SB

348

HFIN

FILE

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ALASKA STATE CHAMBER OF COMMERCE

March 2, 2004

House Finance Committee
Alaska State Legislature
State Capitol Building
Juneau, Alaska

Re: Support for SB 348 – Flint Hills Resources Royalty Oil Contract

Dear Finance Committee Members:

The Alaska State Chamber of Commerce, representing approximately 700 business members and 35 local chambers of commerce, supports SB 348, pertaining to the Flint Hills Resources royalty oil sales contract. The contract negotiated by the Alaska Department of Natural Resources appears to be fair and reasonable exchange for Alaska's oil resource.

Enclosed is our resolution in support of royalty oil contracts such as the one proposed in this legislation. Refined products in Alaska create over 500 jobs and nearly $1 billion in annual spending as 1 billion gallons of fuel are produced. Many industries rely on the production of refined products in Alaska. In-state refineries provide 60% of the jet fuel used in our state. Over 11,000 jobs at Alaskan airports depend on a stable and affordable supply of jet fuel. The shipment of refined projects provides the largest source of operating revenue for the Alaska Railroad. Refined products also provide over $4 million in local taxes.

We respectfully urge your committee to support this contract to ensure long-term production of refined products and continued capital investment growth in Alaska.

Sincerely,

Pamela LaBolle

Pamela LaBolle
President

Sale of North Slope Royalty In-Kind Oil to Flint Hills Resources

Division of Oil and Gas

Alaska Department of
Natural
Resources

Background

- Sale of Williams' assets to Flint Hills
- Williams bought State's royalty oil
- Now, Flint Hills needs contract to purchase State royalty oil for use in North Pole refinery
- RIK v RIV—what is it?

Background, cont.

- DNR negotiated contract with Flint Hills
- State relied on internal expertise and outside experts in evaluating contract terms
- Royalty Board recommended contract for approval
- Legislative approval comes by enacting legislation (AS38.06.055)

Proposed Contract Provisions

- Quantity
- Price
- Term
- Special Commitments
- State Benefits

Quantity

- FHR may purchase between 24,000 and 77,000 barrels per day.
  - Equals nearly all of FHR's requirements.
  - Initial quantity is 56,000 to 77,000 barrels per day to accommodate FHR's seasonal demand.
  - Once every 12 months, FHR may request a change in quantity.
  - State will sell no more than 85 percent of North Slope royalty production.
  - Minimum quantity = 24,000 barrels per day.

Price

- Price
  - ◆ State will get a premium of $0.30 per barrel above the price of Royalty in-Value ("RIV").
  - ◆ State will receive additional annual revenue ranging from $2.6 million and $8.4 million per year, depending on volumes.

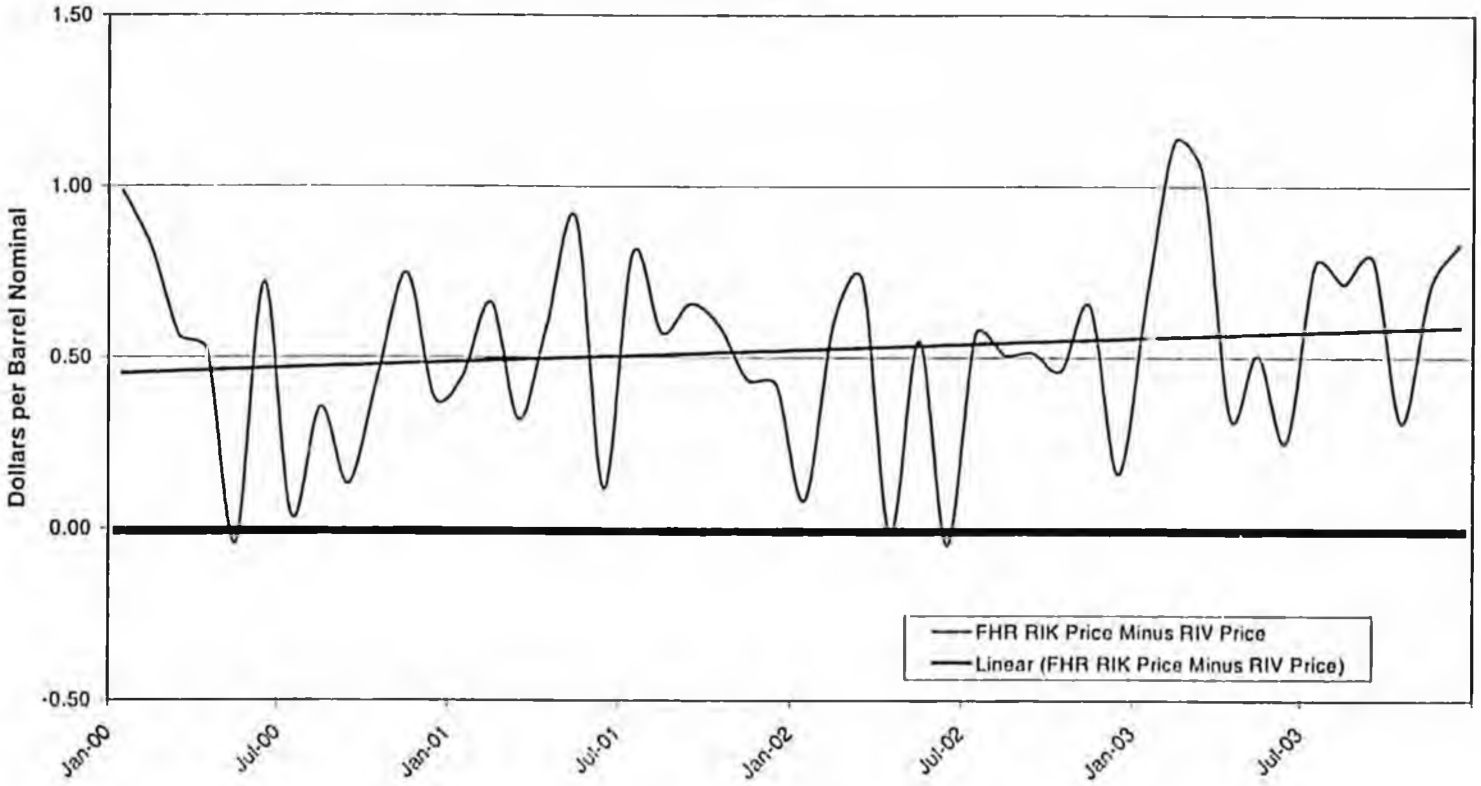
Price

- Example Calculation of FHR RIK Price

	ANS Spot Price
–	$1.55
–	Tariff Allowance
±	Quality Bank Adjustment
–	Line Loss
=	**FHR Price**
–	Royalty Field Cost Payment to Lessees
=	RIK Value

Price

- Looking back in time demonstrates that the proposed RIK contract price would have been favorable to State.



krb 2/04

Special Commitments/State Benefits

- Equipment Installation for Clean Fuels Processing
- Anchorage Tank Removal and Tank Farm Evaluation
- Shipment by Rail
- Fairbanks International Airport
- Wholesale Gasoline Rack Price Parity

State Benefits

- Local Hire
  - Clean fuels project expected to be $100 million
  - 100 to 200 direct construction jobs+twice that number for indirect and induced employment.
  - North Pole refinery currently employs 150 FTE
  - Annual payroll estimated $8-$12 million

State Benefits

- Projected environmental effects.
  - Clean Fuels project will provide potentially lower priced, low sulfur diesel and gasoline instead of importing such fuels into Alaska.
  - FHR will complete Anchorage tank farm improvements.
  - FHR has indicated that its is improving its environmental record and "is now and industry leader in cutting pollution."

State Benefits

- Projected effects on existing patterns of investment.
  - FHR committed to shipments by rail.
  - Fairbanks International Airport Marketing and Improvements Study.
  - The refinery and its employees generate between $3 and $4 million per year in property taxes.

State Benefits

- Present and projected local and regional needs for oil and gas products.
  - Alaska's refineries supply nearly all of the in-state consumption of jet fuel.
  - In-state jet fuel demand is increasing at 4 percent per year.
  - The North Pole refinery supplies 56 percent of the state's jet fuel consumption.
  - Total in-state demand for gasoline = 16,000 barrels per day.

Summary of State Benefits

- More state revenue than leaving oil for sale in kind with producers.
- Positive special commitments
  - Jobs/Local hire
  - Community commitments
  - In-state fuel refining
  - Alaska Railroad

THE ALASKA ROYALTY OIL AND GAS DEVELOPMENT ADVISORY BOARD

Resolution 04-1

On February 10, 2004, the Commissioner of Natural Resources provided the Alaska Royalty Oil and Gas Development Advisory Board ("Royalty Board") with a copy of the proposed contract "Agreement for the Sale of Royalty Oil Between and Among the State of Alaska, Flint Hill Resources, LLC, a Delaware Limited Liability Company and Flint Hills Resources Alaska, LLC, An Alaska Limited Liability Company" ("Proposed Contract"). On February 12, 2004, the Commissioner emailed copies of the "Best Interest Finding and Determination for the Sale of Alaska North Slope Oil to Flint Hills Resources Alaska, LLC" ("Finding") and hand-delivered a copy of the Finding to the Royalty Board at its February 17, 2004 hearing. Under the proposed Contract, the Department of Natural Resources will sell to Flint Hills Resources Alaska, LLC, between 24,000 to 77,000 barrels per day of North Slope royalty oil. Delivery of the royalty oil will begin upon enactment of legislation approving the Proposed Contract.

The Proposed Contract was negotiated between representatives of the Division of Oil and Gas and Flint Hills Resources over the past several months.

On February 17, 2004, the Royalty Board met to discuss the proposed agreement and take public comments. Representatives from the division, representatives of Flint Hills Resources and members of the public attended the meeting. A presentation from division staff about the proposed sale and contract was given to the Royalty Board. After review and consideration of the information presented, public comment, and the criteria of AS 38.06.070, the Royalty Board approved the proposed sale and recommended the proposed agreement be approved by the legislature.

Based on the Royalty Board's review of the Proposed Contract, the Commissioner's Finding, and the information presented at its public hearing, the Royalty Board is of the opinion that the proposed disposition of North Slope royalty oil to Flint Hills Resources Alaska, LLC meets the requirements of AS 38.06.070. In accordance with AS 38.06.050 the Royalty Board adopts the Commissioner's Finding, and recommends that the Alaska State Legislature approve the Proposed Contract.

2.17.04		2/17/04	
Lynn M. Aleshire	Date	Dan E. Dickinson	Date
2.17.04		02.17.04	
Charles E. Cole, Esq.	Date	Edgar Blatchford	Date
2/17/04		2/17/04	
Kenneth O. Stout	Date	Thomas E. Irwin	Date

Best Interest Finding and Determination

For the Sale of

Alaska North Slope Royalty Oil

To

Flint Hills Resources Alaska, LLC

Alaska Department of
NATURAL
RESOURCES
DIVISION OF OIL & GAS

550 West 7th Avenue, Suite 800
Anchorage, Alaska 99501-3510

February 12, 2004

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Executive Summary

The Department of Natural Resources has negotiated a proposed ten-year contract to sell the State's North Slope royalty oil to Flint Hills Resources Alaska, LLC (FHR). FHR is negotiating the purchase of the assets of Williams Alaska Petroleum, Inc. including its refinery at North Pole, Alaska. This document summarizes the terms of the State's royalty oil sale contract and describes the criteria and considerations underlying the determination that this sale of royalty oil in-kind (RIK) is in the State's best interest.

UNDER THE PROPOSED CONTRACT FLINT HILLS RESOURCES WILL BE OBLIGATED TO MEET THE FOLLOWING TERMS:

- **Price**

FHR will pay a price calculated using the following formula:

ANS Spot Price – $1.55 – Tariff Allowance + Quality Bank Adjustment – Line Loss

DNR forecasts the future additional royalty revenues under the proposed contract to be $0.30 per barrel or approximately $2.6 million to $8.4 million per year.

- **Special Commitments**

As additional consideration for the RIK purchase, FHR agrees to:

1. Invest approximately $100 million to install clean fuels processing equipment and facilities in the North Pole Refinery and/or elsewhere in Alaska.
2. Fulfill and enhance the previous commitments made by Williams Alaska Petroleum Inc. to the Government Hill Community Council in Anchorage to address concerns about gasoline storage tanks near Government Hill and undertake additional projects to improve the Anchorage Tank Farm facility.
3. Continue to ship refined products to Anchorage via the Alaska Railroad.
4. Study the use and viability of the hydrant fueling system at the Fairbanks International Airport (FIA), concentrate on promoting FIA to cargo carriers, evaluate and possibly upgrade FIA fuel distribution facilities, and charge a jet fuel customer in Fairbanks the same or lower price as FHR charges that same customer in Anchorage.
5. Maintain the wholesale truck rack prices for gasoline in Fairbanks at a price not to exceed the wholesale truck rack prices for gasoline in Anchorage.

- **In-State Processing**

FHR will make all commercially reasonable efforts to insure that the royalty oil it purchases under this contract will be processed at the North Pole Refinery or exchanged for oil that will be processed at the North Pole refinery. FHR's substantial investments, both in purchase of the North Pole refinery and in its contractual agreement to invest in Clean Fuels facility upgrades, further ensure the continued long-term prospects for in-state refining of State royalty oil.

- **Local Hire**

FHR agrees to employ Alaska residents and Alaska companies.

<u>IN RETURN FOR THESE PROVISIONS THE STATE WILL PROVIDE</u>:

- **Quantity**

The State agrees to sell to FHR ANS royalty oil within the range of 24,000 to 77,0000 barrels per day, or nearly FHR's total refinery requirements, for the ten-year contract term. The State may limit the amount of oil sold to not more than 85 percent of the State's total North Slope royalty oil.

- **Term**

The term of the contract is ten years.

I. Introduction

The commissioner of the Department of Natural Resources (DNR), on behalf of the State of Alaska, has negotiated a long-term contract to sell the State's North Slope royalty oil to Flint Hills Resources Alaska, LLC (FHR) and Flint Hills Resources, Inc. (as guarantor), both of which are subsidiaries of Koch Industries, Inc. FHR has executed a contract for the purchase of the assets of Williams Alaska Petroleum Inc. (Williams) including Williams' North Pole refinery. FHR's contract with Williams is contingent on FHR's successful negotiation of a ten-year contract for purchase of State North Slope royalty oil to provide feedstock for the refinery.

The State proposes this sale of RIK oil to relieve market conditions for crude oil to meet in-state needs. The negotiations that have resulted in the attached proposed contract have been carried out under the procedures for a non-competitive disposition of royalty oil set out in 11 AAC 03.024. Under the terms of this contract the sale price for the royalty oil will exceed the amount the State would have received by taking its royalty oil in-value.

From an in-depth consideration of the potential economic, environmental, and social impacts, and the various requirements for sale of the State's royalty oil, with a focus on the criteria specified under the terms of AS 38.05.183(a) and (e) and AS 38.06.070(a), the commissioner finds that a negotiated long-term contract for the sale of the State's royalty oil to FHR is in the State's best interest.

II. Background

The State of Alaska owns the mineral estate, including oil and gas, under State-owned lands. It has entered into lease agreements with third parties who explore for, develop, and produce oil and gas from these lands. The State receives a royalty share of 12.5 to as much as 33-1/3 percent of the oil and gas produced from these leased lands, which it may take either "in-kind" (RIK) or "in-value" (RIV). When the State takes its royalty as RIV, the lessees who produce the oil market the State's share along with their own production and pay the State the value of its royalty share. When the State takes its royalty share of the oil as RIK, it assumes ownership of the oil, and the commissioner disposes of it through sale procedures designated either "competitive" or "non-competitive" under AS 38.05.183.

Over the years the State has sold nearly half of its royalty oil to in-state refineries, and occasionally has auctioned its royalty oil to customers in the Lower 48. Figure 1 summarizes the many North Slope RIK contracts since 1979 and Figure 2 illustrates the average annual volumes of royalty oil committed to these contracts during this period.

Figure 1: Major North Slope Royalty in-Kind Sales Contracts 1979-2003

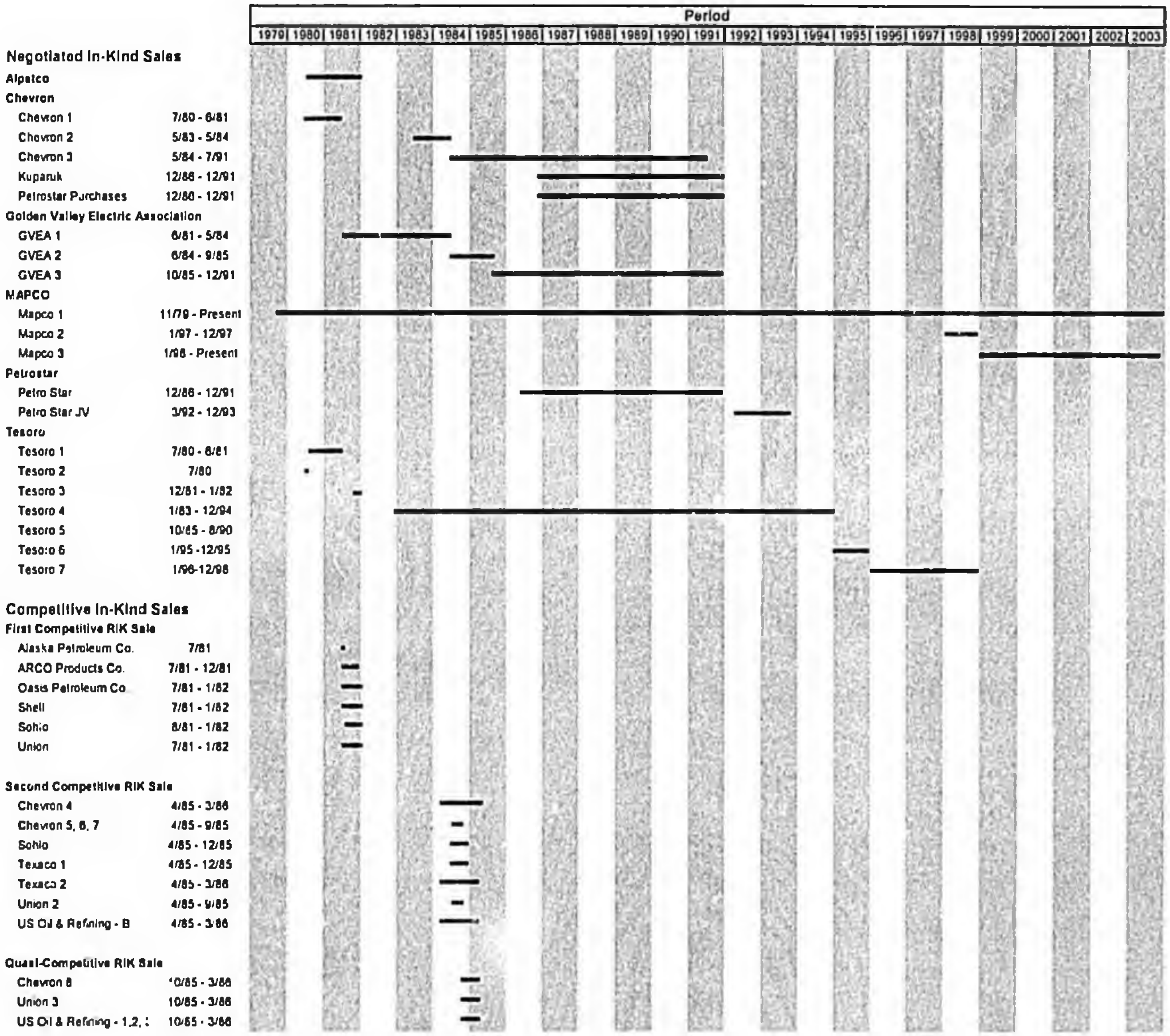
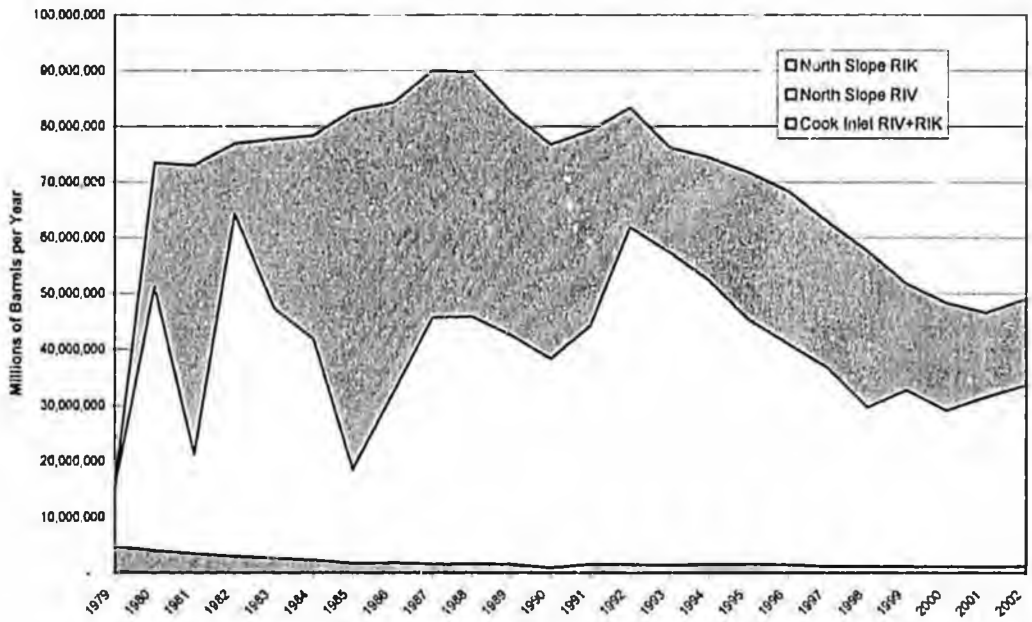


Figure 2: Composition of Total North Slope Royalty Dispositions
1979-2003
Royalty in-Kind (RIK) and Royalty in-Value (RIV)



A. The Current Royalty In-Kind Contracts with Williams

When the Prudhoe Bay field began production, the State entered a 25-year contract to sell North Slope royalty oil to Earth Resources, Inc. who later built the refinery at North Pole, Alaska. The 25-year Earth Resources royalty oil contract supplied the North Pole refinery with an average of 35,000 barrels of royalty oil per day and was eventually assigned to Mapco Alaska, Inc. In 1997, the State and Mapco Alaska, Inc. negotiated a one-year contract for approximately 13,000 barrels per day to augment the supply of royalty oil delivered under the 25-year contract. In 1998, the State and Mapco "extended" this one-year contract by negotiating a new five-year contract that was subsequently approved by the Legislature. This five-year contract provided an average of 22,800 barrels per day in addition to the 35,000 barrels per day delivered under the old 25-year contract. Later in 1998 Mapco sold its Alaskan assets and assigned both the 25-year contract and the 5-year contract to Williams. Under these contracts, the State was obliged to deliver only royalty oil produced from the Prudhoe Bay Unit. These two contracts expired on December 31, 2003.

Following the expiration of the 1978 and 1998 RIK contracts on December 31, 2003, the State has continued to supply the North Pole refinery with royalty oil for feedstock under a short-term contract between the State and Williams that will expire on March 31, 2004.[1] The State has

[1] See Alaska Department of Natural Resources. October 1, 2003. "Best Interest Finding and Determination for the Sale of Alaska North Slope Oil" for a copy of this short-term contract.

executed a second short-term RIK contract with Williams to provide the refinery with an uninterrupted supply of royalty oil through September 30, 2004[2] to enable the continued operation of the refinery while the Department of Natural Resources and FHR conclude their negotiations on the proposed RIK contract that is the subject of this Finding and Determination. The two short-term RIK contracts are required to accommodate the nomination procedures required under the State leases, unit agreements, and the royalty settlement agreements between the State and the North Slope producers. The leases and agreements require the State to nominate the monthly quantity of royalty oil it elects to take in-kind 90 to 180 days before the production month for which the RIK nomination is made. The State must therefore execute its RIK sale contracts three to six months in advance of the month of first delivery in order to limit State nominations to quantities that are the contractual obligation of the ultimate RIK purchaser. Thus, the State's second short-term contract with Williams for deliveries to the North Pole refinery beginning April 1, 2004, was required to be executed prior to January 1, 2004.

The short-term contracts obligate Williams to take RIK oil that the State will nominate before the conclusion of Williams' refinery sale to FHR and the execution of the State's proposed RIK contract with FHR. The proposed RIK contract with FHR can not become effective until DNR (1) publishes the commissioner's findings on whether the contract serves the best interests of the State: (2) convenes the Alaska Royalty Oil and Gas Development Board ("Royalty Board") to review the contract (11 AAC 03.020); and (3) receives approval for execution of the multi-year contract from the Legislature. After the sale of the refinery is completed and provided that the State's long-term RIK contract with FHR receives all required approvals, FHR will take over the operation of the North Pole refinery and the RIK oil nominated under the short-term Williams' contracts will be assigned to FHR. FHR will pay for the RIK oil assigned to it under the terms (including price) set forth in the proposed long-term RIK contract.

B. RIK Oil Sale Procedure

Before executing a contract for the disposition of royalty oil in-kind, the commissioner must find that the disposition is in the best interests of the State. The commissioner establishes the terms, conditions, and methods of disposition of the State's royalty oil that is taken in-kind. The oil may be sold under "competitive" or "non-competitive" procedures. RIK oil may be sold under the "non-competitive" procedures, if the commissioner determines that the best interest of the State will be served by a non-competitive sale. (AS 38.05.183(a)). In making this determination, the commissioner must consider the criteria listed in AS 38.05.183(e) and AS 38.06.070(a). The RIK contract must be awarded to the prospective buyer whose proposal offers maximum benefits to the citizens of the State.

In March of 2003, Williams met with staff at the Division of Oil and Gas and requested a new five-year RIK contract to fully supply the North Pole refinery feedstock requirements following expiration of the 1978 and 1998 RIK contracts. Williams informed the State that it was actively seeking to sell its Alaska assets and intended to assign the proposed RIK contract to the purchaser of the North Pole refinery. In early July 2003, FHR met with the Governor and his staff and indicated that it intended to buy the Williams' North Pole refinery and that a long-term

[2] See Alaska Department of Natural Resources. December 29, 2003. "Best Interest Finding and Determination for the Sale of Alaska North Slope Oil" for a copy of this second short-term contract.

contract with the State would make it possible for FHR to upgrade the properties it would acquire. The Governor called a meeting for July 29, 2003, and invited all potential in-state purchasers of North Slope RIK to discuss what terms each company might offer the State.

As a result of these meetings, and after consideration of all the criteria of AS 38.05.183(e) and AS 38.06.070(a), the commissioner determined that FHR was the prospective buyer whose proposal offered the maximum benefits to the citizens of the State, and agreed to negotiate an RIK contract directly with FHR. Individual findings on each of the statutory criteria are set out in Sections IV and V, below.

The commissioner determined that the sale of RIK oil to FHR would relieve market conditions by providing crude oil required for the continued operation of the North Pole refinery. In addition, the State would benefit from a sale price throughout the term of the long-term contract that would be higher than the volume-weighted average of the reported netback prices applicable to royalty oil taken in-value for the same period. The commissioner concluded, on balance, that entering into a long-term RIK sale contract with FHR, on the terms and conditions as included in the attached proposed contract, is in the best interests of the State.

This Best Interest Finding and Determination and a copy of the proposed RIK contract are available from the State by contacting:

Division of Oil and Gas
Attn: Kevin Banks
550 W. 7th Ave, Suite 800
Anchorage, Alaska 99501
Phone: (907) 269-8781
E-mail: krb@dnr.state.ak.us

and will also be published on the Division of Oil and Gas website at:

http://www.dog.dnr.state.ak.us/oil/

A copy of the proposed RIK oil sale contract is attached as an appendix to this Best Interest Finding and Determination.

III. Discussion Contract Provisions

The proposed contract represents an evolution of RIK contract terms of the most recent (1998) State RIK contract with Williams as modified through negotiations between the State and FHR. The 1998 RIK contract with Williams is the latest in a 25 year history of long-term contracts between the State and the in-state refineries. This section is a summary of the essential terms of the proposed contract.

A. **Price (Section 2.3 and Appendix 2)**

The price per barrel of the royalty oil sold to FHR is set each month and is defined by the equation:

ANS Spot Price – $1.55 – Tariff Allowance + Quality Bank Adjustment – Line Loss

Each of the elements of this equation are explained below:

1. ANS Spot Price

The ANS Spot Price is a monthly average of the daily average prices reported by three industry trade publications: Platt's Oilgram Price Report, Telerate online data reporting service, and Reuters online data reporting service. The ANS Spot Price represents the market value for North Slope oil sold on the U.S. West Coast. Judging by the prevalence of its use among the many buyers and sellers of North Slope oil, the use of the ANS Spot Price as defined in the proposed RIK contract is a credible and reliable measure of the ANS market. The Alaska Department of Revenue has adopted a similar definition for use in its calculation of Prevailing Value for production tax purposes.

The FHR contract contemplates the possibility that one or more of these reporting services may fail to publish a market price for North Slope oil or that the ANS Spot Price may no longer accurately represent the price for North Slope oil in the U.S. West Coast. In the first case, the ANS Spot Price will be calculated by using data from the remaining reporting services. In the second case, FHR and the State will attempt to arrive at a mutually agreeable alternative source of data to determine the ANS Spot Price.

2. $1.55 per Barrel Deduction

Unlike former long-term RIK contracts between the State and in-state refinery customers, the proposed FHR contract does not directly reference the RIV netback value in the price term. The flat $1.55 per barrel deduction from the ANS Spot Price replaces the actual (adjustable) marine transportation cost factor included in former RIK contracts. This is a deduction that FHR makes to its price paid for RIK oil, and thus the smaller the deduction, the higher the price paid by FHR to the State.

The $1.55 deduction provides a premium to the State compared to DNR data on the deduction for marine transportation costs for the last three years allowed in the royalty settlement agreements with the lessees to calculate the RIV netback. The RIV netback is subject to change as the lessees are audited and when a current marine transportation cost "reopener" with ExxonMobil is resolved.[3] DNR's estimate of the deduction for marine transportation costs for

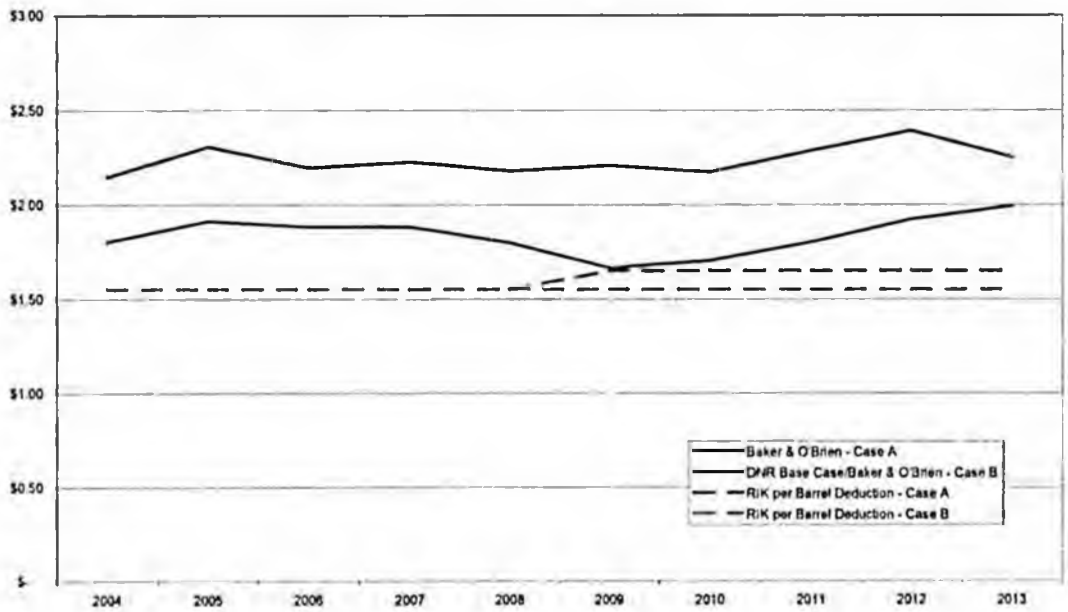
[3] Each of the royalty settlement agreements with the North Slope lessees provides opportunities for the State or the lessee to renegotiate elements of the RIV netback formula. The State and ExxonMobil are currently disputing the calculation of ExxonMobil's destination value, marine transportation cost deduction, and the deduction for line losses.

the last three years allowed in the royalty settlement agreements ranges from $1.73 to $1.92. Based on a somewhat optimistic view of where the State may end up when the RIV netback is finally determined, DNR concluded that the difference between the RIV deduction for marine transportation and the RIK $1.55 per barrel deduction yielded a premium of $0.30 over this three year period.

The $1.55 per barrel deduction is subject to revision at the end of year five of the proposed contract term. The revision will be calculated as follows: First, the State will take an average of the deduction for marine transportation costs for years 3, 4, and 5 of the contract term used to calculate the RIV netback. Second, subtract $0.30 from this average. If the result is less than $1.45 per barrel, then the RIK per barrel deduction for the years 6-10 will be $1.45. If the result is greater than $1.65, the RIK per barrel, then the RIK per barrel deduction for years 6-10 will be $1.65.

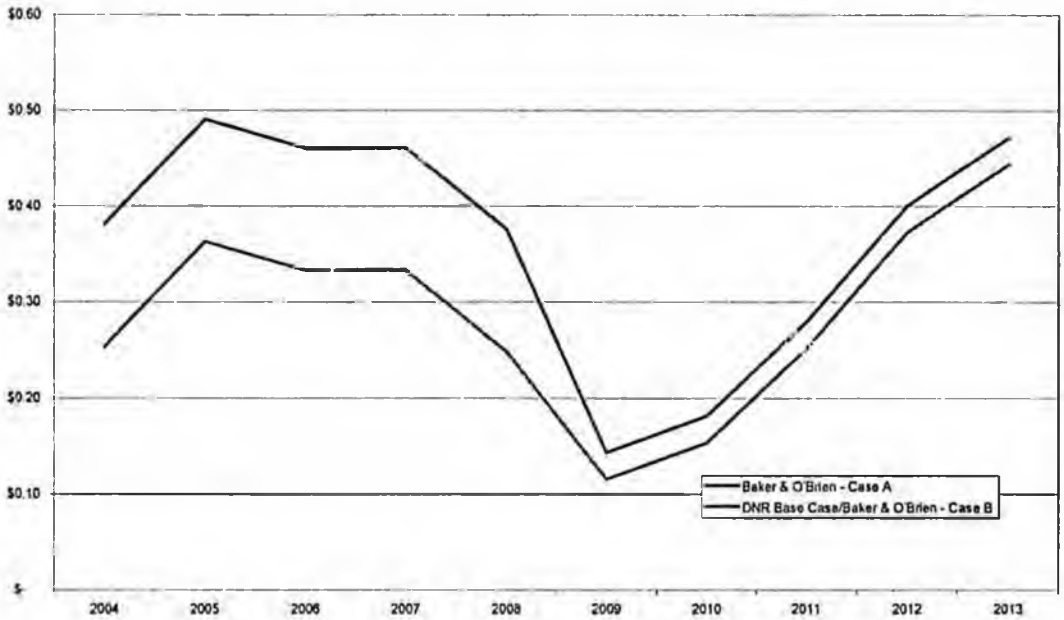
DNR prepared a forecast of the RIV deduction for marine transportation costs for RIV and retained Baker & O'Brien to review the methodology used by DNR.[4] The results of this work are shown in Figure 3 and 4. Two forecasts are illustrated and both employ a hypothetical revision of the RIK per barrel deduction after year five of the proposed contract. The DNR base case suggests that the proposed contract will yield an average premium of about $0.30 per barrel over the RIV netback for the ten-year term of the contract. Baker & O'Brien's Case A suggests that the proposed contract will yield a premium of $0.36 per barrel. The difference in these two forecasts is explained by the different predictions DNR and Baker O'Brien assumed about the outcome of the current reopener dispute with ExxonMobil.

Figure 3: RIV Marine Transportation Deduction Versus RIK Differential



[4] Dileep Sirur, Baker & O'Brien, Inc., Dallas, TX. Personal Communication, December 22, 2003.

Figure 4: RIK Contract Premium



3. Tariff Allowance

The Tariff Allowance provides an additional deduction from the ANS Spot Price equal to the average cost of pipeline transportation paid in transporting ANS oil to the spot markets on the U.S. West Coast. It is calculated as the sum of the ownership-weighted average minimum interstate TAPS tariff filed for each of the TAPS owners, plus any tariffs paid by FHR for shipment of royalty oil on pipelines on the North Slope upstream of Pump Station No. 1. Buyers and sellers in the Alaska market generally set contract prices in recognition that Alaska sales are an alternative to interstate shipments to the U.S. West Coast, and pricing terms are set accordingly.

All prior State RIK contracts for ANS oil have provided oil from the Prudhoe Bay Unit. Under the proposed contract with FHR, the State has the option of providing royalty oil from any ANS production unit, and the additional allowance for tariffs paid on pipelines upstream of Pump Station No.1 is a reimbursement of FHR's additional tariff costs incurred due to the State's choice of production unit. The State will also provide line fill for these upstream pipelines; i.e., the inventory of barrels delivered and sold under the terms of the proposed contract will be tracked in such a way that FHR will take delivery of barrels counted at the inlet of the pipelines but pay for the barrels counted at Pump Station No. 1. These terms will make FHR indifferent to the State's selection of the production unit from which the RIK oil is provided. In return, the

State has the freedom to maximize value by judiciously nominating royalty oil from different combinations of North Slope production units.

The Tariff Allowance is one of the elements of the price term in the proposed contract that is subject to retroactive adjustments. The Tariff Allowance may be adjusted if the tariff used in the calculation of the Tariff Allowance at the time of FHR's payment is changed (or subject to a refund order) by the Federal Energy Regulatory Commission (FERC) at a later date.

4. Quality Bank Adjustment

The Quality Bank Adjustment is a positive or negative number that reflects the value of different streams of oil that are shipped in TAPS. The Quality Bank is administered by the owners of TAPS and regulated by the FERC. Oil tendered for shipment at Pump Station No. 1 is produced from several different production units and the shippers of oil of lesser value must reimburse the shippers of oil of greater value for the degradation of value of the co-mingled mixture of oil. Similarly, the refineries in North Pole and Valdez also take oil out of TAPS, extract the valuable components of the oil in manufacturing petroleum products, and re-inject into the pipeline a mixture of lower valued components. The return streams from the refineries bear a quality bank payment to each of the owners of the passing TAPS stream.

The Quality Bank Adjustment in the proposed contract is calculated as the difference of the value of royalty oil where it is tendered at the point of sale—either at Pump Station No. 1 or at the entry into a pipeline upstream of Pump Station No. 1—and the value of the oil in TAPS downstream of the PetroStar Valdez refinery. Appendix 2 in the proposed contract provides an example for how the Quality Bank Allowance is calculated for RIK oil produced at the Duck Island Unit and processed in the unit's Endicott Main Production facilities. The State may readjust the Quality Bank Allowance if the Quality Bank administrator recalculates one of the values used in the calculation of the Quality Bank Allowance. After six months the only retroactive adjustments of the Quality Bank Allowance that may occur are those that result from a direct order issued by the FERC.

5. Line Loss

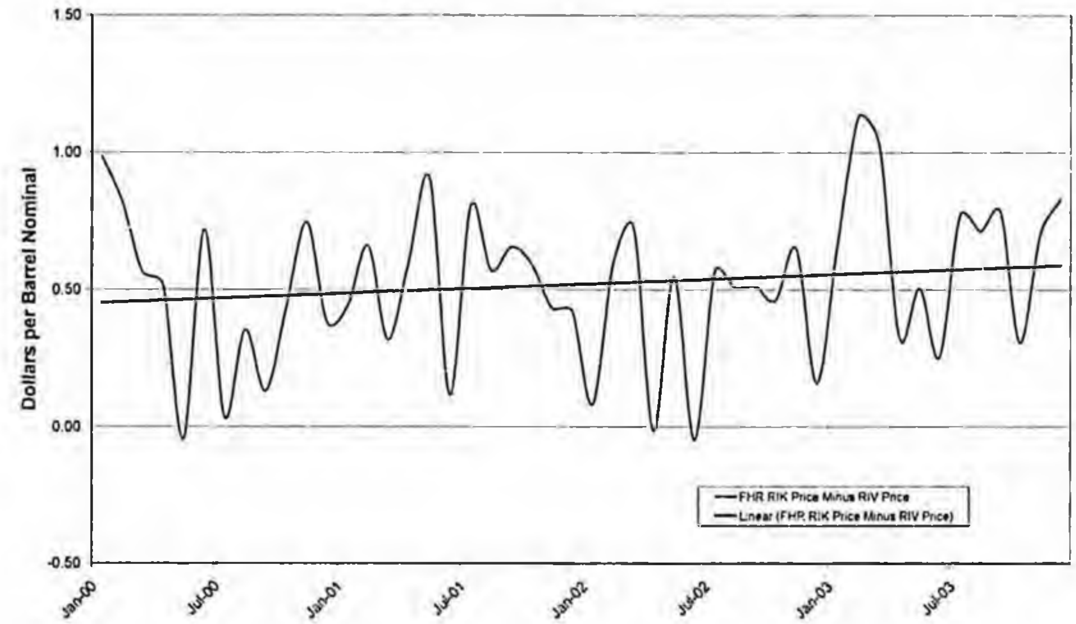
Line Loss is a per barrel amount equal to

(.0009) x (ANS Spot Price – \$1.55 – Tariff Allowance + Quality Bank Adjustment).

This term accounts for the minor change in the volumes of oil delivered at Valdez caused as compared to the volumes tendered at Pump Station No. 1. A line loss element also appears in the netback formulas in the royalty settlement agreements.

In summary, the price term in the proposed contract provides a mechanism that replaces the RIV netback formulas embedded in the price term of former RIK contracts. On the basis of the difference between the deduction for marine transportation costs in the RIV netback and the \$1.55 per barrel deduction in the proposed contract, the State will realize a premium of \$0.30. This represents a conservative estimate of the value of the proposed contract. There are differences in other elements of the RIV formulas that may also contribute to additional benefits for the State. The calculation of the destination value in the RIV netback and the ANS Spot Price in the proposed contract is one element in each formula that may be the source of an additional premium for the State. Figure 5 shows a historical comparison between the RIV netback value at Pump Station No. 1 and the RIK price. If the proposed contract were in place in 2000-2003, the State would have earned $0.52 per barrel more than RIV netback value.[5]

Firgure 5: Backcast of Proposed FHR RIK Contract Price Difference from RIV Netback



B. Special Commitments (Article V and Appendix 4)

Appendix 4 of the contract lists the Special Commitments agreed to by FHR. These commitments are listed here followed by a brief explanation.

1. Clean Fuels Processing

After performing an engineering study, FHR will install necessary equipment and complete such modifications to its North Pole Refinery, or will participate in the modification of other refinery facilities in Alaska, as required to produce gasoline and on-road, off-road, marine, and rail diesel fuels that meet or exceed all U.S. Environmental Protection Agency ("EPA") low sulfur fuel requirements ("Clean Fuels"). FHR will make commercially reasonable efforts to complete necessary installations and modifications on or before the effective dates of the Clean

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[5] A comparison between the proposed contract price and the price paid by Williams over the same time period (2000-2003) yields a premium of $0.46 per barrel. Williams' 25-year contract price is equal to the RIV netback; Williams' 1998 contract price is equal to the RIV netback price plus $0.15 per barrel.

Fuels requirements of the EPA regulations. These projects will result in a significant reduction in gasoline and diesel sulfur levels.

The EPA Clean Fuels regulations require that U.S. refineries must supply low-sulfur on-road diesel by June 2006.[6] Low sulfur diesel must be available for new heavy-duty vehicles equipped with emission control devices that will be introduced in the 2007 model year, i.e., the fall of 2006. Low sulfur "Tier 2" gasoline and non-road diesel must be supplied by 2010.

FHR's total project costs are expected to exceed $100 million and will likely include the construction of processing units, including hydrotreating, a hydrogen plant and sulfur removal equipment. The construction project will have a significant, though temporary, impact on the local and State economy. Most of the equipment to be installed will be manufactured outside of Alaska, and so the personal income and employment effects will be generated by the construction activities on-site and will depend on the availability of skilled workers who are residents of Alaska.

In a study provided by Anadarko Petroleum, Inc. and EnCana Oil and Gas (formerly AEC Oil and Gas, Inc.) in support of their 2002 proposal to buy North Slope royalty gas the proportion of in-state expenditures to total expenditures for the development phase of their North Slope Foothills project was approximately 46 percent.[7] This suggests a conservative estimate of $40 million for in-state expenditures could apply to FHR's Clean Fuels projects. This same study also indicated that the largest in-state development cost item was personnel expenses at 20 percent of total. If the Anadarko study is any indication, FHR's project will inject $20 million into the State economy in the form of wages and salaries. Applying the Anadarko analogy to the FHR Clean Fuels projects, DNR estimates 100 to 200 direct jobs during construction with possibly twice that for indirect jobs.[8] To the extent that FHR's preferred strategy to produce Clean Fuels in Alaska will involve improvements at the North Pole refinery these construction jobs will occur in the Fairbanks North Star Borough and the central Alaska region.

Impacts on local and statewide employment and personal income from construction will be temporary. Incremental long-term employment and personal income effects generated by the Clean Fuels projects at North Pole of the refinery should be rather small.[9]

2. Anchorage Tank Farm Evaluation.

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[6] 40 CFR Parts 69, 80, 86. Diesel fuels must meet a 15 parts per million sulfur standard. Under current EPA regulations, diesel fuels must meet a 500 ppm sulfur standard.

[7] Northern Economics, Inc. January 2002. "Economic Impacts of Anadarko Exploration, Development, and Production of Alaska North Slope Foothills Gas Operations" p. 2-7.

[8] Additional support for the estimate can be found in the number of construction jobs generated by a 1995 expansion project conducted by Tesoro Alaska Petroleum Company at its Nikiski, Alaska refinery. Installation of a $26 million vacuum unit upgrade generated 180 direct and indirect jobs. Alaska Department of Natural Resources. September 1995. "Final Finding and Determination to sell Royalty Oil to Tesoro Alaska Petroleum Company" p. 18.

[9] In 1998 Williams Alaska Petroleum, Inc. invested in a $70 million expansion of the North Pole refinery. Williams indicated that the expansion created 17 new jobs. Alaska Department of Natural Resources. March 1998. " Final Finding and Determination to Sell Royalty Oil to MAPCO Alaska Petroleum Alaska, Inc." p. 13.

FHR agrees to discharge the commitments previously made by Williams in the "Memorandum of Agreement between Williams Alaska Petroleum, Inc. and The Government Hill Community Council" (attached as Appendix 6 to the proposed contract). The key requirements are as follows:

a. Remove three (3) tanks from east of the Ocean Dock Road with a total capacity of over 5,500 barrels;

b. Refrain from installing additional tanks east of the Ocean Dock Road;

c. Evaluate all remaining tanks east of the Ocean Dock Road to determine whether they comply with all State and Federal requirements for overfill protection, fire protection, tank seal monitoring, potential for change of product service, and possible removal of additional tanks, and prompt remediation of any violations of these requirements;

d. Installation of new tanks west of the Ocean Dock Road will occur provided that existing tanks on the east side of Ocean Dock Road are retired and removed on a tank-for-tank basis; and

e. Continue cooperative efforts in connection with the ongoing Bulk Fuel Hazard Study currently underway through the Municipality of Anchorage.

3. Shipment by Rail.

Williams currently ships refined products by rail under contract with Alaska Railroad Corporation (an Agreement originally entered by MAPCO Alaska Petroleum Inc. in May of 1993). Williams transported about 1.4 million gallons per day of jet fuel during 2001, plus naphtha, and about 3,000 barrels per day of gasoline by rail to south central Alaska. As part of FHR's refinery acquisition from Williams, FHR will assume the rights and obligations of Williams under the rail agreement and continue to ship refined products to Anchorage through the term of its current railroad contract until 2013.

4. Fairbanks International Airport.

The proposed contract requires FHR and the State to jointly explore commercially reasonable options for increasing passenger and cargo air traffic through the Fairbanks International Airport (FIA), with a focus on promoting the FIA to cargo carriers operating between Asia and Europe. FHR shall also evaluate the airport's fuel distribution facilities and the feasibility of using or upgrading the existing hydrant fueling system.

Alaska's three refineries supply all of the in-state jet fuel consumed at the international airports in Anchorage and Fairbanks, and at military bases in the state.[10] The North Pole refinery is the largest producer of jet fuel in Alaska. It accounts for about two thirds of total jet fuel consumption, as shown in Table 1.[11] While the North Pole refinery accounts for more than half of the Anchorage jet fuel consumption, the Fairbanks International Airport will remain an important jet fuel market for FHR.

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[10] Jet fuel is generally not imported into Alaska unless unusual circumstances arise, such as the West Coast longshoremen strike of mid 2002, which resulted in greater-than-usual air cargo activity.

[11] Dileep Sirur, Baker and O'Brien, Inc., Dallas, TX. Personal Communication. November 11, 2003.

Table 1: Regional Composition of Jet Fuel Production by Refinery

(Barrels per Day)

	TOTAL	Williams	PetroStar	Tesoro	Chevron[12]
Anchorage	52,000	29,000	3,400	13,600	6,000
Fairbanks	3,500	3,300	200	---	---
Military	5,100	1,400	3,700	---	---
TOTAL	**60,600**	**33,700**	**7,300**	**13,600**	**6,000**

The proposed RIK contract further provides for jet fuel price parity between Fairbanks and Anchorage. FHR has agreed that it will charge a jet fuel customer at the Fairbanks International Airport the same or lower jet fuel price as FHR charges that customer at the Anchorage International Airport.

5. Wholesale Gasoline Rack Price Parity

FHR agrees, for the term of the proposed contract, to maintain its wholesale truck rack posted price for gasoline in Fairbanks at a price not to exceed its wholesale truck rack posted price for gasoline in Anchorage on an annual simple average basis (within a tolerance/variation of 1 cent per gallon (cpg)). If the annual average variation of these posted prices exceeds 1 cpg, FHR will, in the first 90 days of the following year, reduce the variation below 1 cpg, averaged over the year-plus-90-day period. This provision will not apply to gasoline exchanges.

A review of OPIS wholesale gasoline truck rack price show that for the period January 2000 through October 2003, Fairbanks prices averaged 1.5 cpg lower than Anchorage prices for regular and premium grades.[13] These are wholesale prices, not prices that consumers pay at the pump. Furthermore, posted prices do not necessarily reflect prices realized in actual transactions. Discounts (also known as "Temporary Competitive Allowances" or "TCAs") are offered about two or three times per year, but can last for extended periods and are offered to just a few customers.

A significant volume of gasoline is offered in exchanges between Williams and Tesoro. Williams provides approximately 500 to 600 barrels per day (21,000-25,000 gallons per day) to Tesoro in Fairbanks for an equal volume from Tesoro to Williams in Anchorage. Tesoro pays 4–5 cpg as an "exchange premium" for this arrangement because it can avoid the transportation charge to physically haul gasoline northbound on the Alaska Railroad. Tesoro's incentive to participate in this exchange arises from the fact that Tesoro's Nikiski refinery produces more gasoline than Tesoro can sell to its customers in the south central region. Tesoro's alternatives to

[12] Chevron purchased jet fuel for re-sale from Williams under a 5-year contract.

[13] Dileep Sirur, Baker and O'Brien, Inc., Dallas, TX. Personal Communication, December 9, 2003. OPIS refers to the Oil Price Information Service, Rockville, Md. OPIS reports Alaska posted wholesale rack prices for only Fairbanks and Anchorage.

the exchange are to reduce gasoline production at the Nikiski refinery or to export the excess gasoline production at distressed prices. This suggests that the exchange premium paid by Tesoro is unlikely to put any upward pressure on the price of gasoline in Fairbanks relative to Anchorage. The effective cost to Tesoro at Fairbanks of the exchange is likely to be well below its Anchorage wholesale price plus the exchange premium.

The parity provision in the proposed contract will help to ensure that differences in pricing strategies between Fairbanks and Anchorage will not arise. Also, the parity provision will not adversely affect the exchange arrangements that contribute to supply efficiencies between the two communities that can benefit the consumer. On the other hand, the practice of using TCAs means that the parity provision will create transparency in the market at the expense of including all transactions.

C. In-State Processing (Article IV)

FHR will use "all commercially reasonable efforts" to process royalty oil purchased under the proposed contract in the North Pole refinery. FHR may exchange royalty oil for other crude oil that is also processed in the refinery. By comparison, in its 1998 contract Williams agreed to process at least 80 percent of the sale oil at its refinery in its current and prior RIK purchase agreements. Production capacity and processing equipment for the Williams' refinery at North Pole is compared with other Alaska refineries in Table 2.

Table 2: Alaskan Refinery Capacity
(Barrels per Stream Day)

Company	Location	Atmospheric Crude Oil Distillation	Vacuum Distillation	Hydro-cracking	Reforming
ConocoPhillips	Kuparuk	16,000	0	0	0
BP	Prudhoe Bay	14,200	0	0	0
Williams	North Pole	227,513	6,000	0	0
PetroStar	North Pole	18,000	0	0	0
PetroStar	Valdez	50,000	0	0	0
Tesoro	Kenai	80,000	19,800	9,050	12,000
TOTAL		**405,713**	**25,800**	**9,050**	**12,000**

As discussed above, the North Pole refinery is the largest in the state. It produces the following product slate:

Gasoline & Naphtha	19%
Jet Fuel	57
Diesel	19
Gas Oil	4
Asphalt	1
Total	100%

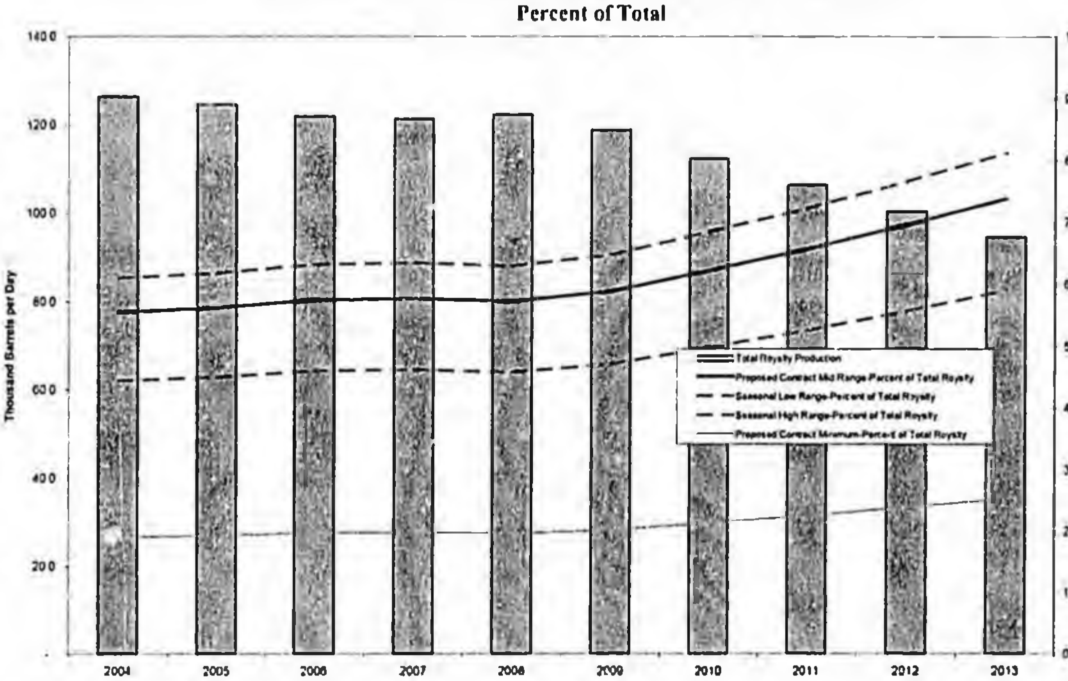
D. Employment of Alaska Residents (Article XXIV)

FHR agrees to employ Alaska residents and companies "to the extent they are available, willing, and at least as qualified as other candidates."

E. Quantity (Section 2.1)

The FHR contract will initially provide between 24,000 to 77,000 barrels per day of royalty oil from the North Slope or nearly the total oil supply requirements of the North Pole refinery.[14] The range is intended to approximate the seasonal fluctuation in the refinery's requirements. Based on DNR North Slope oil production forecast, the initial quantity will commit 44 to 62 percent of the State's North Slope royalty oil to FHR in 2004. Owing to an anticipated decline in North Slope oil production over time, the initial contract quantity will likely equal between 59 and 82 percent of the State's North Slope royalty oil by 2013. Figure 5 illustrates the State's forecast of total North Slope Royalty oil and the percent of royalty oil committed to the FHR contract.

Figure 6: Total Royalty Production and Proposed Contract Quantity Percent of Total



[14] The range is equal to 80 percent and 110 percent of 70,000 barrels per day.

Even as these percentages may rise and/or fluctuate through time, the commissioner retains the right to limit the amount of the monthly royalty oil production supplied to the refinery to not more than 85 percent of total North Slope royalty oil or not more than 95 percent of the royalty oil produced from any single production unit.

FHR has the right to reduce the initial amount of royalty oil it takes under the contract after the first year of the contract following a six-month notice of the reduction. Additional reductions are allowed at intervals of not less than 12 months following the most recent reduction. FHR may not reduce below a minimum quantity to less than 24,000 barrels per day in the first five years of the contract term except for Force Majeure (see below) or a shut down of the refinery. During the second five years of the contract term FHR may reduce the quantity to zero, but otherwise the 24,000 barrels per day minimum remains.

FHR may also subsequently request an increase in the quantity of royalty oil 12 months after the most recent reduction. Approval of a requested increase will be in the discretion of the commissioner and the total quantity may never be increased above the initial contract quantity range.

In negotiating this quantity provision, DNR recognized that FHR sought to limit its exposure to major changes in the markets for its products. For example, should a change in jet cargo traffic occur in the next ten years because more efficient airplanes and routes are employed, FHR might reduce its manufacture of jet fuel and reduce its quantity of royalty oil. Under this scenario, the State would be able to sell the royalty oil once committed to FHR to buyers in other markets (or let the lessees take the royalty oil in-value). By the same token, the State did not want to provide FHR with the unbridled ability to arbitrage its royalty oil supply against the potential supply of oil from other North Slope producers. This situation would disadvantage independent North Slope producers (those producers without the marine transportation capability to sell oil Outside) whose "natural" market for their oil are the in-state refineries. Furthermore, unfettered ability to reduce the amount of oil taken by FHR has the potential of denying the State the potential revenue benefits of the contract.

By limiting changes in quantity to once every 12 months with six-month notice, the contract cannot easily set a cap on the value of North Slope oil sold in the state. The lead-time imposed by these requirements will make it somewhat difficult for FHR to find alternative suppliers unless those suppliers are willing to provide oil to FHR under long-term contracts. The minimum quantity requirement preserves for the State its price premium over RIV value on at least 24,000 barrels per day in the first five years of the contract. The discretion of the commissioner to refuse to increase the quantity once FHR has reduced it (as the commissioner would certainly do if the royalty oil were committed to another buyer) provides a disincentive for FHR to stop taking royalty oil in the second five years of the contract.

F. Term (Article IX):

From the start of negotiations FHR consistently held that it requires a ten year contract term in order to provide ten years of certainty of feedstock supply, if FHR was to commit to purchase of the North Pole refinery and major investment in clean fuels technology. Alaska statutes require that any contract for sale of State royalty oil be approved by the Alaska legislature if the contract term exceeds one year. The Governor is committed to have legislation introduced immediately following action on the proposed contract by the Royalty Board to provide for legislative approval of the total contract term of ten years. The proposed contract is drafted with a "one year plus nine year" term in order that the commissioner may execute the contract and FHR may proceed with its purchase and operation of the North Pole refinery during the interim period between the date of the Governor's signing of enacted legislation approving the proposed contract, and the effective date of the legislation 90 days later.

G. Other Contract Provisions

1. Invoicing and payment (Article III):

DNR will send monthly invoices and FHR will pay by the later of the third business day of the date of the invoice or the twentieth calendar day of the month. If adjustments are required after the initial payment and qualify under the price provisions, the State will send an invoice for the adjustment and FHR will pay by the later of the third business day or the twentieth of the month. Any amount not paid by the date required shall bear interest as required by AS 38.05.135(d), and will be subject to a penalty equal to five percent of the total amount not timely paid.

2. Security (VI and VII):

Flint Hills Resources Alaska, LLC is the buyer and the wholly owned subsidiary of Flint Hill Resources, LLC who is the guarantor under the proposed contract. The provisions of contract Articles VI and VII describe the obligation FHR Alaska, LLC as buyer, and FHR, LLC as guarantor, to pay amounts due and provide assurances of performance.

FHR, LLC will hire a Financial Analyst, approved by the commissioner to evaluate the financial health of FHR, LLC. Each year the Financial Analyst will render an opinion in the form of an Opinion Letter about FHR, LLC's current and future credit rating by Standard and Poor's and Moody's. The Opinion Letter will identify all documents reviewed in forming the opinion, identify people interviewed in forming the opinion, state the current long term and short term credit ratings of FHR, LLC, and express an opinion whether those ratings are likely to fall below a Standard and Poor's BBB+ or Moody's Baa1 rating.

If the opinion states that FHR's bond rating is likely to fall below those levels FHR must provide the State an irrevocable stand-by letter of credit issued for the benefit of the State in the principal face amount reasonably estimated by the commissioner to be equal to the price of all oil to be delivered during the 90 days immediately following notice of requirement for the letter. At $26.00 per barrel, the price under the proposed contract using data for December 2003, and average deliveries of 70,000 barrels per day, the face value of the letter of credit would be approximately $165 million.

3. Dispute Resolution (Article XIII):

This provision sets out the process that the State and FHR will use should disputes arise. FHR and Alaska agree to accept the findings of the commissioner "...that are supported by substantial evidence in light of the whole record."

4. Force Majeure (Article XV)

The proposed contract provides relief for either party from a liability to perform if the performance is substantially prevented by Force Majeure. FHR is not relieved from its obligations to pay, provide assurances of its financial health, or accept royalty oil nominated for delivery under the quantity provisions of the proposed contract. Various Force Majeure events are described. If the Force Majeure event cannot be remedied in 180 days the commissioner may terminate the contract with sixty days notice.

IV. Analysis of State Benefits

Section IV sets out the commissioner's analysis of the benefits to the State from the proposed sale of ANS royalty oil to FHR, considering the criteria set out from AS 38.05.183(e) and AS 38.06.070(a).

A. The cash value offered:

The State considers the cash value of the proposed contract from two perspectives. First, the absolute magnitude of the future RIK revenues is based on the product of price and quantity provided in the proposed contract. The price is expected to range between $16.60 and $22.56 based on the Alaska Department of Revenue projections of the ANS spot price, Tariff Allowances, Quality Banks, and DNR's estimate for Line Loss.[15] The proposed contract stipulates a RIK quantity ranging between 24,000 and 77,000 barrels per day.[16] These upper and lower quantities translate to 44 and 62 percent of the State's total royalty share of production, respectively. Over time, as total ANS production declines, these RIK limits will increase, as a proportion of the total (to 69 and 82, respectively, in 2013).

These price and quantity provisions, combined with assumptions about the future spot price of ANS crude on the U.S. West Coast, imply annual total RIK revenues ranging from a low of $198 million to a high of $634 million, depending on quantity nominated, with an overall average of $368 million.

The second cash value perspective looks to the incremental RIK revenue premium over the RIV alternative. As a non-competitive RIK sale to relieve "market conditions," the sales price throughout the term of the disposition must be higher than the volume-weighted average of

[15] Alaska Department of Revenue, *Fall 2003 Revenue Sources Book*, Table 45 p. 35.
[16] The range is calculated as 70,000 plus 10 percent and minus 20 percent.

the current reported netback prices filed by lessees for royalty purposes. The price shown above implies a premium of approximately $0.30 per barrel over revenues generated under RIV, based on DNR's forecast of the RIV alternative.[17] DNR forecasts the future royalty revenues under the proposed contract to be approximately $2.6 to $8.4 million per year above revenues if taken as RIV.[18]

B. The projected effects of the sale, exchange or other Disposal on the economy of the State:

In addition to the above described $2.6 to $8.4 million annual royalty revenue increase above the RIV alternative, the proposed contract will facilitate substantial capital expenditures for the installation of equipment to process Clean Fuels in Alaska. Of the total project cost estimate of over $100 million, up to $40 million may be spent in Alaska to build these improvements with $20 million injected into the State economy in the form of wages and salaries. The Clean Fuels project could lead to as much as 100 to 200 direct jobs during construction with possibly twice that number of indirect jobs. To the extent that FHR's preferred strategy to produce Clean Fuels in Alaska will involve improvements at the North Pole refinery, construction employment will occur in the Fairbanks North Star Borough and the central Alaska region. Impacts on local and statewide employment and personal income from construction will be temporary. Incremental long-term employment and personal income effects generated by the Clean Fuels projects at North Pole of the refinery should be rather small.

Further, completion of the FHR refinery acquisition depends on a successful implementation of the proposed contract between FHR and the State. The proposed State RIK contract will help to ensure that transactions costs associated with the refinery sale are kept to a minimum. A delay of the sale of the North Pole refinery could result in deterioration of commercial arrangements with existing wholesale products buyers (e.g., airlines for jet fuel) and result in greater product imports into Alaska, with consequent job losses and higher in-state jet fuel intermediate prices and gasoline retail prices.

Finally, the business experience and qualifications of FHR as the new owner of North Pole refinery will ensure a seamless transition and ongoing success in operations at the North Pole Refinery.[19] FHR's core business is refining and its financial condition is well suited to support new investments at the North Pole refinery.

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[17] See Section III. A.1. DNR's forecast of the RIV alternative assumes that the destination value in the royalty settlement agreements will, over time, be revised through reopeners to achieve a value at or close to the ANS Spot Price. The $0.30 per barrel premium used here is the difference between the RIV deduction for marine transportation costs and $1.55.

[18] This range is based on multiplying the $0.30 per barrel premium times the minimum 24,000 barrels per day and maximum 77,000 barrels per day quantity FHR may purchase under the proposed contract.

[19] The proposed contract gives FHR the right to assign the contract to a third party at a future date. The right of assignment qualifies the relevance of specific attributes and qualifications attached to a particular RIK purchaser, such as FHR.

C. The projected benefits of refining or processing the oil or gas in the state:

The North Pole refinery was expanded in 1998 and has a total capacity throughput of 227,500 barrels per day of ANS shipped to the refinery via TAPS. It consumes about 64,000 barrels of crude per day on average to manufacture petroleum products and, after removing the lighter components used to make petroleum products, returns the remaining 150,000 barrels per day of residual oil to TAPS. About 60 percent of refinery output is jet fuel. The remainder is evenly divided between gasline/naptha and diesel. These products are marketed to customers in Alaska, Western Canada and the Pacific Rim.

The refinery transported about 1.4 million gallons per day of jet fuel during 2003 and accounts for 56 percent of jet fuel consumption statewide, including military bases. Approximately half of the gasoline manufactured at the refinery is sold through Williams' branded retail stores throughout the state. Approximately 3,000 barrels per day of gasoline are shipped by rail to south central Alaska. FHR's commitment to process Clean Fuels in Alaska will mean that Alaska will not have to import low sulfur diesel and gasoline at potentially higher prices.

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

Production capacity and processing equipment for the North Pole refinery is listed above in Table 2. The North Pole refinery has run successfully for 25 years and has seen several expansions. As buyer of the North Pole refinery, FHR brings considerable expertise and financial strength to Alaska. FHR is a wholly owned subsidiary of Koch Industries, a large, privately held company with interests in refining, chemicals, and fertilizer manufacturing. FHR operates a petrochemical refinery complex in Corpus Christi, Texas and another plant in Rosemount, Minnesota. It has controlling interests in Canadian oil sands development, as well as other Canadian crude oil marketing, trading, transportation and storage operations. In addition, FHR markets jet fuel, diesel, heating oil, gasoline, and other petroleum products.

The proposed contract requires that FHR use all commercially reasonable efforts to insure that royalty oil will be processed at the North Pole refinery. Furthermore, FHR is investing over $265 million to purchase the North Pole refinery and has committed to implement construction projects that will likely total over $100 million more, to allow for processing of Clean Fuels in Alaska. These financial commitments will bind FHR to a long-term presence in Alaska and ensure continued in-state refining to the benefit of Alaska citizens.

E. The revenue needs and projected fiscal condition of the State:

The State budget gap (the difference between unrestricted general fund revenues and general fund budget expenditures) is forecast to rise from $275 million in FY 2004 to $951 million in 2010, absent new revenue sources. Despite fairly stable oil production through 2010, the oil and gas sector's contribution to general fund revenue is expected to decline from 86% in 2004 to 77% in 2010 due to increasing production from new, lower-netback-value fields and a higher economic limit factor (ELF).[20] The long-term cash proceeds from the sale of RIK gas and the premium over RIV will not fill this gap, but every positive contribution to State revenues is important to the State's fiscal balance, and the proposed contract would generate approximately $2.6 to $8.4 million per year in incremental revenue (over RIV) to help fill the State's fiscal gap.

F. Present and projected local and regional needs for oil and gas products and by-products:

Total annual fuel sales in Alaska by major product type are summarized in Table 3. The trend in annual fuel sales tends to be increasing for most products, except for modest downturns in 2000 (gasoline and No. 2 diesel) and in 2001 (jet fuel). Average annual jet fuel consumption increased 3.4 percent from 1997 to 2000, and then declined sharply before rebounding in 2002. The jet fuel decline in 2001 is probably related to the sharp nationwide decline in commercial aviation in the fourth quarter of 2001. Seasonal data (not reported) indicate that jet fuel consumption has recovered from the demand shocks of September 2001 and is consistent with average annual growth exhibited prior to 2001. Alaska's refineries supply nearly all of the in-state jet fuel consumed based on EIA data on prime supplier sales.[21] Total motor gasoline gas consumption exhibits a stationary pattern over the past six years. Annual average aviation gasoline consumption has increased slightly.

Table 3: Prime Supplier Sales for Alaska, 1998 – 2002
(Thousands of Gallons per Day)

	Transportation Fuels					Non-Transport Fuel	
Year	Total[a] Gasoline	Aviation Gasoline	Jet Fuel[b]	No. 2 Diesel	Total Fuel Sold	No. 2 Heating Oil	No. 2 Distillate
1998	771.4	57.6	2,285.2	427.7	3,541.9	357.4	785.1
1999	784.4	58.7	2,434.4	467.2	3,744.7	295.9	W
2000	744.8	58.7	2,502.9	396.5	3,702.9	287.6	684.1
2001	761.3	61.2	2,461.9	462.5	3,746.9	227.4	689.8
2002	755.2	55.3	2,777.1	512.8	4,100.4	W	639.3

1. Jet Fuel Consumption and Airport Operations

Alaska's three refineries supply all of the jet fuel consumed at the international airports in Anchorage and Fairbanks, and at military bases in the state.[22] The international airport

[20] Alaska Department of Revenue, *Fall 2003 Revenue Sources Book*, Table 2-8, p. 18.
[21] Prime suppliers include firms that produce, import, or transport petroleum products across state boundaries and local marketing areas, and sell the products to local distributors, local retailers, or end users. According to the EIA, prime supplier sales within a given state may serve as a proxy for consumption but may not equal actual consumption by the end-users in the state because a product may be sold by a prime supplier in one state and transported by local distributors to another state for final consumption. Southeast Alaska communities import jet fuel and other products from the Lower 48.
[22] Jet fuel is generally not imported into Alaska unless unusual circumstances arise, such as the West Coast longshoremen strike of mid 2002, which resulted in greater-than-usual air cargo activity.

complexes in Anchorage and Fairbanks play a significant role in the state's economy. The Ted Stevens Anchorage International Airport alone employs 9,100 workers with a $367 million annual payroll.[23] During the 1990s air cargo landings grew at an average annual rate of 9 percent, consistent with doubling in eight years.

Total statewide jet fuel consumption, driven largely by the strong growth at Ted Stevens Anchorage International Airport, increased from 2.3 million gallons per day in 1998 to 2.8 million gallons per day in 2002, an average annual rate of 4 percent per year.

2. Supply and Demand for Gasoline

The North Pole refinery and the Tesoro refinery in Nikiski are the only Alaska refineries that produce gasoline, with combined total production capacity of 22,000 barrels per day.[24] Gasoline production from these two refineries exceeds total in-state demand of about 16,000 barrels per day. The excess production (about 6,000 barrels per day, produced by Tesoro) is exported to the U.S. West Coast and to foreign consumers.

Approximately 300 retail outlets sell motor gasoline currently in Alaska. Williams' and Tesoro branded service stations account for about half of this total.

H. The desirability of localized capital investment, increased payroll, secondary development and other possible effects of the sale:

The proposed contract includes several special commitments that could involve investment spending and improved refinery operations. These are outlined above and include the Clean Fuels project, a promise to examine feasibility to upgrade the Fairbanks International Airport hydrant fueling system, and potential tank farm improvements at the Port of Anchorage. In addition, FHR's substantial investment in purchasing the North Pole refinery, and its commitment to additional capital investment in the State, provide a more secure, long-term prospect for continued refinery payroll in the North Pole and Fairbanks region.

I. The projected social impacts of the transaction:

The sale by itself will have no incremental social impacts. If there were no RIK contract executed to supply crude oil to the refinery, however, operations at the refinery might be suspended or cut back with possibly serious social consequences caused by worker lay-offs and fuel product supply disruptions.

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[23] Equals onsite annual average employment and payroll at Ted Stevens International Airport in 2000. These figures do not include "offsite jobs generated by airport business purchases and workers spending their earnings within the community." (Scott Goldsmith, "Ted Stevens Anchorage International Airport: Economic Significance 2000," Institute of Social and Economic Research, July 2001.

[24] The PetroStar refineries in Fairbanks and Valdez produce only jet fuel and diesel.

J. The projected additional costs and responsibilities that could be imposed upon the State and affected political subdivisions by development related to the transaction:

The proposed contract is expected to generate negligible additional public-sector costs and responsibilities. The proposed contract could result in improvements in the utilization of existing capacity but the growth of new basic-sector jobs over the long run is expected to be small. Refinery direct employment of approximately 150 full time equivalent, high-wage positions is expected to remain the same. Indirect and induced employment effects, induced population expansion are not expected to vary from recent patterns as a result of the transaction. Industry-related property tax revenues should rise as a consequence of the Clean Fuels investments at the refinery. Construction jobs related to the Clean Fuels project are expected to be temporary.

According to a recent Commonwealth North study by the Institute of Social and Economic Research, each new basic-sector job creates a $1,100 annual burden on public finances.[25] This transaction is not expected to generate many new long-term basic sector jobs and should therefore not significantly increase public-sector costs. As indicated above, the potential unrestricted general fund revenues from this transaction are expected be positive $2.6 to $8.4 million per year.

K. The existence of specific local or regional labor or consumption markets or both which should be met by the transaction:

The Williams refinery at North Pole employs approximately 150 full time positions, representing about 1/3 of total direct oil and gas employment for the five largest petroleum-related companies in the greater Fairbanks area.[26] The annual payroll associated with these refinery jobs ranges between $8 to $12 million. The refinery generates additional "indirect" jobs and payroll through vendors that provide goods and services to the refinery, as well as "induced" jobs through local spending of direct and indirect payroll. The refinery and its employees generate between $3 and $4 million per year in property tax revenues to the Fairbanks Northstar Borough.

The proposed contract is expected to have a small impact on long-term, direct refinery employment, other than by providing more assurance of continued operation of a refinery in the Fairbanks region. The proposed contract could increase property tax revenues if the Clean Fuels project adds $100 million investment to the tax base for the North Pole refinery.

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[25] See http://www.iser.uaa.alaska.edu/Products/2StrategiesforGrowth.ppt.

[26] The companies are: Alyeska Pipeline Service Company, ConocoPhillips (formerly ARCO), BP Exploration, PetroStar, and Williams Alaska Petroleum. See Information Insights, "Economic Impact of the Petroleum Industry on the Fairbanks North Star Borough," December 1999.

L. The projected positive and negative environmental effects related to the transaction:

There are positive environmental provisions included in the special commitments contained in the FHR's proposed contract.[27] The Clean Fuels project will provide potentially lower priced, low sulfur diesel and gasoline instead of importing such fuels into Alaska. FHR will also continue and complete the Anchorage tank farm improvements which include evaluation of facilities to determine compliance with State and Federal requirements including overfill protection, fire protection, tank seal monitoring, potential for change of product service, and possible removal of additional tanks, and prompt remediation of any violations of these requirements.

M. The projected effects of the proposeu ·ansaction upon existing private commercial enterprise and patterns of investmen.,:

Flint Hills Resources agrees to the following special commitments that ensure continuation and and/or enhancement of existing commercial relationships involving the North Pole refinery.

1. Shipment by Rail

Williams currently ships refined products by rail under an agreement with Alaska Railroad Corporation (an Agreement originally entered by MAPCO Alaska Petroleum Inc. in May of 1993). As part of Buyer's refinery acquisition from Williams, FHR will assume the rights and obligations of Williams under the rail agreement and continue to ship refined products to Anchorage.

2. Air Traffic Marketing and Structural Improvement Study

FHR and the State will jointly explore commercially reasonable options for increasing passenger and cargo air traffic through the Fairbanks International Airport. FHR will work with the Fairbanks International Airport to concentrate on promoting the Fairbanks International Airport to cargo carriers operating between Asia and Europe and otherwise and will evaluate, and possibly upgrade, the airport's fuel distribution facilities, including the feasibility of using or upgrading the hydrant fueling system.

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[27] FHR has past issues regarding environmental compliance, including $10 million in fines in 2001 for criminal violations regarding a cover-up of improper benzene emissions at its Corpus Christi refinery and over $300 million in payments to settle lawsuits regarding pipeline spills in Texas. FHR spokesmen have indicated to the press that the company "has worked hard to improve its environmental record." Anchorage Daily News, November 18, 2003.

V. Findings and Determination

A. Disposal of the Royalty Oil In-kind is in the State's Best Interest

In accordance with AS 38.05.182, the Commissioner determines that it is in the best interest of the State to take its royalty oil in-kind to provide necessary crude oil supplies to the North Pole refinery.

B. Competitive Bidding is Waived

The Commissioner determines, in accordance with AS 38.05.183(a) and 11 AAC 03.030, that the best interest of the State will be served by sale of its royalty oil in-kind to FHR under non-competitive procedures to relieve market conditions. The proposed contract will promote the interest of the State through increased revenues and by facilitating uninterrupted operation of the North Pole refinery.

In deciding to sell RIK to FHR under the proposed contract the commissioner considered that without the contract the State will receive less revenue because its royalty oil would be taken in-value without the potential $0.30 per barrel price premium. FHR is uniquely qualified and positioned to assume ownership of the North Pole refinery and has agreed to provide significant additional benefits to Alaska through the Special Commitments of the proposed contract.

A copy of this Finding and Determination is being delivered to the Royalty Board as notification under 11 AAC 03.040 that the commissioner has determined that the best interest of the State does not require competitive bidding in this circumstance.

C. The RIK Oil Sale Will Relieve Market Conditions

A non-competitive sale of royalty oil is permitted where necessary to relieve market conditions. DNR regulations, at 11 AAC 03.024, provide that a non-competitive sale of RIK oil may be held to relieve "market conditions" when one of four alternative conditions is met. The proposed FHR contract meets two of the alternative conditions:

> (1) in a noncompetitive disposition of royalty oil, gas, or associated substances the commissioner estimates that the sale price throughout the term of the disposition will be higher than the volume-weighted average of the current reported netback prices filed by the lessees for royalty purposes for those filing periods applicable to the term of the disposition; and...
>
> (3) the royalty oil, gas, or associated substances disposed of will be used to meet in-state needs for crude oil, gas, or associated substances or petroleum products and the sale price of that royalty oil, gas, or associated substances is at least equal to the in-value amount which would have been received by the state during the same period.

The proposed contract will relieve market conditions because it will provide needed crude oil supplies to the North Pole refinery and the price for oil delivered throughout the term of the contract will provide a potential premium of $0.30 per barrel over the volume-weighted average of the netback prices reported by the North Slope lessees.

D. The Proposed RIK Oil Sale Offers Maximum Benefits to the State

When RIK oil is to be sold through a process other than by competitive bid, the commissioner must award the disposal to the prospective buyer whose proposal offers the maximum benefits to the State. In making the award the commissioner must consider the criteria set out in AS 38.05.183(e) and in AS 38.06.070(a). The commissioner's in-depth review and consideration of all of the required statutory criteria is set out above in Section IV of this Best Interest Finding and Determination. The commissioner finds that the proposed sale of ANS royalty oil to FHR, under the terms and conditions of the attached proposed contract, offers the maximum benefit to the State.

E. Alaska Royalty Oil and Gas Development Board

This finding and determination and a copy of the proposed contract is being submitted to the Royalty Board in compliance with AS 38.05.183(c) and 11 AAC 03.024 and 11 AAC 03.040, which require the commissioner to give written notice to the Board of intent to waive competitive bidding of an RIK sale.

F. Legislative Approval

Legislative approval is required for RIK oil dispositions with a term of more than one year. (AS 38.05.183). Legislation approving the sale has been prepared and is intended to be introduced immediately following receipt of written recommendations from the Alaska Royalty Oil and Gas Development Board.

VI. Conclusion

On careful consideration of the circumstances of the proposed sale, material information and legal requirements, the commissioner determines, in accordance with AS 38.05.183, that the best interest of the State does not require this RIK oil sale to be made by competitive bid, and that the proposed contract with FHR offers maximum benefits to its citizens.

<Signed> 2/12/04

Thomas E. Irwin
Commissioner

Date

Appendix A
Proposed Contract

AGREEMENT FOR THE SALE OF

ROYALTY OIL

BETWEEN AND AMONG

THE STATE OF ALASKA,

FLINT HILLS RESOURCES, LLC, A DELAWARE LIMITED LIABILITY COMPANY

AND

FLINT HILLS RESOURCES ALASKA, LLC, AN ALASKA LIMITED LIABILITY COMPANY

EFFECTIVE ________, 2004

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AGREEMENT FOR THE SALE AND PURCHASE OF ROYALTY OIL

This Agreement is between the State of Alaska ("State"), Flint Hills Resources Alaska, LLC, an Alaska Limited Liability Company ("Buyer") and Flint Hills Resources, LLC, a Delaware Limited Liability Company ("Guarantor"). Buyer, an indirect wholly-owned subsidiary of Guarantor, intends to purchase the refinery at North Pole, Alaska now owned by Williams Alaska Petroleum, Inc. The effective date of this Agreement is the first Day on which it has been signed by all Parties.

ARTICLE I
DEFINITIONS

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

1.1 "Affiliate" is defined in Section 22.1

1.2 "ANS" means the Alaska North Slope.

1.3 "ANS Spot Price" is defined in Section 2.3.

1.4 "Assignee" is defined in Section 22.1.

1.5 "BP" means BP Exploration (Alaska) Inc. and its successors and assigns.

1.6 "Business Day" means any day, or part of a day, during which federally chartered banks are open for business in the place designated in this Agreement for payment.

1.7 "Closing" is defined in Section 2.4.1.

1.8 "Commissioner" means the Commissioner of the Alaska Department of Natural Resources or the Commissioner's designee.

1.9 "CPAI" means ConocoPhillips Alaska, Inc. and its successors and assigns.

1.10 "Day" means a period of twenty-four consecutive hours, beginning at 12:01 a.m., Alaska Local Time.

1.11 "Day of First Delivery" is defined in Section 2.4.1.

1.12 "Enactment" is defined in Section 9.4.

1.13 "ExxonMobil" means ExxonMobil Corporation and its successors and assigns.

1.14 "Financial Analyst" is defined in Section 6.3.

1.15 "FERC" means Federal Energy Regulatory Commission.

1.16 "Force Majeure" is defined in Section 15.2.

1.17 "Initial Term" is defined in Section 9.2.

1.18 "Leases" means the oil and gas leases issued by the State on the Alaska North Slope from which the State takes or may take Royalty Oil in-kind.

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

1.20 "Letter" is defined in Section 7.1.

1.21 "Letter Effective Date" is defined in Section 7.2.

1.22 "Line Loss" is defined in Section 2.3.

1.23 "Minimum Interstate TAPS Tariff" is defined in Section 2.3.

1.24 "Month" means a period beginning at 12:01 a.m., Alaska Local Time, on the first Day of the calendar Month and ending at 12:01 a.m., Alaska Local Time, on the first Day of the following calendar Month.

1.25 "Moody's" means Moody's Investor's Services, Inc., a subsidiary of Moody's Corporation, and its successors.

1.26 "Notice" means written notice in accordance with Article XVI.

1.27 "Notice Effective Date" is defined in Section 16.2.

1.28 "Opinion Letter" is defined in Section 6.3.

1.29 "Parties" means, collectively, Buyer, Guarantor and State.

1.30 "Party" means Buyer, Guarantor or State, individually.

1.31 "Person" is defined in AS 01.10.060.

1.32 "Point of Delivery" means the transfer point at which the State receives Royalty Oil in-kind from the Lessees.

1.33 "Price" is defined in Section 2.3.

1.34 "Process" is defined in Section 4.1.

1.35 "PSVR Reference Stream" is the blended TAPS stream immediately downstream from the Petro Star Valdez Refinery.

1.36 "Quality Bank" means a system of calculations administered under the authority of the FERC that accounts for the differences in value between the individual tendered streams and the delivered co-mingled stream of TAPS.

1.37 "Quality Bank Adjustment" is defined in Section 2.3.

1.38 "RIV Marine Cost" is defined in Appendix 5.

1.39 "Royalty Oil" means the total volume of crude petroleum oil and other hydrocarbons and associated substances from the Leases, including such substances as crude oil, condensate, natural gas liquids, or return oil from crude oil topping plants, that may be blended with crude oil before the Point of Delivery and tendered as a common stream to the State as Royalty Oil that the State may take in-kind, regardless of whether the State takes the Royalty Oil in-kind.

1.40 "Royalty Settlement Agreement" means any written royalty settlement agreement.

1.41 "Sale Oil" means the oil the State has agreed to sell to the Buyer, and the Buyer has agreed to purchase from the State under this Agreement.

1.42 "Standard and Poor's" means Standard and Poor's, a division of McGraw-Hill Companies, Inc., and its successors.

1.43 "TAPS" means the Trans Alaska Pipeline System

1.44 "Tariff Allowance" is defined in Section 2.3.

1.45 "Unit" has the meaning defined in 11 AAC 83.395(7).

1.46 "Unit Agreement" means any unit agreement for a Unit from which the State takes or may take Royalty Oil.

1.47 "Williams" means Williams Alaska Petroleum, Inc.

1.48 "Williams' Alaska Properties" means the following assets currently owned by Williams: (a) a refinery located near North Pole, Alaska; (b) a petroleum products terminal located at or near the Fairbanks International Airport; (c) a petroleum products terminal located at Anchorage, Alaska; and (d) tangible and intangible assets related to the properties described in (a), (b), and (c).

ARTICLE II
<u>SALE AND PURCHASE OF ROYALTY OIL</u>

2.1 <u>Quantity</u>.

2.1.1 <u>Sale Oil Quantity</u>. The State agrees to sell to Buyer, d Buyer agrees to purchase from the State, an initial Sale Oil quantity of a maximum of 77,000 barrels per Day and a minimum of 56,000 barrels per Day averaged for the Month of Sale Oil delivery, as nominated by Buyer in accordance with Section 2.1.5. The Commissioner may limit the total amount of

Sale Oil for any Month to not more than 85 percent of the total Royalty Oil for the Month or not more than 95 percent of the Royalty Oil for the Month from any single Unit.

2.1.2 Buyer's Elective Reduction of Quantity. Buyer may elect to reduce the initial Sale Oil quantity by giving Notice. The initial Sale Oil quantity shall remain as stated in Section 2.1.1 for 12 Months after the Day of First Delivery. Notice of a reduction shall be delivered to the State at least six Months before the effective date of the reduction. The reduced maximum quantity shall be 137.5 percent of the reduced minimum quantity. For example, if the reduced minimum quantity is 40,000 barrels per Day, the reduced maximum quantity shall be 55,000 barrels per Day (40,000 times 1.375=55,000.)

Buyer may elect additional reductions to the Sale Oil quantity following a reduction to the initial Sale Oil quantity. A reduction cannot be effective until at least 12 Months after the effective date of the most recent reduction in quantity. Notice of an additional reduction shall be delivered to the State at least six Months before the effective date of the additional reduction. The reduced maximum quantity shall be 137.5 percent of the reduced minimum quantity.

The minimum Sale Oil quantity shall not be reduced below 24,000 barrels per day, except (1) in the case of a temporary quantity reduction in the event of a Force Majeure under section 2.1.4, (2) in the event that the North Pole refinery is shut down, or (3) during the second five years of the contract term if the Sale Oil quantity is reduced to zero.

2.1.3 Increase in Quantity Following Elective Reduction. Following a reduction of Sale Oil quantity under Section 2.1.2, Buyer may request an increase in the Sale Oil quantity to an amount that does not exceed the initial Sale Oil quantity. The increased maximum quantity must be 137.5 percent of the increased minimum quantity, and the minimum quantity shall not be increased to less than 24,000 barrels per day. An increase cannot be effective until at least 12 Months after the effective date of the most recent change in quantity (*i.e.*, a decrease under Section 2.1.2 or an increase under Section 2.1.3). The Commissioner may approve or deny a request for an increase in Sale Oil quantity.

2.1.4 Temporary Quantity Reduction in Event of Force Majeure. In the event of a Force Majeure, Buyer may temporarily reduce the Sale Oil quantity by an amount equal to the reduction in Buyer's requirements that is a direct result of the Force Majeure event. Buyer shall include a notice of temporary reduction in Sale Oil quantity under this Section with each of Buyer's monthly nominations of Sale Oil made in accordance with Section 2.1.5. Each notice of temporary reduction shall include documentation of the nature of the event and quantification of the direct impact of the event on Buyer's Sale Oil requirements for the affected Month of nomination. Temporary reductions in Sale Oil quantity under this Section shall be effective to the extent that the State is able to reduce the volume of Royalty Oil that it actually receives through the nomination process set out in Section 2.1. Buyer shall accept delivery of the total volume of Royalty Oil delivered to the State in accordance with the State's nominations. Buyer acknowledges that some of the Leases from which the State must nominate Royalty Oil require six Months notice to the Lessee prior to decreasing the State's nomination of Royalty Oil to be taken in-kind in any Month.

2.1.5 Monthly Nomination. Buyer shall nominate the total monthly Sale Oil quantity by giving Notice. Except when the additional notice provisions of Section 2.1.6 are invoked by Lessees, a monthly nomination shall be effective on the first Day of the Month following expiration of a minimum of one hundred Days after the Notice of Buy· 's nomination. The State will make commercially reasonable efforts to nominate, in accordance with applicable

Unit Agreements, percentages of the State's estimated Royalty Oil volume from one or more Units, at the State's discretion, that will equal the Sale Oil quantity nominated by the Buyer. Buyer agrees to accept the volume of Royalty Oil delivered in accordance with the State's nomination. See Appendix 1 for an illustration of the State's nomination procedure for Sale Oil nominated from the Prudhoe Bay Unit for July 2004.

2.1.6 Additional Notice Provisions. Buyer acknowledges that if a Lessee invokes the Force Majeure provisions of its Royalty Settlement Agreement, the State may be required to give up to 180 Days (*i.e.*, an additional 90 Days) notice to the Lessee prior to decreasing the State's nomination of Royalty Oil to be taken in-kind in any Month. If a Lessee invokes the Force Majeure terms of its Royalty Settlement Agreement as a result of a reduction in Buyer's nomination, Buyer's reduced nomination shall not become effective until the end of the additional 90 Day notice period. If a Lessee invokes the Force Majeure terms of its Royalty Settlement Agreement and extends the notice period an additional 90 Days, the State agrees to make commercially reasonable efforts to reduce its Royalty Oil nominations to other Lessees that have not invoked Force Majeure in order to limit Buyer's obligation to purchase Sale Oil.

2.1.7 No Guarantee of Quantity. The State shall exercise its rights under the Leases and Royalty Settlement Agreements to request that Royalty Oil be delivered as Sale Oil. The State can deliver Sale Oil only to the extent it receives Royalty Oil from the Lessees. The quantity of Royalty Oil available to the State may vary and may be interrupted from time to time depending on a variety of factors, including the rate of production from the Leases. The State disclaims and Buyer waives, any guarantee, representation, or warranty, either express or implied, that a specific quantity of the total, daily, monthly, average, or aggregate Royalty Oil will be delivered as Sale Oil.

2.1.8 Source of Sale Oil. The State will deliver, as Sale Oil, Royalty Oil produced from the Leases and delivered to the State as Royalty Oil in-kind. The availability to the State of Royalty Oil in-kind in any Month may vary depending on a variety of factors, including the rate of production from the Leases. The State disclaims and Buyer waives, any guarantee, representation, or warranty, either express or implied, that Sale Oil delivered and sold by the State in any Month is from a certain Lease, Unit, or other area.

2.1.9 State's Warranty of Title. The State warrants that it has good and marketable title to the Royalty Oil delivered and sold as Sale Oil.

2.2 Quality.

2.2.1 Quality of Sale Oil. The Royalty Oil the State delivers to Buyer as Sale Oil shall be of the same quality as the Royalty Oil delivered to the State at the Point of Delivery. The quality of the Royalty Oil delivered to the State may vary from time to time. The State disclaims, and Buyer waives, any guarantee, representation, or warranty, either expressed or implied, of merchantability, fitness for use, or suitability for any particular use or purpose, or otherwise, and of any specific, average, or overall quality or characteristic of Sale Oil. Buyer specifically waives any claim that any liquid hydrocarbons, including such substances as crude oil, condensate, natural gas liquids, or return oil from the crude oil topping plant, delivered with the Sale Oil, are not Sale Oil for purposes of this Agreement.

2.3 Price of the Sale Oil. The price per barrel of Sale Oil delivered from each Unit by the State to the Buyer each Month shall be equal to

ANS Spot Price - $1.55 - Tariff Allowance + Quality Bank Adjustment - Line Loss.

"AN‿ Spot Price" means the monthly average of the daily high and low assessments for the Month for ANS oil traded at the United States West Coast as reported by Platts' Oilgram Price Report, Telerate online data reporting service, and Reuters online data reporting service. The ANS Spot Price calculation will not include days on which prices are not reported, such as weekends or holidays. If one or two of these publications ceases to report daily assessments for ANS oil traded at the United States West Coast, the Parties agree to calculate the ANS Spot Price using the data from the remaining reporting service or services. If either Buyer or Seller makes a good faith determination that the ANS Spot Price no longer accurately represents the price for ANS oil traded at the United States West Coast, Buyer and Seller will attempt in good faith to arrive at a mutually agreeable alternative source to establish, or substitute for, the ANS Spot Price. If the Buyer and Seller arrive at a mutually agreeable ıative source, that source shall be used to determine the ANS Spot Price beginning the Month following the Month in which the alternative source was determined. If Buyer and the State are unable to agree on an alternative source, either may provide written notice of dispute to the other Party, and the dispute shall be administered in accordance with Section 13.1.

"Tariff Allowance" means the sum of (1) the average, weighted by ownership, of the Minimum Interstate TAPS Tariff (Pump Station No. 1 to Valdez Marine Terminal) for each owner in effect on the Day the Sale Oil is tendered by the State to Buyer; and (2) any tariffs paid by Buyer for shipment of Sale Oil upstream of Pump Station No. 1. "Minimum Interstate TAPS Tariff" means the effective TAPS tariff on file with the Federal Energy Regulatory Commission ("FERC") for each carrier on a given Day, excluding incentive tariffs. If a tariff which has been used in the calculation of a Tariff Allowance is changed or subject to a refund order by the FERC, the Tariff Allowance will be recalculated using the changed FERC-ordered tariff, the

Sale Oil Price will be adjusted accordingly, and the resulting refund to the State (or credit to Buyer) will be made in accordance with Article III. If a FERC-ordered tariff is suspended or enjoined from implementation, the Tariff Allowance shall not be recalculated until the suspension or injunction is lifted and the FERC order is implemented and goes into effect.

The "Quality Bank Adjustment" is a per-barrel amount, positive or negative, that accounts for the difference in quality between the oil produced from the units on the North Slope and the co-mingled ANS TAPS stream downstream of the PSVR connection. The Quality Bank Adjustment for a Unit's stream will be calculated each Month as the difference between the stream value for the PSVR Reference Stream and the stream value for each Unit. The stream value and PSVR Reference Stream are reported by the TAPS quality bank administrator. If the stream value or the PSVR Reference Stream is recalculated by the Quality Bank administrator, the Quality Bank Adjustment shall be recalculated and the Price shall be adjusted as follows: (1) a recalculation of a Quality Bank Adjustment that is not the direct result of an order issued by the FERC shall apply to Sale Oil that has been delivered to Buyer from and after the effective date of the adjustment, but any retroactive application of the adjustment shall be limited to Sale Oil that has been delivered to Buyer in the six calendar Months immediately prior to the Month of invoice of the recalculation, and the Price shall be adjusted in accordance with Article III; and (2) a recalculation of a Quality Bank Adjustment that is the direct result of an order issued by the FERC, including but not limited to any and all orders issued in Docket No. OR89-2-016 et al. shall apply to all Sale Oil deliveries that occur within the time frames affected by the FERC order(s), and any resulting liability for retroactive adjustments shall be payable by the State or Buyer in equal monthly installments over the same number of Months as the number of Months of Sale Oil deliveries to which the recalculation of the Quality Bank Adjustment applied. The payments (or credit) of retroactive adjustments shall begin in the Month following the Month in which the Quality Bank administrator issues an invoice that implements a retroactive adjustment required by the FERC and shall be subject to the billing and payment (or credit) provisions of Article III. If monthly payments are owed at termination, the amount owed (i.e., the monthly payment times the number of months remaining for payments to be made) shall be paid as an adjustment under Article III as follows: (a) the first $1 million of the amount owed shall be paid in full; and (b) the remainder of the amount owed, if any, shall be discounted to its net present value and the discounted amount shall be paid in full. The discount rate used in this calculation shall be the Bank of America prime rate plus 2 percentage points and the term for discount shall be the number of months of payments remaining at termination. An adjustment under subsection (2) of this paragraph will not be implemented until the relevant FERC order is final and not subject to further appeal.

"Line Loss" is a per barrel amount equal to (.0009) x (ANS Spot Price - $1.55 – Tariff Allowance + Quality Bank Adjustment).

Appendix 2 is an illustrative example of the calculation of the Price of Sale Oil. If there is a conflict between Appendix 2 and Section 2.3, Section 2.3 shall control. The $1.55 component used in calculation of the Price shall be adjusted one time for Sale Oil deliveries on and after April 1, 2009, according to the terms of Appendix 5.

2.4 Delivery of Sale Oil.

2.4.1 Day of First Delivery. The State will make first delivery of the Sale Oil to Buyer at the Point of Delivery on the first Day of the Month following the Month of Closing ("Day of First Delivery"). "Closing" means the transfer from Williams to Buyer of legal title to all of Williams' Alaska Properties. All nominations made by Williams prior to Closing that provide for the deliveries of Royalty Oil by the State on and after the Day of First Delivery shall be deemed to be nominations by Buyer under this Agreement and shall be subject to all terms of this Agreement, including Price.

2.4.2 Later Deliveries. After the first delivery, the State shall tender the Sale Oil to Buyer at the Point of Delivery immediately upon the receipt of the Royalty Oil from the Lessees at the Point of Delivery.

2.5 Passage of Title and Risk of Loss. Title to, and risk of loss of, the Sale Oil shall pass from the State to Buyer for all purposes when the State tenders delivery of the Sale Oil to Buyer at the Point of Delivery. Buyer shall bear all risk and responsibility for the Sale Oil after passage of title.

2.6 Indemnification After Passage of Title. Buyer shall indemnify and hold the State harmless from and against any and all claims, costs, damages (including reasonably foreseeable consequential damages), expenses, or causes of action arising from or related to any transaction or event in any way related to the Sale Oil after title has passed to Buyer. If Buyer suffers damages or losses caused by third parties and related to the Sale Oil, the State agrees to cooperate with the Buyer to permit Buyer to attempt to recover such damages or losses. The State will, on request, assign the State's claims to Buyer and cooperate in Buyer's pursuit of State assigned claims.

2.7 Transportation Arrangements. Buyer shall make all arrangements for transportation of the Sale Oil from the Point of Delivery, to, through and away from the TAPS, and all pipelines upstream from Pump Station No. 1, and shall be responsible for meeting any linefill and storage tank bottom requirements related to transportation of the Sale Oil after passage of title, except that the State shall be responsible for meeting any linefill requirements for pipelines upstream of Pump Station No. 1. If Buyer provides the necessary data, the State shall meet its linefill requirements by passing title to Sale Oil to Buyer at the Point of Delivery but not invoicing Buyer for the portion of Sale Oil required for linefill until that portion of Sale Oil has been delivered to Buyer at Pump Station No. 1. For purposes of invoicing, Buyer and State agree that the linefill upstream of Pump Station 1 that has not been invoiced will be deemed to be the last barrels injected at the Point of Delivery. On the State's request, Buyer shall provide the State with evidence of the arrangements for transportation of the Sale Oil from the Point of Delivery, through and away from TAPS, and all pipelines upstream from Pump Station No. 1, and evidence of arrangements for resale, exchange, or other disposal of the Sale Oil. Buyer's failure to provide information, evidence, or assurances requested by the State shall, at the State's election and after Notice to Buyer, constitute a material default under this Agreement.

ARTICLE III
INVOICING AND PAYMENT

3.1 Invoices. On or before the twentieth calendar Day of each Month after the first Month of delivery of Sale Oil, the State shall send to Buyer via facsimile a statement of account with an invoice for the total amount due for the estimated quantity of Sale Oil delivered to Buyer during the immediately preceding Month and the estimated Price applicable to those deliveries. The State will base its estimates on the best information reasonably available to the State. The State shall adjust invoices as provided in Section 3.3.

3.2 Payment of Invoices. Buyer shall pay the total amount of each invoice, in full, on or before the later of (1) the third Business Day after the date of the statement of account in which the invoice is included; or (2) the twentieth calendar Day of the Month. Any amount that

Buyer does not pay in full on or before the payment due date calculated in accordance with this section shall accrue interest as provided in Section 3.5, and become subject to the late payment provisions of Section 3.7, and any other remedies available to the State under this Agreement and at law.

3.3 Adjustments. Buyer acknowledges that any time after an invoice is sent, the State may receive more accurate information concerning the ANS Spot Price, actual quantity of Sale Oil delivered to Buyer, the proper calculation of Tariff Allowance, and Quality Bank Adjustments that affect the Price of the Sale Oil. Buyer agrees that any time such information becomes available to the State, the State shall make adjustments and invoice or credit Buyer the amount of the adjustment in accordance with the process and retroactivity limits described in Section 2.3. The State shall invoice or credit Buyer in a statement of account for the adjustments as promptly as reasonably possible. All adjustments shall be paid within 30 Days of the end of the term.

3.4 Payment of Adjustments. The Buyer shall pay the total amount of each adjustment invoice in full, on or before the later of (1) the third Business Day after the date of the statement of account that includes the adjustment invoice; or (2) the twentieth calendar Day of the Month. If an adjustment is due to Buyer for an overpayment, the State shall credit to Buyer the amount of the overpayment on the following Month's invoice or, if no following Month invoice is provided, the State shall refund to Buyer the amount of the overpayment by the twentieth calendar Day of the following Month. Any amount the Buyer does not pay in full when due shall bear interest at the rate provided in Section 3.5 and become subject to the late payment provisions of Section 3.7, and any other remedies available to the State under this Agreement and at law.

3.5 Interest. All amounts under this Agreement that Buyer does not pay in full when due, or that the State does not credit Buyer or pay in full when due, shall bear interest from the date payment is due, calculated in accordance with Section 3.4, at the rate provided by Alaska Statute 38.05.135(d) or as that statutory provision may later be amended.

3.6 Adjustments After Termination. Buyer and State agree that the State shall continue to make adjustments after termination of this Agreement, and agree that the provisions of Articles III, VI, VII, and IX shall survive termination of this Agreement for any reason. ' following termination of this Agreement an adjustment is determined to be due to Buyer for overpayment in an amount that exceeds the amount of all sums remaining due from Buyer to the State, the State shall credit the overpayment against any sums due from Buyer to the State, and shall refund to Buyer the remaining amount of the adjustment. Any adjustments made after termination must be paid within thirty Days after the date of the invoice.

3.7 Late Payment Penalty. In addition to all other remedies available to the State, if Buyer fails to make timely payment in full of any amount due, including adjustments, Buyer shall pay the State as a late payment penalty an amount equal to five percent of the total amount not timely paid, in addition to the amount not timely paid. The Commissioner shall waive imposition of the late payment penalty if the Buyer provides evidence that the failure to make timely payment was not willful and was not due to one mistake in a chronic pattern of mistakes. Appendix 3 contains an illustrative example of interest and late payment penalties.

3.8 Disputed Payments. If a dispute arises concerning the amount of an invoice, Buyer agrees to pay in full all amounts not in dispute, and to explain in writing with particularity the basis for and calculation of any disputed amounts withheld.

3.9 Confidential Information. The State and Buyer agree that the State may invoice Buyer for, and Buyer agrees to pay, amounts that are based upon confidential information held or received by the State. If confidential information is used as the basis for an invoice, upon receipt of a written request from Buyer, the State shall furnish to Buyer a certified statement of the Commissioner to the effect that, based upon the best information available to the State, the invoiced amounts are correct. At the request and expense of Buyer, the Commissioner's certified statement will be based on an audit by an independent third party.

3.10 Manner of Payment. Except as provided in Section 3.8, Buyer shall pay all invoices in full within the times specified and without any deduction, set off, or withholding. Buyer shall pay all invoices by either Automated Clearinghouse or by Federal Reserve Wire Transfer (immediate funds available) procedure to the following State account and address:

State Street Bank & Trust Company
Boston, Massachusetts
ABA #011000028
For Credit to the State of Alaska
General Investment Fund – AY01
Account No. 00657189 (Federal Reserve Wire Transfer)
Account No. 00653220-10000 (Automated Clearinghouse)

Buyer may pay an invoice in such other manner or to such other address the State has specified in an invoice or by written notice. All other payments due shall be paid in the same manner and according to the same time schedule provided in this Article. If payment falls due on a Saturday, Sunday, or federal bank holiday, payment shall be made on the next Business Day.

ARTICLE IV
IN-STATE PROCESSING

4.1 In-State Processing. Buyer shall use all commercially reasonable efforts to insure that Sale Oil will be processed at its Alaska refinery or be exchanged for other crude oil that will be processed at its Alaska refinery. "Process" means the manufacture of refined petroleum products.

ARTICLE V
BUYER'S SPECIAL COMMITMENTS

5.1 Buyer agrees to comply with and perform the list of "Special Commitments" contained in Appendix 4 to this agreement.

ARTICLE VI
BUYER'S AND GUARANTOR'S REPRESENTATIONS AND OBLIGATIONS

6.1 Good Standing and Due Authorization of Buyer. Buyer warrants that it is, and shall remain at all times during the term of this Agreement: (1) qualified to do business in Alaska; and (2) in good standing with the State. Buyer warrants that it has all company power and authority necessary, and has performed all company action required, to enter into and fulfill its obligations under this Agreement.

6.2 Good Standing and Due Authorization of Guarantor. Guarantor warrants that it is, and shall remain at all times during the term of this Agreement: (1) qualified to do business in Alaska; and (2) in good standing with the State. Buyer warrants that it has all company power and authority necessary, and has performed all company action required, to enter into and fulfill its obligations under this Agreement.

6.3 Financial Information. As soon as practicable after the execution of this Agreement, and annually as soon as practicable after March 31 but no later than June 30, Guarantor shall cause a financial analyst (the "Financial Analyst") to submit an opinion to the Commissioner in the form of a letter (the "Opinion Letter") about Guarantor's current and expected future credit rating by Standard and Poor's and Moody's. The Financial Analyst shall be qualified to render an opinion as to the creditworthiness of the Guarantor and shall be in the business of understanding complex financial matters and financial statements to the extent required to render such opinion. Buyer shall have the right to designate the Financial Analyst, subject to approval by the State. The Financial Analyst shall be a contractor to Guarantor, and Guarantor shall be responsible for entering into any necessary contractual arrangements with the Financial Analyst and paying the fees and expenses of the Financial Analyst.

The contract between Guarantor and the Financial Analyst and each Opinion Letter must recite that the Financial Analyst (1) has been provided a copy of this Agreement, (2) understands the significance of the Opinion Letter in the administration of this Agreement, (3) understands that the State will rely on the Opinion Letter, and (4) understands that the Opinion Letter is for the benefit of the State. The contract between Guarantor and the Financial Analyst shall be subject to approval by the State, and the State shall be given a copy of the contract and all amendments to it.

The Opinion Letter shall (i) identify all documents reviewed in forming the opinion, (ii) identify people interviewed in forming the opinion and discuss the nature of the interview, (iii) state the current long term (and short term, if available) credit ratings of Guarantor by Standard and Poor's and Moody's and (iv) express an opinion whether those ratings are reasonably likely to fall to or below BBB+ (Standard and Poor's) and Baa1 (Moody's) at any time during the following twelve Months. Guarantor shall cause the Financial Analyst to review evidence of the most current ratings by Standard and Poor's and Moody's of Guarantor's long and short term debt, all bank presentations provided to Guarantor's lenders, all reports on Guarantor prepared by Standard and Poor's or Moody's, any assessment (if available to the Guarantor) of Guarantor's financial condition conducted on behalf of the Port Commission of the Port of Corpus Christi Authority, concerning the Port of Corpus Christi Authority of Nueces County, Texas Solid Waste Disposal Revenue Bonds, all documents filed by Guarantor with the Securities and Exchange Commission, if any, any other documents reasonably necessary to deliver the Opinion Letter, and a complete set of year-to-year comparative, independently audited financial statements, including footnotes, prepared in accordance with generally accepted accounting principles.

Guarantor's contract with the Financial Analyst may require the Financial Analyst to protect the confidentiality of the information supplied to it under Section 6.3. The State may review the information supplied to the Financial Analyst under Section 6.3 by executing a confidentiality agreement with Guarantor but will not take any action that will make the information part of the State's public records.

6.4 Financial Condition. Guarantor warrants (1) that all financial information submitted to the Financial Analyst or reviewed by the State under Section 6.3 is complete and accurate at the time of preparation, and fairly represents Guarantor's financial condition at the time of submission; and (2) that there has been no material change in Guarantor's financial condition, business operations, or properties since the financial information was prepared. Guarantor warrants that the financial statements were prepared in accordance with generally accepted accounting principles. Guarantor and Buyer shall immediately inform the State of any material change in Guarantor's ownership or ownership of Buyer, ownership of parent companies, or financial condition, business operations, agreements, or property that is likely to affect their ability to perform their obligations under this Agreement.

6.5 Absolute Obligations. Buyer's and Guarantor's obligations to pay amounts due, provide assurances of performance in accordance with Article VII, accept, and dispose of and pay for Sale Oil, are absolute. These obligations shall not be excused or discharged by the operation of any disability of Buyer or Guarantor, event of Force Majeure, impracticability of performance, change in conditions, or other reason or cause.

6.6 Guaranty. Buyer was formed to purchase the refinery at North Pole, Alaska now owned by Williams Alaska Petroleum, Inc. Buyer is an indirect, wholly-owned subsidiary of Guarantor. Buyer does not have any operating history, does not have public financial statements, and does not have debt rated by Moody's or Standard and Poor's. The State is not willing to make this Agreement based solely on the credit worthiness of Buyer. Guarantor therefore agrees that it guarantees performance of all of Buyer's obligations under this Agreement as if Guarantor were the Buyer and legally indistinguishable from Buyer. The State may require Guarantor at any time to satisfy any unsatisfied obligation of Buyer.

ARTICLE VII
ASSURANCE OF PERFORMANCE

7.1 Credit Review. If Guarantor fails to timely submit its financial statements and other documents and information required under Article VI such that the Financial Analyst is unable to timely submit the Opinion Letter; or if, in the opinion of the Financial Analyst, Guarantor's credit ratings have fallen to or below, or are reasonably likely in the twelve Months following the Opinion Letter, to fall to or below (a) "BBB+" (Standard and Poor's "Long term issuer"), or (b) "Baal" (Moody's Investor Services "Issuer Ratings/Long Term Obligation Ratings"); or Guarantor is not rated by Standard and Poor's and Moody's, Guarantor shall immediately deliver to the State a one year irrevocable stand-by letter of credit (the "Letter") meeting the requirements of Sections 7.2 through 7.5.

Guarantor shall annually renew and continuously maintain the Letter in effect until such time as, in the opinion of the Financial Analyst, Guarantor's credit rating is no longer reasonably likely to fall to or remain below (a) "BBB+" (Standard and Poor's "Long term issuer"); or (b)

"Baal" (Moody's Investor Services "Issuer Ratings/Long Term Obligation Ratings") at any time during the twelve Months following the Opinion Letter.

7.2 Letter of Credit. In the event that Guarantor is required to deliver a letter of credit to the State in accordance with Section 7.1, the Letter shall be in a form satisfactory to the Commissioner and shall be in effect no later than five Business Days after the effective date of Notice from the State to the Guarantor ("Letter Effective Date"). The State's Notice shall include a description of the circumstances that trigger the Letter requirement in accordance with Section 7.1. The Letter shall be issued for the benefit of the State by a state or national banking institution of the United States that is insured by the Federal Deposit Insurance Corporation and has an aggregate capital and surplus amount of not less than One Hundred Million Dollars ($100,000,000) ("Issuer"), or other banking institution approved by the Commissioner, such approval not to be unreasonably withheld. The principal face amount of the Letter shall be an amount reasonably estimated by the Commissioner to be equal to the Price of all Sale Oil to be delivered by the State to Buyer during the 90 Days immediately following the Letter Effective Date. The Letter shall not require the State to submit any documentation in support of drafts drawn against it other than a certified statement by the Commissioner and the State's Attorney General that Guarantor is liable to the State for an amount of money equal to the amount of the draft, that the amount of money is due and payable in full, and it has not been timely paid.

7.3 Performance Assurance After Termination. If in accordance with the terms of Section 7.1, a Letter is in effect immediately prior to Termination of the Agreement, the Commissioner may require that, after Termination, the Letter be maintained in an amount estimated by the Commissioner to be equal to the value of all adjustments which may be made under Article III. As an alternative to maintaining a Letter after Termination, the Guarantor may establish and maintain an interest-bearing escrow account in the same amount and including the same payment terms as the Letter requirements of Section 7.2, on commercial terms acceptable to the Commissioner.

7.4 Other Performance Assurance. The Commissioner may allow Guarantor to provide security other than the Letter if the Commissioner determines other security is adequate to protect the State's interest.

7.5 Correction of Defects in Letter. Guarantor shall have five Business Days to correct any defect in the Letter beginning on the Business Day Guarantor first learns of the defect whether through Notice from the State or otherwise. A defect is any failure to comply with the terms and conditions of Article VII.

ARTICLE VIII
MEASUREMENTS

8.1 Measurements. The quantity and quality of Sale Oil the State delivers under this Agreement shall be determined by measurement at the Point of Delivery. Procedures used for metering and measuring the Sale Oil shall be in accordance with the procedures in effect at the Point of Delivery.

ARTICLE IX
EFFECTIVE DATE AND TERM

9.1 Effective Date. This Agreement shall be effective when it is signed by all parties ("Effective Date").

9.2 Initial Term. The Initial Term of this Agreement shall begin on the Day of First Delivery and terminate at the end of the last Day of the 12th Month after the Day of First Delivery, including the Month in which the Day of First Delivery occurs.

9.3 Extension of Term. Under Alaska Statute 38.06.055, this Agreement is limited to a term of no longer than one year unless a longer term is approved by the Alaska legislature. The Commissioner shall have legislation to approve the extension of the term of this Agreement for an additional nine years following the last Day of the Initial Term prepared for introduction to the 23rd Legislature in 2004. The Commissioner and Buyer agree to use their best efforts to support the passage of the legislation.

9.4 Termination Prior to Legislative Approval. Buyer, Guarantor, or the State may terminate this Agreement, with no further obligation or liability to each other, if Enactment has not occurred on or before March 17, 2004. Notice of termination shall be in writing, and shall be effective if delivered to the other Party in accordance with Section 16.1 before Enactment. "Enactment" means the Governor's signing of a bill passed by the 23rd Legislature that approves the extension of the term of this Agreement for an additional nine years following the last Day of the Initial Term.

9.5 Closing on Williams' Alaska Properties. Buyer, Guarantor, or the State may terminate this Agreement, with no further obligation or liability to each other, if Closing has not been completed before April 1, 2004. Notice of termination shall be in writing, and shall be effective if delivered to the other Party in accordance with Section 16.1 before Closing.

9.6 Continuation of Obligations. Except as provided in Sections 9.4 and 9.5, termination of this Agreement shall not relieve either Party from any expense, liability, or other obligation or any remedy that has accrued or attached prior to the date of termination. For Sale Oil actually delivered under this Agreement, termination of this Agreement shall not relieve Buyer of its obligation to pay all production Month invoices, initial adjustments, subsequent adjustments, and interest, and, where applicable, penalties, costs, attorney fees, and any other charges related to the Sale Oil actually delivered.

ARTICLE X
DEFAULT OR TERMINATION

10.1 Default.

10.1.1 Events of Default. The Commissioner may suspend or terminate the State's obligations to tender, deliver and sell Sale Oil to Buyer, and may exercise any one or more of the rights and remedies provided in this Agreement, or at law, if any one or more of the following events of default occur:

(i) Buyer or Guarantor fails to pay in full any sum of money owed under this Agreement within five Business Days after the State gives Buyer Notice that payment is past due;

(ii) Within five Business Days after Notice from the State, Buyer or Guarantor fails to provide written assurances satisfactory to the State of Buyer's or Guarantor's intention to perform its obligations under this Agreement and evidence or assurances of transportation arrangements under Section 2.7;

(iii) There is a material change in Buyer's or Guarantor's financial condition, business operations, agreements, or property or ownership that is likely to affect Buyer's or Guarantor's ability to perform its obligations under this Agreement, and within five Business Days after Notice from the State, Buyer or Guarantor is unable or unwilling to provide a Letter meeting the requirements of Sections 7.1 and 7.2;

(iv) Buyer or Guarantor fails to perform any of its obligations under this Agreement, and cannot cure the non-performance or the non-performance continues for more than 30 Days after the State has given Notice to Buyer or Guarantor of its non-performance;

(v) Any representation or warranty made by Buyer or Guarantor in this

Agreement is found to have been materially false or incorrect when made; or

(vi) Guarantor fails, or is unable for any reason (including reasons beyond Guarantor's control), to maintain the Letter required under Article VII, regardless of Guarantor's willingness or ability to perform any other obligations under this Agreement.

10.1.2 Default by Inability to Pay. Buyer or Guarantor shall immediately provide the State with Notice if Buyer or Guarantor is unable to pay any of its debts when due, makes an arrangement for the benefit of creditors, files a bankruptcy petition, or is otherwise insolvent. Upon Notice from Buyer or Guarantor, or if the State independently determines that Buyer or Guarantor is unable to pay any of its debts when due or is otherwise insolvent, the State's obligations to deliver and sell Sale Oil to Buyer shall automatically and immediately terminate without any requirement of Notice to Buyer or Guarantor or other action by the State. Within 30 Days after termination under this Article 10.1.2, the State shall have the right, upon consent of Buyer or Guarantor, to reinstate all of the State's, Buyer's and Guarantor's obligations under this Agreement retroactive to the date of termination.

10.2 State's Remedies. If Buyer or Guarantor defaults under this Agreement, in addition to all other remedies available to the State under this Agreement or at law, the following remedies shall be available to the State:

10.2.1 Buyer's and Guarantor's Obligations Become Due. All monetary obligations Buyer or Guarantor has accrued under this Agreement, even if not yet due and payable, shall immediately be due and payable in full.

10.2.2 State May Dispose of Sale Oil. The State may dispose of some or all of the Sale Oil to third parties. If the State exercises this remedy, regardless whether this Agreement is terminated, Buyer and Guarantor shall be and shall remain liable to the State for the amount of the difference between the Price for the Sale Oil under Article II and the actual price the State receives from disposition of the Sale Oil to third parties.

10.2.3 Indemnification for Loss. Buyer and Guarantor shall hold the State harmless and indemnify it against all its liability, damages, expenses, attorney's fees and costs, and losses directly arising out of Buyer's or Guarantor's default, termination of the State's obligations, and disposal of the Sale Oil to third parties. Additionally, if Buyer or Guarantor defaults in the payment of any monetary amounts due to the State for Sale Oil tendered or delivered under this Agreement, Buyer or Guarantor shall pay the State 100 percent of reasonable actual costs and attorney fees incurred by the State in pursuing payment of the monetary amounts due, regardless of whether litigation is commenced and regardless of whether legal services are provided by the Attorney General's office or private counsel.

10.2.4 Other Rights and Remedies. The State shall have the right cumulatively to exercise all rights and remedies provided in this Agreement and by law, and obtain all other relief available under law or at equity, including mandatory injunction and specific performance.

10.3 Limitation of Buyer's and Guarantor's Remedies. If Buyer or Guarantor breaches or defaults in any of its obligations under this Agreement, Buyer or Guarantor shall not obtain a temporary restraining order or preliminary injunction preventing the State from disposing of the Sale Oil in accordance with Section 10.2.2.

10.4 Article Survives Termination. This Article survives termination of the Agreement.

ARTICLE XI
DISPOSITION OF OIL UPON DEFAULT OR TERMINATION

11.1 Disposition of Oil Upon Default or Termination. Buyer and Guarantor acknowledge that the State may be required to provide six Months notice to the Lessees before the State may decrease its in-kind nomination of Royalty Oil in any Month. The Commissioner may request a waiver of any notice provision, condition, or requirement of a Lease, Unit Agreement, Royalty Settlement Agreement or other agreement. If this Agreement terminates for default or any other reason after Buyer has nominated or is deemed to have nominated Sale Oil, Buyer shall continue to accept and pay for Sale Oil through the first Day of the Month following expiration of a minimum of 100 Days after the date of termination, if the Commissioner so requires. Under no circumstances will Buyer be deemed to have nominated Sale Oil if Closing does not occur. If, however, the additional notice provisions of Article 2.1.6 are invoked, Buyer shall continue to accept and pay for Sale Oil until the expiration of six Months and ten Days after the Date of default or notice of termination.

11.2 Security for Disposal of Sale Oil. To secure the Buyer's obligations to purchase and dispose of Sale Oil, upon the Commissioner's request, if Buyer refuses to accept or receive Sale Oil under this Agreement, Buyer shall assign or otherwise transfer to the State, or its designee, Buyer's right to transport the Sale Oil through and away from the TAPS, and all pipelines upstream from Pump Station No. 1, whether such rights are under nominations, leases, contracts, tariffs, charter parties, or other agreements. The State shall not incur liability or obligations unless the State actually exercises its rights under this Section.

ARTICLE XII
NONWAIVER

12.1 Nonwaiver. The failure of a Party to insist upon strict or a certain performance, or acceptance by a Party of a certain performance or course of performance under this Agreement shall not: (1) constitute a waiver or estoppel of the right to require certain performance or claim breach by similar performance in the future; (2) affect the right of another Party to enforce any provision; or (3) affect the validity of any part of this Agreement.

ARTICLE XIII
DISPUTE RESOLUTION

13.1 Dispute Resolution. Any disagreement or dispute about the meaning or application of a word, term, condition, right, or obligation in this Agreement shall be decided according to the dispute resolution procedure set forth in this Article. The procedure set forth in this Article shall be initiated by a Party by providing written Notice of the disagreement or dispute to the other Parties. No later than sixty Days after a Party provides written Notice, the Parties shall each present any arguments and evidence supporting its view of the disputed term, condition, right, or obligation in writing to the Commissioner for consideration. The State, Buyer and Guarantor shall not have the right to civil litigation-type discovery or a civil litigation-type trial with the right to call or cross-examine witnesses unless granted by the Commissioner, after request. Within thirty Days after the Parties submit their arguments and evidence, the Commissioner shall issue a finding interpreting the meaning or application of the disputed word, term, condition, right, or obligation and shall set forth the basis for the conclusions. The Parties agree to accept findings of the Commissioner under this Article that are supported by substantial evidence in light of the whole record.

ARTICLE XIV
SEVERABILITY

14.1 Severability. If a court decrees any provision of this Agreement to be invalid, all other provisions of this Agreement shall remain valid. If, however, invalidation of a provision impairs a material right or remedy under this Agreement, the Parties will negotiate in good faith to maintain the original intent and benefits of this Agreement. If the Parties cannot restore the original intent and benefits of this Agreement, then either Party may terminate this Agreement by giving Notice.

ARTICLE XV
FORCE MAJEURE

15.1 Effect of Force Majeure. Except for Buyer's and Guarantor's obligations to pay amounts due, provide assurance of performance in accordance with Article VI, and to accept, dispose of, and pay for Sale Oil, no Party shall be liable for failure to perform if performance is substantially prevented by Force Majeure after commercially reasonable efforts to perform.

15.2 Force Majeure. The term "Force Majeure" means an event or condition not within the reasonable control of the Party claiming "Force Majeure." Force Majeure Events include, but are not limited to, the following events:

i. act of God, fire, lightning, landslide, earthquake, storm, hurricane, hurricane warning, flood, high water, washout, explosion, well blowout, failure of plant, pipe or equipment, or;

ii. strike, lockout, or other industrial disturbance, act of the public enemy, war, military operation, blockade, insurrection, riot, epidemic, arrest or restraint by government of people, terrorist act, civil disturbance, or national emergency;

iii. act, order, or requisition of any governmental agency or acting governmental authority or any governmental proration, regulation, or priority.

15.3 Notice and Remedy of Force Majeure. If a Party believes that Force Majeure has occurred, the Party shall immediately notify the other Parties of its claim of Force Majeure. Except for Buyer's and Guarantor's absolute obligations to pay amounts due, provide assurances of performance in accordance with Article VII, and accept, dispose of and pay for Sale Oil, the disabled Party's obligations to perform that are affected by the Force Majeure shall be suspended from the Notice Effective Date until the disability caused by the Force Majeure should have been remedied with reasonable diligence. If Buyer or Guarantor is prevented by Force Majeure from performing any material obligation for 180 successive Days or more, the Commissioner may terminate this Agreement on sixty Days Notice.

ARTICLE XVI
NOTICE

16.1 Method. All notices, consents, requests, demands instructions, approvals, and other communications permitted or required ("Notice") shall be made in writing and delivered by any two of the following methods: (a) personally delivered, (b) delivered and confirmed by facsimile transmission, (c) delivered by Federal Express, DHL, or other reputable overnight courier delivery service, (d) e-mail, or (e) deposited in the United States mail, first class, postage prepaid, certified or registered, return receipt requested, addressed as follows:

State of Alaska
Commissioner of Natural Resources
400 Willoughby Avenue
Juneau, Alaska 99801
Facsimile Number: (907) 465-3886
e-mail: commissioner@dnr.state.ak.us

and

Director, Division of Oil and Gas
550 West 7th Street, Suite 800
Anchorage, Alaska 99501-3510
Facsimile Number: (907) 269-8938
e-mail: director_dog@dnr.state.ak.us

the Buyer:

Flint Hills Resources Alaska, LLC
4111 E. 37th St. N.
Wichita, KS 67220
Facsimile Number: (316) 828-8245
Attention: President
e-mail: allen.lasater@fhr.com

the Guarantor:

Flint Hills Resources, LLC
4111 E. 37th St. N.
Wichita, KS 67220
Facsimile Number: (316) 828-8245
Attention: President
e-mail: david.robertson@fhr.com

or to any other place within the United States of America designated in writing by the State, Buyer or Guarantor.

16.2 Notice Effective Date. Notice given by personal delivery, overnight courier, or mail shall be effective on the date of actual receipt at the appropriate address. Notice given by facsimile or e-mail shall be effective on the date of actual receipt if received during recipient's normal business hours, or at the beginning of the next business Day after receipt if received after recipient's normal business hours. The Notice Effective Date is the effective date of the first of the two Notices received.

16.3 Change of Address. A Party may notify the other Parties of changes in its address by giving Notice.

ARTICLE XVII
RULES AND REGULATIONS

17.1 Rules and Regulations. This Agreement is subject to all applicable laws of the State of Alaska, and orders, rules and regulations of the United States, the State of Alaska, and any duly constituted agency of the State of Alaska.

ARTICLE XVIII
SOVEREIGN POWER OF THE STATE

18.1 Sovereign Power of the State. This Agreement shall not be interpreted to limit in any way the State's ability to exercise any sovereign or regulatory powers, whether conferred by constitution, statute or regulation. The State's exercise of any sovereign or regulatory power shall not be deemed to enlarge any of Buyer's or Guarantor's rights, or limit any of Buyer's or Guarantor's obligations or liabilities under this Agreement.

ARTICLE XIX
APPLICABLE LAW

19.1 Governing Law. This Agreement, and all matters arising from or related to this Agreement, shall be governed, construed and determined by the laws of the State of Alaska.

19.2 Jurisdiction. After exhaustion of the dispute resolution provisions in Article XIII, any legal action or proceeding arising out of or related to this Agreement shall be brought in a State court, and Buyer and Guarantor irrevocably submit to the jurisdiction of the State court in any action or proceeding.

ARTICLE XX
WARRANTIES

20.1 Warranties. The purchase and sale of Royalty Oil under this Agreement are subject only to the warranties the State has expressly set forth in this Agreement. The State disclaims and Buyer and Guarantor waive all other warranties, express or implied in law.

ARTICLE XXI
AMENDMENT

21.1 Amendment. This Agreement may be supplemented, amended, or modified only by written instrument duly executed by the Parties, and, where required, only on approval under Alaska Statute 38.06.055.

ARTICLE XXII
SUCCESSORS AND ASSIGNS

22.1 Assignments and Other Transfers. Buyer may freely assign its rights and obligations to an Affiliate formed under the laws of a state in the United States of America. An "Affiliate" shall mean an entity that is directly or indirectly controlled by Guarantor or Guarantor's permitted assigns, or is directly or indirectly controlled by an entity that directly or indirectly controls Guarantor or Guarantor's permitted assigns, where control means the right to vote more than fifty percent of the voting interest in the entity.

Buyer and Guarantor may, without consent of the State, collectively assign their rights and obligations under this Agreement to a Person that acquires all or substantially all of the Alaska refining assets of Buyer and Guarantor (the "Assignee"), provided that at least 45 Days before the effective date of the assignment the Assignee provides to the State (a) all of the financial information and warranties Guarantor is required to provide under Article VI and (b) a copy of the form of the assignment, including Assignee's obligation to assume and discharge all of Buyer's and Guarantor's obligations under this Agreement. If, based on the financial information supplied under Article VI, Assignee is required to supply a Letter under Article VII, the Letter in the form and amount required by Article VII must be provided to the State at least 30 Days before the effective date of the assignment. No assignment can be made to an Assignee with long term credit ratings of less than BBB- (Standard and Poor's) or Baa3 (Moody's). From and after the effective date of the Assignment, Buyer and Guarantor shall be relieved of their rights and obligations under this Agreement. No assignment shall be effective until after 45 Days Notice to the State.

Buyer and Guarantor may not otherwise assign their rights or obligations under this Agreement without first obtaining the written consent of the Commissioner, which may not be unreasonably withheld.

22.2 Binding on Successors. This Agreement shall be binding upon and inure to the benefit of the legal representatives, successors, and assigns of the Parties.

ARTICLE XXIII
RECORDS

23.1 Inspection of Records. Buyer and Guarantor and the State shall each accord to the other and the other's authorized agents, attorneys, and auditors access during reasonable business hours to any and all property, records, books, documents, or indices related to Buyer's, Guarantor's or the State's performance under this Agreement, and which are under possession or control of the Party from which access is sought, so the other Party may inspect, photograph, and make copies of the property, records, books, documents, or indices except: (1) the State shall not be required to disclose any information, data, or records that it is required by state or federal law or regulation, or by agreement with the Person suppiying the record, to be held confidential; (2) the State's access to and treatment of Guarantor's financial records shall be limited by Section 6.3; and (3) no party shall be required to produce documents that are protected by the attorney-client privilege. If information the State obtains from Buyer or Guarantor may be held confidential under state or federal law or regulation, Buyer may request in writing that the State hold the information confidential, and the State shall keep the information confidential to the extent and for the term provided by law.

ARTICLE XXIV
EMPLOYMENT OF ALASKA RESIDENTS

24.1 Employment of Alaska Residents. Buyer shall comply with all valid federal, state, and local laws in hiring Alaska residents and companies, and shall not discriminate against Alaska residents and companies. Within the constraints of law, Buyer voluntarily agrees to employ Alaska residents and Alaska companies to the extent they are available, willing, and at least as qualified as other candidates for work performed in Alaska in connection with this Agreement. "Alaska resident" means an individual who is physically present in Alaska with the intent to remain in the state indefinitely. An individual may demonstrate an intent to remain in the state by maintaining a residence in the state, possessing a resident fishing, trapping or hunting license, or receiving a permanent fund dividend. "Alaska companies" means companies incorporated in Alaska or whose principal place of business is in Alaska. If a court invalidates any portion of this provision, Buyer agrees to employ Alaska residents and Alaska companies to the extent permitted by law.

ARTICLE XXV
COUNTERPARTS

25.1 Counterparts. This Agreement may be executed in multiple counterparts. It is not necessary for the Parties to sign the same counterpart. Each duly executed counterpart shall be deemed to be an original and all executed counterparts taken together shall be considered to be one and the same instrument.

ARTICLE XXVI
MISCELLANEOUS

26.1 Agreement Not to Be Construed Against Any Party as Drafter. The Parties recognize that this Agreement is the product of the joint efforts of the Parties and agree that it shall not be construed against any Party as drafter.

26.2 Entire Agreement. This Agreement constitutes the entire agreement and understanding between the Parties about the subject matter of this transaction and all prior agreements, understandings, and representations, whether oral or written, about this subject matter are merged into and superseded by this written Agreement.

26.3 Headings. The headings throughout this Agreement are for reference purposes only and shall not be construed or considered in interpreting the terms and provisions of this Agreement.

26.4 Authority to Sign. Each Person signing this Agreement warrants that he or she has authority to sign the Agreement.

26.5 Further Assurances. The Parties agree to do such further acts or execute such further documents as may reasonably be required to implement this Agreement.

26.6 Currency. All dollar amounts are U.S. dollars.

SIGNATURES:

the State: THE STATE OF ALASKA

____

Commissioner
Department of Natural Resources

Date:

FLINT HILLS RESOURCES ALASKA, LLC

____

Printed Name:

Title:

Date:

FLINT HILLS RESOURCES, LLC

____

Printed Name:

Title:

Date:

APPENDIX 1
NOMINATION PROCEDURE EXAMPLE
For Sale Oil Delivered in July 2004

		PBU IPA & Satellites	Greater Pt McIntyre Area	Total
March 15, 2004				
State receives preliminary barrel per day (bpd) production forecasts from the unit operator 105 days prior to the start of the production month		456,000	63,200	519,200
Not later than March 19, 2004				
RIK purchaser notifies state of monthly bpd nomination (a)				56,362
Not later than March 31, 2004				
State computes RIK percent of Royalty Oil based on Buyer's Sale Oil nomination				
	Estimated royalty rates	12.50%	13.34%	
	Total state estimated royalty bpd (bpd * royalty rate)	57,000	8,431	65,431
	State's RIK nomination percentage (Purchaser RIK bpd/estimated royalty bpd)			86.14%
March 31, 2004				
State notifies unit operator of state's RIK nomination percentage		86.14%	86.14%	86.14%
May 24, 2004				
Unit operator notifies state and working interest owners of updated production forecast				
Production forecast (bpd) for May production month		441,752	62,600	504,352
State calculates RIK bpd				
	Royalty rates based on updated estimates (b)	12.50%	13.391158%	
	State's RIK nomination percentage	86.14%	86.14%	
	RIK bpd (bpd production forecast * Royalty rate * nomination %)	47,566	7,221	54,787
May 31, 2004				
State notifies RIK purchaser of bpd volume available for July production month		47,566	7,221	54,787
August 2, 2004				
State invoices RIK purchaser for July production				
	Alyeska meter volume for July 1-31, 2003	14,392,425	2,045,163	16,437,588
	State's RIK nomination percentage	86.14%	86.14%	86.14%
	Royalty rate	12.50%	13.391158%	
	Total RIK bbls	1,549,704.36	235,912.49	1,785,616.85
	bpd volume (Total RIK/31) (varies from forecast)	49,990.46	7,610.08	57,600.54

Table notes:

(a) The state determines from which units to nominate RIK volumes (section 2.1.5 of the Agreement)

(b) The estimated royalty percentage for Greater Pt McIntyre is a composite royalty rate from several fields and will vary with production

APPENDIX 2:
EXAMPLE OF CALCULATION OF PRICE OF SALE OIL

The Price of the Sale Oil delivered by the State to the Buyer each Month for each Unit from which the Sale Oil is nominated is:

Price = ANS Spot Price – $1.55 – Tariff Allowance + Quality Bank Allowance – Line Loss

ANS Spot Price

Table 2-1 illustrates the calculation of the ANS Spot Price for July 2004.

Table 2-1: Calculation of ANS Spot Price

	Platt's Oilgram Price Report			Telerate On-line Data Reporting Service			Reuters On-line Data Reporting Service		
Effective Date	ANS Daily Low	ANS Daily High	ANS Daily Midpoint Average	ANS Daily Low	ANS Daily High	ANS Daily Midpoint Average	ANS Daily Low	ANS Daily High	ANS Daily Midpoint Average
07/01/04	$24.01	$24.05	$24.03000	$24.03	$24.08	$24.05500	$23.81	$23.98	$23.89500
07/02/04	$23.62	$23.66	$23.64000	$23.67	$23.72	$23.69500	$23.50	$23.67	$23.58500
07/06/04	$24.55	$24.58	$24.56500	$24.49	$24.54	$24.51500	$24.19	$24.36	$24.27500
07/07/04	$23.70	$23.74	$23.72000	$23.72	$23.77	$23.74500	$23.61	$23.78	$23.69500
07/08/04	$24.27	$24.31	$24.29000	$24.23	$24.28	$24.25500	$23.61	$24.37	$23.99000
07/09/04	$25.04	$25.08	$25.06000	$24.98	$25.03	$25.00500	$24.20	$25.07	$24.63500
07/12/04	$25.77	$25.81	$25.79000	$25.72	$25.77	$25.74500	$25.61	$25.78	$25.69500
07/13/04	$25.42	$25.46	$25.44000	$25.35	$25.40	$25.37500	$25.30	$25.47	$25.38500
07/14/04	$26.63	$26.67	$26.65000	$26.50	$26.60	$26.55000	$26.47	$26.64	$26.55500
07/15/04	$27.33	$27.36	$27.34500	$27.17	$27.27	$27.22000	$27.17	$27.34	$27.25500
07/16/04	$26.71	$26.75	$26.73000	$26.94	$27.04	$26.99000	$26.53	$26.70	$26.61500
07/19/04	$27.16	$27.20	$27.18000	$27.34	$27.44	$27.39000	$27.03	$27.20	$27.11500
07/20/04	$26.83	$26.87	$26.85000	$27.03	$27.13	$27.08000	$26.80	$26.97	$26.88500
07/21/04	$27.11	$27.15	$27.13000	$27.48	$27.58	$27.53000	$27.25	$27.42	$27.33500
07/22/04	$27.49	$27.53	$27.51000	$27.58	$27.68	$27.63000	$27.33	$27.78	$27.55500
07/23/04	$27.31	$27.35	$27.33000	$27.30	$27.40	$27.35000	$27.01	$27.26	$27.13500
07/26/04	$28.14	$28.18	$28.16000	$27.66	$27.91	$27.78500	$27.56	$28.01	$27.78500
07/27/04	$27.25	$27.29	$27.27000	$27.60	$27.85	$27.72500	$27.20	$27.37	$27.28500
07/28/04	$26.53	$26.56	$26.54500	$26.83	$27.08	$26.95500	$26.42	$26.59	$26.50500
07/29/04	$27.09	$27.12	$27.10500	$27.65	$27.75	$27.70000	$27.66	$27.83	$27.74500
07/30/04	$27.59	$27.63	$27.61000	$28.21	$28.31	$28.26000	$28.17	$28.34	$28.25500
	Platt's Montly Avg. =		$26.18810	Telerate Monthly Avg. =		$26.31214	Reuters Monthly Avg. =		$26.15143

$$\text{ANS Spot Price}_{\text{July 2004}} = \frac{\text{Platts Monthly Average + Telerate Monthly Average + Reuters Monthly Average}}{3} = \$26.21722$$

Tariff Allowance

The Tariff Allowance (TA) is the sum of (1) the average, weighted by ownership, of the Minimum Interstate TAPS Tariff for each owner in effect on the Day the Sale Oil is tendered by the State to the Buyer; and (2) any tariffs paid by Buyer for shipment of Sale Oil upstream of Pump Station No. 1. Table 2-2, 2-3, and 2-4 illustrate how the state will calculate the TA for each of the Units from which Sale Oil may be offered.

Table 2-2: Calculation of TAPS Portion of Tariff Allowance

Ownership-Weighted Average Minimum Interstate TAPS Tariff – July 2004				
Pipeline Company	FERC No.	Percent Pipeline Company Ownership	Minimum Interstate TAPS Tariff (Pump Station No.1 to Valdez Marine Terminal) by Pipeline Company	TAPS Tariff times Company Ownership Percentage
Phillips Transportation Alaska, Inc.		28.2953%	$3.32	$0.93940
ExxonMobil Pipeline Company		20.3378%	$3.34	$0.67928
Williams Alaska Pipeline Company		3.0845%	$3.28	$0.10117
BP Pipelines (Alaska) Inc.		46.9263%	$3.28	$1.53918
Unocal Pipeline Company		1.3561%	$2.83	$0.03838
		100.0000%		
Ownership-Weighted Average Minimum Interstate TAPS Tariff:				$3.29741

Table 2-3: Calculation of Portion of Tariff Allowance Upstream of Pump Station No. 1

Minimum Tariff on Pipelines Upstream of Pump Station No. 1 – July 2004				
Pipeline Company	FERC No.	RCA Tariff Advice Letter No.	Pipeline	Tariff
Kuparuk Transportation Company			Kuparuk River Unit to TAPS Pump Station No. 1	$0.20000
Endicott Pipeline Company			Endicott Main Production Island to TAPS Pump Station No. 1	$0.36000
Kuparuk Transportation Company			Milne Point Pipeline Connection to TAPS Pump Station No. 1	$0.14400
Milne Point Pipeline Company			Milne Point Central Facilities to Kuparuk Transportation Company Tie-in	$0.28000
			Total MPU Upstream Tariff Allowance:	$0.42400
Kuparuk Transportation Company			Kuparuk River Unit to TAPS Pump Station No. 1	$0.20000
Alpine Transportation Company			Colville, Alaska Alpine Field to Kuparuk River Unit	$0.78000
			Total CRU Upstream Tariff Allowance:	$0.98000
BP Transportation (Alaska) Inc.			Northstar Unit Seal Island to TAPS Pump Station No. 1	$2.02000

Table 2-4: Calculation of Tariff Allowance for Each Unit

Calculation of TA for Prudhoe Bay Unit	
Ownership-Weighted Average Minimum Interstate TAPS Tariff:	$3.29741
Upstream Tariff	$0.00000
TA_{PBU}	$3.29741
Calculation of TA for Kuparuk River Unit	
Ownership-Weighted Average Minimum Interstate TAPS Tariff:	$3.29741
Kuparuk Transportation Co.Tariff	$0.20000
TA_{KRU}	$3.49741
Calculation of TA for Duck Island Unit	
Ownership-Weighted Average Minimum Interstate TAPS Tariff:	$3.29741
Endicott Pipeline Co. Tariff:	$0.36000
TA_{DIU}	$3.65741
Calculation of TA for Milne Point Unit	
Ownership-Weighted Average Minimum Interstate TAPS Tariff:	$3.29741
Kuparuk Transportation Co. Tariff	$0.14400[1]
Milne Point Pipeline Co. Tariff	$0.28000
TA_{MPU}	$3.72141
Calculation of TA for Colville River Unit	
Ownership-Weighted Average Minimum Interstate TAPS Tariff:	$3.29741
Kuparuk Transportation Co. Tariff:	$0.20000
Alpine Transportation Company Tariff:	$0.78000
TA_{MPU}	$4.27741
Calculation of TA for Northstar Unit	
Ownership-Weighted Average Minimum Interstate TAPS Tariff:	$3.29741
BP Transportation (Alaska) Inc. Tariff:	$2.02000
TA_{DIU}	$5.31741

[1]Kuparuk Pipeline/Milne Point Pipeline connection to TAPS Pump Station No. 1.

Quality Bank Adjustment (QBA)

The TAPS Quality Bank compensates shippers of a high-value crude oil stream when a lower-value crude oil stream is blended in the common stream.[1] To calculate the Price of the Sale Oil at the Point of Delivery an adjustment must be made for the impact that the sale oil will have on the value of the commingled crude oil stream when it enters the TAPS Valdez terminal.

[1] Mitchell & Mitchell, 8300 Douglas Avenue, #800, Dallas, TX 75225, administers the TAPS Quality Bank. Anyone who ships oil on TAPS must make prior arrangements with Mitchell & Mitchell to participate in the TAPS Quality Bank.

The QBA is a per-barrel value, either positive or negative, and will be calculated each Month by the State for Sale Oil from each Unit. The State will estimate a QBA for each applicable Unit for the initial billing. Typically, the State receives the data to calculate the actual QBA for the Month about two Months after the Month the Sale Oil is delivered. For this reason the QBA will be subject to a routine true-up in a subsequent adjustment.

Table 2-5: Hypothetical TAPS Quality Bank Data

TAPS Quality Bank
Stream Values and Total Stream Volume Shipped
July 2004

Sample Location	Stream	Volume (BBL)	Stream Value ($/BBL)	Total Stream Value ($)
PBU IPA	PBU IPA	19,000,000	$27.9380000000	$530,822,000.00
LISBURNE	LISBURNE	3,500,000	$27.537[illegible]400000	[illegible]6,380,340.00
ENDICOTT	ENDICOTT	1,250,000	$27.25[illegible]8000000	$34,074,750.00
KUPARUK	KUPARUK	12,000,000	$27.4418300000	$329,301,960.00
NORTHSTAR	NORTHSTAR	2,000,000	$28.0000000000	$56,000,000.00
PS #1	PS #1 REFERENCE	37,750,000	**$27.7239483444**	$1,046,579,050.00
GVEA OFFTAKE	GVEA PASSING	28,000,000	$27.6546500000	$744,330,200.00
GVEA RETURN	GVEA RETURN	3,500,000	$26.6753800000	$93,363,830.00
GVEA	GVEA REFERENCE	31,500,000	**$27.5458422222**	$867,694,030.00
PSVR OFFTAKE	PSVR PASSING	30,000,000	$27.5517600000	$826,552,800.00
PSVR RETURN	PSVR RETURN	1,000,000	$26.8450200000	$26,845,020.00
PSVR	PSVR REFERENCE	31,000,000	**$27.5289619355**	$853,397,820.00

EPC Quality Bank
Stream Values and Total Stream Volume Shipped
July 2004

Sample Location	Stream	Volume (BBL)	Stream Value ($/BBL)	Total Stream Value ($)
BADAMI	BADAMI	80,000	$27.4526400000	$2,196,211.20
ENDICOTT REFERENCE	ENDICOTT REFERENCE	1,250,000	$27.2598000000	$34,074,750.00
ENDICOTT MAIN PROD	ENDICOTT MAIN PROD	1,170,000	$27.2466143590	$31,878,538.80

KTC Quality Bank
Stream Values and Total Stream Volume Shipped
July 2004

Sample Location	Stream	Volume (BBL)	Stream Value ($/BBL)	Total Stream Value ($)
ALPINE	ALPINE	3,000,000	$27.8000000000	$83,400,000.00
MILNE POINT	MILNE POINT	1,500,000	$27.1352300000	$40,702,845.00
KUPARUK REFERENCE	KUPARUK REFERENCE	12,000,000	$27.4418300000	$329,301,960.00
KUPARUK RIVER UNIT	KUPARUK RIVER UNIT	7,500,000	$27.3598820000	$205,199,115.00

Table 2-5 shows the kind of information supplied by the TAPS quality bank administrator that will be used to calculate the quality bank differential for Sale Oil produced from each Unit. The TAPS quality bank administrator provides this information to the State, pipeline owners, and shippers. As a shipper on TAPS, the Buyer will also receive this information. In the column titled "Stream Value ($/BBL)" are the different per-barrel values of each stream produced from the Units from which Sale Oil may be delivered. The PSVR Reference Stream value is labeled

"PSVR Reference" and is the stream value of the blended TAPS stream immediately downstream of the Petro Star Valdez Refinery return stream. The Quality Bank Adjustment is calculated as the difference between the stream value of each Unit and the PSVR Reference Stream.

For example, assume that the Month is July 2004 and the Sale Oil is produced from the Duck Island Unit. The QBA for Sale Oil from the Duck Island Unit (QBA_{DIU}) is calculated as the per-barrel difference between the Stream value for the Duck Island Unit, indicated as the "Endicott Main Prod" in Table 2.5, and the PSVR Reference Stream Value. In this example Sale Oil from the Duck Island Unit lowers the value of the stream of oil measured at Valdez. Therefore, $0.2823475765 per barrel is the QBA incorporated in the calculation of Price for Sale Oil from the Duck Island Unit.

Quality Bank Adjustment for the Duck Island Unit = the stream value for Endicott Main Production minus the stream value of PSVR Reference (from Table 2-5)

QBA_{DIU}= 27.2466143590 - 27.5289619355

QBA_{DIU}= -$0.28235

Note: The Price of Sale Oil from the PBU IPA and Lisburne are invoiced separately.

Line Loss

Using the results of the example calculations above, Line Loss for Sale Oil delivered from the Duck Island Unit in July 2004 equals

$$\text{Line Loss}_{DIU} = (.0009) \times (\$26.21722 - \$1.55000 - \$3.65741 + -\$0.28235) = \$0.01865.$$

Calculating the Price of Sale Oil

The Price of Sale Oil delivered from the Duck Island Unit in July 2004 is

$$\text{Price}_{DIU} = \$26.21722 - \$1.55000 - \$3.65741 + -\$0.28235 - \$0.01865 = \$20.70881$$

Note that the each number in the equation is rounded to five decimal places. If a number's sixth decimal is 0, 1, 2, 3, or 4, the number shall be truncated to the fifth decimal. If a number's sixth decimal is 5, 6, 7, 8, or 9, the number shall be truncated to the fifth decimal and the fifth decimal shall be increased by 1.

APPENDIX 3
EXAMPLE OF CALCULATION OF INTEREST AND LATE PAYMENT PENALTIES

Sample Calculation of an Invoice for July 2004 Deliveries

Assumptions:

1. Month is August 2004.
2. Sale Oil delivered to the Buyer from the Duck Island Unit in July 2004 = 2,170,000 barrels (70,000 bpd).
3. July 2004 Price of the Sale Oil for the Duck Island Unit as initially estimated by the State = $21.00000 per barrel.
4. Statement of account, with July 2004 invoice, sent to the Buyer on August 3, 2004.
5. July 2004 invoice payment due to the State = August 20, 2004.
6. Buyer pays State only $10,000,000 on the due date, August 20, and pays the outstanding balance on August 25, 2004.
7. Annual interest rate provided by Alaska Statute 38.05.135(d) for August 2004 is 11 percent.

Method for calculating Buyer's invoice payment for July 2004 deliveries:

Invoice Amount = Quantity of Sale Oil x Buyer's Price of Sale Oil
= 2,170,000 x $21.00000 = $45,570,000.00

Because payment in full was not received by the State on or before August 20, 2004, interest will accrue on the unpaid balance from August 20, 2004 through the date the payment is received, and a late payment penalty will be assessed.

Below is a sample calculation of late payment penalty fee (assuming that it is not waived under Section 3.7) and interest. This sample calculation shows what will happen if the Buyer makes a partial payment on August 20 and the balance on August 25.

Late Payment Penalty Fee:		
Statement of Account amount	=	$45,570,000.00
Amount paid on August 20	=	10,000,000.00
Outstanding balance (8/20/04)	=	$35,570,000.00
Late Payment Penalty Fee ($35,570,000 x 5%) =	=	$1,778,500.00
Interest:		
$35,570,000 x (11%/366) x 5 Days	=	$53,452.19
Amount Buyer owes on August 20, 2004	=	$37,401,952.19

Note: As more accurate data is received by the State, the State may adjust the Price and/or the actual quantity of Sale Oil and invoice the Buyer in the initial adjustment invoice submitted with the following Month's (August 2004) statement of account.

Sample Calculation of an Adjustment Invoice in September 2004

Assumptions:

1. Month is September 2004.
2. Sale Oil delivered in July 2004 has been revised to 2,169,0000 barrels.
3. July 2004's price for Sale Oil is unchanged at \$21.00000 per barrel.
4. Date of the statement of account that contains the adjustment invoice is September 2, 2004.
5. Date the adjustment invoice payment is due to the State = September 20, 2004.

Method for calculating the Buyer's adjustment invoice amount for July 2004:

Invoice Amount = Quantity of Sale Oil x Buyer's Price of Sale Oil
= 2,169,000 x \$21.00000
= \$45,549,000.00

Adjusted Invoice Amount for July 2004	=	\$45,549,000.00
Amount previously paid by the Buyer for July 2004	=	\$45.570.000.00
Overpayment for July 2004	=	(\$21,000.00)

Credit due the Buyer against statement of account amount dated September 2 due September 20, 2004.

Note: As more accurate data is received by the State, the State may adjust the Price and/or the actual quantity of Sale Oil and invoice the Buyer in the adjustment invoice submitted with the following Month's (October 2004) statement of account.

Sample Calculation of an Adjustment Invoice in October 2004

Assumptions:

1. Month is October 2004.
2. July 2004's price for Sale Oil is changed to \$21.05000 per barrel due to a change in the quality bank.
3. The statement of account that contains the adjustment invoice is October 1, 2004.
4. The adjusted invoice payment is due to the State = October 20, 2004.

Method for calculating the Buyer's adjustment invoice amount for July 2004:

Production Month Invoice Amount = Quantity of Sale Oil x Buyer's Price of Sale Oil
= 2,169,000 x \$21.05000
= \$45,657,450.00

Adjusted Invoice Amount for July 2004	=	\$45,657,450.00
Amount previously paid by the Buyer for July 2004	=	\$45.549.000.00
Underpayment for July 2004	=	\$108,450.00

The underpayment is due the State on October 20, 2004

APPENDIX 4
SPECIAL COMMITMENTS

Buyer agrees to the following list of Special Commitments:

A. **Clean Fuels Processing.** After performing an engineering study, Buyer will install necessary equipment and complete such modifications to its North Pole Refinery or will participate in the modification of other refinery facilities in Alaska as required to produce gasoline and on-road, off-road, marine, and rail diesel fuels that meet or exceed all EPA low sulfur fuel requirements ("Clean Fuels").Buyer will make commercially reasonable efforts to complete necessary installations and modifications on or before the effective dates of the Clean Fuels requirements of the EPA regulations.

   Total project costs are expected to exceed $100,000,000.00 and will likely include the construction of processing units, including hydrotreating, a hydrogen plant and sulfur removal equipment. These projects will result in a significant reduction in gasoline and diesel sulfur levels.

B. **Anchorage Tank Farm Evaluation.** Buyer agrees to discharge the commitments previously made by Williams in the "Memorandum of Agreement between Williams Alaska Petroleum, Inc. and The Government Hill Community Council" attached as Appendix 6 to this agreement. The key requirements are as follows:
   - Removal of three (3) tanks from east of the Ocean Dock Road with a total capacity of over 5,500 barrels
   - Refrain from installing additional tanks east of the Ocean Dock Road
   - Evaluation of all remaining tanks east of the Ocean Dock Road to determine whether they comply with all State and Federal requirements viz. overfill protection, fire protection, tank seal monitoring, potential for change of product service, and possible removal of additional tanks, and prompt remediation of any violations of these requirements.
   - Installation of new tanks west of the Ocean Dock Road will occur provided that existing tanks on the east side of Ocean Dock Road are retired and removed on a tank-for-tank basis.
   - FHR agrees to continue cooperative efforts in connection with the ongoing Bulk Fuel Hazard Study currently underway through the Municipality of Anchorage.

C. **Shipment by Rail.** Williams currently ships refined products by rail under an Agreement with Alaska Railroad Corporation (an Agreement originally entered by MAPCO Alaska Petroleum Inc. in May of 1993). As part of Buyer's refinery acquisition from Williams, Buyer will assume the rights and obligations of Williams under the rail agreement and continue to ship refined products to Anchorage.

D. **Air Traffic Marketing and Structural Improvement Study.** Buyer and the State shall jointly explore commercially reasonable options for increasing passenger and cargo air traffic through the Fairbanks International Airport. Buyer shall work with the Fairbanks International Airport to concentrate on promoting the Fairbanks International Airport to cargo carriers operating between Asia and Europe and otherwise; shall evaluate, and possibly upgrade, the airport's fuel distribution facilities, including the feasibility of using or upgrading the hydrant fueling system; and shall charge a jet fuel customer in Fairbanks the same or a lower price as Buyer charges that same customer in Anchorage.

E. **Wholesale Rack Price Parity.** Buyer agrees, for the term of the Agreement, to maintain the Buyer wholesale truck rack posted price for gasoline in Fairbanks at a price not to exceed the Buyer wholesale truck rack posted price for gasoline in Anchorage on an annual simple average basis (within a tolerance/variation of 1 cent per gallon (cpg)). Buyer makes no guarantee of the price parity for Buyer's wholesale truck rack posted prices for gasoline in Fairbanks and Anchorage on a daily basis. If the annual average variation of the aforementioned posted prices exceeds 1 cpg, Buyer shall have ninety (90) days to reduce the variation below 1 cpg, averaged over an all-inclusive timeframe, including the ninety (90) day period and the previous annual period. This provision shall not apply to any gasoline exchanges. An example of the calculations appears in Table 4-1.

Table 4-1 Wholesale Truck Rack Posted Price True-Up

Wholesale Rack Price Parity	Scenario 1			Scenario 2		
	Buyer Fairbanks Posting (cpg)	Buyer Anchorage Posting (cpg)	Fairbanks minus Anchorage (cpg)	Buyer Fairbanks Posting (cpg)	Buyer Anchorage Posting (cpg)	Fairbanks minus Anchorage (cpg)
January	104.00	102.44	1.56	106.00	102.44	3.56
February	103.00	100.76	2.25	103.00	100.76	2.25
March	100.00	103.01	(3.01)	105.00	103.01	1.99
April	108.00	110.02	(2.02)	112.00	110.02	1.98
May	112.00	110.07	1.93	112.00	110.07	1.93
June	111.00	109.40	1.60	111.00	109.40	1.60
July	106.00	108.38	(2.38)	108.00	108.38	(0.38)
August	107.00	109.77	(2.77)	109.00	109.77	(0.77)
September	112.00	114.02	(2.02)	115.00	114.02	0.98
October	115.00	114.02	0.98	115.00	114.02	0.98
November	115.00	113.38	1.62	113.00	113.38	(0.38)
December	112.00	113.70	(1.70)	113.00	113.70	(0.70)
Annual Average	**108.75**	**109.08**	**(0.33)**	**110.17**	**109.08**	**1.09**
January	Not Applicable			119.00	119.95	(0.95)
February				125.00	126.19	(1.19)
March				133.00	134.13	(1.13)
15 Month Average				**113.27**	**112.61**	**0.65**

APPENDIX 5
PROCEDURE FOR ADJUSTING THE FORMULA FOR CALCULATIONS OF PRICE

Step 1: Calculate the volume-weighted average cost of marine transportation reported on the royalty returns of BP, ExxonMobil, and CPAI for the production Months January 2006 through December 2008. Adjustments through March 31, 2009 shall be used in the calculation. For example, the royalty returns for December 2008 productions are due in January 2009. The marine transportation cost reported in January can be adjusted through March 31, 2009, but not later. The amount calculated is defined as "RIV Marine Cost."

Step 2: Subtract from the RIV Marine Cost the amount $0.30. The answer shall be substituted for the $1.55 used in the calculation of the Price (as defined in Section 2.3) subject to the following limitations:

1. if the answer is less than $1.45, substitute $1.45 for the $1.55 used in the calculation of the Price;
2. if the answer if greater than $1.65, substitute $1.65 for the $1.55 used in the calculation of the Price.

Step 3: For Sale Oil deliveries beginning April 1, 2009, the $1.55 that had been used in the calculation of the Price shall be replaced with the number determined in Step 2, above. That number used in the calculation of the Price shall remain in effect through the end of the term of the Agreement.

APPENDIX 6
MEMORANDUM OF AGREEMENT
BETWEEN
WILLIAMS ALASKA PETROLEUM, INC.
AND
THE GOVERNMENT HILL COMMUNITY COUNCIL

6/02/01/3:00 p.m.

MEMORANDUM OF AGREEMENT

between

Williams Alaska Petroleum, Inc.,

and

the Government Hill Community Council,

an unincorporated association

WHEREAS, Williams operates bulk fuel storage and distribution facilities including storage tanks, loading racks, and related industrial structures in the vicinity of Government Hill and the Port of Anchorage and wishes to build a double track rail loop (the Loop Track Project) on its property and on certain tidelands it will acquire from the Alaska Railroad; and;

WHEREAS, construction of the Loop Track project will reduce traffic congestion in the Port area, allow for more efficient transfer of fuel from rail cars to storage and transmission facilities and enable Williams to build additional storage tanks west of Ocean Dock Road should the need arise in the future, and

WHEREAS, the Government Hill Community Council (the Council) desires to allow Williams to proceed with the orderly development of its Loop Track project while also reducing risks associated with the continued presence of fuel storage facilities near Government Hill,

NOW THEREFORE, THE PARTIES AGREE AS FOLLOWS:

1. **Non Opposition to Loop Track project** The Council and its officers agree not to oppose the Loop Track project proposed by Williams and will not, officially or unofficially continue efforts to convince public and private entities to take a position or other action adverse to construction of the Loop Track project.. The Council will also take reasonable efforts to inform the residents of Government Hill of this agreement and its official position on the Loop Track project.

2. **Letters stating the Official Position of the Council on the Loop Track project** Upon execution of this Agreement, the Council president shall sign several letters setting forth the official position of the Council on the Loop Track project. The letters shall be substantially

in the same form as those contained in Exhibit B and may be presented by Williams to any public or private entity in connection with the Loop Track project as Williams determines. The letters include:

1. A letter from the Council's executive committee recommending the Council withdraw its support for Resolution AR 2001-146 now before the Anchorage Assembly and that the Council request the Resolution be withdrawn from the Assembly agenda. The parties have been advised that upon approval of this Agreement, the sponsor of that Resolution will request that the Assembly table that resolution indefinitely.

2. A letter to the Anchorage Assembly supporting the Alaska Railroad's efforts to lease back the small portion of tidelands from the Municipality required to complete the Loop Track Project.

3. A letter supporting Williams' efforts to build the Loop Track project throughout the permitting and construction process. Specifically, the Council will advise the Division of Governmental Coordination that it has withdrawn its opposition to the Loop Track project. The Council will also send a letter to the Corps of Engineers stating it has withdrawn its opposition to Williams's Fill Permit application currently under review by the Corps and withdrawing the Council's request for a public hearing.

4. A letter to the municipality stating the Council's non-objection to the extraction and use of the railroad's gravel deposit on the Hollywood Vista for the Loop Track project consistent with this agreement.

5. A letter supporting Williams's efforts to build future tanks on the west side of Ocean Dock road consistent with this agreement.

3. Construction of New Tanks East of Ocean Dock Road Williams agrees not to construct any new fuel storage tanks on property it owns or leases which is located east of Ocean Dock Road.

4. **Construction of New Tanks West of Ocean Dock Road** The Council agrees that Williams may build new fuel storage tanks on property it owns or leases west of Ocean Dock Road provided that existing tanks on the east side of Ocean Dock Road are retired and removed on a tank-for-tank basis, after the conditions specified in Section 5 below are met.

5. **Removal of Three Existing Tanks East of Ocean Dock Road** If the Loop Track project is constructed, Williams agrees that the tanks shown on the site plan attached as Exhibit A will be removed at its own expense no later than the dates specified below:

Tank # 3296	Built 1950	December 31, 2002
Tank # 3578	Built 1950	December 31, 2003
Tank # 3577	Built 1950	December 31, 2004.

After removing those three tanks, the parties agree that Williams will have banked a "credit" to build one tank on the west side of Ocean Dock Road, without the requirement to remove an additional tank as defined under the provision of Section 4 above.

6. **Mineral Resource (gravel) extraction operations** To build the Loop Track project, Williams may acquire gravel from a pit owned by the Alaska Railroad in the vicinity of the former Hollywood Vista apartments. The Municipality of Anchorage has provisionally taken the position that a conditional use permit granted by the Planning and Zoning Commission on 2/05/96 for gravel extraction in that area remains in effect until 12/31/01. If Williams acquires gravel from that area for its project, Williams will comply with applicable terms and conditions of that conditional use permit and will complete gravel extraction for the Loop Track project from the Railroad Property by no later than 12/31/01 unless extended by mutual consent of the parties. Subject to this agreement, the Council does not object to gravel extraction from the railroad site necessary for construction of the Loop Track project.

7. **Port of Anchorage Bulk Fuel Hazard Study**

1. The parties agree to continue cooperative efforts in connection with the ongoing Bulk Fuel Hazard Study currently underway through the Municipality of Anchorage. Williams agrees to ensure that the study includes an assessment of alternatives for reducing the

likelihood and/or consequence of risks associated with the presence of bulk fuel storage facilities in the Government Hill Area. Mitigative alternatives to be considered will include development of a buffer zone between fuel storage facilities and residential areas.

2. Upon completion of the Bulk Fuel Hazard Study, the parties will work cooperatively in obtaining public approval(s) of municipal and state legislation, including bond propositions to fund implementation of the Study.

8. Compliance with all laws Nothing in this agreement shall excuse Williams from its continuing obligation to comply with all local ordinances and regulations, together with all state and federal laws and administrative regulations that apply to the Loop Track project.

9. Integration.

A. This Memorandum and its attached exhibits contain the entire agreement of the parties. There are no other promises, terms, conditions, or representations binding on any party to this agreement which are not expressed herein.

2. The following are incorporated into this agreement by reference:

Exhibit A: Site Plan
Exhibit B: Letters stating Council's position on Loop Track project.

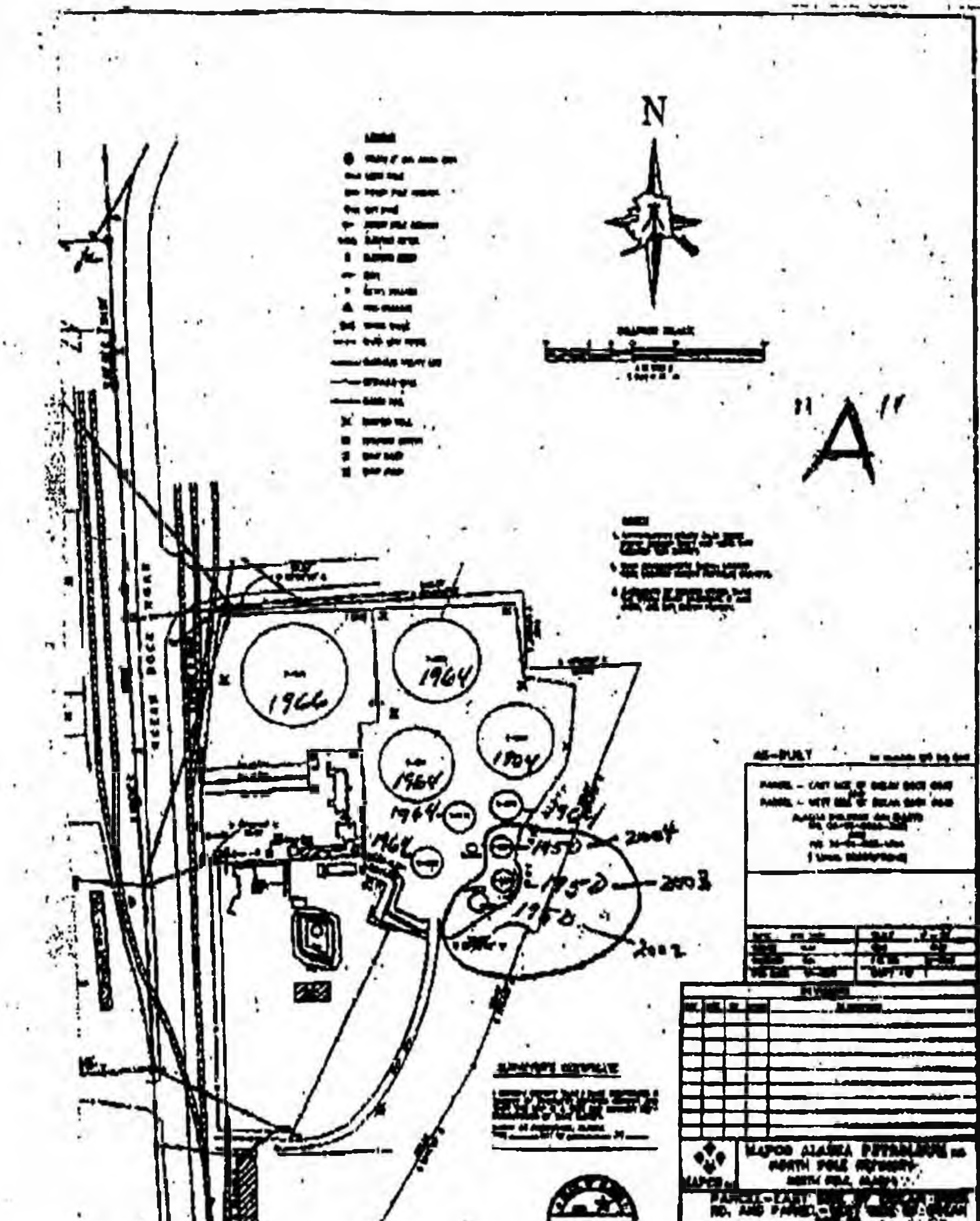
DATED THIS 2d DAY OF JUNE, 2001 AT ANCHORAGE, ALASKA

Williams Alaska Petroleum Co. Inc.

Its President

The Government Hill Community Council

Its Vice-President



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Dear Mr. Newcomer,

This letter conveys the Government Hill Community Council's position of support for the construction of new bulk fuel storage tanks by Williams Alaska Petroleum, Inc., on lands west of Ocean Dock Road, subject to the terms of an agreement between the Council and Williams concerning the removal of tanks from the east side of Ocean Dock Road. This letter is directed to the attention of anyone it may concern.

Government Hill Community Council has for many years advocated for the creation of a safety buffer area to separate bulk fuel storage tanks from residences and other sensitive land uses in our area. In May, 2001, the Council and Williams negotiated an agreement to begin implementation of a buffer zone at Williams' fuel terminal along Ocean Dock Road. Under this agreement, Williams committed to removal of three tanks from the east side of Ocean Dock Road in 2002, 2003, and 2004, and to future removal of additional tanks from the east side of Ocean Dock Road whenever new tanks are built west of Ocean Dock Road, according to a formula that was arrived at mutually by the parties.

In consideration for Williams' agreement to removal of these tanks and staged creation of the safety buffer area, Government Hill Community Council supports construction of the new tanks west of Ocean Dock Road required to continue and expand Williams' operations. The council commits to continued support of new tank construction so long as such new tanks contribute to the establishment of the safety buffer as explained in the agreement.

Thank you for your continued communication with the council and your participation in our joint negotiations and agreement.

Sincerely,

SCH

Stuart C. Hall
President,
Government Hill Community Council

"B"

Dear Mr. Newcomer

Pursuant to the agreement between Williams Alaska Petroleum Inc. and the Government Hill Community Council, this letter states, for anyone it may concern, the council's official position of non-objection to extraction of gravel from Alaska Railroad Corp. land adjacent to the Hollywood Vista property on Government Hill for the purpose of construction of your Loop Rail Project, subject to the understandings contained herein.

The council is of the understanding that the Municipality of Anchorage has provisionally taken the position that a conditional use permit granted by the Planning and Zoning Commission on February ~~8~~,5 1996, remains in effect until December 31, 2001, for gravel extraction from certain Alaska Railroad Corp. land near Government Hill. Subject to compliance with the provisions of that permit, the Council does not object to removal of gravel from that site for the Loop Rail Project prior to the last day of 2001.

This letter and the Council's position of non-objection is offered to Williams in consideration for Williams' agreement to remove three bulk fuel storage tanks from near the Government Hill neighborhood and for the further future removal of other tanks as new tanks are built west of Ocean Dock Road. This letter does not apply to other lands than those covered in the February ~~8~~5 1996, conditional use permit, nor to any project Williams or the Alaska Railroad may contemplate subsequent to the end of 2001.

Thank you for your continued communication with the council and participation in our negotiation process and agreement.

Sincerely,

Stuart Hall
President,
Government Hill Community Council

GOVERNMENT HILL COMMUNITY COUNCIL
Post Office Box 100018 · Anchorage, Alaska 99510-0018

Wednesday, 30 May 2001

Honorable Dick Traini, Chair
Anchorage Municipal Assembly
P.O. Box 196650
Anchorage, Alaska 99519-6650

RE: Lease-back, Tidelands, Port of Anchorge (ARRC/Williams Petroleum, Inc.)

Dear Mr. Chairman and Members of the Assembly:

In light of recent negotiations between Williams Petroleum, Inc, members of the Assembly and representatives of the Government Hill Community Council, the Executive Committee of the Council convened this date agrees to support the efforts of the Alaska Railroad Corporation to lease back a small portion of tidelands in the Port of Anchorage from the Municipality of Anchorage to permit completion of a loop track railroad project by Williams Petroleum, Inc.

Very truly yours,

STUART C. HALL, President

GOVERNMENT HILL COMMUNITY COUNCIL

Post Office Box 100015 · Anchorage, Alaska 99510-0015

Wednesday, 30 May 2001

District Engineer
U.S. Army Corps of Engineers, Alaska District
Post Office Box 898
Anchorage, Alaska 99506-0898

Att'n: David C. Casey, Regulatory Branch

RE: N-920060; Knik Arm 119/Williams Petroleum, Inc.

Dear Mr. Casey:

In light of recent negotiations between Williams Petroleum, Inc., members of the Anchorage Municipal Assembly and representatives of the Government Hill Community Council, the Executive Committee of the Council convened this date withdraws its opposition to the application of Williams Petroleum, Inc., for a fill permit and withdraws the Council's request for a public hearing on this application.

Very truly yours,

STUART C. HALL, President

TOTAL P.09