase of Amerada Hess Co.'s and Shell's interest in the Northstar Unit leases, citing a confidentiality agreement between the parties that prohibits its doing so. The state played no role in the offering or selling of Amerada Hess Co.'s and Shell's interest in the

Northstar Unit leases to BP Exploration (Alaska) Inc. Lessee commonly sell interests in leases without the state's involvement other than approving assignments resulting from sale. [NOR WAS IT OFFERED THE OPPORTUNITY TO COMPETE FOR THE LEASES.]

Amendment to Page 4-5, Line 31, Paragraph 11

Replace with...

(11) In its purchase of the Northstar Unit leases from Amerada Hess Co. and its partners, BP Exploration (Alaska) Inc. acquired [INHERITED] the net profit share development accounts for those leases. The amount of accrued costs in the Northstar Unit net profit share development accounts has been estimated by BP Exploration (Alaska) Inc. [DEPARTMENT OF NATURAL RESOURCES] to be \$262,000,000. Under the terms of the leases and the Department of Natural Resources' regulations, although BP Exploration (Alaska) Inc. did not actually spend the \$262,000,000 in the development accounts, it would be entitled to recover those costs, plus its actual future costs of development, with interest, before it would be obligated to pay the state a share of net profits from the development of the Northstar Unit leases.

Amendment to Page 5, Line 29, Paragraph 2

Replace with...

(2) Effective January 19, 1995, then Director Eason [THE DNR] approved assignment of the state Northstar Unit leases to BP Exploration (Alaska) Inc. as had been requested earlier, and on January 20, 1995, both then Director Eason of the Department of Natural Resources and the Minerals Management Service approved BP Exploration (Alaska) Inc. as the successor operator of the Northstar Unit:

Amendment to Page 6, Line 9, Paragraph 4

Replace with...

(4) The following day, on January 24, 1995, then Director Eason of the Department of Natural Resources approved BP Exploration (Alaska) Inc.'s request for a 90 day extension to submit a new plan of development because, according to Director Eason, it was "in everyone's best interest to allow BP additional time to conclude its acquisition and to formulate a new plan of development," Mr. Eason has not explained why he took this action, instead of simply disapproving the plan and letting the unit terminate. There is no evidence that Director Eason consulted the Department of Law regarding whether he could have used this authority to grant the extension and approve the Plan of Development to leverage earlier production. [AND] On January 24, 1995, the Minerals Management Service also

approved BP Exploration (Alaska) Inc.'s request for an extension to file a more detailed Plan of Development until April 30, 1995.

Amendment to Page 6, Line 12, Paragraph 5

Replace with...

(5) On March 30, 1995, BP Exploration (Alaska) Inc. submitted a revised and more comprehensive Plan of Development and a request to extend the Northstar Unit Agreement for a three-year term coincident with its revised Plan of Development. Importantly, the revised plan included sanction within the last year. The plan included the following specific activities: 1) Data gathering and project development, including environmental data gathering and studies, promulgation of marine mammal incidental take regulations, and a cooperative agreement with the Alaska Eskimo Whaling Commission; 2) 3-D seismic acquisition, including the appropriate government permits and seismic processing, pipeline and facility engineering and reservoir descriptions; 3) Project sanction including project construction permits, integrated 3-D seismic and reservoir descriptions, permit approvals, and, finally, sanction by BP Exploration (Alaska) Inc.'s headquarters. The revised Plan of Development added the steps required by BP Exploration (Alaska) Inc. to take the Northstar development to project sanction. The estimated cost of these activities was \$12,000,000. In the two year plan the estimated cost was \$10,000,000.

Amendment to Page 6, Line 15, Paragraph 6

Replace with...

(6) [IT IS UNCLEAR FROM THE RECORD WHY] [T]The term of the second Plan of Development was increased from the originally proposed two-year to a three-year term, because of increased commitments by BP Exploration (Alaska) Inc. [THUS EXTENDING THE TIME DURING WHICH THE DEPARTMENT OF NATURAL RESOURCES CANNOT MOVE TO FORCE PRODUCTION FROM THE NORTHSTAR UNIT LEASES.]

(7) On May 1, 1995, the Minerals Management Service approved the revised plan concluding that the "new schedule of activities are deemed necessary to bring the unit into production."

Amendment to Page 6, Line 19, Paragraph 7

Replace with...

[(7)] (8) On June 2, 1995, the Department of Natural Resources "conditionally" approved BP Exploration (Alaska) Inc.'s revised three-year Plan of Development. Director Boyd approved the plan because, in his judgment, it was a reasonable one that allowed the new operator, BP Exploration (Alaska) Inc., adequate time to interpret the existing geological, geophysical and engineering data,

shoot what he considered important 3-D seismic data, begin work on development options, define the scope of reservoir/conceptual engineering, and submit permits  
is the ultimate goal of getting Internal BP Exploration (Alaska) Inc. sanction in the fourth quarter of 1997. The plan was tailored to the shortest deadlines that an operator could reasonably be expected to meet. The plan explicitly stated that sanction would "depend on economic competitiveness of the project compared to other BP Exploration (Alaska) Inc. projects worldwide, the business climate (oil price, etc.), and the status of the external permitting processes." It also noted that the risks included "[d]evelopment and production economics."

Amendment to Page 6, Line 21, Paragraph 8

Replace with...

[(8)] (2)....

Amendment to Page 7, Line 22, Paragraph 4

Replace with...

(4) Based upon testimony by both Commissioner Shively and BP Exploration (Alaska) Inc.'s Mr. Morgan, it is clear that even had HB 207 been amended

to include explicit authority for the commissioner to reduce the state's net profit share under the same circumstances as the commissioner was ultimately authorized to reduce the state's royalty share under the terms of HB 207, to encourage production that otherwise would not be economically feasible, the commissioner could not have done so in this instance because production from the Northstar Unit is forecasted to [WOUT.D] be economic without amendments to the net profit share provision.

Amendment to Page 8, Line 7, Paragraph 2

Replace with...

(2) Both the Department of Natural Resources and BP Exploration (Alaska) Inc. have testified that BP Exploration (Alaska) Inc.'s development of the Northstar Unit leases under the original lease terms would be economic under the most likely scenario. According to BP Exploration (Alaska) Inc.'s President, Mr. Morgan, "[W]e have never argued that the development of Northstar could not be profitable under the terms including the net profit arrangements. In profitability in terms of return on capital, this would be possible. This is not a marginal oil field."

Amendment to Page 8, Line 25, Paragraph 5

Replace with...

(5) Based upon Bp Exploration (Alaska) Inc.'s own analysis development of the Northstar project under a supplemental royalty as proposed "would have

approximately \$485 million (in inflation-adjusted dollars) and a full project rate of return (ROR) of around 21%” forecasting price volatility in the future.

Amendment to Page 9, Line 29, Paragraph 1

Replace with...

(1) The [DEPARTMENT OF NATURAL RESOURCES'] decision by the commissioner of the Department of Natural Resources to offer the Northstar leases with the net profit share as the competitive bid variable in 1979 [REPRESENTED A CONSCIOUS] resulted in a trade-off of larger immediate bonus payments for the speculative potential to receive a share of the lessees' net profits from the development of any field subsequently discovered. Since oil and gas exploration is inherently risky, with commercial discoveries occurring far less frequently than dry holes, the commissioner's [DEPARTMENT OF NATURAL RESOURCES'] bid strategy entailed risk sharing with the lessees. Compared to other bidding terms available to the commissioner [DEPARTMENT OF NATURAL RESOURCES], the selection of net profit share terms allowed successful bidders to obtain the leases for less cash than would otherwise have been required. The then director of the Division of Minerals and Energy Management Thomas Cook thought that using a net profit share method was a bad idea because it “promotes unrealistically high bids [and there is nothing to constrain a bid whose cost is a promise and whose associated obligations are limited.” Director Cook has stated that the net profit share method, unlike the cash

bonus bid method, does not require "careful evaluation on the part of the bidder, and history shows that tracts with high bonus bids receive timely exploration and expeditious development of exploration yields a commercial discovery."

Amendment to Page 10, Line 7, Paragraph 2

Replace with...

(2) Director Cook has also stated that: "In using net-profit share as the bid variable in 1979, the state sacrificed hundreds of millions of dollars in lease bonuses it could have gotten with cash bonus bidding." Interpolating [BASED UPON ITS REVIEW OF THE BONUS] revenue received for the federal leases within the Northstar Unit, which was leased with a 16 2/3 percent sliding scale royalty and the bonus as the bid variable, and making many speculative assumptions, the Department of Natural Resources [ESTIMATES] has guessed that the state's Northstar Unit leases could have brought \$268,406,052, as opposed to the \$15,469,000 actually received, had the leases been offered with a 12 1/2 percent royalty, no net-profit share and with the bonus as the bid variable.

Amendment to Page 10, Line 13, Paragraph 3

Replace with...

(3) Assuming the Department of Natural Resources' guesstimate [ESTIMATE] of bonuses is correct and based upon the annual realized rate of returns reported by the Alaska Permanent Fund Corporation in its 1995 report, the balance of the 50 percent of the \$268,406,052 that would have been deposited to the permanent fund would have been \$704,588,494 at year-end 1995.

Amendment to Page 10, Line 18, Paragraph 4

Replace with...

(4) Director Cook has said that the "state cannot recapture the past [lost bonus bids] by cancelling and re-offering the leases at another date." He believes that the "best course of action the state can take is to cut its losses from past mistakes by dropping the net-profits terms from Northstar leases and getting on with development." He further stated that the "days of large cash bonuses are gone." A 1993 United States Department of Energy study concluded that the "net profit share provisions of the state leases "add a very significant burden to the economic viability of the INSU."

Amendment to Page 10, Line 18, Paragraph 4 (5)

Replace with...

~~[(4)]~~ (5) The Department of Natural Resources has provided estimates of the expected mean value to a bidder of the Northstar Unit leases. [ OF THE BONUS REVENUES THAT THE STATE WOULD RECEIVE TODAY.] [I] If the Northstar Unit leases were returned to the state for reoffering in a competitive sale with bonus as the bid variable, with royalty set at 12 1/2 percent or 20 percent, with no net profit share and with estimated recoverable reserves, capital and operating costs as estimated in its economic modeling of the agreement with BP Exploration (Alaska) Inc., the estimated expected mean value would represent the most a bidder would bid. This bidder would have to have made the same economic assumptions about the Northstar Unit leases as were used by BP Exploration (Alaska) Inc. For a 12 1/2 percent royalty and at discount rates of 10 percent and 15 percent, the Department of Natural Resources estimates that the expected mean value to a bidder [OF ANTICIPATED BONUSES] would be between zero and \$225,000,000 [AND] or \$130,000,000, respectively. For a 20 percent royalty and at discount rates of 10 percent and 15 percent, the Department of Natural Resources estimates the expected mean value to a bidder [OF ANTICIPATED BONUSES] would be between zero and \$182,000,000 [AND] or \$98,000,000, respectively. If a prospective bidder thought that the Northstar Unit leases could be developed for not less than the \$1,400,000,000 predicted by Amerada Hess Co., the bidder would not likely bid at the sale. Based on this assessment of the potential competition for a re-offering sale of the Northstar Unit leases, the Department of Natural Resources expects the bids to be very small at any royalty rate.

(6) The initial assumption, in the analysis is Paragraph (5) above, i.e., that the Northstar Unit leases would be returned to the state to be re-offered in a single competitive lease sale, would not likely occur. At the end of the current Plan of Development in April 1998, only two of the Northstar Unit leases would be returned to the state. The other three leases are held by wells certified capable of producing in paying quantities. Moreover, both of the federal leases are subject to a suspension of their primary term so that termination of the unit may not trigger termination of the federal leases. One of these leases is also held by a certified well. These circumstances underscore the fact that the Northstar Unit leases would be available for lease at different times. It is very unlikely that the Northstar Unit leases could ever be sold as a single property. The Department of Natural Resources believes this would further reduce the expected mean value to the bidders because of the added risk of fragmented ownership.

Amendment to Page 11, Line 1, Paragraph 1

Replace with...

(1) Notwithstanding the acknowledged forecasted profitability of developing the Northstar field under its existing lease terms, BP Exploration (Alaska) Inc.'s President, Mr. Morgan, has testified that BP Exploration (Alaska) Inc. will not develop the Northstar Unit leases unless the State of Alaska agrees to eliminate the net profit share provisions of the leases.

Amendment to Page 11, Line 12, Paragraph 4

Replace with...

(4) The Department of Natural Resources has testified that there is an implied covenant for lessees of Alaska's oil and gas leases to diligently explore and develop their leases. The Department of Natural Resources also has testified, however, that since the department has approved a three-year Plan of Development for the Northstar Unit leases that does not explicitly require development of the field, it believes that so long as BP Exploration (Alaska) Inc. meets the requirements of that plan, it would be seen as fulfilling its obligation to develop, and cannot be forced to proceed with production during the term of the current plan which does not expire until ~~[JUNE]~~ April 30, 1998.

Amendment to Page 11, Line 25, Paragraph 6

Replace with...

(6) The Department of Natural Resources has testified that if the department had not approved a further three-year extension for the Northstar Unit in June 1995, the ~~two~~ leases within the unit that did not have wells upon them certified to be capable of production in paying quantities would have reverted to the state, becoming available for releasing. Under the lease provisions and the regulations, the department could then have given notice to BP Exploration (Alaska) Inc. to begin production from

[THESE] the three leases that did have wells certified as capable of production in paying quantities within a reasonable time to do so, that could not have been less than six months. The department has never previously given such a notice to any lessee and there could be litigation over what constitutes "reasonable time" on the North Slope to put a well into production. Furthermore, the leases provide that the leases with certified wells can not be terminated without "an appropriate judicial proceeding."

Amendment to Page 12, Line 8, Paragraph 8

Replace with...

(8) The Department of Natural Resources' approval of the second Plan of Development, and the resulting three-year extension, effectively eliminated any short term leverage the department might have had otherwise to expedite BP Exploration (Alaska) Inc.'s development of the Northstar Unit leases without amendment of the leases. The Department of Natural Resources' approval was consistent with the Department of Natural Resources' approval of virtually every other Plan of Development in the recent past.

Amendment to Page 12, Line 12, Paragraph 9

Replace with...

(9) Both the Department of Natural Resources and the Department of Law have testified that the Department of Natural Resources did not consult with the Department of Law regarding whether the state might have any legal basis for moving earlier than 1998 to force production under the lease terms. [GIVEN THE UNIQUE FACTS IN THE CASE.] The Department of Natural Resources saw nothing unique about this case which would justified consulting the Department of Law.

Amendment to Page 12, Line 23, Paragraph 2

Replace with...

(2) As its principal reason for proceeding with the negotiations to amend the leases, the Department of Natural Resources cited its desire to assure that production begins earlier than it otherwise would under the timeline estimated by the Department of Revenue. The Department of Natural Resources maintains that, if the legislature does not pass SB 318. [THE EARLIEST THAT] the department could [NOW] not force BP Exploration (Alaska) Inc. to develop the field [WOULD BE 2002] until after the expiration of the current Plan of Development.

Amendment to Page 17, Line 7, Paragraph 1

Replace with...

(1) Based upon the Department of Natural Resources' analyses, the negotiated amendments to the Northstar Unit leases may or may not [WILL] reduce

expected state revenue from the development of the Northstar Unit. [HOWEVER,] [T]  
The Department of Natural Resources cannot precisely define the state's future revenue losses or gains because of the numerous assumptions about the future.

Commissioner Shively noted that "the only thing we know about all these numbers (the DNR's economic modeling of the effects of amending the NSU leases), is since they are projections, is that they are wrong, we just don't know how wrong."

Amendment to Page 17, Line 14, Paragraph 2

Replace with...

(2) The Department of Natural Resources' Mr. Coughlin has testified regarding potential state revenue loss that "[i]f you look at it as if they (BP Exploration (Alaska) Inc.) would go ahead and develop it because it's, they say, an economic field, the state loses, in essence, \$48 million by trading a net profit share for the supplemental royalty." On the other hand, if full production does not begin until after 2002, the state could lose money if the amendments are not accepted.

Amendment to Page 17, Line 18, Paragraph 3

Replace with...

(3) The Department of Natural Resources' representative has testified that its evaluation of the economic consequences to the state of amending the Northstar Unit

leases to remove the net profit provisions is based upon the assumption that the "mean" recoverable oil reserves from the Northstar Unit are likely to be 130,000,000 barrels, and that there is a [10] 90 percent probability that recoverable reserves will be greater than 105,000,000 barrels and a 90 percent probability that recoverable reserves will be less than 160,000,000 barrels.

Amendment to Page 18, Line 4, Paragraph 6

Replace with...

(6) The Department of Natural Resources' petroleum economist, Mr. Kevin Banks, who was responsible for evaluating the economic effects of the Northstar Unit lease amendments, has testified that the negotiated agreement is an "okay" deal rather than a "good" deal for the state. In response to the question of why he characterized the deal as "okay" rather than "good", Mr. Banks, testified "I think it has to do with the fact that the net profit share has considerable up-side for the state. If there's any change in the economics of the field that improves, if prices are considerably higher, for example, or if production is any higher. As some of the materials we sent over to you earlier would indicate, the net profit share really pours in. By the same token, it's exactly the problem that BP has with it: that for any increase in the "benefits" that might be associated with the higher production rates or higher prices, or some other economic feature, the state gets all of it, virtually all of it. And it has a fairly serious impact on the economics and the incentives for incremental kinds of projects for the company. And that's why I say it's "okay". There is a high side to this that I think we can't ignore." On

the other hand, Mr. Banks has provided the committee with information that under low side cases the net profit share would pay nothing while the supplemental royalty would still pay something, and the longer the project is delayed the more likely a supplemental royalty would pay more than a net profit share.