

LEG. FINANCE - BILLS 1977 - 1978 877

HCR 112am

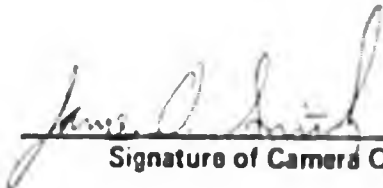
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Signature of Camera Operator



Date

COMMITTEE REPORT
SENATE

FURTHER: _____

5/10/77

Date: _____

Mr. President:

The Committee on FINANCE has had HCR 112 am
conditionally approving the sale of royalty oil to Alaska Petrochemical Company

under consideration and (a majority of the committee) (the committee reports it back as follows)

- recommends it do pass recommends it do not pass
 recommends it do pass with attached amendment(s)
 recommends it be replaced with CS for HCR 112

and _____ new title same title

- AND attaches a Letter of Intent New Fiscal Note
 reports it back without recommendation
 and recommends it be referred to the _____ Committee

MEMBERS SIGNING DO PASS:

OTHER RECOMMENDATIONS:

Chairman

Original sponsor: Rules Committee by
request of the Governor

Offered: 5/26/78
Referred: Resources and
Finance

1 IN THE HOUSE

BY THE SPECIAL COMMITTEE ON THE
SALE OF ROYALTY OIL AND GAS

2 SENATE CS FOR HOUSE CONCURRENT RESOLUTION NO. 112

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TENTH LEGISLATURE - SECOND SESSION

5 Approving the sale of royalty oil to
6 Alaska Petrochemical Company.

7 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

8 WHEREAS the State of Alaska has the right under AS 38.05.180 and its oil
9 and gas leases to take its royalty of crude oil production removed or sold
10 from these leases either in value (money) or in kind (oil); and

11 WHEREAS the legislature has, by enactment of AS 38.06 and AS 38.05.182,
12 established a policy favoring the taking of that royalty in kind (referred to
13 as "royalty oil"); and

14 WHEREAS, under his statutory authority as set out in AS 38.05 and 38.06,
15 the commissioner of natural resources has negotiated an agreement entitled
16 "AGREEMENT FOR THE SALE AND PURCHASE OF STATE ROYALTY OIL." ("Agreement") for
17 the sale and purchase of royalty oil with Alaska Petrochemical Company; and

18 WHEREAS, under its duties and powers as set out in AS 38.06, the Alaska
19 Royalty Oil and Gas Development Advisory Board has considered and, on
20 February 22, 1978, approved the Agreement; and

21 WHEREAS the commissioner of natural resources has fulfilled the statu-
22 tory prerequisites necessary to selling the royalty oil which is the subject
23 of the Agreement and has obtained approvals from the Alaska Royalty Oil and
24 Gas Development Advisory Board, to the extent required under AS 38.05 and
25 38.06; and

26 WHEREAS the Agreement contains a provision stating that it takes effect
27 on the date on which it has been approved by a concurrent resolution of a
28 majority of each house of the Tenth Alaska State Legislature; and

29 WHEREAS, under AS 38.06.055(a), no sale of royalty oil may be made by

1 the commissioner of natural resources without the prior approval of the
2 legislature by a concurrent resolution concurred in by a majority of the
3 members of each house; and

4 WHEREAS the commissioner of natural resources submitted the Agreement to
5 the legislature for consideration and approval; and

6 WHEREAS the legislature has reviewed and evaluated the Agreement, and
7 has conducted public hearings and otherwise received background information,
8 expert advice, and expressions of public opinion sufficient to make a
9 reasoned determination with respect to the Agreement; and

10 WHEREAS the commissioner of natural resources and Alaska Petrochemical
11 Company have negotiated certain amendments to the Agreement, dated May 17,
12 1978; and

13 WHEREAS the Royalty Oil and Gas Development Advisory Board has con-
14 sidered and, on May 19, 1978, approved those amendments; and

15 WHEREAS the legislature finds the Agreement, as amended, to be in the
16 best interest of the State of Alaska and its citizens, and further finds that
17 the Agreement, as amended, is in compliance with all applicable constitu-
18 tional directives and requirements of law;

19 BE IT RESOLVED by the Alaska State Legislature that the agreement en-
20 titled "AGREEMENT FOR THE SALE AND PURCHASE OF STATE ROYALTY OIL," as
21 amended, between the State of Alaska, acting through its commissioner of
22 natural resources, and Alaska Petrochemical Company, is hereby approved.

S. Amundson

Introduced: 3/6/78
Referred: The Special Committee
on the Sale of Royalty Oil and
Gas

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

1 IN THE HOUSE

2 HOUSE CONCURRENT RESOLUTION NO. 112 am

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 TENTH LEGISLATURE - SECOND SESSION

5 Conditionally approving the sale of
6 royalty oil to Alaska Petrochemical Company.

7 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

8 WHEREAS, the State of Alaska has the right under AS 38.05.180 and its
9 oil and gas leases to take its royalty of crude oil production removed or
10 sold from said leases either in value (money) or in kind (oil); and

11 WHEREAS, the legislature has by enactment of AS 38.06 and AS 38.05.-
12 182, established a policy favoring the taking of that royalty in kind
13 (referred to as "royalty oil"); and

14 WHEREAS, under his statutory authority as set out in AS 38.05 and
15 38.06, the commissioner of natural resources has negotiated an agreement
16 entitled "AGREEMENT FOR THE SALE AND PURCHASE OF STATE ROYALTY OIL" ("Agree-
17 ment") for the sale and purchase of royalty oil with Alaska Petrochemical
18 Company; and

19 WHEREAS, under its duties and powers as set out in AS 38.06 the Alaska
20 Royalty Oil and Gas Development Advisory Board has considered and, on
21 February 22, 1978, approved the Agreement;

22 WHEREAS, the commissioner of natural resources has fulfilled the
23 statutory prerequisites necessary to selling the royalty oil which is the
24 subject of the Agreement and has obtained approvals from the Alaska Royalty
25 Oil and Gas Development Advisory Board, to the extent required under AS
26 38.05 and 38.06; and

27 WHEREAS, the Agreement contains a provision stating that it takes
28 effect on the date on which it has been approved by a concurrent resolution
29 of a majority of each house of the Tenth Alaska State Legislature; and

1 WHEREAS, under AS 38.06.055(a), no sale of royalty oil may be made by
2 the commissioner of natural resources without the prior approval of the
3 legislature by a concurrent resolution concurred in by a majority of the
4 members of each house; and

5 WHEREAS, the commissioner of natural resources submitted the Agreement
6 to the legislature for consideration and approval; and

7 WHEREAS, the legislature has reviewed and evaluated the Agreement, and
8 has conducted public hearings and otherwise received background infor-
9 mation, expert advice, and expressions of public opinion sufficient to make
10 a reasoned determination with respect to the Agreement; and

11 WHEREAS, the legislature finds that the provisions of the Agreement which
12 allow Alaska Petrochemical Company to export crude oil from the state are not
13 in the best interests of the State of Alaska and its citizens; and

14 WHEREAS, the legislature finds the Agreement to be otherwise in the
15 best interest of the State of Alaska and its citizens, and further finds that
16 the Agreement is in compliance with all applicable constitutional directives
17 and requirements of law;

18 BE IT RESOLVED by the Alaska State Legislature that the agreement
19 entitled "AGREEMENT FOR THE SALE AND PURCHASE OF STATE ROYALTY OIL," between
20 the State of Alaska, acting through its commissioner of natural resources,
21 and Alaska Petrochemical Company, is hereby approved, provided that the
22 Agreement is amended so that the total amount of crude oil deliverable under
23 the Agreement may not exceed the amount Alaska Petrochemical Company uses
24 or causes to be used within the State of Alaska as petrochemical or refining
25 feedstock.
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Introduced: 3/6/78
Referred: The Special Committee
on the Sale of Royalty Oil and
Gas

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

2 HOUSE CONCURRENT RESOLUTION NO. 112
3 IN THE LEGISLATURE OF THE STATE OF ALASKA
4 TENTH LEGISLATURE - SECOND SESSION

5 Approving the sale of royalty oil
6 to Alaska Petrochemical Company

7 BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:

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17 ment") for the sale and purchase of royalty oil with Alaska Petrochemical
18 Company; and

19 WHEREAS, under its duties and powers as set out in AS 38.06 the Alaska
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21 February 22, 1978, approved the Agreement;

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24 subject of the Agreement and has obtained approvals from the Alaska Royalty
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27 WHEREAS, the Agreement contains a provision stating that it takes
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29 of a majority of each house of the Tenth Alaska State Legislature; and

1 WHEREAS, under AS 38.06.055(a), no sale of royalty oil may be made by
2 the commissioner of natural resources without the prior approval of the
3 legislature by a concurrent resolution concurred in by a majority of the
4 members of each house; and

5 WHEREAS, the commissioner of natural resources submitted the Agreement
6 to the legislature for consideration and approval; and

7 WHEREAS, the legislature has reviewed and evaluated the Agreement, and
8 has conducted public hearings and otherwise received background infor-
9 mation, expert advice, and expressions of public opinion sufficient to make
10 a reasoned determination with respect to the Agreement; and

11 WHEREAS, the legislature finds the Agreement to be in the best interest
12 of the State of Alaska and its citizens, and further finds that the Agree-
13 ment is in compliance with all applicable constitutional directives and
14 requirements of law;

15 BE IT RESOLVED by the Alaska State Legislature that the agreement
16 entitled "AGREEMENT FOR THE SALE AND PURCHASE OF STATE ROYALTY OIL," between
17 the State of Alaska, acting through its commissioner of natural resources,
18 and Alaska Petrochemical Company, is hereby approved.
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AMENDMENT

Dated May 17, 1978

to the

AGREEMENT FOR THE SALE AND
PURCHASE OF STATE ROYALTY OIL

THIS AMENDMENT entered into as of the 17th day of May, 1978, by and between THE STATE OF ALASKA, hereinafter called the "Seller," acting by and through its Commissioner of Natural Resources, and ALASKA PETROCHEMICAL COMPANY, an Alaska corporation, hereinafter called the "Buyer," and being the Amendment to the Agreement between Seller and Buyer entered into February 22, 1978.

WITNESSETH:

WHEREAS, an Agreement for the Sale and Purchase of State Royalty Oil was duly executed on February 22, 1978, between the State of Alaska, as Seller, and Alaska Petrochemical Company, as Buyer ("Agreement"); and

WHEREAS, the Agreement may be amended under Article XXII thereof; and

WHEREAS, Seller and Buyer desire to clarify certain intentions of the Buyer and Seller therein;

NOW THEREFORE, in consideration of the representations, covenants and conditions herein contained, Seller and Buyer hereby amend the Agreement as follows:

1. Article 1.13 is hereby amended by adding the following sentence at the end of Article 1.13:

"Total Project Costs shall not include any amounts paid for the purchase of crude oil."

2. Article I is hereby further amended by the addition of Article 1.14 which reads as follows:

"1.14 The terms "committed to be expended" as used in Article 1.13 and "commit to expend" as used in Article 10.2 shall mean contractually binding agreements, contracts and purchase orders."

3. Article 2.2 is hereby amended by the addition of a sentence at the end of such Article 2.2 as follows:

"Notwithstanding any other provision of this Article 2.2 Buyer shall not be entitled to receive delivery of any royalty crude oil hereunder until (a) Buyer has actually expended at least \$100 million in Total Project Costs, and (b) at least twenty-five (25) months have passed since the Effective Date."

4. Article II is further amended by the addition of a new Article 2.7, to read as follows:

"2.7 Reduction of Quantity of Oil Deliverable to Buyer. Notwithstanding any provision of Article II requiring Seller to deliver to Buyer quantities of crude oil up to 150,000 barrels per day, in the event six years after the Effective Date the

capacity of the Petrochemical Facility is less than 150,000 barrels per day, the maximum quantities deliverable by Seller for the remaining term of this Agreement shall be reduced to that quantity equal to the capacity of the Petrochemical Facility at such time. Coincident with such reduction, the figure "145,000 barrels" appearing several places in Article 2.4 shall be reduced by a like amount. For the purposes of determining capacity under this Article 2.7, the capacity of the Petrochemical Facility shall not be diminished or reduced because of temporary reductions due to market conditions or shutdowns in the Petrochemical Facility, regardless of cause."

5. The first sentence of Article 4.2.1 is hereby amended and revised to read as follows:

"4.2.1 Construction Obligations. In consideration of the obligations assumed by each party herein, Buyer will proceed with reasonable diligence to design, construct, start up and thereafter initiate operation of a petrochemical manufacturing and fuels refining facility in the State of Alaska with capacity to process at least 150,000 barrels of crude oil per day."

IN WITNESS WHEREOF, the Seller has caused this Agreement to be executed by its Commissioner of Natural Resources and the Buyer has caused this Agreement to be executed by its

Chairman of the Board, thereunto duly authorized by its Board of Directors in accordance with the certified seal, duly attested, to be affixed hereto, as of the day and year first above written.

ATTEST:

Frederick H. Benson

APPROVED AS TO FORM:

Arthur H. Quinn

ATTEST:

William McHugh



THE STATE OF ALASKA

BY: Robert E. Resch
Commissioner, Department
of Natural Resources

"SELLER"

ALASKA PETROCHEMICAL COMPANY

BY: O. Charles Hanning
Chairman of the Board

"BUYER"

Senate Royalty Oil and Gas
Committee Report on

SCS HCR 112, Approving the Sale of
Royalty Oil to Alaska Petrochemical Company

The Senate Special Committee on Royalty Oil and Gas has heard testimony from numerous independent consultants, from Administration witnesses and from representatives of Alaska Petrochemical Company. That testimony has addressed a broad range of issues and considerations. The Committee has carefully reviewed this testimony and the contract presented to the Legislature, including certain amendments to the original contract which were executed by the Commissioner of Natural Resources and Alaska Petrochemical Company on May 17, 1978, and finds that the contract, as amended, is in the best interest of the State of Alaska and its citizens. It is the Committee's recommendation that the Agreement between the State and Alaska Petrochemical Company, as amended, be approved by the Legislature. A Committee Substitute for HCR 112 has been prepared which approves both the original Agreement and the Amendments of May 17, thereto.

Because the review and public debate on this contract has been long and at times strenuous, the Committee believes it appropriate to review in this report certain of the key questions which have been raised during the past several months. The focus of attention has centered principally in two areas which are: 1) the viability of the Alpetco project, and 2) the specific provisions of the contract.

ECONOMIC VIABILITY

A general theme of much of the testimony presented by witnesses, other than Alpetco's witnesses, has been that the prospects for petrochemicals during the early to mid 1980's is poor and that consequently Alpetco simply will not be able to build the facility to which it commits itself in the contract. A mainstay of this contention is that the cost of building and operating the facility in Alaska will be greater than elsewhere in the United States and that therefore the facility will be unable to compete in the world market. The Committee finds there is some merit to this concern, but for reasons explained below believes such concern is not a basis for rejection of the Agreement.

The Committee finds that the above line of reasoning will likely apply to most any project and facility proposed for Alaska and whose market for products is outside Alaska. Hence, to reject a project on the grounds that it might be a more viable project elsewhere in the United States is to condemn all efforts to utilize our royalty oil and gas in-state, except such uses which would be for the purpose of supplying Alaskan product markets, which at this time and for the foreseeable future are too small to support world-scale facilities.

The Committee believes the appropriate framework for judgment concerning the question of economic viability of a pro-

posed project is to assess the danger posed to the State's own economic and social health from any doubt about the economic viability of a project. Measured in this light the Committee finds the Alpetco proposal satisfactory. The contract provides for automatic termination of the Agreement after 18 months if Alpetco is unable to obtain \$1.5 billion worth of financing for its project. Beyond that, the contract contains a number of additional benchmarks which must continually be met or the contract will terminate. The Committee believes that these benchmarks provide the security necessary to the State to ensure that if the project is not an economically sound venture, Alpetco will be unable to advance its project in the market place and the Agreement will terminate. The danger to the State of severe economic or social injury is minimal for this reason. The Committee finds that the only danger of any significance posed for the State by virtue of the uncertain economic viability is that identified by Milton Lipton, namely that the project once completed might come upon hard times and at that point seek a modification of the Agreement or other relief from the State. The Committee expressly finds that this "risk" is inherent in any development project, and further finds that as also noted by Mr. Lipton, such assistance may or may not be in the State's long run interest. We have faith that future Administrations and Legislatures will make the (perhaps) difficult choices in the best interests of Alaska and therefore reject the notion that this contract should be repudiated so that we might "save us from ourselves".

In summary, the Committee believes that there is some question about Alpetco's probability of meeting the benchmarks contained in the Agreement and actually building its proposed petrochemical facility, but we also believe there is no loss to the State from affording Alpetco the opportunity to try.

CONTRACT PROVISIONS

We turn now to the contract itself and some of the questions which have been raised about it. The Committee took notice that certain members of the House had suggested that the contract permitted Alpetco to build only a small in-state fuels refinery and market the remainder of the oil outside Alaska. We, therefore, examined this matter closely. Initially, we were of two minds, at least some members of the Committee seemed to feel there might be some merit to this concern. Others did not agree. However, whatever doubt did exist has been eliminated by the Amendments of May 17, which in the Committee's opinion provide satisfactory assurance that Alpetco is committed to construction of a 150,000 b/d facility in Alaska.

A word must also be said about in-state use of Alaska's royalty oil and about brokerage of that oil. Based on

information submitted to the Legislature by Mr. Earl Johnson, by Battelle and the Committee's own review of the pricing provision in the contract we conclude that brokerage of Alaska's royalty oil by Alpetco in the competitive oil market is extremely unlikely both before and after completion of construction of the Alpetco facility. For example, Mr. Earl Johnson, after carefully studying the pricing provisions of the contract advised the Committee it was his conclusion that based on present marketing of the crude "there would be no incentive for Alpetco to exercise its crude option -- and certainly no way to discount in the West Coast market . . ."

The Committee further notes that much of the discussion concerning brokerage of the State's royalty oil has overlooked certain fundamental points. The discussion often seems to assume that if Alpetco will broker the State's oil, then we should reject the contract so that we might capture that benefit ourselves. However, the Committee notes that the State's "downside risk," in the present contract is minimal -- we will never receive a price less than the in-value price. It may well be -- and in our opinion it must be -- that to capture the possible benefits from brokering royalty oil one must also bear the risk of receiving less than the in-value price. Thus, we conclude it is inappropriate to assume that the Alpetco contract must be rejected simply because it might be possible for Alpetco

to make money if it resells the State's royalty oil. The State has lost nothing, even if Alpetco gains something and we have no assurance that even if Alpetco can resell royalty oil at a profit the State could do likewise. At the present time, neither the Administration nor the Legislature is set up to market oil effectively and we are not prepared to recommend that the State should jump squarely into the oil marketing business to compete with major oil companies.

Much of the public debate has centered on whether or not Alptetco is required to use the oil in Alaska. It is asserted the contract does not expressly require use of the oil in the facility once it is built. The Committee finds that contention correct but of little significance for several reasons. First, the Committee is satisfied that, with the May 17 Amendments, Alpetco is sufficiently committed to building a major in-state facility and that any wavering from that commitment will result in diminishment of the amount of oil available to Alpetco (under the Amendments) and/or termination of the contract. Second, the Committee finds no evidence or logic to support the notion that a facility once constructed in Alaska will be left idle while state royalty oil is used elsewhere. The need to operate the facility to generate revenue to service the debt will be overwhelming and will be able to be achieved only by operating the plant which produces large "added-value" and hence substantial gross revenues. Such revenues simply cannot be

achieved by resale of the oil. Third, we conclude that an express contract provision requiring the oil be processed in the plant offers little real value to the State. If the facility cannot be operated profitably over the long run, then a contract provision requiring in-state use we expect would be breached. This, of course, would result in cancellation of the Agreement. We believe cancellation would be in the State's interest but judged realistically we believe the State's royalty in such circumstances could only be taken in-value and that it would be impossible to encourage other major development in Alaska. Fourth, we accept Alpetco's statement that financing will not be possible with such a provision in the contract. That being the case, we believe it a subterfuge to demand such a term when to do so will necessarily prevent the project from going forward.

In summary, the Committee has reviewed the contract carefully and studied the statements of several expert witnesses. We have focussed upon the key issues which have been raised in public debate. We believe the contract is not "riskless", in fact we believe there is no such thing as a riskless contract. All agreements preclude certain options and as such always entail the risk that "something better might come along." However, we believe the royalty statute and the wishes of a majority of people of this state dictate that an effort be made to encourage in-state use of Alaska's

royalty resources. The Alpetco contract in our opinion fulfills that objective with a minimum of cost and risk to the state and its citizens and we therefore recommend its approval.

Mike Colletta

Senator Mike Colletta, Chairman
Senate Royalty Oil and Gas Committee

Kay Poland

Senator Kay Poland

Senator Pat Rodey

Senator John Sackett

Bill Sumner

Senator Bill Sumner

14B12

March 6, 1978

The Honorable Hugh Malone
Speaker of the House
Alaska State Legislature
Juneau, Alaska 99811

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, Alaska Constitution, I am transmitting a concurrent resolution providing for legislative approval of the proposed contract between the State of Alaska and Alaska Petrochemical Company.

The contract with Alaska Petrochemical Company provides for the sale and purchase of up to 150,000 barrels per day of state royalty oil. In exchange for the oil, Alaska Petrochemical Company guarantees that it will pay the state the sum the state would have received from the producers if royalty were paid in value. Alaska Petrochemical Company also promises to construct a petrochemical facility in Alaska, with the capacity to produce 30,000 barrels per day of energy fuels for instate use. If Alaska Petrochemical Company fails to proceed with construction of the facility according to a timetable set out in the contract, the agreement will automatically terminate. A copy of the contract document is attached.

This resolution is being concurrently submitted to both the Senate and House in order to expedite consideration.

In the past, there have been questions raised over the constitutionality of the legislature's approval of an executive act by the means of a concurrent resolution. In an effort to avoid raising that issue by submitting this contract for approval, I insisted that a clause requiring legislative approval be placed in the contract itself. I did so to insure that legislative approval in this instance could be sustained on the basis of a contractual provision rather than raise a constitutional debate over legislative power to require such approval.

I hope that you agree that this sale is in the best interest of all Alaskans, and I urge your prompt approval.

Sincerely,

S. J. Hammond
Jay S. Hammond
Governor

HOUSE ROYALTY OIL AND GAS
COMMITTEE REPORT

on HCR 112, approving the sale of royalty oil
to Alaska Petrochemical Company; April 27, 1978

The Constitution of the State of Alaska calls for the legislature to provide for the utilization, development and conservation of all natural resources belonging to the State, including land and water, for the maximum benefit of its people. It was within this context, with special emphasis on maximizing benefits to Alaskans, the House Royalty Oil and Gas Committee expended hundreds of hours studying the ALPETCO Royalty Oil Sales Contract.

Several issues surfaced during the Committee's deliberations on the ALPETCO contract. These issues were addressed in the numerous reports prepared on the sale of the State's royalty oil or by the consultants hired to address the issue.

The issues, each to be dealt with separately, are as follows:

1. Benefits to the People of Alaska
2. Economic Feasibility of the ALPETCO Project
3. Marketing of the Products
4. Commitment of Undiscovered, Unknown Reserves
5. Early Delivery of Crude
6. Risks to the State

Each of the items will be addressed individually. The Committee's findings will be documented and a conclusion on each of the main issues will be stated.

I. BENEFITS TO THE PEOPLE OF ALASKA

The principal benefits to the people of the State claimed for the ALPETCO proposal include the creation of new job opportunities and the addition of millions of dollars to the State and local governments from direct and indirect sources.

A. Jobs. The Institute of Social and Economic Research (ISER) Economic Impact Analysis finds that a high total employment figure of 22,253 (in 1983) will be created by the ALPETCO project. Following the peak construction years, 7,000 to 9,000 jobs, direct and indirect, will result from project.

However, as appealing as the creation of new employment sounds, there were certain negative factors noted. The question of the resident Alaskans who would be hired on the project was raised.

"In our opinion, therefore, potential for job creation offered by one of the proposed refineries or petrochemical complexes should be evaluated in light of (1) secondary job creation on the order of 2-5 new secondary jobs for each ten new refinery jobs, and (2) the fact that at best only 50 - 60% of the new refinery petrochemical jobs are likely to be filled by Alaskans."

(From Report to the Alaska Royalty Oil and Gas Development Advisory Board, David M. Reaume, Principal Economist, Division of Economic Enterprise, State of Alaska, December 14, 1977.)

In assessing the possibility of in-State crude processing and its relationship to the creation of jobs, E. L. Patton, the chief executive officer of Alyeska Pipeline, calculated in a letter-to-the-editor in the January, 1978, issue of Alaska Construction and Oil that each of the jobs:

"in the royalty refinery costs Alaskan taxpayers \$240,000 per year."

B. Revenues to State and Local Government. A positive fiscal impact results at the local-government level as a direct result of the ALPETCO project, although the ISER reports states that it appears only after completion of the project.

Revenues to the State general fund begin in 1979 at \$1.9 million and reach a construction period high of \$68.8 million. In 1985, the general fund revenue from the project dips to \$18.1 million, but increases steadily to \$41.8 million in 1990. In 1995, the general fund revenue is estimated to be \$68.6 million. In the year 2000, the general fund revenue is estimated

to be \$95.4 million. However, the ISER report states that general fund revenues:

"respond negatively because the increased demand for public services indirectly generated by ALPETCO requires that a larger proportion of the petroleum revenues be spent on current government expenditures and a smaller proportion saved."

Additionally, many non-government demands are mandated, i. e., service and haul roads, school construction and the like.

In calculating the revenues minus expenditures directly and indirectly related to the ALPETCO project, the report finds that in 1979, the general fund will be increased by \$1.9 million. The general fund loss directly and indirectly attributable to the ALPETCO project runs from a low figure of minus \$6.6 million in 1980 to a high figure of minus \$221.8 million in 1984. There is general fund loss of \$58.9 million in 1990, of \$76.4 million in 1995 and of \$48.1 million in the year 2000. In every year between 1980 and the year 2000, the report shows a general fund loss attributable to the ALPETCO project.

In order to verify these figures, the Committee directed the Legislative Research Division to review the assumptions that went into the ISER study. The assumptions

were found to be correct.

And finally, the Alaska Department of Community and Regional Affairs found that:

"Quite clearly, insistence on the establishment of a world-scale refinery in Alaska would cost the State between \$1 1/2 and \$2 1/2 billion in loss of revenue over the life of the refinery."

(From Economic Feasibility of Royalty Oil Refining, Niall Trimble, Principal Economist, Department of Community and Regional Affairs, State of Alaska, December 8, 1977.)

CONCLUSION. The Committee feels that the cost of government and non-government service will continue to increase as the ISER report indicates. Automobiles and eggs rise in price almost monthly; so do the prices of roads and schools. And, the demand increases as the number of people increase. While it would be good to assume they will not increase, the Committee realizes historic trends may continue. Thus, the Committee finds few net benefits to the people of Alaska. Those enumerated are far overshadowed by attendant costs.

II. ECONOMIC FEASIBILITY OF THE ALPETCO PROJECT

The Committee felt it most important to look into the

economic feasibility of the project. The question was addressed in numerous reports; each consultant coming before the Royalty Oil and Gas Committee commented on the subject. ALPETCO feels that it can overcome the general economic disadvantage of Alaskan enterprise through the ultimate value-added concept. The consultants unanimously disagreed with ALPETCO.

"My fourth observation is that ALPETCO's view of the economics of Alaska refining and petrochemical and of the world petrochemical market is a minority view. It is a view that is generally not shared by the major oil or chemical companies, by the trade press or by the government specialists in energy and chemicals in either the United States or Japan. The more general view is that Alaska is not presently a competitive location for a world scale plant because of transportation factors plus high construction and operating costs."

(From Statement by Arlon Tussing to the Royalty Oil and Gas Development Advisory Board, February 22, 1978.)

The oil producers have the largest investment in resource development in the State of Alaska. What is their opinion of petrochemical development as outlined?

"Finally, when considering the profit potential of petrochemicals in Alaska, we must ask, 'Where are the major oil companies?' W. Monte Taylor, Exxon's manager of Alaska operations, has provided his firm's answer. In a press release reported mid-November, he stated clearly that in Exxon's opinion, petrochemical production is a non-economic venture in Alaska."

(From Report to the Alaska Royalty Oil and Gas Development Advisory Board, David Reaume, Principal Economist, Division of Economic Enterprise, State of Alaska, December 14, 1977.)

Additionally, E. L. Patton, chief executive officer of Alyeska Pipeline, said:

"Taken together, the higher product transportation costs, the higher capital costs and the higher operating costs add up to the fact that Alaska products would arrive at a West Coast location at appreciable higher cost than the products of an identical West Coast refinery. Therefore, in order to compete with West Coast products, the only recourse the royalty refinery has is to obtain the royalty crude at a discounted price."

(From a letter-to-the-editor by E. L. Patton, Alaska Construction and Oil, January, 1978.)

CONCLUSION. There have been several unique attempts in the various royalty oil sales proposals to offset the "Alaska disadvantage," but the ALPETCO proposal does not reach that difficult goal. And, as indicated in the Reaume Report and the Patton letter, and as apparently envisioned by the principal negotiators of the contract, a price reduction of feedstock (Alaska's Royalty Oil) is a probable long-range solution to overcoming the disadvantage. Such a potential crude price reduction is intolerable in light of forecasted high-cost of crude coupled with its world-wide depletion in the future.

III. MARKETING OF THE PRODUCTS

The Committee felt it necessary to ascertain, at the minimum, a conceptual idea of where the products were to be sold. While it understands that firm contracts may not be in order at this time, the probability of having a market, in order to reduce the risk of the project, had to be determined.

A. West Coast Markets. A tremendously high crude oil surplus exists on the West Coast today, and is generally projected to exist for several years. There is very little primary petrochemical production capacity on the West Coast. The Gulf Coast of the United States produces a large supply of America's petrochemicals at the current time. Environmental and other production restrictions have retarded the growth of the petrochemical industry on the West Coast.

However, there is a potential for delivery of petrochemicals to the West Coast from newly developing Mexican production.

"...Mexico will be investing \$15 billion in its petroleum and petrochemical operations over the next six years, targeting for Mexican as well as exported markets. Mexico's plans for petrochemical development are no less ambitious -- self-sufficiency in 1979 and exportable surplus equal to 20% of its total

production by 1982. Even discounting these figures somewhat, Mexico will be a major factor in the future."

(From the Evaluation of the Proposed Refinery/Petrochemical Plant in the State of Alaska, Data Resources, Inc., November 22, 1977.)

B. Japanese Markets. In ALPETCO's original presentation to the Royalty Oil and Gas Advisory Board, a number of letters were presented to show possible Japanese interest in the project. There were no commitments to purchase.

During the later deliberations of the House Royalty Oil and Gas Committee, three negative letters concerning the project were obtained. Additionally, a Japanese petrochemical trade journal article did not seem to support the project.

Although the majority of the letters neither strongly supported nor strongly objected to the project, a translation of a letter from an official of the Petrochemical Industry Association of Japan to the Minister of the International Trade and Industry was substantially damaging to the project as it stated that:

"The petrochemical industry in Japan is agonizing under the long-protracted recession, beleaguered with

many problems including the declining international competitiveness mainly due to the higher cost of naphtha in Japan." The letter goes on to say that "What is worse, considerable volumes of in-flow of petrochemical products from abroad are anticipated for the future upon completion of those overseas petrochemical projects which are now going on in Singapore, Iran and Saudi Arabia with participation of Japanese petrochemical producers. Therefore, we must say that the glut petrochemical products will last for some time to come, aside from projection for distant future, say over ten years from now." The letter concludes by stating that "Therefore, our fundamental thought on this matter is that under the present environment where a substantial demand-supply gap is expected to continue over a considerable period of time, the petrochemical industry in Japan cannot afford and does not need to participate in the project for the foreseeable future."

Comments made by financial consultants Smith Barney, Harris, Upham and Company, economist Arlon Tussing, as well as industry experts Joe Moore and Milton Lipton, all seem to concur in the feeling that the time is simply not right for Japanese involvement.

CONCLUSION. The committee finds that there is little potential for product purchase in Japan; there is more of a potential on the West Coast and other lower 48 markets, but Mexican petrochemicals may preclude such prospects.

IV. COMMITMENT OF UNKNOWN, UNDISCOVERED RESERVES

Section 2.4 of the contract allows ALPETCO the option to

take "70% (70 percent) of the royalty oil production of any field, lease, or contract in which the seller has an interest." This language refers to non-Prudhoe Bay royalty oil that is not otherwise committed (such as Cook Inlet crude) and which, to date, has neither been discovered nor is known to be in sufficient quantity.

During last year's legislative debate on the sale of royalty gas, a major objection to the gas contracts was that they committed all of the State's Prudhoe gas, and the questionable wisdom of such commitment.

In the current ALPETCO contract, we are not only committing 85% of all Prudhoe Bay royalty oil (the other 15% remaining for existing in-State uses), but we are also committing up to 70% of all other royalty oil.

The State Energy Policy Committee, consisting of members of the legislature, members of the administration, and members of the general public, deliberated on this issue last summer and unanimously agreed that the State should not "sell more than its royalty share of Prudhoe crude."

The rationale consistent with this argument seems fairly basic. If, like any other merchant, the State neither possesses a commodity or knows its location, basic business

practices would undoubtedly discourage sale of such an unknown, undiscovered commodity.

CONCLUSION. The Committee feels that making a commitment for the sale of unknown, undiscovered crude is in direct conflict with basic principles of good business. To roll the dice in the hope of finding new sources of crude to reach the necessary 150,000 barrels per day for operation of the facility is only asking for a crude price reduction once the facility is completed and the State cannot deliver the necessary amount of crude oil. Such a commitment gives ALPETCO a virtual monopoly on all future royalty oil.

V. EARLY DELIVERY OF CRUDE

Article 2.2 of the contract calls for the first delivery of crude prior to completion, or even commencement of construction, of a petrochemical facility. The contract states that "initiation of deliveries, therefore, may occur prior to the date the petrochemical facility is completed and operational."

In essence, this provision allows ALPETCO to take the oil after receiving a financial commitment from lenders to build the facility.

As the contract reads, it invites costly, lengthy litigation during which time, ALPETCO could be receiving the entire amount of crude oil while failing to move forward on the construction of the facility.

CONCLUSION. The committee can find no justification for commitment for pre-delivery of crude oil. Rather, it would much prefer to see delivery of oil commence upon completion of the facility.

VI. RISK

Perhaps one of the strongest arguments made by ALPETCO is that there is absolutely no risk to the State in this contract. Representatives of ALPETCO said this on any number of occasions.

However, virtually every expert that has come before the legislature disagrees strongly with this position. Even Commissioner Le Roche, the chief architect of the contract, when testifying, agreed that there are risks stating that:

"Now when you talk directly about the risks to the State-- there has been a lot of talk about a riskless contract. This is not a riskless contract," although he suggested the risks were minimal.

Additionally, Milton Lipton emphasized a number of risks under the contract:

"I think the biggest risk is that the contract will collapse, as we personally assess the probability of success is not all that great. And this is the risk."

Further in his testimony, he stated that "The other risk is that everything is going to go, and the investments are all going to be made, and it may lead to a very, very difficult time."

In the short-term, it is unlikely the State will be inclined to enforce the letter of the performance benchmarks set out in the contract. Assuming ALPETCO will demonstrate substantial commitment and sincere effort, it may not be realistic to expect the State will cut ALPETCO off if it falls short of the desired goals.

If the facility is built, ALPETCO may not have the financial capability to withstand five or six difficult, non-profitable years. It may become the responsibility of the State to give ALPETCO essential support (lower price for feedstock) on the chance things will be better in the future.

Looking at the structure of ALPETCO, the committee finds that ALPETCO is no more than a "paper corporation." That is to say, ALPETCO is a consortium of various enterprises joined together in a business venture. None of the assets

of the individual corporations forming the consortium are put on the line. Should any problems arise along the way, the State has absolutely no premise to pursue its legal remedy. As Arlon Tussing's statement to the Royalty Board noted:

"Again, the problem here is that the owners don't propose to put up any capital. They propose 100% debt financing or, if I read it correctly, there is something like 107% financing. When the thing goes on-stream, the facility will have a negative net worth. That is, they will owe more than the plant is worth. And so the only security... the thing they have to do, since there is no security in terms of an equity cushion, say all the cash flow has to be available for debt repayment--there is no equity cushion--they're not taking any oath, there's no recourse against the owners."

If ALPETCO was a firm willing to risk a percentage of its corporate assets, or collective corporate assets, the State would be in a much more secure position should ALPETCO default any portion of the contract.

Even Forbes Magazine, April 3, 1978, questioned the ability of ALPETCO's finances:

"That project would involve building and operating refineries and petrochemical plants worth some \$2.5 billion. That is a very big development for a company with total assets of only about \$273 million and debt of \$128 million."

None of the consultants queried on this matter gave the project more than a 50-50 chance of success. In fact, the Bonner and Moore Report states that "Overall it appears that a royalty oil processing facility can be built in Alaska, but there is a definite risk that each project could founder for any of several causes."

The Committee would like to see a sound petrochemical facility in Alaska. If the legislature approves this contract, it is, in fact, giving ALPETCO up to two years (18 months plus a 6 month extension) to put its financing together. If, at that time, ALPETCO is unable to put its financing together, the State finds itself just a few short years away from the down turn of Prudhoe Bay production...and perhaps an opportunity that will be lost forever.

If, on the other hand, the State withholds approval this legislative session and urges the administration to negotiate a better contract to be presented early in the eleventh legislature, then only six months is lost and the element of risk could be greatly reduced.

Finally, coupled with the risks cited above, the contract does not require ALPETCO to process the crude in-State, further complicating the question of the risks inherent

in the contract. If, as ALPETCO and the Administration assert, there is going to be an in-State petrochemical complex, why doesn't the contract require in-State processing?

In fact, the provisions dealing with the in-State processing are all provisions couched in the terms the word "if."

Eddie Rogers, chief contract negotiator for ALPETCO said before the House Oil and Gas Committee, March, 1978:

"No, there's no requirement that we process a certain amount of barrels, there is no requirement that we continue the operation, but, if we follow the criteria of 10.2, and meet those criteria, - those are the bench marks - if we meet the general requirement which is described in Article IV - the two of those together should satisfy..." (Emphasis added.)

Deputy Commissioner of Natural Resources, Fred Boness, one of the State's negotiators for the contract said

"This language, which we finally concluded was as far as we can go, really did not commit them, I mean if they want to build in the capacity and let it sit idle, or build in the capacity, manufacture the products and export them all to California, they would not be in breach of the contract for doing so." (Emphasis added.)

Boness added that "there is no obligation in the contract to run 150,000 barrels through that facility."

CONCLUSION. The Committee finds a number of serious risks to the State are inherent in the contract: Risks involving future resource development, risks involving financing, risks involving completion of project, risks involving litigation.

SUMMARY. The House Oil and Gas Committee strongly supports the development of a petrochemical facility in the State, to process the State's resources, for the many economic and social benefits that have been enumerated. However, insofar as the ALPETCO contract is concerned, the committee is forced to make a negative recommendation.

The Committee feels that the legislature should certainly entertain, at the earliest date, a newly-negotiated contract from the administration. Several additional items should be pointed out at this time.

First, a number of the consultants and witnesses presenting testimony before the committee stated the need for an overall decision concerning resource development. It appears that the State of Alaska is progressing in a patchwork way toward resource development. First there was the oil pipeline. Next there was a major petrochemical proposal. And just recently, the State received a proposal to finance the gas line. These individual projects, although tremendously

important to the future of the State, are being looked at in isolation. The Committee urges the administration to put together a total resource development package and present this package to the legislature, rather than approaching the idea of resource development on a "catch-as-catch-can" basis. It should look at aspects that heretofore have not been given adequate attention: The timing of development, the possibility of tankering resource discoveries, the possibilities of an overall development plan for our natural resources, detailed cost/benefit analyses with the various proposals it submits.

No advisor to the legislature stated that it is imperative that we move on this now. Quite the contrary, several consultants have indicated that because of a number of factors existing on the world and national levels, it would do no harm to delay a decision.

In a world market that is experiencing a diminishing supply of natural resources and an increasing value on domestic sources of crude oil and natural gas, we must move forward cautiously and conservatively, nurturing and encouraging health development while taking care not to sell out the rights of the next two generations.

Finally, the House Royalty Oil and Gas Committee is strongly committed to the development of an in-State petrochemical facility. However, it feels the ALPETCO contract is obviously lacking in adequate benefits to Alaskans and in living up to Alaskan Constitutional mandates.

B. Miles

Bill Miles, Chairman
House Royalty Oil and Gas Committee

Alvin Osterback does not concur

Alvin Osterback, Vice Chairman

C. V. "Chat" Chatterton 4/27/78

C. V. "Chat" Chatterton

Joe McKinnon

Charles Parr

Charles Parr

A M E N D M E N T

TO THE AGREEMENT FOR THE SALE AND PURCHASE OF STATE ROYALTY OIL BETWEEN THE STATE OF ALASKA AND THE ALASKA PETROCHEMICAL COMPANY, dated February 22, 1978.

In Article 2.1 of the Agreement, at page 5, line 1, after "in kind." add the following language:

"Seller shall not be required under any provision of this Agreement to deliver to Buyer any amount of crude oil in excess of the amount Buyer uses or causes to be used within the State of Alaska as petrochemical or refining feedstock."

The pencil changes on this draft reflect clerical and grammatical clarifications added after execution of the contract and agreed to by both parties. The printed contract, which is to be reexecuted on March 6, 1978, will contain these revisions and changes.

AGREEMENT FOR THE SALE AND PURCHASE

OF

STATE ROYALTY OIL

ALASKA PETROCHEMICAL COMPANY
an Alaska corporation

THE STATE OF ALASKA
Department of Natural Resources

February 22, 1978

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AGREEMENT FOR THE SALE AND
PURCHASE OF STATE ROYALTY OIL

THIS AGREEMENT entered into as of the 22nd day of February, 1978, by and between THE STATE OF ALASKA, hereinafter called the "Seller," acting by and through its Commissioner of Natural Resources pursuant to Alaska Statute 33.05.183 and ALASKA PETROCHEMICAL COMPANY, an Alaskan corporation, hereinafter called the "Buyer."

W I T N E S S E T H :

WHEREAS, it is in the mutual best interests of Seller and Buyer that Buyer construct and operate a petrochemical facility in Alaska to process the oil sold hereunder, said facility to have the capacity to process approximately 30,000 barrels per day of crude oil into energy fuels for in-state distribution and sale; and

WHEREAS, Seller has the right under each of the leases identified in Exhibit "A" to this Agreement to be delivered or paid by the lessee thereunder a royalty of twelve and one-half percent (12-1/2%) in kind (amount) or value of the crude oil production removed or sold from the lands covered by each such lease; and

WHEREAS, the lessees of such aforesaid leases and other parties have represented to Seller that crude oil can be recovered from such leases in significant quantities and that such lessees intend to market such crude oil; and

WHEREAS, Seller is presently receiving royalty payments based on more than 90,000 barrels of crude oil per day from the aforesaid leases and anticipates the quantity of such royalty oil payments to increase for the next year; and

WHEREAS, Seller is authorized by Alaska Statute 38.05.183 to sell such royalty oil; and

WHEREAS, Seller desires to sell royalty oil to Buyer and Buyer desires to purchase royalty oil from Seller under the terms and upon the conditions hereinafter set forth;

NOW, THEREFORE, in consideration of the representations, covenants and conditions herein contained, Seller and Buyer hereby agree as follows:

ARTICLE I

DEFINITIONS

As used herein, the following terms shall have the following meanings:

1.1 "Affiliate" shall mean any person, firm, corporation or other entity affiliated with Buyer by means of a material direct or indirect ownership interest.

1.2 "Commissioner" means the Commissioner of Natural Resources of the State of Alaska.

1.3 "Date of First Delivery" means the date the first royalty oil sold hereunder passes the Point of Delivery.

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

1.5 "Effective Date" shall have the meaning defined in Article XI.

1.6 "Force Majeure" shall have the meaning defined in Article 15.2.

1.7 "Leases" or "Lease Contracts" means the oil and gas leases which are described in Exhibit "A" attached hereto and made a part hereof.

1.8 "Lessee" means any party owning a working interest in a Lease or Lease Contract.

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

1.10 "Oil" or "crude oil" shall have the same meaning as the word "oil" under the Prudhoe Bay Unit Agreement dated April 1, 1977, by and between the Seller and Lessees.

1.11 "Point of Delivery" shall have the meanings defined in Article III.

1.12 "Petrochemical Facility" shall have the meaning defined in Article 4.2.1.

1.13 "Total Project Costs" shall mean the aggregate of all sums and costs expended, incurred or contractually committed to be expended by Buyer, its Affiliates, direct and indirect beneficial shareholders, consultants, advisers and design, engineering and construction contractors in connection with responding to the requests

for proposal for the sale of royalty oil from the Leases; the preparation and execution of this Agreement; the performance of any and all obligations, transactions or events required by this Agreement; and the design, engineering and construction of the Petrochemical Facility or any portion thereof, all such costs to be measured from January 1, 1975. Total Project Costs shall also include (i) interest costs actually paid or accrued, and (ii) sums and costs expended, incurred or contractually committed to be expended by any city, borough or other governmental agency on any pollution control, sewage or water treatment, port, pipeline, terminal or other facilities, directly connected with or a part of the Petrochemical Facility, to the extent such facilities are utilized by the Petrochemical Facility. Any indirect or allocated costs shall be substantiated in writing to the satisfaction of the Commissioner.

ARTICLE II

QUANTITY PURCHASED AND SOLD

2.1 Sale of Prudhoe Bay Royalty Oil. Subject to the terms and conditions hereinafter provided, and subject to the prior obligations of Seller to deliver 5,000 barrels of crude oil per day under its contract with Golden Valley Electric Association, Inc. ("Golden Valley"), for the term and in the quantity now stated therein, Seller agrees to sell to Buyer, and Buyer agrees to buy from Seller, eighty-five percent (85%) of the total amount of Seller's royalty oil out of the crude oil production removed or sold from the Leases which the Seller has the right to take, and is available to the Seller for tak-

Subject to the further provisions of this Article 2.1)

ing, in kind. Seller reserves the right to use or dispose of the remaining fifteen percent (15%) in its discretion. After completion of the Petrochemical Facility, Seller's obligations to Golden Valley, if any, shall first be satisfied out of the fifteen percent (15%) portion of the oil from the Leases not being sold by Buyer hereunder. In addition to the crude oil deliverable under the other provisions of this Article 2.1, Buyer shall also possess the option to purchase an additional five percent (5%) of the total amount of Seller's royalty oil out of the Leases:

(a) in the event Seller enters into a contract with North Pole Refining Company ("NPR") granting NPR an option to purchase part or all of the fifteen percent (15%) portion of the oil out of the Leases not sold to Buyer under other provisions of this Article 2.1 and NPR does not exercise its option in full to purchase the oil on which it has an option, but Buyer's option to purchase shall extend to the purchase of that quantity of oil from time to time not purchased by NPR; or

(b) in the event Seller does not enter into or have in effect a contract with NPR as recited in Article 2.1(a).

In the event it exercises its option under Article 2.1(a) or 2.1(b) above, Buyer agrees to give Seller an additional thirty (30) days notice of any nominations under this Article in addition to the time for notice specified in the Prudhoe Bay Unit Agreement. In the event under any agreement with NPR Seller obtains a right to purchase

from NPR any oil returned to the Trans Alaska Pipeline System by NPR, Seller shall assign all such rights to Buyer for the term of such NPR agreement.

Seller represents to Buyer that it has obtained sufficient advance written consents to termination and an agreement from Lessees (which to Seller's knowledge has been performed) to require similar consents from all subsequent purchasers agreeing to waive or terminate any supplier-purchaser relationship as to sufficient quantities of Seller's royalty crude oil out of the Leases to enable Seller to perform its delivery obligations under this Agreement.

2.2 Initiation of First Delivery. After the date Buyer has obtained the financing commitment referred to in Article 10.2(3)(d) and has furnished satisfactory evidence of same to Seller, Buyer shall have the right, subject to the further terms of this Article 2.2, to call for the initiation of delivery of crude oil under this Agreement by notifying Seller that Buyer seeks to initiate deliveries and stating the quantity desired, which such quantity shall be not less than one thousand (1,000) barrels per day. Initiation of deliveries, therefore, may occur prior to the date the Petrochemical Facility is completed and operational. Seller, within thirty (30) days after receipt of such notice from Buyer, shall deliver notice to all Lessees that it is exercising its right to take its royalty oil in kind and stating the quantity required to be delivered. In the event Seller shall obtain a modification of the Lease Contracts or Prudhoe Bay Unit Agreement to reduce the notice period required to less than six (6) months, the Date of First Delivery under this Agreement shall be reduced accordingly, but only upon sixty (60) days' prior written

notice of such time reduction to Buyer. Buyer agrees, in the event it calls for delivery of crude oil prior to the date the Petrochemical Facility is ready to process the crude oil, that it shall fully comply with its obligations under Article 26.6.

2.3 Certain Future Sales of Oil Taken in Kind by Seller.

From and after the Effective Date, as to any royalty oil of Seller (other than royalty oil out of the Leases) taken in kind and proposed to be offered for sale, other use or disposition to third parties by Seller at a price or value which, when the reasonable costs of transportation of such royalty oil to the site of the Petrochemical Facility are added thereto, is less, on the date so offered, than the price stipulated in Article 8.1 plus the reasonable costs of transportation from the Point of Delivery to the site of the Petrochemical Facility, equitably adjusted to reflect quality and gravity differences between the crude oil offered to be sold and the crude oil from the Leases, Seller shall first offer to Buyer the opportunity to purchase ninety percent (90%) of the royalty oil proposed to be offered. Said oil shall be offered to Buyer at the same price, and on the same terms and conditions, as offered to third parties. The offer to Buyer shall remain open for sixty (60) days, after which time, if Buyer has not accepted the offer, Seller shall be free to sell the oil under the same terms and conditions to a third party. Seller may freely dispose of the ten percent (10%) portion of the royalty oil not sold to Buyer hereunder at such price and on such terms as Seller may desire. Notwithstanding the preceding provisions of this Article 2.3, Seller may freely sell any of its royalty oil otherwise subject

to this Article 2.3 free of the terms of this Article 2.3 so long as any such sales and deliveries of oil at a lower price, as defined above, cease and terminate on the date the Petrochemical Facility initiates processing of crude oil; further, the provisions of this Article 2.3 shall not apply to Seller's currently pending contract for the sale of oil out of the Leases to North Pole Refining Company ~~and except~~ ^{nor to} ~~for~~ any renewal or renewals of the current contract of Seller with Tesoro Petroleum Company ("Tesoro") for a like quantity of oil as is now being delivered under Seller's contract with Tesoro. If Buyer purchases oil pursuant to the provisions of this Article 2.3, Buyer may reduce its purchases of royalty oil from the Leases by a like amount (and shall do so to the extent its aggregate purchases of all Seller's royalty crude oil under all provisions of this Agreement exceed 150,000 barrels per day, averaged monthly) during the period it is purchasing oil pursuant to this Article 2.3. Such reductions shall be effected in accordance with the restrictions of Article 2.5 and subject to Buyer's obligation to buy and receive such oil as it has previously nominated. Oil purchased pursuant to this Article 2.3 shall be deemed oil out of the Leases for the purposes of Article 14.1(ii) only.

2.4 Buyer Option in the Event Certain Quantities Not Delivered. Upon and after the inception of operation of the Petrochemical Facility, in the event at any time and from time to time Seller has not made available for delivery to Buyer for more than two (2) consecutive months average daily quantities (averaged monthly) of royalty crude oil from the Leases equal to or in excess of 145,000 barrels per day, upon written request by Buyer, Seller shall immediately exercise any option which it as lessor may then possess, as directed by Buyer, under any other lease or leases to receive its royalty crude oil in kind rather than in value in order that Buyer has the ability to receive from Seller 150,000 barrels of oil per day, with such prior notification to the lessors under such

other leases as may be required thereunder; provided, however, that ~~the~~
^{exercise of} such option ~~exercise~~ by Seller shall only apply to seventy percent
(70%) of the available royalty oil to be taken in kind and only as to
such quantity of royalty crude oil as may be necessary to assure Buyer
of the availability of 150,000 barrels per day in the aggregate. To
protect and insure Buyer's right to receive at least 150,000 barrels
of crude oil per day hereunder, after the date of execution hereof
and for the full term hereof, all contracts for the sale of any
royalty crude oil of Seller taken in kind (except for Seller's cur-
rently pending contract for the sale of oil out of the Leases to
North Pole Refining Company and except for any renewal or renewals
of the current contract of Seller with Tesoro for a like quantity
of oil as is now being delivered under Seller's contract with
Tesoro) shall contain a provision that Buyer shall possess a
paramount right to call for and receive such royalty oil in the
event deliveries to Seller from the Leases and available for sale
and delivery to Buyer fall below 145,000 barrels per day pursuant
to the provisions of this Article 2.4. Notwithstanding any other
provisions contained in this Article 2.4, Buyer's option hereunder
shall extend only to seventy percent (70%) of the royalty oil
production of any field, lease, or contract in which Seller has
an interest. Seller agrees that any lease agreements and agreements
for the sale of royalty crude oil taken in kind hereinafter entered
into will include the advance written ^{Consent} ~~notice~~ of the purchaser, ex-
change partner or other recipient of the crude oil to the termination
of any supplier-purchaser relationship which may be deemed to exist

with respect to the State of Alaska royalty crude oil for purposes of any mandatory crude oil allocation program under applicable law or regulations of the Department of Energy or its successors then in effect upon the call therefor by Buyer under the provisions of this Article 2.4. In order to effectuate the purposes of this paragraph Seller shall furnish Buyer such information as Buyer reasonably requests from time to time concerning leases of which the State is Lessor and possesses the right to receive its royalty in kind. At such time as the average daily quantity of crude oil available to be delivered pursuant to the provisions of Articles 2.1 and 2.3 reaches or exceeds 150,000 barrels per day for more than two (2) consecutive months after such option has been exercised by Buyer, Seller shall have the right to terminate Seller's taking of royalty crude oil in kind under the other leases as described above in this Article 2.4, upon prior written notice which is thirty (30) days more than the period necessary to provide legal notice to Seller's lessees of Seller's return to taking its royalty in value rather than in kind, but on not less than ninety (90) days' written notice to Buyer. Thereafter, Buyer shall again be entitled to exercise its rights under this Article 2.4 should the aggregate average quantity of 145,000 barrels of crude oil per day available to be delivered under Articles 2.1 and 2.3 not be attained for more than two (2) consecutive months. If for any reason Buyer's election or elections to receive oil under this Article 2.4, along with the other obligations of Buyer to receive oil under this Agreement result in Seller being required to take from its lessors or the lessees referred to in Articles 2.3 and 2.4

more than 150,000 barrels per day, Buyer will take all such oil from Seller and shall advise Seller so that Seller may give notice to its ^{or lessees} Lessees, to reduce the quantities of oil it is taking in kind pursuant to Buyer's nominations to an aggregate of 150,000 barrels per day.

2.5 Increases or Decreases of Crude Oil. Notwithstanding any other provision of this Agreement to the contrary, after the Date of First Delivery and from time to time thereafter, Buyer shall have the right upon notice to Seller to require Seller to exercise its right under the Prudhoe Bay Unit Agreement (and under any other lease the oil from which is being sold to Buyer under Articles 2.3 and 2.4 if the terms of such lease so permit) to increase or decrease, by the terms of said Unit Agreement (or lease), the quantity of royalty oil to be delivered to Seller, and the quantity of royalty oil to be delivered to and purchased by Buyer under this Agreement shall be so adjusted; provided, however, that the provisions of this Article 2.5 shall not operate or be construed to require that Seller deliver and sell to Buyer the percentage portions of Seller's royalty oil out of the Leases or out of the leases referred to in Articles 2.3 and 2.4 which Seller has expressly reserved as not to be sold and deliverable hereunder, and further provided that Seller shall not be required to deliver more than 150,000 barrels per day hereunder as an average daily delivery during any calendar month. In addition to the time for notice specified in the Prudhoe Bay Unit Agreement (or any such other lease), Buyer agrees to give Seller an additional thirty (30) days' notice of any nominations under this paragraph. In order to provide maximum administrative efficiency, nominations

under this Article 2.5 shall be made not more than once every thirty (30) days.

2.6 Delivery of TAPS Fill by Seller. Upon initiation of deliveries pursuant to Article 2.2, Seller in addition to all other quantities of crude oil deliverable hereunder shall deliver to Buyer on or prior to the Date of First Delivery a sufficient quantity of crude oil for Buyer to fulfill its tariff obligations to supply Trans-Alaska Pipeline System pipeline fill and storage tank bottom requirements. Buyer shall pay for such quantity of oil on the date of termination pursuant to the provisions of Article IX, X or XIV hereof, at the price stipulated in Article VIII as if such oil had been delivered to Buyer at the Point of Delivery forty-five (45) days prior to the said date of termination. In the event that Buyer, prior to the completion of the Petrochemical Facility, suspends its purchase of oil from the Leases after having initiated deliveries and after Seller has delivered the pipeline fill and storage tank bottom requirements as provided by this Article 2.6, Buyer shall pay for such quantity of oil as if it had been delivered at the Point of Delivery on the date Buyer suspended its purchases. Thereafter Seller shall again be obligated to provide pipeline fill and storage tank bottom requirements upon Buyer's reinitiation of deliveries of oil out of the Leases as provided by other provisions of this Article II.

ARTICLE III

POINT OF DELIVERY AND PASSAGE OF TITLE

3.1 Point of Delivery. Delivery of the oil sold from

Seller to Buyer under Article 2.1 shall be made at the Seller's or Lessees' A.C.T. meter at the inlet inception point of the Trans-Alaska Pipeline System at Pump Station Number 1, Prudhoe Bay, Alaska. Delivery of any oil sold pursuant to the provisions of Articles 2.3 and 2.4 shall be at the same point of delivery that such oil is delivered to Seller by the lessee paying such oil as royalty oil in kind to Seller. Delivery under this Article 3.1 may be made at such other point or points of delivery as may be mutually agreed between Buyer and Seller. The Point or Points of Delivery set forth in this Article 3.1 shall hereinafter be referred to as the "Point of Delivery" or "Points of Delivery."

3.2 Passage of Title. Title to the oil to be sold hereunder shall pass from Seller to Buyer upon delivery.

3.3 Buyer's Responsibility. Buyer shall be responsible for the oil to be sold hereunder after passage of title hereunder. Buyer shall indemnify and hold Seller harmless from and against any and all claims, costs, damages, expenses or causes of action as a result of any loss, injury or damage incurred by any party as a result of any transaction or event which relates to the crude oil after title thereto has passed to Buyer. Buyer shall make all necessary arrangements for transporting the oil sold hereunder from the Point of Delivery ~~to the Petrochemical Facility~~

ARTICLE IV

REPRESENTATIONS AND OBLIGATIONS OF BUYER

Buyer represents, warrants and agrees that:

4.1 Good Standing. Buyer is and at all times hereunder

will remain a corporation qualified to do business in, and in good standing with, the State of Alaska.

4.2 Construction of a Petrochemical Facility in the State of Alaska.

4.2.1 Construction Obligations. In consideration of the obligations assumed by each party herein, Buyer will proceed with reasonable diligence to design, construct, start up and thereafter initiate operation of a petrochemical manufacturing facility with fuels refining capacity in the State of Alaska. Such facility shall include facilities for the manufacture of energy fuels, aromatics, olefins and petrochemical derivatives of such basic feedstocks, and will include "offsite" facilities such as power supply, water supply, port facilities and administration buildings. Final process configuration and production rates of the various products listed above will be determined by (i) marketing considerations based on sales contracts for the products and (ii) process optimization of the overall facility design to produce the desired products in the most effective manner. Variations in process optimization will occur throughout the anticipated life of the facility. Such facilities shall be hereinafter referred to as the "Petrochemical Facility."

4.2.2 Siting of Petrochemical Facility. Buyer has chosen several preferred sites for the location of its Petrochemical Facility. Buyer shall notify the Commissioner no later than six (6) months after the Effective Date which site it has chosen (and the reasons for its choice of such site in reasonable detail), which

site shall be subject to the approval of the Commissioner within ninety (90) days after receipt of notice by Seller of Buyer's choice of site. In making his decision, the Commissioner shall consider, among other things, the desires of the people who live in the immediate surroundings of any proposed site. Failure of Buyer to receive written reply from the Commissioner within such ninety (90) day period shall be deemed an approval of the site selection; provided, however, that such approval shall in no manner diminish or alter Buyer's obligation to obtain all requisite state and federal permits, licenses and applications or to comply with other applicable laws or regulations. In the event the Commissioner disapproves a proposed site, Buyer shall resubmit with additional pertinent information its original proposed site or shall propose an alternate site to the Commissioner within ninety (90) days from the date Buyer receives notice of disapproval. Resubmissions or submissions of alternate sites shall continue in like manner until a site is approved by the Commissioner.

4.2.3 Progress Reports by Buyer. From the Effective Date and until the conditions stated in Articles 10.2(1) through 10.2(3) have been satisfied, on or before the twentieth (20th) day of each month, the Buyer shall furnish the Commissioner a written progress report as of the end of the preceding calendar month describing compliance with the requirements of ~~such Articles~~ ^{Article 10.2}, the engineering, design and construction activities of Buyer with respect to the Petrochemical Facility, programs in the marketing of the products therefrom, and the proposed financings and scheduled expenditures of the Buyer. After fulfillment of all the conditions stated

in Articles 10.2(1) through 10.2(3) and until all the conditions stated in Articles 10.2(4) through 10.2(9) have been satisfied, Buyer shall furnish like progress reports (also to be on the twentieth (20th) day of the month) each calendar quarter as of the end of the calendar month immediately preceding the month in which the report is made, beginning on the twentieth (20th) day of the third month next following the month during which the conditions under Articles 10.2(1) through 10.2(3) were fulfilled. Such reports, or portions thereof, shall be held confidential as requested by Buyer to the extent permitted by law.

4.3 Production of Energy Fuels for Intrastate Use. In order to provide fuels for distribution within the State of Alaska, Buyer shall design and construct the Petrochemical Facility to include a capacity to process 30,000 barrels of crude oil per day into energy fuels. If Buyer does not utilize the royalty oil sold and delivered hereunder, or traded or exchanged oil, in the Petrochemical Facility, then it shall utilize its best efforts to assure that at least 30,000 barrels per day of said royalty oil will be processed instate for production into energy fuels for intrastate distribution and sale, unless such processing would be surplus to the then prevailing intrastate domestic and industrial needs.

4.4 Establishment of Charitable Foundation. Buyer covenants and agrees to establish the Alaska Endowment Trust, the purpose of such trust being to further the social, educational, cultural and environmental conditions in the State of Alaska. The

Alaska Endowment Trust shall be established under the terms of a trust instrument proposed by Buyer and approved by the Governor of Alaska and Alaska Legislature; the trust corpus shall be administered by a Board of Trustees unaffiliated with Buyer. Trustees shall be appointed by the Governor of Alaska and confirmed by the Alaska Legislature. The corpus of the Alaska Endowment Trust shall be created from contributions by Buyer of amounts equal to five percent (5%) of the net after-tax profits, as hereinafter defined, realized from the operation of the Petrochemical Facility and sale of fuels and petrochemical products produced from the Petrochemical Facility. Each such annual contribution shall be paid on or before July 1 of each year based upon the net after-tax profits of the immediately preceding calendar year, the first such year of measurement to commence on January 1 next following ten (10) years after the Petrochemical Facility is completed, as measured by the delivery of the certificate of completion and operability by the prime contractor of Buyer in charge of construction of the Petrochemical Facility or sixteen (16) years after the Effective Date, whichever is earlier. "Net after-tax profits" shall mean the net income of Buyer prior to deduction or accrual of amounts payable under this Article 4.4 and shall be determined in accordance with generally accepted accounting principles applied on a consistent basis after deduction for all taxes which would have been provided for in the financial statements of Buyer for the year but for the payment of the amounts payable under this Article 4.4. Since the parties

have assumed that payments under this Article 4.4 will be deductible as an expense for purposes of any tax imposed on the income of Buyer, in the event any taxing authority does not permit such deduction, the amount payable hereunder shall be adjusted to reflect such non-deductibility. Charges made by or to any Affiliate shall be reasonable and shall not exceed those charges which would have been made in arm's length bargaining with an unaffiliated party in light of all the circumstances of the transaction, including the length of term of any contracts, financing terms and any other direct and indirect benefits offered or received. All sales between Buyer and any Affiliate shall be at a fair market price or value for such goods or services in light of all the circumstances, including the length of term of any contractual relationship, financing terms and any other direct or indirect benefits offered or received.

ARTICLE V

REPRESENTATIONS AND OBLIGATIONS OF SELLER

Seller represents, warrants and agrees that:

5.1 Seller's Royalty Oil. Pursuant to the Leases and the leases presently in effect and referred to in Article 2.4, Seller has the right to take its royalty in kind (amount), which royalty oil it represents is at least twelve and one-half percent (12-1/2%) of any crude oil production removed or sold from the Leases, unless otherwise described in Exhibit "A".

5.2 Title. Seller hereby warrants good and marketable title to the oil sold by it hereunder and its right to sell the same,

and warrants that all such oil is owned by Seller free from all liens, encumbrances and adverse claims.

5.3 Storage of Oil. Under Paragraph 13 of the Lease Contracts, Seller may be entitled, under certain conditions, to storage of Seller's royalty oil from Lessees free of charge. Seller hereby licenses to Buyer its storage rights, if any, under the Lease (and under any other leases the oil from which is being sold to Buyer pursuant to Articles 2.3 and 2.4) effective upon the Date of First Delivery, to the fullest degree permissible under the Lease Contracts and to an extent proportionate to the proportion of Seller's royalty oil being delivered hereunder. Seller further agrees that it will aid and work with Buyer to resolve any uncertainties or ambiguities concerning Seller's right to storage under the Lease Contracts, including the institution and pursuit of litigation at Buyer's cost to clarify Seller's legal rights of storage under said Paragraph 13. Buyer and Seller agree that their mutual objective shall be to maximize the Seller's and Buyer's rights to receive storage of the oil from the Lessees. Notwithstanding anything stated herein, Seller does not warrant that it possesses any right or rights to storage under the Lease contracts or any other leases. Buyer agrees that any failure to obtain storage hereunder from the Lessees shall not relieve Buyer of its obligations under Article 10.2. Buyer will indemnify Seller and hold it harmless against all claims, costs, loss or liabilities arising from Buyer's use of said storage facilities or rights.

5.4 Covenant to Aid in Obtaining Governmental Permits.

In order to construct the Petrochemical Facility, Buyer must obtain numerous permits, licenses and authorizations from state, federal and other governmental authorities. Seller agrees to utilize its best efforts to support, lend aid and facilitate the grant or approval of Buyer's applications for such permits, licenses and authorizations; provided, however, that the obligations stated herein shall not require Seller to support, lend aid or facilitate the grant or approval of any permits, licenses and authorizations which do not comply with applicable rules, regulations or laws, and provided further that Seller's obligations herein shall not require Seller to waive, rescind, modify or otherwise alter (either in substance or procedure) any of Seller's regulatory responsibilities. Seller, acting through the Commissioner, within thirty (30) days after the Effective Date shall appoint a state official who shall act as Seller's coordinator for the purpose of facilitating the granting of permits by Seller and to act as a liaison officer for Buyer and Seller with the federal government. Such designation may be changed from time to time by the Commissioner.

5.5 Delivery of Information to Buyer. Seller shall deliver to Buyer without cost to Seller (unless any costs to Seller be indemnified by Buyer) within thirty (30) days after the Effective Date:

(1) the most recent report it possesses or can obtain from third parties concerning the volume of hydrocarbons originally in place and the portions of fractions thereof which will be recovered from the Prudhoe Bay unit reserves, accompanied by any related studies or data pertaining to such reports;

(ii) the most recent anticipated production schedules of oil, solution gas, gas cap gas and condensate in its possession or obtainable from third parties out of the Prudhoe Bay unit by year; and

(iii) the most recent information, projections or estimates in its possession or obtainable from third parties of anticipated crude oil discovery and production in Alaska during the term of this Agreement.

During the term of this Agreement, as reasonably requested by Buyer in writing, Seller shall furnish updated information pertaining to Subparagraphs (i) through (iii) of this Article 5.5. Certain information and documents, including but not limited to well logs and related production data pertaining to the Leases and other leases referred to in Articles 2.3 and 2.4 may be required by law or regulation to be held confidential by Seller, its representatives and agents, and such documents shall not be required to be delivered hereunder. Seller understands and acknowledges the importance of reports taken from such data in securing financing for the Petrochemical Facility, and Seller agrees to use its best efforts to obtain and furnish to Buyer all such relevant data and reports as requested by Buyer. Seller agrees to retain, at Buyer's cost, independent consultants acceptable to Buyer to review confidential data, to prepare such updated reports and to state such opinions as may be reasonably requested by and furnished to Buyer to the extent permitted by applicable law and regulation. Seller's obligations under this section are for the purpose of aiding Buyer in obtaining up-to-date information, some or all of which may have been furnished to Seller by third parties; accordingly, Seller does not, by provid-

ing Buyer with the information specified in Subparagraphs (i) through (iii), warrant or represent the accuracy of such information, nor does Seller obligate itself to attempt in any way to bring about the conditions or projections contained in the information provided.

ARTICLE VI

QUALITY

6.1 Standard. The oil to be delivered by Seller to Buyer at the Point of Delivery hereunder shall be the same quality as the oil delivered by the working interest owners from the Leases and the leases. Except for the foregoing, Seller does not warrant, represent or guarantee, either expressly or impliedly the quality, merchantability, fitness for use, or suitability for any particular use or purposes, or otherwise of any oil to be delivered to Buyer under this Agreement. There are no warranties, representations or agreements concerning the quality of the oil which extend beyond the description of the oil in this Article VI.

ARTICLE VII

MEASUREMENTS AND TESTS

7.1 Testing Standards and Procedures. The quantity and quality of the crude oil sold and purchased from the Leases shall be determined at Lessees' A.C.T. meters at Pump Station No. 1, ^{only} Prudhoe Bay, Alaska. The quantity and quality of the crude oil sold and purchased from the other leases shall be determined at the Lessee's point of delivery. All measurements hereunder shall represent one hundred percent (100%) volume, consisting of United States barrels of forty-two (42) gallons, the quantity and gravity of which shall be adjusted to a temperature of sixty degrees (60°) Fahrenheit. Full deduction

shall be made for all basic sediment and water content according to the ASTM Standard Method then in effect. Unless agreed otherwise between Buyer and Seller or set forth herein, procedures for measuring and testing and for metering the crude oil shall be completed in accordance with standard oil field practices. Procedures for metering^{ing} deliveries under the Leases shall be in accordance with accepted oil field practices in effect at Prudhoe Bay, Alaska. At the direction of Buyer, Seller shall direct the Lessee^es or lessees to test the accuracy of their measuring equipment if and to the extent that the provisions of the Prudhoe Bay Unit Agreement or any other agreement between Seller and Lessees or lessees permit Seller to make such request. Notice of the time and nature of each test of Lessees' or lessees' measuring equipment shall be given by Seller to Buyer sufficiently in advance to permit convenient arrangement for Buyer's representative to be present. Tests and adjustments shall be made in the presence of representatives of Buyer if present at the time scheduled for such test and adjustment. At Buyer's election and subject to obtaining the permission of any necessary third parties, Buyer may also install equipment to measure or gauge all oil received by Buyer hereunder at the Point of Delivery, and Buyer shall bear the entire acquisition, calibration, maintenance and operating cost of any such loading, measuring or testing equipment required by Buyer.

7.2 Delivery of Crude Oil Samples by Seller. Upon reasonable request by Buyer, Seller at its cost shall utilize its best efforts to aid Buyer in obtaining a representative sample of one barrel of crude oil taken at Valdez, Alaska, in order for Buyer

to perform an assay to analyze the composition, gravity, sulphur content and other characteristics of such crude oil sample. If any sample of the oil is delivered to Buyer, there is no representation or warranty by Seller that any other oil delivered hereunder will conform to the sample, it being understood that Seller will deliver only such oil as shall be delivered to it by the Lessees or lesses under the Leases or leases. Seller shall provide Buyer copies of all other assays obtained or received by it during the term thereof.

ARTICLE VIII

PRICE

8.1 Price.

8.1.1 Price of Oil Delivered Out of the Leases. As to oil sold and delivered hereunder out of the Leases, the price to be paid by Buyer to Seller shall be equal to the sum the Seller would have received from the Lessees had Seller received its royalty in value instead of taking the quantity of royalty oil delivered hereunder as its royalty in kind (amount). Seller and Buyer recognize that the method and basis of computing the royalty due Seller from Lessees under the Leases is currently a matter of dispute and litigation among the Seller and its Lessees, said litigation being entitled State of Alaska, et. al. vs. Aerada Gas Corp. et al., (No. CA 77-647, Superior Court of the State of Alaska, First Judicial District at Juneau). Pending resolution of said dispute among Seller and Lessees, by judicial decision or settlement in the above-

referenced case, the in value royalty under the Leases, and therefore the price hereunder, shall be computed in accordance with Exhibit "B", attached hereto and by reference made a part hereof. After such time as said dispute shall be resolved among Seller and its Lessees, the parties hereto will be bound by the terms of such resolution, judicial or otherwise. Seller and Buyer expressly recognize that adjustment in prices previously paid may be necessary following said resolution and said adjustment shall be duly made, with interest, pursuant to the applicable provisions of Article IX. Any settlement agreement which agrees to the imposition of costs which are reimbursable by Buyer to Seller under Article 8.2, however, shall not be final and binding upon Buyer, unless Buyer has consented in advance to such settlement.

8.1.2 Price of Oil Sold Under Article 2.3. Oil sold pursuant to the provisions of Article 2.3 shall be the same lower price on the same terms and conditions as Seller is proposing to offer such oil.

8.1.3 Price of Oil Sold Under Article 2.4. The price of the oil sold pursuant to the provisions of Article 2.4 shall be the greater of (i) the best and highest price offered by a bona fide offeror for a like quality and quantity of the crude oil to be produced from such lease out of which oil is being delivered; or (ii) a price equal to the sum Seller would have received from its lessee or lessees had Seller received its royalty in value instead of taking the quantity of royalty oil delivered hereunder as its royalty in kind (amount).

8.2 Reimbursement of Certain Costs of Seller. In addition to the price stated in Article 8.1, Buyer shall also reimburse Seller for Seller's pro rata share of (i) any basic sediment and water removal costs if Seller is required to pay such costs as a result of Seller's election to take its royalty oil in kind; and (ii) any other direct costs reasonably incurred and paid by Seller which would not have been incurred by Seller had the Seller taken its royalty in value rather than in kind and if such costs under Article 8.2(i) and (ii) were not previously reflected in applicable computations of value for payments of royalty in value. Seller shall use its best efforts to minimize any such costs incurred by Seller by reason of Seller's taking royalty oil in kind; such best efforts shall include but not be limited to litigation in cooperation with Buyer, ^{and at the request of} at Buyer's cost, to the extent necessary to contest the imposition of unwarranted or improper charges; provided, however, that Seller shall in no event be required to advocate legal positions or adopt legal strategies which it, in its discretion, deems contrary to its own interests, in any such litigation. Seller at this date does not know of any potential costs to be incurred by it as a result of its taking in kind rather than in value other than the costs stipulated in Article 8.2(i) above.

8.3 Minimum Taking in Value by Seller. In order to facilitate the establishment of prices under Article 8.1 Seller agrees at all times during the term of this Agreement to take and receive in value rather than in kind the minimum number of barrels per day required to obtain a report of the in-value price from each lessee.

8.4 Federal Price Regulation. In the event a maximum price is established by the federal government during the term of this Agreement which applies to the royalty oil and which is lower than the prices established under this Article VIII above, then Buyer shall pay the Seller that maximum price for royalty oil delivered to Buyer, but only during such period such maximum price is in effect.

ARTICLE IX

PAYMENTS AND ACCOUNTING

9.1 Billing. Seller shall furnish Buyer monthly, on or before the tenth (10th) business day of each month after the first full month of delivery of crude oil, a statement of account of all crude oil delivered through and measured at the Point of Delivery during the immediately preceding month according to the best information available to Seller, the price or prices applicable thereto according to the best information available to Seller, the basis for computation of the applicable price or prices in full detail and the total net amount due. Seller shall render its billings to Buyer based upon the values, receipts, costs and computations reported ~~by the lessors~~ ^{by the lessors and the lessees referred to in Articles 2.3 and 2.4.} to Seller. Seller shall thereafter adjust its initial billings pursuant to Article 9.5. Buyer and its authorized agents shall be permitted access during reasonable business hours to Seller's books and records pertinent to this Agreement to determine the correctness of the billings of Seller to the extent not contrary to law.

9.2 Payment. Buyer shall make payment on or before the twenty-fifth day of the calendar month in which such statement is rendered or fifteen (15) days after rendition of the invoice called for in Article 9.1, whichever is later, by direct wire transfer of federal reserve funds through the Federal Reserve Bank wire transfer system to the following address or such other address as Seller may designate upon seven (7) days' prior written notice:

Bank of America, NT & SA
San Francisco, California
Securities Department 3255
Credit to: State of Alaska
Investment Account

All other payments to be made under this Agreement shall be paid in the same manner. If payment is to be made on a Saturday, Sunday or legal holiday under the preceding provisions hereof, payment shall be made on the next following business day.

9.3 Billing Disputes. Should any portion of the account furnished to Buyer by Seller be disputed in good faith, Buyer and Seller agree to mutually arrive at a fair and equitable resolution of such dispute, if possible, and Buyer agrees to pay the amount so determined to be due to Seller within fifteen (15) days after such resolution. Buyer shall pay for such amounts as it does not in good faith dispute in accordance with the provisions of this Article IX.

9.4 Late Payment Charge. If Buyer fails to make timely payment to Seller of any amount due under this Agreement, including

any payment delayed by a bona fide dispute which is later determined to be validly owing, or if Buyer is required to pay and does pay any amount which is later determined not to be validly payable to Seller, interest shall accrue and be payable on said sum from the date when such payment was due or was paid, as the case may be, until the same is paid or repaid, at the lower of (i) a rate per annum equal to the prime rate then being charged by Chemical Bank of New York, New York, plus one and one-quarter percent (1-1/4%) per annum, or (ii) the maximum lawful rate of interest per annum which may be charged to Buyer under the laws of the State of Alaska.

9.5 Adjustments to Billings. Each month Seller shall adjust its statement of accounts to reflect the actual amounts delivered and the price or prices applicable thereto. Seller shall from time to time adjust its prior billings to reflect adjustments necessitated as a result of (i) a final judgment or settlement entered in certain pending litigation between Seller and the Lessees styled State of Alaska, et al. vs. Amerada Hess Corporation, et al., No. CA 77-847, in the Superior Court of the State of Alaska, First Judicial District at Juneau; (ii) adjustments necessitated as a result of the filing with the Seller by the Lessees^(or lessees) of more current reports applicable to the billing period in question; (iii) actual adjustments necessitated as a result of changes to values, receipts, costs and computations previously reported by the Lessees^(or lessees) and utilized by Seller as a basis for billing under Article 9.1, if such adjustments are based upon actual later severance tax or royalty

oil payments by or refunds to the Lessees; or (iv) adjustments re-
quired as a result of clerical or arithmetical errors in the bill-
ings of Lessees^(or lessees) or of Seller; provided, however, that no adjustments,
whether credits or debits, under Articles 9.5(ii) through 9.5(iv)
shall be made by Seller or demanded by Buyer more than twelve (12)
months after billing except as to matters which are the subject of
(x) pending litigation by either party, (y) pending regulatory pro-
ceedings (or appeals thereof) whether or not Seller or Buyer is a
party thereto, or (z) bona fide audits by Seller which audits have
been terminated or completed by Seller within twelve (12) months
after initiation of same.

Due to the potentially large sums of money involved, any
adjustments to any billing under the provisions of this Article 9.5
by Seller made more than sixty (60) days after such billing was
initially rendered shall be paid to or refunded by Buyer or Seller
over the same period over which such adjustments accrued or thirty-
six (36) months, whichever is longer, beginning with the first pay-
ment next following the date such adjustment has been determined;
provided, however, no such payment extension permitted hereunder
shall extend beyond the term stipulated in Article 10.1, and accord-
ingly the full balance of any unpaid adjustments shall become due
and payable on the termination date hereof.

9.6 Cancellation in Event of Non-Payment. Except for
amounts disputed in good faith, should Buyer fail to make any pay-
ment due to Seller under this Agreement (i) within sixty (60) days

from the date said payment is due or (ii) within thirty (30) days from the date that Seller gives written notice of non-payment to Buyer in the manner provided in Article 16.1 hereinafter (except that said notice shall be directed to the attention of the President of Buyer), whichever occurs earlier, this Agreement shall automatically be cancelled.

ARTICLE X

TERM

10.1 Term. Subject to the further provisions of Articles 10.2 and 10.3 this Agreement shall become effective on the Effective Date and except as extended by Article XV hereof shall continue and remain in force and effect for a period of twenty-seven (27) years from the Effective Date.

10.2 Termination by Seller. This Agreement shall terminate upon failure of Buyer to take each and every one of the following actions within the time specified for each, including any time extensions provided for in this Article 10.2:

(1) Within six (6) months after the Effective Date:

(a) Actually expend at least Two Million Dollars (\$2,000,000.00) in Total Project Costs.

(b) Negotiate with interim lenders and obtain commitment to provide funds deemed necessary by Buyer for organizational costs and initial design costs of the Petrochemical Facility.

(c) Commence planning for optimization of design of the Petrochemical Facility.

(d) Notify Seller of Buyer's final selection of site location, such notification to be accompanied or preceded by site studies and recommendations based on preliminary engineering, including compression tests and cost estimates of infrastructure, offsite and marine facilities.

The Commissioner may extend the above six (6) month period as to Articles 10.2(1)(b), (c) and (d) thirty (30) days, but only in the event Buyer has, prior to such extension, fulfilled the requirements of Article 10.2(1)(a).

(2) Within twelve (12) months after the Effective Date:

(a) Actually expend at least Three Million Dollars (\$3,000,000.00) in Total Project Costs.

(3) Within eighteen (18) months after the Effective Date:

(a) Expend or commit to expend or cause contractually bound third parties to expend or commit to expend at least Ten Million Dollars (\$10,000,000.00) in Total Project Costs.

(b) Negotiate sale terms with prospective purchasers of products from the Petrochemical Facility; delineate product requirements, production ratios and quantities for the range of products to be produced from the Petrochemical Facility; and draft contracts for the sale of products from the Petrochemical Facility.

(c) Enter into contracts for the sale of at least seventy percent (70%) of the product output from the Petrochemical Facility.

(d) Obtain or cause contractually bound third parties to obtain written commitments to lend or invest at least One Billion Five Hundred Million (\$1,500,000,000.00) in the aggregate for payment of Total Project Costs.

(e) Obtain a commitment or commitments for interim financing for the construction of the Petrochemical Facility.

(f) Complete and file an Environmental Impact Assessment on the Petrochemical Facility.

(g) Complete and file all material state, local and federal permit applications.

(h) Complete plant design and optimization necessary to obtain a definitive project cost estimate ("definitive" meaning a cost estimate containing no more than fifteen percent (15%) variance in anticipated costs).

The Commissioner may extend the above eighteen (18) month period as to any one or more of the criteria or events stated in Articles 10.2(3)(a) through (h) six (6) months.

(4) Within twenty-four (24) months after the Effective

Date:

(a) Expend or commit to expend or cause contractually bound third parties to expend or commit to expend at least One Hundred Million Dollars (\$100,000,000.00) in Total Project Costs.

The Commissioner may extend the above twenty-four (24) month period as to the attainment of the criteria stated in Article 10.7(4)(a) six (6) months.

(5) Within thirty (30) months after the Effective Date:

(a) Execute definitive documents relating to the long-term loan of funds for the Petrochemical Facility.

(b) Commence construction of the Petrochemical Facility.

The Commissioner may extend the above thirty (30) month period as to one or more of the events or criteria stated in Articles 10.2(5)(a) and (b) above six (6) months.

(6) Within thirty-six (36) months after the Effective Date:

(a) Expend or commit to expend or cause contractually bound third parties to expend or commit to expend at least Six Hundred Million Dollars (\$600,000,000.00) in Total Project Costs.

The Commissioner may extend the above thirty-six (36) month period as to the attainment of the criteria stated in Article 10.2(6)(a) six (6) months.

(7) Within forty-eight (48) months after the Effective

Date:

(a) Expend or commit to expend or cause contractually bound third parties to expend or commit to expend at least One Billion Dollars (\$1,000,000,000.00) in Total Project Costs.

The Commissioner may extend the above forty-eight (48) month period as to the attainment of the criteria stated in Article 10.2(7)(a) six (6) months.

(8) Within sixty (60) months after the Effective Date:

(a) Expend or commit to expend or cause contractually bound third parties to expend or commit to expend at least One Billion Two Hundred Million Dollars (\$1,200,000,000.00) in Total Project Costs.

The Commissioner may extend the above sixty (60) month period as to the attainment of the criteria stated in Article 10.2(8)(a) nine (9) months.

(9) Within seventy-two (72) months after the Effective

Date:

(a) Expend or commit to expend or cause contractually bound third parties to expend or commit to expend at least One Billion Five Hundred Million Dollars (\$1,500,000,000.00) in Total Project Costs.

The Commissioner may extend the above seventy-two (72) month period as to the attainment of the criteria stated in Article 10.2(9)(a) twelve (12) months.

(10) In addition to the periods of time which the Commissioner may extend the periods for performance of the criteria stated in this Article 10.2, the Commissioner may further extend the time for performance of any of the criteria stated in Article 10.2(1) through 10.2(9) for that period of time necessary to permit the Commissioner and the Alaska State Legislature to consider an amendment or modification of this Agreement, particularly of the provisions contained in Article 10.2. Such time extension shall not, however, extend beyond a period of time in excess of ninety (90) consecutive days during which the Alaska State Legislature is in session, nor shall such time extension include a consecutive period of less than ninety (90) days during which the Alaska State Legislature is in session without the prior written consent of Buyer.

10.3 Termination by Buyer. In the event that Buyer after expending all reasonable efforts fails to obtain the necessary binding commitments from interim and permanent lenders for all the funds necessary to permit construction of the Petrochemical Facility under a loan or loans providing for repayment of such loans during the life of this Agreement or fails to obtain site approval from the Commissioner after submitting at least two sites to the Commissioner pursuant to Article 4.2.2, Buyer may thereupon elect to cease design and construction of the Petrochemical Facility and terminate this Agreement without liability to either party by giving Seller notice of termination; on the thirtieth (30th) day after the giving of such notice this Agreement shall terminate, and Buyer shall deliver to Seller all documents and data pertinent to the Petrochemical Facility (or