

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2477 SCOMM 104: HOUSE SPEC. COMM. OIL & GAS, 1997-98

In fact, the differences between Oil Rim and Gas Cap holdings of each owner are quite significant, and therefore potentially divisive. BP holds roughly 51% of the Oil Rim, but only 14% of the Gas Cap. Arco and Exxon each hold roughly 22% of the Oil rim, but 43% of the Gas Cap. The smaller owners hold roughly 5% of the Oil Rim and 1% of the Gas Cap.⁵ These disparities are large enough to create substantial economic conflicts among the owners regarding how the two assets should be jointly managed.

(3) Conflict Resolution. The ultimate impact of conflicts that stem from the dual participating-area structure depends on the owners' ability to bargain, compromise, and set aside individual interests for the good of the entire unit. If conflicts can be quickly resolved in accordance with the greatest good, at reasonably low cost, and without delaying field development activities, then the conflicts that occasionally arise between Oil Rim and Gas Cap owners would be of little concern to the Commission. However, past experience shows that the process of resolving disputes among these owners is expensive, time-consuming, and disruptive to the planning and execution of field development activities. I will elaborate later on the potential for unresolved Gas Cap-Oil Rim conflicts to impair efficient operation and development of the Prudhoe Oil Pool.

It may be helpful to review the parties' own concerns about the extent to which the dual participating-area structure would engender conflict and impede development. There is no doubt that this was initially a concern to Arco and Exxon. [REDACTED]

[REDACTED].⁶ I believe that the Arco and

⁵ The percentages may not add up to 100% due to rounding.

⁶ [REDACTED]

Exxon traders still acknowledge having been concerned back then about the potential for Oil Rim-Gas Cap conflicts--even before any such disputes had arisen.⁷ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Despite repeated efforts to consolidate the Oil Rim and Gas Cap interests, however, the parties failed in their negotiations to form a single participating-area. In lieu of that, and to avoid subsequent conflicts between Oil Rim and Gas Cap interests, the traders carefully crafted provisions of the Prudhoe Bay Unit Operating Agreement (PBUOA) in a manner that was intended to achieve a balance of interests and to commit all parties to what appeared to be an effective plan of development. Close attention was paid to the matter of how costs and production would be allocated between the two participating areas and the responsibilities of each participating area in meeting Unit plans and objectives. There were also special provisions included in the agreement to maintain balance between the interests of the two participating areas as the field proceeded through different stages of development, and provisions to restore balance if development scenarios deviated from expectations.

This approach appears to have worked reasonably well for several years during the first phase of field development. However, by the mid-1980s the system of trades designed to balance

⁷ See, for example, [REDACTED] and Mr. Harrison's AOGCC testimony at page 951.

[REDACTED]

[REDACTED]

the competing interests and produce consensus on major development issues appears to have broken down. Serious disputes arose between Oil Rim and Gas Cap interests and these conflicts threatened to impair Unit operations.¹⁰ Only through a series of protracted legal proceedings and private negotiations, leading in some cases to revisions of the PBUOA, were the owners able to resolve these disputes and move on to implement planned development activities.¹¹

The [redacted] distinction between "company economics" versus "unit economics" that ran through these disputes confirms the extent to which the dual participating-area structure has failed to fulfill the basic purpose of unitized development.¹² Within a properly functioning unit, the distinction between company-based and unit-based economics would be transparent and innocuous. By looking at the unit, each owner would see an image of himself. The same tradeoffs, opportunities, and costs facing one would be shared by all. This is not how things appear to work within the Prudhoe Oil Pool.

Although the original PBUOA may have achieved a certain *balance* among interests of the competing owners (at least as those interests were perceived at the time), it did not *align* their interests. This is a key distinction that has not been emphasized much in the testimony of previous witnesses before this Commission. Any balance that is effected through a series of fixed trades among owners is precarious since the value of the constituent trades will very likely change with the passage of time as prices, costs, and reservoir performance evolve. Once certain trades grow less favorable, the owners who are adversely affected will experience individual incentives

¹⁰ The basic disputes centered on the allocation of costs and produced substances between the Oil Rim and Gas Cap participating areas [redacted]

¹¹ The resolution of disputed issues has taken place in a piecemeal fashion, with a series of individual agreements being reached (or imposed) on separate issues as they have arisen. Consider, for example, the San Diego FGSO arbitration, the GHX Agreement, the Issues Resolution Agreement, and Conservation Order No. 360.

¹² See, for example, [redacted] and the AOGCC testimony of Mr. Meggs at page 785.

to reinterpret or renegotiate the burdensome contract provisions, perhaps even to the extent of withholding performance.

Unitization is intended to mitigate such problems not by balancing the interests of all owners at a certain point in time, but by aligning their interests permanently. By effectively consolidating all interests into one asset which is jointly owned, (i.e., one participating area), the interests of all owners tend to remain aligned in support of a common plan--that which maximizes the value of the unit--even as market conditions, investment timing, and field development opportunities evolve.

To summarize my thoughts on this issue, the existing contractual arrangements that treat the Oil Rim and Gas Cap as separate assets are likely to engender conflicts that are difficult to resolve and which have the potential to impair development and operation of the field. This situation is not consistent with the purposes of unitized operations.

(4) *How significant would be the costs, uncertainty, "malincentives," and other problems that working interest owners claim would result from compulsory unitization proceedings?*

I believe that the costs of a compulsory unitization procedure would be significant. I am in general agreement with other witnesses who have described the inherent difficulty of combining the two participating areas into a single equity structure. We know that the owners have already attempted to achieve a single equity structure on several occasions, and failed at each juncture. I believe that the owners' efforts in this direction have been in earnest, and that their repeated failure reflects, at least partially, the difficulty of their task.

I do not necessarily agree, however, that the Commission should conclude from these prior failures that the task of compulsory unitization must be viewed as prohibitively difficult. Nor do I agree that the process of compulsory unitization would be chaotic or unfair. The

principal difficulty that the Commission would face in a compulsory unitization proceeding would be to arrive at appropriate estimates of the net economic values of the Gas Cap and Oil Rim assets. There are three major uncertainties associated with that estimation: (1) future netback values of the oil and gas resources at wellhead; (2) timing of a major gas sale; and (3) expected volumes of oil and gas to be sold from the field. Compulsory unitization would require probabilistic judgments to be made, either explicitly or implicitly, regarding each of these factors, and for the associated development scenarios to be weighted accordingly in arriving at the expected net economic value of future sales from each participating area.

Although difficult, these uncertainties are not unlike what the owners must deal with anyway. Evaluation of alternative development plans requires certain assumptions or judgments to be made regarding these three factors whether equities are organized into one or two participating areas. In other words, I do not believe that the owners or the Commission would have to start from scratch in pondering these factors. Further, part of the cost and effort that would be required of the owners and of the Commission in preparing for a compulsory unitization proceeding would probably be incurred anyway somewhere along the line in the normal course of reservoir study, development planning, performance review, and regulatory oversight that is required for diligent and proper management of the Prudhoe Oil Pool.

The most notable cost of a compulsory unitization proceeding, and one that would constitute a large burden borne by the owners, is the cost of uncertainty--each owner having to accept an outcome that would have an unpredictable impact on the value of their holdings. The risk of an adverse outcome is a true economic cost that the owners cannot afford to ignore. I believe that the owners' reluctance to put their whole equity at risk in any single proceeding has played a dominant role in the failure of the previous voluntary efforts to achieve a single

participating area. Rather than putting the whole pie up for grabs at once, the owners prefer to continue working within a framework that deals with a series of somewhat smaller and more compartmentalized issues. That approach requires negotiations over each slice of the pie as it is placed on the table, and it may seem less risky for the owners than compulsory unitization. Any one who feels shortchanged at one stage can hope to make it up at the next. And by continuing with voluntary efforts to resolve their conflicts, the owners are able to retain control of the process, including veto power over any outcomes that they strongly oppose. This further reduces the risk they face.

Although the fear of losing equity to others would be a burden placed on each owner in the process of compulsory unitization, the Commission would not directly bear any part of that burden or share in the cost of uncertainty. That does not necessarily mean, however, that the Commission should ignore the burden of risk in deciding how to proceed. I believe that a key issue in deciding whether to move to compulsory unitization is the question of how much weight (if any) to place on the owners' discomfort with the risk that such a proceeding would entail. If the Commission's responsibility encompasses a role in assisting owners to minimize costs (including the cost of bearing commercial risk), then more emphasis should be placed on this aspect. If the Commission's responsibility is limited to protecting the State of Alaska's interest in the field as a whole, then more weight should be placed on the question of whether compulsory unitization would increase the size of the pie and reduce economic waste--letting the chips fall where they may.

Several witnesses have described the process of compulsory unitization as almost certainly being chaotic, inherently unfair, and virtually impossible to complete. I disagree. The process of compulsory unitization of the Prudhoe Oil Pool would benefit significantly from the fact that the

resource has already been fairly divided into two assets. The remaining task that would be the subject of compulsory unitization proceedings would be to consolidate these two participating areas, not to revisit or revise the basis on which initial equity allocations were determined.

The only deliberations that should play any role in the proceedings would be focused on the single question of what is the economic value of the Gas Cap asset *relative* to that of the Oil Rim asset. That ratio is a single number, one parameter. I call that parameter the "e-factor" for "equity." I have already commented on the difficulty in arriving at that number, and I am not discounting those remarks here. What I am saying is that the proceedings could be narrowly focused and specifically organized around this one question: what is an appropriate value for the e-factor?

Other witnesses have emphasized the extent to which the owners have relied on trades that were made when the Unit was formed, as reflected in provisions of the PBUOA. They also suggest that it would be unfair (and perhaps violate the owners' correlative rights) to abandon or circumvent those provisions now. I agree. But I do not see that issue as being one of the dangers of a compulsory unitization proceeding. In arriving at an appropriate value for the e-factor, I would imagine that the provisions of the PBUOA would be taken into account exactly as the owners have agreed to them. Each owner of the Gas Cap holds a determinate share of that asset and certain responsibilities as a Gas Cap owner for financing shared unit operations. Likewise for the Oil Rim. In determining the net economic value of the Gas Cap asset under any particular development scenario, the net present value of Gas Cap revenues less costs would be estimated, in accordance with all relevant provisions of the PBUOA. As I understand that agreement, it translates the various trades between Gas Cap and Oil Rim owners into specific formulae and rules for allocating produced substances and costs. I do not see anything unfair or in violation of

the owners correlative rights in applying those rules to estimate the net value of the Gas Cap asset or the Oil Rim asset.

Once an appropriate value for the e-factor has been determined, the process of compulsory unitization would be straightforward. Each owner's share in the consolidated participating area would consist of the weighted average of that owner's existing equity shares in the Gas Cap and Oil Rim, respectively. The e-factor would be the appropriate weighting factor for this calculation and it would be applied uniformly to all owners.

Since calculation of the e-factor would incorporate and conform with all agreements that have been mutually agreed by the owners, it would then embody the various trades upon which the existing agreement rests and it would circumvent none of the deals upon which the various owners have been relying. For that reason, I do not see the process of consolidating the two participating areas into a single equity as being unfair to the interests of any owner, or in violation of correlative rights

(5) *Are there significant development or operational decisions still to occur in the future that could be adversely affected by features of the existing contractual and property arrangements for the Prudhoe Oil Pool?*

There are several major issues remaining where the Gas Cap and Oil Rim interests might conflict. I would start by recalling Mr. John Morgan's testimony to the effect that 50% of the production from the Prudhoe Oil Pool that BP deems possible by the year 2005 depends on investments that have yet to be made.¹³ The owners' mutual agreement to fund those investments

¹³ See the AOGCC testimony of Mr. Morgan at page 797.

will therefore play a significant role in the remaining life of the field, as it is currently expected to play out.

Additionally, we should consider the ability of the owners to respond to various unexpected developments that might affect future operations. What would be the impact on production incentives and development planning at Prudhoe Bay if world oil prices were to double within the next few years. For example, suppose that civil unrest within Saudi Arabia and elsewhere in the Mideast permanently slows oil production from those areas. What types of enhanced oil recovery at Prudhoe Bay would make sense under that higher-price scenario, and what portions of the field would be involved in heightened efforts to enhance oil recovery? What types of risk would be associated with relatively high-cost enhanced oil recovery facilities? And is it possible that some of those risks might fall disproportionately on owners of the Gas Cap while the rewards would be concentrated on owners of the Oil Rim?

Rising oil prices usually carry gas prices in the same direction. Therefore, we might pursue further the scenario of high oil prices sketched above. Suppose that due to the rising price trend, the Prudhoe Bay gas reserve becomes "commercial" at roughly the same time that oil prices are rapidly appreciating. By "commercial" I mean that the gas could be transported to market leaving a positive, but small, netback value at the wellhead. Should the gas then be sold, or should it be used for enhanced oil recovery? Would all of the owners agree on this type of issue? According to all previous testimony presented to this Commission, the decision to proceed with a major gas sale is a "no-brainer" on which all sides would obviously agree. If the netback value per mcf were large enough, that might be true. But I have strong doubts. If the netback value were relatively small, especially when compared to the value of 400 million barrels of oil

production which the major gas sale would be expected to displace, then I see the potential for serious disputes to emerge between the Oil Rim and Gas Cap interests.

Exxon's position, as I understand it, is that no such dispute would matter. The owners are already committed by contract to support a major gas sale of 2 TCF per day. The contract is apparently interpreted by Exxon to mean that it and Arco could unilaterally proceed to sell their gas. I find this testimony to be less than convincing. Speaking of plans to unilaterally undertake any type of depletion policy, over the protest of other owners, is far removed from the ideal of unitized operations undertaken to promote the common good. Moreover, I am surprised if it is Exxon's position that a major gas sale of 2 TCF per day has already been determined to promote the common good and therefore must proceed against whatever opposition BP would mount. Prior to knowing the netback value of gas at the wellhead, it would be impossible to know whether its sale does in fact promote the common good. Of course, the eventual netback value has not yet been determined, and that is why the owners have testified that uncertainty in gas values has stymied voluntary efforts to consolidate the two participating areas.

Nonetheless, if for the sake of argument we temporarily accept Exxon's claim that it has already been determined that it would be in the interest of the Unit for the gas to be sold, there is still a problem: how can we be sure that BP would also agree to produce and sell its gas? If it is appropriate Unit policy for Exxon's gas to be produced and sold, would it not also be appropriate Unit policy for BP's gas to be produced and sold? Whereas Exxon's unilateral action to sell its gas might solve all of Exxon's problem, it may solve only one-half or one-third of the Unit's problem. Thus, I see management concurrence in the size and timing of a major gas sale as a possible source of future Gas Cap-Oil Rim conflicts.

Another type of potential conflict between the Gas Cap and Oil Rim interests, and one of major importance, could arise as the field approaches the end of its productive life. Eventually, it will come time for the owners to reach a decision to terminate production and abandon the field. At that point, would the Gas Cap interests gain by prolonging oil production past the economic limit of the oil reserve if the payoff to them was that continued operations would keep alive the option for an eventual major gas sale? Would the incentive for them to do so be reinforced by the differential allocation of produced liquids (gas condensate and NGL) to the Gas Cap owners? I am not sure of the answers, but I think these questions should be addressed.¹⁴

(6) *Has the two participating-area structure resulted in benefits for developing the Prudhoe Oil Pool that would not have occurred otherwise?*

The principal benefit of the two participating-area structure is that it helped to facilitate the negotiations that ultimately lead to formation of the Prudhoe Bay Unit. If it is presumed that voluntary negotiations would have failed without the two participating areas, and that development of the field would not have proceeded, then we must count the creation of the dual participating-area structure as an enormous benefit to all parties concerned. However, if it is presumed that the State of Alaska would or could have used its powers to intervene and "revive" the failed negotiations in some manner, as seems likely, then the strategic importance of the two participating areas is diminished.

The owners have testified that the structure of competing interests which stems from their Gas Cap-Oil Rim rivalry has also been of significant value in stimulating greater scrutiny of development decisions and promoting more extensive research and better understanding of

¹⁴ [REDACTED]

development opportunities than would otherwise have occurred. What I do not understand about this argument is why, if extra effort and scrutiny are beneficial to the unit in cases where the owners are in conflict, such effort and scrutiny would not also be provided or undertaken in instances where the interests of the owners are more closely aligned. Whether interests are aligned or in contention, all owners share the incentive to research and debate matters that are vital to the value of their investment.

Further, I would expect the exchange of ideas and information among multiple owners to actually work better and carry greater weight in units where the interests and goals of respective owners are aligned--as in a single participating area. At least in that case there would be less incentive for any owner to shade or distort information to reflect favorably on projects that might enhance that owner's individual position at the expense of others. If owners have competing incentives within the unit, I would expect each owner to discount to some degree the information, analyses, and interpretations that are provided by the others.

(7) *To what degree would changes in the contractual and property arrangements for the Prudhoe Oil Pool such as combining the two participating areas reduce or eliminate the incentives for competitive, as distinguished from cooperative, behavior on the part of the working interest owners or otherwise reduce or eliminate disputes among them?*

While certain technical differences and commercial conflicts might remain, I believe that representatives of all the major owners agree that consolidation of the two participating areas into a single equity structure, *once achieved*, would go very far towards eliminating the conflicts that have accompanied development of the Prudhoe Oil Pool.

Of course, not all potential conflicts can be avoided no matter how the Unit is structured. If there are multiple owners who face significantly different costs of capital or who realize

different netbacks on produced oil, conflicts may emerge in taking one course of action over another. Such conflicts are based on circumstances that originate outside the Unit.

Unfortunately, there is no way to structure the Unit to anticipate the ebb and flow of those external differences or to neutralize them. This contrasts with the type of conflicts that stem from the existence of dual participating areas, which are not inherent in the nature of unitized operations, and which could be eliminated by consolidation of equity within a single participating area.

It is my opinion that few, if any, of the conflicts that have divided the owners of the Prudhoe Oil Pool stem from external circumstances. The cost-sharing disputes that caused the parties to adopt the so-called GHX-1 agreement did not arise because Exxon faced a higher cost of capital than Arco. BP did not initiate the Energy Conservation Task Force to save fuel gas in 1984 because it had a contract to sell petrol in Europe that Arco could not duplicate. The recent standoff on MI-NGL did not arise because Arco pays more federal income tax than BP. The fundamental conflict that drives all of these disputes is the fact that the owners have varying stakes in oil versus gas-related projects. Consolidating the two participating areas would go a long way towards resolving the disputes that have impaired development of the field.

[REDACTED]

15 [REDACTED]

[REDACTED]

(8) *Are there alternatives to compulsory unitization that could be employed to reduce or eliminate incentives for competitive behavior on the part of the working interest owners or otherwise reduce or eliminate disputes among them?*

I am not aware of any other approach, besides consolidating the holdings into a single participating area, that would ensure that the interests of the respective owners are in alignment and remain so as events unfold over the remaining life of the field. I have already commented on the limitations of attempting to balance the interests of multiple owners at one point in time in order to win agreement on a particular issue. The problem with this approach is that it is not robust--the balance is likely to be lost as circumstances and opportunities change. The environment is not static, and even with a binding and well-executed contract in hand, disputes may arise among owners whose interests fall out of alignment. At that point, each owner will find reasons to interpret the provisions of the contract in favor of its own position and to resist interpretations that threaten its interests.

Several witnesses have discussed the "case-by-case" approach to resolving Unit conflicts, which is an alternative to compulsory unitization that the Commission must consider. Rather than aligning the owners' interests once and for all via unitization, the case-by-case approach would rely on the Commission's oversight to deal with any future disputes if and when they arise. The idea would not be to eliminate future conflicts, but to get the Commission's help in resolving them.

There are some risks associated with the case-by-case approach. If intervention by the Commission in field operations is not something that the owners generally welcome, certain disputes and conflicts may simmer beneath the surface for an indefinite period of time before any owner would come forward. If the underlying issues are time-sensitive, with physical or economic waste hanging in the balance, such delay could be an important drawback.

In addition, the positions and analyses that respective owners might put to the Commission during such proceedings would be subject to the problem of malincentives. If the issues in dispute are not purely technical in nature, but based on conflicting equity interests within the pool, some owner may have an incentive to shade its presentation toward the outcome that is most favorable to its vested interest. In adjudicating these disputes, the Commission would very likely have to consider, at least implicitly, many of the same factors that would enter into a compulsory unitization proceeding.

Another danger in waiting for disputes to emerge is that the delay in responding to some potential problem could jeopardize major opportunities to enhance recovery. Consider the prospect of a major gas sale, for example. Any sale of gas from Alaska will require a major investment in transportation infrastructure, whether the gas is to be moved by pipeline or tanker. That investment will depend, in part, on the willingness of outside financiers to provide funds. If

a major conflict between the Gas Cap and Oil Rim owners regarding the size or timing of gas sales remains unresolved at that stage, the resulting project uncertainty would probably impact the financing, and perhaps preclude the project from going forward. There are lots of major gas projects on the drawing boards of producers all over the globe, each poised to proceed under the right market conditions. Anything that delays the ability of Alaskan producers to seize a window of commercial opportunity for a major gas sale also diminishes the likelihood that a major gas sale will ever occur. Other things being equal, there is a clear advantage in having put the affairs of the Unit in good working order well in advance, not at the last minute.

(9) *Has the two participating-area structure or other features of the contractual and property arrangements for the Prudhoe Oil Pool resulted in any delay of or failure to pursue any development project or impaired any operation?*

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]⁶

Conflicts stemming from the two participating-area structure have also impaired the implementation of major field development initiatives. Apart from the MI-NGL dispute, about

20 [REDACTED]
21 [REDACTED]
22 [REDACTED]
23 [REDACTED]
24 [REDACTED]
25 [REDACTED]
26 [REDACTED]

which the Commission has heard from others,

[REDACTED]

[REDACTED]

[REDACTED]

28 [REDACTED]
29 [REDACTED]

[REDACTED]

Weighing the Arguments Against Compulsory Unitization

Many of the witnesses who have already appeared before the Commission have offered a wide range of reasons why a compulsory unitization proceeding should not be initiated. I will close my remarks by commenting on some of the most prominent reasons given, and in the process attempt to summarize some of my own views.

Reason #1: *"The Unit is not broken; there is no problem, and therefore no need to fix it."*

Proponents of this view claim that the interests of the owners are already integrated to the extent possible, and that the conflicts that do emerge from time to time stem from external differences between the owners, not from the two participating-area structure of the Prudhoe Oil Pool. 1

30 [REDACTED]
31 [REDACTED]
32 [REDACTED]

disagree. The two participating-area structure appears to generate major conflicts among owners that put the intended benefits of unitization in jeopardy.

Reason #2: *"The Unit may be broken; but the Commission should not attempt to fix it via compulsory unitization because that cure may be worse than the disease."* I have mixed feelings about this argument. The "cure" admittedly involves putting each owner's equity interest at some risk, and this represents a heavy burden--large enough to have prevented the owners from voluntarily consolidating the two participating areas into one. If this burden is a matter that properly falls under the Commission's purview, then it would have to be weighed very carefully against the benefits of achieving a greater alignment of interests among the owners. However, I do not agree that the "cure" is bad for the other reasons often given: I do not think that the process of compulsory unitization would be chaotic, unmanageable, or inherently unfair or in violation of the correlative rights of the owners.

Reason #3: *"Compulsory unitization should not be imposed by the State because it would not be a panacea for all that ails the Unit."* In my opinion, this argument is a red herring that deflects attention from the issues at hand. It is akin to arguing that we should not vaccinate children against disease because that would not solve the problem of world hunger. Most of the major conflicts that have been associated with Unit developments do stem from the two participating-area structure, and these problems would be resolved if the dual equities were consolidated. If other problems would remain unresolved, then the owners and the Commission might want to consider additional measures to further enhance operations within the Unit.

Reason #4: *"Compulsory unitization would be viewed by many as the State reneging on an agreement and would therefore establish a damaging precedent that could discourage future investment from coming to Alaska."* On legal grounds I cannot say whether initiating a

compulsory unitization procedure at this stage in the life of the field would constitute reneging on a contract. I do believe that the Commission operates under a charter that requires it continuously to guard the State's oil and gas resources against preventable waste. In that sense, any owner who enters into an agreement with the State to operate subject to the Commission's authority must know that its operations will be constrained by and subject to such considerations at all times. Moreover, from an economic perspective, I believe that consolidation of the separate equities into a single participating area can be accomplished without destroying any of the agreements, trades, or deals upon which the owners have been relying.

Reason #5: *"Compulsory unitization should not be imposed because the Commission has no statutory or legal authority to do so."* I have no knowledge or opinion regarding the validity of this claim or the weight that should be attached to it.

Reason #6: *"Compulsory unitization should not be attempted because the problem of malincentives would undermine the process and interfere with field operations."* The malincentives that threaten to interfere with operations at the Prudhoe Oil Pool stem from the dual participating-area structure, not from the attempts to consolidate the separate equities.

Whether or not compulsory unitization is pursued, the same malincentives will exist. It is misleading to argue that by circumventing the process of compulsory unitization we can also circumvent the effects of whatever malincentives are thought to exist within the Unit. Proponents of the "case-by-case" approach to conflict resolution apparently believe that the malincentives of the owners would be less damaging if played out over a long series of disputes than if confronted once and for all during the process of consolidating the two participating areas. My own view is that malincentives that are allowed to linger and persist beneath the surface would probably be

more damaging in the long run, and less predictable, than the rather obvious preference of each owner to emerge from compulsory unitization with the largest possible equity share.

I want to thank the Commission for allowing me to present these views. This completes my prepared testimony.

ATTACHMENT I

Curriculum Vita of Dr. James L. Smith

CURRICULUM VITA

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PERSONAL INFORMATION

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Marital Status: Married (Agnes Cheng), two children (Lisa and Stephanie).

EDUCATION

B.S. [1972] Dept. of Economics, University of Illinois.

M.A. [1976] Dept. of Economics, Harvard University.

Ph.D. [1977] Dept. of Economics, Harvard University.

PROFESSIONAL EXPERIENCE

Cary M. Maguire Chair of Oil and Gas Management, Edwin L. Cox School of Business,
Southern Methodist University, 1995-to date.

Professor, Dept. of Economics, University of Houston, 1989-95.

Board of Directors, International Assoc. for Energy Econ., Houston Chapter, 1989-93.

Director, Bureau of Business and Economic Research, and Professor of Economics,
University of Maryland, 1991.

Director, Center for Public Policy, University of Houston, 1987-90.

Associate Professor, Department of Economics, University of Houston, 1983-89.

Associate Professor, Department of Economics, University of Illinois, Champaign-Urbana,
1981-83.

Research Affiliate, Energy Laboratory, Massachusetts Institute of Technology, 1981-83.

Research Collaborator, Dept. of Applied Mathematics, Brookhaven Natl. Lab., 1980-81.

Visiting Scientist, Center for Energy Policy Research, Massachusetts Institute of
Technology, 1979-80.

Visiting Research Associate, Norwegian School of Economics and Business
Administration, Bergen, Norway, summers 1978-79.

Assistant Professor, Dept. of Economics, Univ. of Illinois, Champaign-Urbana, 1977-81.

Research Analyst, Energy Laboratory, Massachusetts Inst. of Technology, 1976-77.

Technical Assistant, National Bureau of Economic Research, Cambridge, Mass., 1975-76.

SCOMM

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TONY KNOWLES, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

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March 2, 1998

The Honorable Mark Hodgins, Chair
House Committee on Oil and Gas
Alaska State House
State Capitol Rm # 110
Juneau, AK 99811

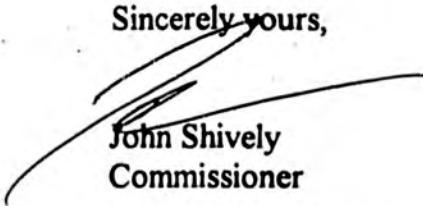
Dear Representative Hodgins:

The Department of Natural Resources requests a House Oil and Gas Committee hearing on HB 440 "An act relating to certain audits regarding oil and gas royalty and net profits." This bill would transfer from the Department of Revenue to the Department of Natural Resources responsibility for audits of oil and gas royalty. This function has been split between the two departments since 1980 based on a Legislative Audit recommendation and subsequent legislation.

Since 1980, however, the state has entered into royalty settlements and made changes to its tax regulations. As result, it is now more beneficial to the state to consolidate the royalty audit function in the Department of Natural Resources. This consolidation will eliminate inefficiencies and duplications in the royalty audit function.

Thank you for your consideration of this request. If you need additional information concerning HB 440, please call me at 465-2400.

Sincerely yours,



John Shively
Commissioner

cc: Carol Carroll
Legislative Liaison

"Develop, Conserve and Enhance Natural Resources for Present and Future Alaskans"

STATE OF ALASKA
1998 LEGISLATIVE SESSION

FISCAL NOTE

Bill Version: HB 440
(H) Publish Date: 2/18/98

Revision Date: _____ Dept. Affected: Revenue
 Title: Transfer Royalty Audit Function BRU: Revenue Operations
 Component: Oil and Gas Audit
 Sponsor: Rules
 Requestor: Governor COMPONENT SERIAL NO. 115

Expenditures/Revenues: (Thousands of Dollars)

OPERATING EXPENDITURES	FY 99	FY 00	FY 01	FY 02	FY 03	FY 04
PERSONAL SERVICES	-210.2	-210.2	-210.2	-210.2	-210.2	-210.2
TRAVEL	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	-212.7	-212.7	-212.7	-212.7	-212.7	-212.7

CAPITAL EXPENDITURES						
----------------------	--	--	--	--	--	--

CHANGE IN REVENUES ()						
------------------------	--	--	--	--	--	--

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	-212.7	-212.7	-212.7	-212.7	-212.7	-212.7
1001 CBRF						
1048 University of AK receipts						
Other						
TOTAL	-212.7	-212.7	-212.7	-212.7	-212.7	-212.7

Estimate of any current year cost \$ 0.0

POSITIONS:

FULL-TIME	-3	-3	-3	-3	-3	-3
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

This bill transfers (from DOR to DNR) responsibilities and authority for auditing reports and payments relating to revenue under oil and gas contracts, agreements and leases. This function is performed by two revenue auditor positions and one clerk position that would be transferred from DOR to DNR.

Prepared by: John Pilkinton, Director
 Division: Oil and Gas Audit
 Approved by Commissioner: Wilson L. Condon
 Agency: Revenue

Phone: 343-9225
 Date: February 13, 1998
 Date: February 13, 1998

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FISCAL NOTE

No: 2

Bill Version: HB 440
(H) Publish Date: 2/18/98

STATE OF ALASKA 1998 LEGISLATIVE SESSION

Revision Date: _____ Dept Affected: Natural Resources
Title: An Act transferring the ... authority for auditing... BRU: Resource Development
oil and gas contracts, agreements, leases ...from DOR to DNR. Component: Oil and Gas Development
Sponsor: Rules Committee
Requestor: Governor Component Serial No. 439

Expenditures/Revenues

(Thousands of Dollars)

OPERATING EXPENDITURES	FY99	FY00	FY01	FY02	FY03	FY04
PERSONAL SERVICES	210.2	210.2	210.2	210.2	210.2	210.2
TRAVEL	2.5	2.5	2.5	2.5	2.5	2.5
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	212.7	212.7	212.7	212.7	212.7	212.7

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
-----------------------------	------------	------------	------------	------------	------------	------------

CHANGE IN REVENUES ()	0.0	0.0	0.0	0.0	0.0	0.0
-------------------------------	------------	------------	------------	------------	------------	------------

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	212.7	212.7	212.7	212.7	212.7	212.7
005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	212.7	212.7	212.7	212.7	212.7	212.7

Estimate of any current year (FY98) cost: \$ none

POSITIONS

FULL-TIME	3	3	3	3	3	3
PART-TIME	0	0	0	0	0	0
TEMPORARY	0	0	0	0	0	0

ANALYSIS:

(Attach a separate page if necessary)

Transfer from the Department of Revenue funds for two Revenue Auditor positions and one clerical position. The Revenue Auditor positions being transferred are filled and perform royalty audits. The departments agree that efficiencies will result in the timeliness of audits with the consolidation of this function in DNR. In the past, many of the tasks required to complete these royalty audits were duplicative of tasks performed in DNR. This fiscal note shows the transfer of the funds and positions from Dept. of Revenue to the Dept. of Natural Resources. A second fiscal note shows the complete fiscal analysis of this legislation.

Prepared by: Carol Carroll, Director *Carol Carroll for* Phone: 465-2400
Division: Support Services Date: 12-Feb-98
Approved by Commissioner: *Carol Carroll for* Date: 2-12-98
Agency: Natural Resources

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FISCAL NOTE

No: 3

STATE OF ALASKA

1998 LEGISLATIVE SESSION

Bill Version: HB 440

(H) Publish Date: 2/18/98

Revision Date:

Title: "An Act transferring the...authority for auditing

...oil and gas contracts, agreements, leases...from DOR to DNR"

Dept Affected: Natural Resources

BRU: Resource Development

Component: Oil and Gas Development

Sponsor: Rules Committee

Requestor: Governor

Component Serial No. 439

Expenditures/Revenues

(Thousands of Dollars)

OPERATING EXPENDITURES	FY99	FY00	FY01	FY02	FY03	FY04
PERSONAL SERVICES	31.4	31.4	31.4	31.4	31.4	31.4
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	31.4	31.4	31.4	31.4	31.4	31.4

CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
-----------------------------	------------	------------	------------	------------	------------	------------

CHANGE IN REVENUES (fund code)	0.0	0.0	0.0	0.0	0.0	0.0
---------------------------------------	------------	------------	------------	------------	------------	------------

FUND SOURCE

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF	31.4	31.4	31.4	31.4	31.4	31.4
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	31.4	31.4	31.4	31.4	31.4	31.4

Estimate of any current year (FY98) cost: \$

0.0

POSITIONS

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

ANALYSIS:

(Attach a separate page if necessary)

The authority to conduct audits of oil and gas contracts, leases, and other agreements managed by DNR now falls under DOR. This situation means that DNR does not have the detailed information about its dealings with the oil and gas industry necessary to efficiently and knowledgeably manage its resources. In the past, DNR has mitigated this situation by careful oversight of DOR audits. The process duplicates manpower and can delay audits. The transfer of audit authority recognizes that the workload of the two departments does not overlap as much as it did in the past. Small oil and gas fields are subject to the economic limit factor and do not require extensive audit effort by DOR for severance taxes; most of the state's oil and gas production is subject to royalty value settlement agreements that limit the audit requirements of the DNR. Attached is a numerical analysis of the affect of the transfer of manpower and the budget savings that will be achieved.

Prepared by: Ken Boyd, Director

Division: Division of Oil and Gas

Approved by Commissioner:

Agency: Natural Resources

Phone: 269-8800

Date: 02/12/98

Date: 2/12/98

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Page 1 of 2

SCOMM

104:12

MAPCO ALASKA PETROLEUM Inc. POSITION PAPER
FIVE YEAR ROYALTY OIL CONTRACT WITH STATE OF ALASKA

April 2, 1998

MAPCO ALASKA PETROLEUM Inc. (MAPI) is seeking ratification of a new five year royalty oil contract from the Alaska State legislature. The contract was unanimously recommended for legislative approval by the Alaska Royalty Oil and Gas Development Advisory Board at their February 17, 1998, meeting. Approval of the contract is now before the legislature in the form of SB 329 and HB 469.

The contract has been signed by the Alaska Commissioner of Natural Resources and the President of MAPI. The contract calls for the sale of approximately 28,000 barrels per day (bpd) of North Slope royalty crude to MAPI. The contract will be effective December 1, 1998, and calls for MAPI to pay the State Royalty-in-Value price for the royalty oil plus a \$.15 per barrel premium. Over the five years of the contract, the State could receive an additional \$7.665 million in gross revenues over what they would receive from other Prudhoe Bay lessees for the royalty oil.

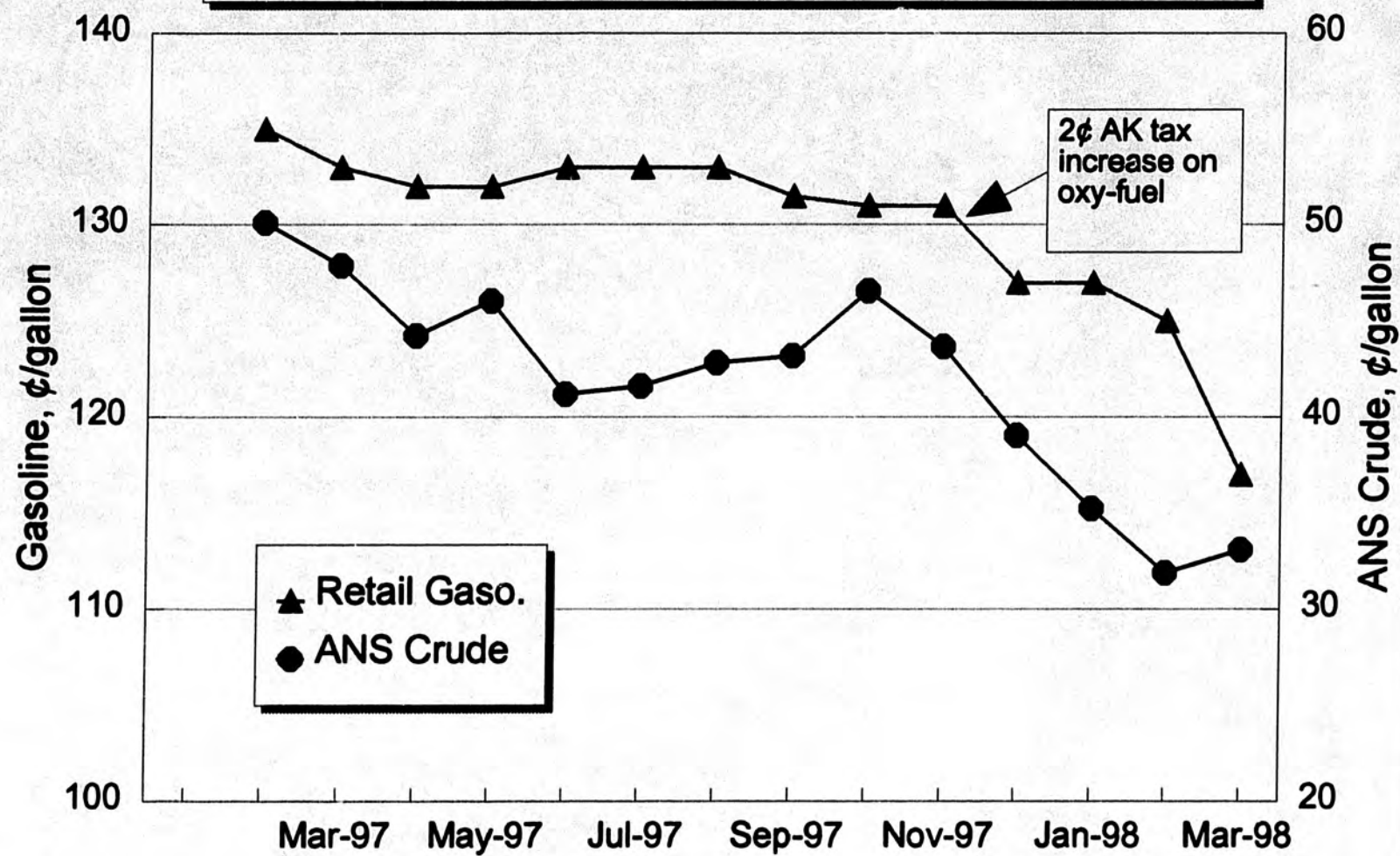
The effective date of December 1, 1998, coincides with the expiration of a current one year contract MAPI now has with the State for 13,000 bpd of royalty oil. The new contract will replace the volume in the one year contract and add the additional volume to provide feed-stock for the \$70 million refinery expansion currently underway at MAPI. The cornerstone of this expansion is the addition of a third crude unit to the refinery. The new crude unit will begin shipping the additional production approximately December 1, 1998.

The \$70 million expansion project currently has 50 Alaska workers on site. Construction employment will peak at about 375 workers this summer. Over 30 Alaskan vendors and contractors will be working on the refinery expansion. Once completed, the new crude unit will produce an additional 14,000 bpd of jet fuel for Alaska's growing air cargo and air passenger business. An additional 25 rail cars of jet fuel will be shipped daily on the Alaska Railroad from Fairbanks to Anchorage when the project is completed. Local property tax payments by MAPI will increase, revenues to GVEA and ARRC will increase, and vendors and contractors will benefit from both the construction and the ongoing operation of the third crude unit. Also, a total of 19 permanent new employees will be hired at the refinery and the Anchorage terminal to support the production expansion.

MAPCO has refining, marketing and retail activities throughout Alaska. MAPI employs 155 people in the refining and marketing business and about 350 workers at the 28 MAPCO Express retail stores in Alaska. MAPI spent approximately \$450 million with over 680 Alaskan vendors and contractors in 1997. In addition, MAPI provided approximately \$500,000 in funding to educational institutions, non profit organizations and for event sponsorships in 1997. MAPI has its refining headquarters at North Pole near Fairbanks and its marketing headquarters in Anchorage.

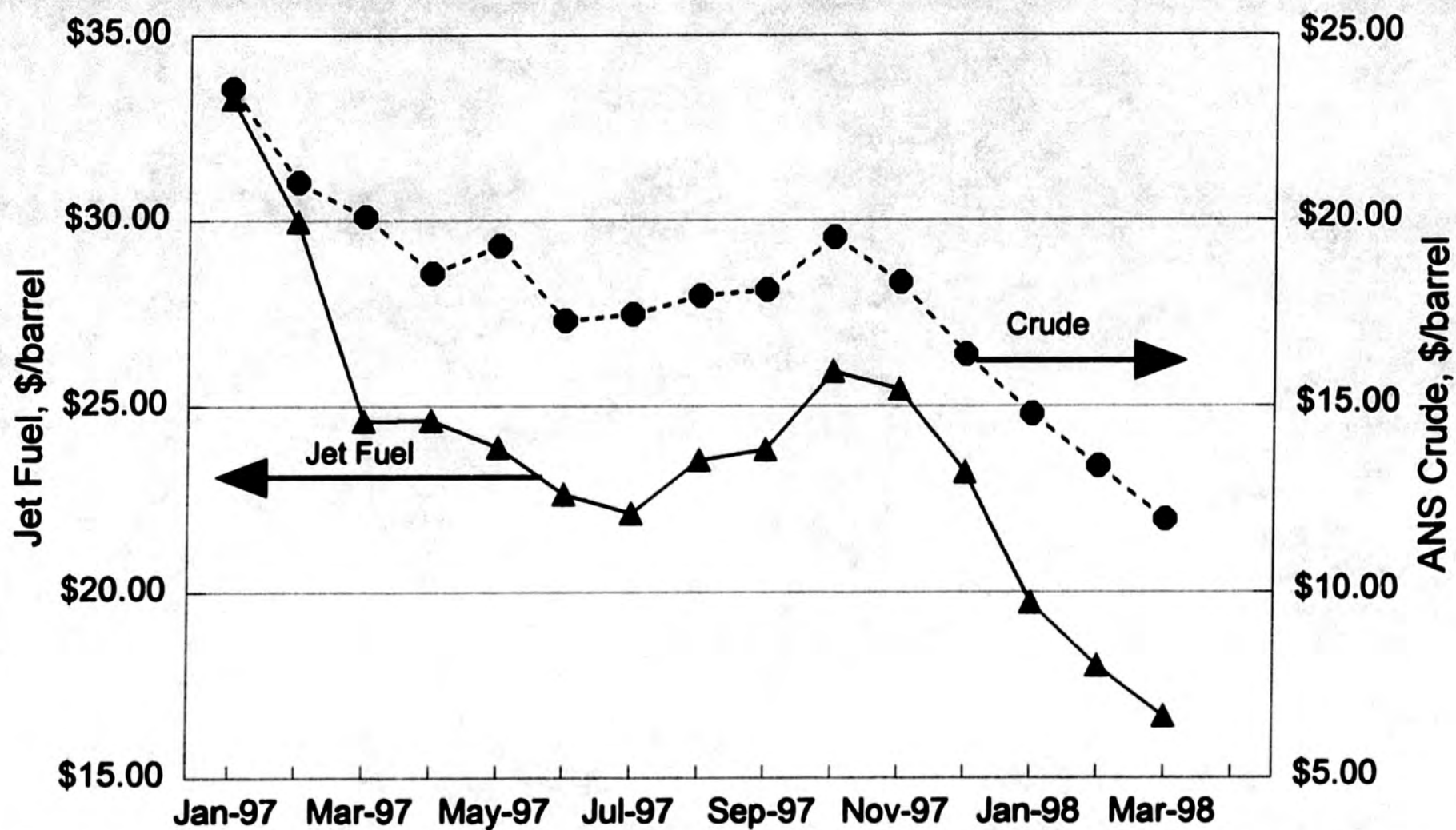
For more information contact Jeff Cook at (907) 488-5104

Alaska Gasoline Prices and ANS

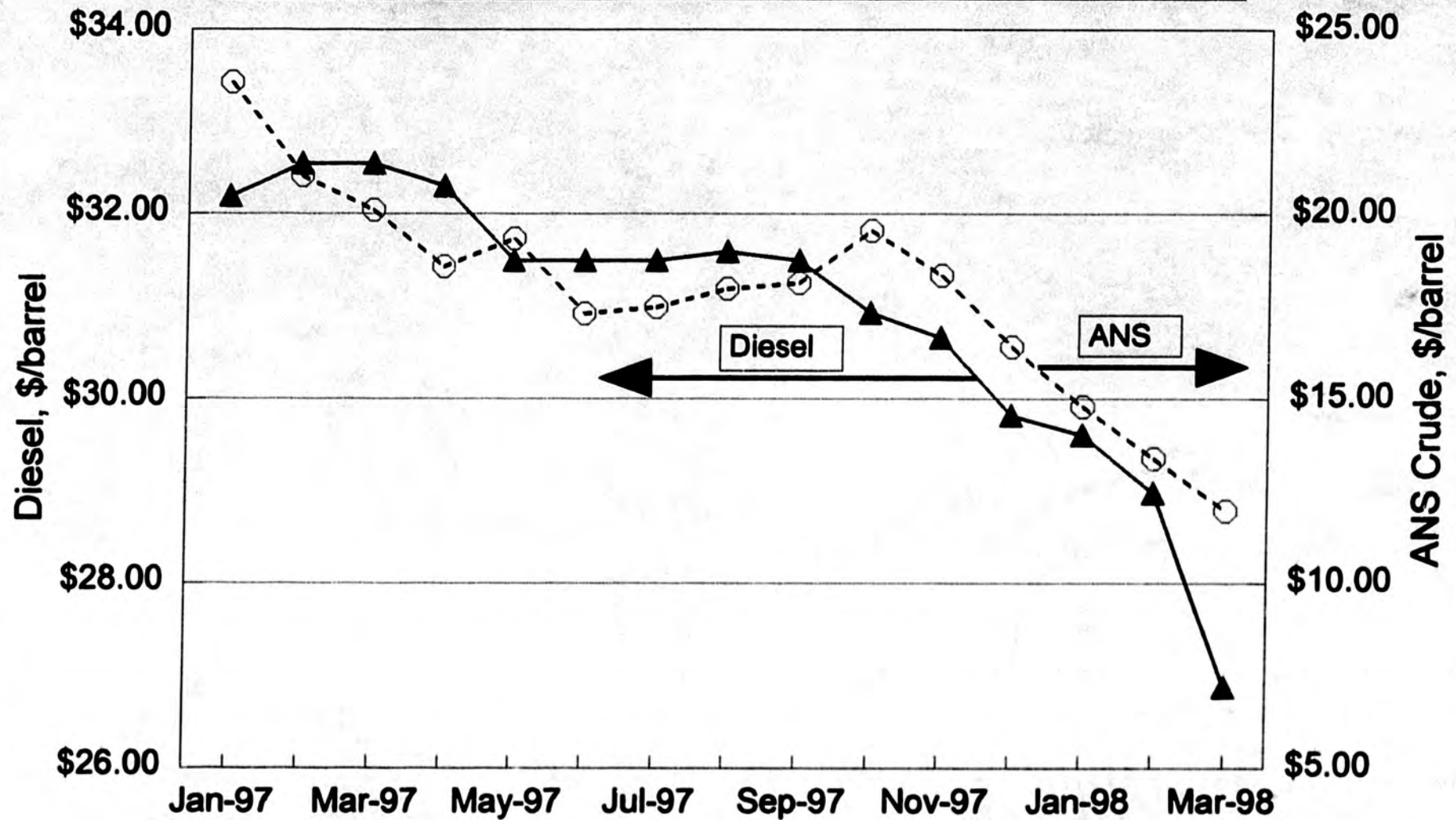


03/27/98

Jet Fuel Price at Anchorage International Vs. ANS



Anchorage Rack Diesel Vs. ANS





Greater Fairbanks

Chamber of Commerce

250 Cushman Street, Suite 2D

(907) 452-1105

Fairbanks, Alaska 99701-4665

FAX: (907) 456-6968

Introduced by: Jeff Cook
Date Introduced: March 30, 1998
Date Passed: March 30, 1998
Date Transmitted: April 2, 1998

RESOLUTION 98-0330

A RESOLUTION BY THE GREATER FAIRBANKS CHAMBER OF COMMERCE SUPPORTING RATIFICATION BY THE ALASKA LEGISLATURE OF A FIVE YEAR ROYALTY OIL CONTRACT FOR MAPCO ALASKA PETROLEUM INC.

WHEREAS, MAPCO ALASKA PETROLEUM INC. (MAPI) is currently undergoing a \$70 million expansion with an addition of a third crude unit at their North Pole Refinery; and

WHEREAS, the expansion will require that MAPCO ALASKA PETROLEUM INC. purchase additional crude oil from the state to provide feed stock for the refinery; and

WHEREAS, this expansion project will provide jet fuel for Alaska's growing air passenger traffic and air cargo business; and

WHEREAS, the construction of the third crude unit will involve work for several hundred Alaskans through this summer and fall and will add fifteen new permanent positions at the refinery; and

WHEREAS, the expansion will significantly increase the purchase of electricity from GVEA, will increase rail shipments on the Alaska Railroad, will increase property tax payments to local governments and income tax paid to the State of Alaska; and

WHEREAS, many Alaskan vendors and contractors will benefit from the expansion during construction and during the long term operation of the refinery; and

WHEREAS, the Alaska Royalty Oil and Gas Development Advisory Board unanimously approved a five year contract to sell MAPCO ALASKA PETROLEUM INC. 28,000 barrels per day (bpd) of Prudhoe Bay Unit royalty oil at their meeting on February 17, 1998; and

CHAMBER BENEFACTORS

Dedicated to Fairbanks' Economic Future



Alaska pipeline

MAPCO



WHEREAS, Commissioner of Natural Resources John Shively and MAPCO ALASKA PETROLEUM INC. President Randy Newcomer have signed the five year contract and the contract has been forwarded to the Alaska Legislature in the form of HB 469 and SB 329 for ratification; and

WHEREAS, said royalty oil contract calls for the State to receive fair market value for the royalty oil plus a \$.15 per barrel premium; and

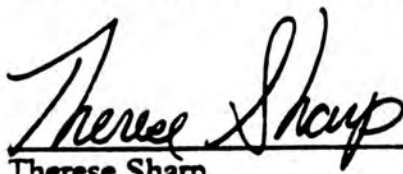
WHEREAS, said premium could result in additional gross revenue of \$7.665 million over what the State would receive from other Prudhoe Bay lessees over the five year contract.

NOW THEREFORE BE IT RESOLVED that the Greater Fairbanks Chamber of Commerce urges the Alaska Legislature to ratify the signed royalty oil contract between the State of Alaska and MAPCO ALASKA PETROLEUM INC. as expeditiously as possible and before the adjournment of this session of the Alaska Legislature.

BE IT FURTHER RESOLVED that this resolution be distributed to:

The Honorable Tony Knowles, Governor of the State of Alaska
Alaska State Legislature ✓
MAPCO ALASKA PETROLEUM INC.

PASSED in Fairbanks, Alaska this 30th day of March, 1998 by the Greater Fairbanks Chamber of Commerce Board of Directors.


Therese Sharp
Chairman of the Board


Pamela J. Held
President/CEO

Final Finding and Determination

to Sell Royalty Oil

to

MAPCO Alaska Petroleum Inc.

SENATE BILL NO. 342
HOUSE BILL NO. 469



Alaska Department of
**NATURAL
RESOURCES**

**Division of Oil and Gas
3601 "C" Street, Suite 1380
Anchorage, Alaska 99503-5948**

March 5, 1998

**Final Finding and Determination To Sell Royalty Oil
To MAPCO Alaska Petroleum Inc.
March 5, 1998**

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Appendix A: Summary of Previous North Slope Royalty Oil Sales

Appendix B: AS 38.05.183(c) & (e), AS 38.06.050(c), AS 38.06.055, and AS 38.06.070(a)

Appendix C: Comments and Responses on the Preliminary Finding and Draft Contract

Appendix D: Changes to the Preliminary Finding and Draft Contract

1

Final Finding and Determination to Sell Royalty Oil to MAPCO Alaska Petroleum Inc.

I. Summary

The commissioner of the Department of Natural Resources, on behalf of the state of Alaska, proposes a five-year sale of approximately 28,000 barrels per day of the state's royalty oil to MAPCO Alaska Petroleum Inc. (MAPCO). MAPCO operates a refinery in North Pole in the Fairbanks North Star Borough and is one of the state's largest retailers of petroleum products. This document provides the final finding and determination required under AS 38.05.183 for the proposed sale.

The department distributed the preliminary finding and draft contract on January 30, 1998. The public comment period ended one month later on March 3, 1998. The department notified the public about the preliminary finding and draft contract and written comments were solicited by sending a notice of the sale or copies of the preliminary finding and draft contract to 200 citizens, special interest groups, industry and government representatives, and the media. The department also advertised through display advertisements in newspapers throughout Alaska. At the close of the comment period, the department received three letters. The letters are included as Appendix C to this finding.

The mailing and advertisements also notified the public of a meeting of the Alaska Royalty Oil and Gas Development Advisory Board (Royalty Board) that was held on February 17, 1998 at which the proposed sale was discussed and public comment was solicited. Except for the representatives from MAPCO, there was no public testimony at the Royalty Board meeting. However, a letter from Hal Whitley, owner of Wet Willy's Carwash in Fairbanks was faxed to the Royalty Board in the morning before the Royalty Board met. The Royalty Board considered Mr. Whitley's comments. Subsequently, the Royalty Board unanimously supported the sale and adopted the Commissioner's findings as its report to the legislature, and passed a resolution recommending approval of the sale by the legislature.

This is a final finding and final conclusions have been reached. The commissioner has determined that the proposed sale to MAPCO is in the state's best interest. The final finding, a copy of the signed contract, and the recommendation from the Royalty Board will be forwarded to the Legislature under AS 38.06.055.

II. Background

The state of Alaska receives a royalty of approximately 12.5 percent of the oil and gas produced from the Prudhoe Bay Unit. The state may take its share of oil production "in-kind or "in-value." When the state takes its royalty share of the oil in-kind (RIK), it assumes ownership of the oil, and the commissioner disposes of the oil through either competitive or non-competitive sales. When oil is taken in-value (RIV), the state's lessees who produce the oil market the state's share along with their own share of production. The lessees are obligated to pay the state the value of the state's RIV share.

MAPCO has a long history as a purchaser of RIK from the state. MAPCO has the longest running contract for ANS RIK. Deliveries under its long-term contract began in November 1979 for 35,000 barrels per day. This contract will not expire until December 2003. Through the end of 1997, MAPCO received approximately 205.8 million barrels of RIK.¹

On August 26, 1997, the state agreed to sell to MAPCO an additional volume of royalty oil equal to 11.6 percent of the daily royalty oil production of the Prudhoe Bay Unit (PBU) for one year. Deliveries under this contract began on December 1, 1997 and will continue through November 30, 1998. By statute this contract may not be renewed without a specific recommendation of the Royalty Board to the legislature and the legislature's subsequent approval. Last October, MAPCO initiated negotiations with the department for a new royalty oil supply contract to begin deliveries when this contract expires.

At the date of this final finding, Williams Companies Inc. is in the final stages of acquiring Mapco Inc. This acquisition will become final when Williams Companies Inc. receives approval from the Federal Trade Commission. On November 24, 1997, the companies announced that they had entered into a definitive merger agreement providing for Williams to acquire MAPCO. On February 26, 1998, MAPCO shareholders approved the acquisition. Standard and Poor's (S&P) revised its outlook for both companies to positive from stable. Primarily, the outlook change reflects the strengthening fundamentals of the Williams' pipelines and prospects for improving earnings at Williams Communications Group and Williams Energy Group. The proposed acquisition of Mapco Inc. is also a positive factor in S&P's outlook change.² The \$3 billion acquisition price includes \$2.2 billion of Williams common stock and the assumption of about \$750 million of acquired company debt. The conservatively financed acquisition should diversify Williams' pipeline operations with a relatively successful downstream energy services company. The merger will have no affect on the proposed sale and contract terms.

This finding and determination and the attached copy of the sales contract represent the result of those negotiations. Much of what was written by way of background to the 1997 contract still applies today.

In the following section of this finding, the description of the contract focuses on how this proposed contract differs from the current one-year contract.

III. Discussion of Contract Provisions

Term

First delivery of RIK oil is set for December 1, 1998 and will continue for five years. The contract will terminate December 31, 2003. This coincides with the termination date of MAPCO's current long-term, 25-year contract.

¹ Golda Valley Electric Association volumes are included in MAPCO's RIK deliveries.

² Standard & Poor's CreditWire dated November 24, 1997.

Quantity

The state agreed to increase the percentage of royalty oil that MAPCO may purchase to assure MAPCO a relatively constant supply of RIK oil as production declines. Over the life of the contract the volume of RIK taken by MAPCO will remain fairly constant. This proposed contract will increase the percentage of PBU royalty oil that MAPCO now receives under the current one-year contract. MAPCO will purchase 27.0 percent of the state's royalty share in 1999 (about 28,000 barrels per day from the PBU). In the second, third, fourth and fifth years, MAPCO's RIK purchase percentage will increase slightly to 28.5 percent, 30.0 percent, 32.0 percent and 33.5 percent, respectively.

Table 1: RIK Percentages and Maximum Quantities

Year	RIK %	RIK Volume (Bpd)
1998	27.0	28,350
1999	27.0	28,350
2000	28.5	28,500
2001	30.0	28,200
2002	32.0	28,480
2003	33.5	28,475

When MAPCO's current long-term RIK contract with the state is considered with the proposed contract, the actual volume taken by MAPCO will increase to approximately 56.7 percent of the state's royalty oil from the PBU.

The percentage of royalty oil designated in the contract for each year is called the "Maximum Quantity." If MAPCO takes less than the Maximum Quantity, it will be subject to a per-barrel reservation fee on each barrel less than the Maximum Quantity. The per-barrel reservation fee is 0.75 percent of the full purchase price.³ MAPCO may elect to decrease or increase the quantity of RIK oil it will actually purchase month-to-month subject to certain notice requirements. MAPCO also has the right to terminate the contract with one hundred days notice to cease deliveries. With the same notice period, MAPCO may elect one time annually to permanently reduce the Maximum Quantity required under the contract. However, once MAPCO issues an annual notice of its option to permanently reduce the Maximum Quantity, MAPCO may not reinstate the Maximum Quantity to the initial level. In addition, MAPCO may not ever increase the Maximum Quantity.

Because of the terms of the PBU Agreement in force among the producers and the state, the state combines royalty production from both the Prudhoe Bay field and royalty oil processed currently through the Lisburne Production Center. The 112,000 barrels per day of royalty crude

³ The contract provides MAPCO with some operational flexibility. With the appropriate one hundred-day notice, MAPCO may take less than the Maximum Quantity, however, a reservation fee would apply to volumes less than the then applicable Maximum Quantity.

oil forecast for 1998 (Table 2) is the sum of the royalty offtake from PBU including both the Initial Participating Areas and the Greater Point McIntyre Area, i.e. Lisburne, Pt. McIntyre, West Beach, North Prudhoe Bay State, and the Niakuk/Alapah Participating Areas.⁴

Table 2 illustrates the present and future royalty crude oil supply from the PBU. The state is obligated to supply 35,000 barrels per day to MAPCO through 2003 and 30 percent of the PBU royalty oil to Tesoro through 1998. If the proposed MAPCO contract is awarded, the state will still keep approximately 13 percent of its royalty share of PBU production as RIV or about 40 percent of the total ANS royalty production in 1998. See Figure 1, titled "Total ANS Royalty and RIK Sale" for the percentage share of ANS RIK oil versus ANS RIV oil.

The state must reserve a sufficient percentage of its PBU royalty oil as RIV to insure that PBU lessees can deduct field costs as a credit from their RIV royalty for the royalty oil the state takes in-kind. The state's flexibility to nominate more RIK oil from the PBU will be limited after this RIK sale to MAPCO. However, there will be some flexibility for the state to offer additional royalty oil from other non-PBU fields on the North Slope as circumstances warrant.

Quality

MAPCO must accept the same quality of oil that the state receives from the producers at Pump Station No. 1. The existing contract with MAPCO does not distinguish between crude oil, condensate, or natural gas liquids (NGLs). MAPCO waives any claim that either condensate or NGLs blended with the crude oil by the lessees tendered to the state as royalty oil is not oil for the purposes of the contract. This waiver will protect the state against any future claim that MAPCO did not receive its full or correct volume of RIK by asserting that condensate or NGLs are not crude oil.

⁴Under the proposed contract, the state reserves the right to supply 100 percent of MAPCO's volume from just the PBU Initial Participating Areas (IPA) rather than include the production from the Greater Point McIntyre Area, i.e., production processed through the Lisburne Production Center. In this case MAPCO would receive initially 33.8 percent of the PBU IPA production. MAPCO will be notified 90 days in advance if the commissioner, in his sole discretion, chooses to exercise this right.

**Figure 1: Total ANS Royalty and RIK Sale
(includes Proposed Mapco Contract)**

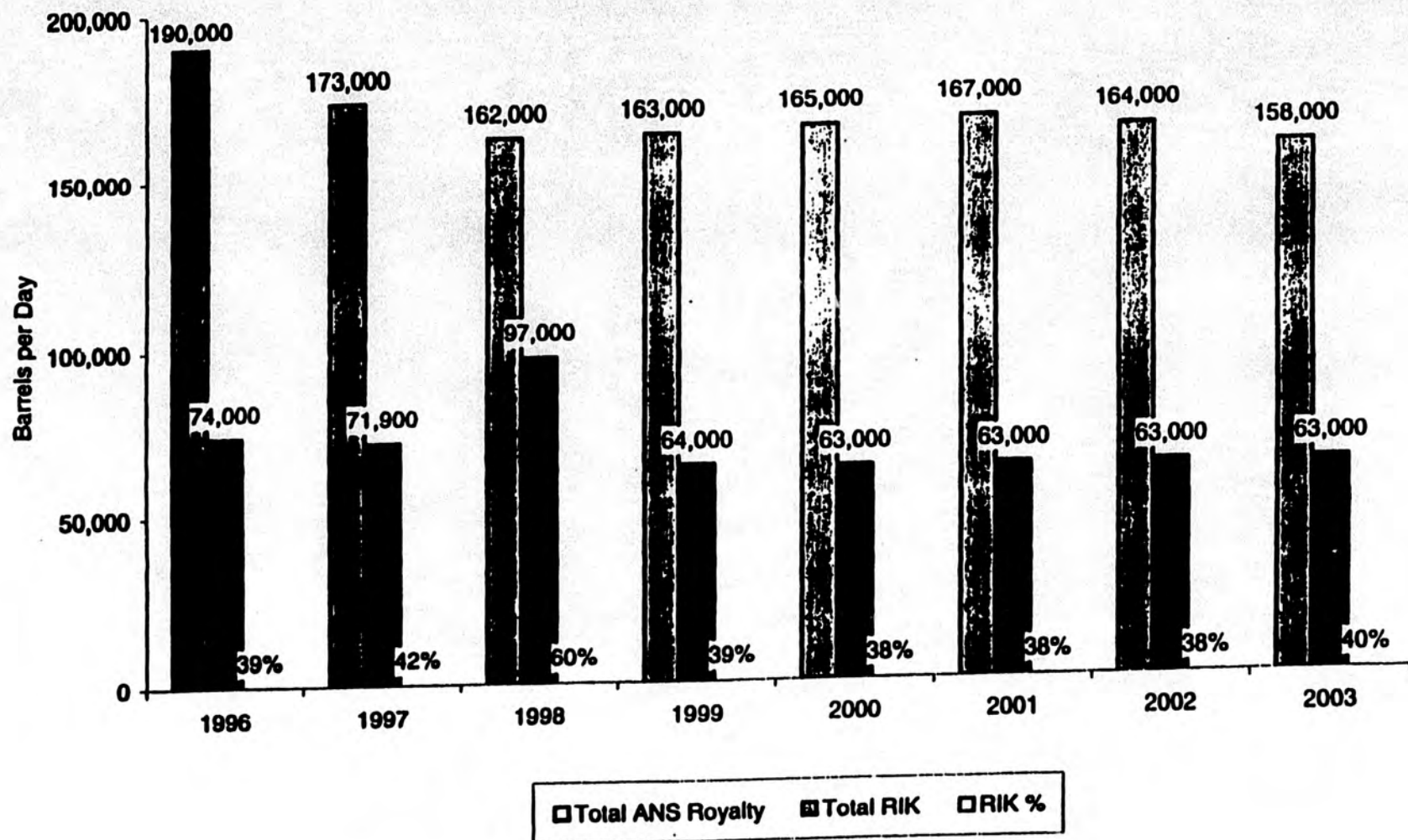


Table 2: North Slope Royalty Crude Oil Production Forecast
(MBOD)

	1998	1999	2000	2001	2002	2003	2004	2005	2006
Greater Point McIntyre Area	23	19	16	13	11	10	9	8	8
Lisburne	1	1	1	1	1	1	1	1	1
Niakuk	4	3	3	3	2	2	2	2	2
Point McIntyre	17	14	11	9	8	7	6	6	5
West Beach -N. Prudhoe Bay State	0	0	0	0	0	0	0	0	0
Prudhoe Bay a/	89	84	81	77	74	71	68	64	60
Satellites b/	0	2	3	4	4	4	5	5	4
Prudhoe Bay Unit	112	105	100	94	89	85	82	77	72
Kuparuk River Unit	33	35	36	34	33	32	29	27	25
Mine Point	8	9	10	11	12	13	13	12	11
Northstar	0	0	0	8	8	7	6	5	5
Other Onshore	0	0	0	0	4	4	4	4	4
Endicott	9	8	8	7	7	6	6	5	5
Badami	0	6	6	5	5	4	4	3	3
Alpine	0	0	6	6	6	6	6	5	5
Total Royalty:	162	163	166	165	164	157	150	138	130
Minus R/V Req'd for Field Cost Allowance									
Prudhoe Bay Unit	11	11	10	9	9	9	3	3	3
Kuparuk River Unit	3	3	3	3	3	3	3	3	3
Mine Point	0	0	0	0	0	0	0	0	0
Endicott	1	1	1	1	1	1	1	1	1
	15	15	14	13	13	13	7	7	7
Minus Current RIK Contracts									
MAPCO #1	35	35	35	35	35	35	0	0	0
MAPCO #2 c/	13	-	-	-	-	-	-	-	-
Tesoro	34	-	-	-	-	-	-	-	-
Total Current RIK Obligation	85	35	35	35	35	35	0	0	0
ANS Royalty Oil Available to Supply New RIK Contracts:									
	65	113	117	117	116	109	143	131	123
MAPCO's proposed 27.0% contract @	d/ 28	28	28	28	28	28	-	-	-
ANS Royalty Oil Remaining:	37	85	89	89	88	81	143	131	123

a/ If the commissioner elects to sell MAPCO RIK from the Prudhoe Bay Initial Participating Area (IPA), then the price per barrel will be calculated on the basis of the volume weighted average of the Royalty Value received from just the IPA, plus \$.15. See Table 2.

b/ Satellites include wells penetrating several smaller, unnamed reservoirs.

c/ MAPCO's #2 contract expires November 30, 1998.

d/ MAPCO's proposed contract is expected to start December 1, 1998 and expires on December 31, 2003.

Price

The proposed contract requires MAPCO to pay a price per barrel equal to the state's royalty value per barrel plus \$.15. The state's royalty value is defined as an amount equal to the per barrel value the state would have received from the Lessees for its royalty oil if the state had taken its royalty in-value instead of in-kind, plus any costs incurred by the state as a result of taking the royalty in-kind rather than in-value. This price meets the statutory requirement that the value of RIK is at least equal to or exceeds RIV. The proposed contract price is comparable to the one-year contract price and the value of RIV. Table 3 illustrates the calculation of MAPCO's price if it took deliveries under the proposed contract in January 1997.

Table 3: Volume Weighted Average Price -All Producers
Value of RIV

<i>Producer</i>	<i>Gross Volume</i>	<i>PS-1 Value</i>	<i>Product of Volume Times PS-1 Value</i>	<i>Average Price</i>
Lisburne Production Center a/ b/ c/				
ARCO	1,803,528.68	\$19.50000	\$35,168,809.45	
BP Exploration	2,565,203.54	\$18.12000	\$46,481,488.14	
Exxon	2,167,463.77	\$18.73000	\$40,596,596.40	
Prudhoe Bay IPA a/				
ARCO	6,812,971.60	\$19.88000	\$135,441,875.41	
BP Exploration	9,731,640.80	\$18.64000	\$181,397,784.51	
Chevron	159,860.30	\$23.24800	\$3,716,432.25	
Exxon	7,700,737.40	\$19.58000	\$148,008,172.83	
Force	9,111.30	\$19.88000	\$181,132.64	
Mobil	362,126.20	\$19.82000	\$7,075,583.82	
Phillips	364,589.50	\$20.89000	\$7,543,356.76	
Texaco	100,129.00	\$18.95000	\$1,897,444.55	
Totals	31,777,362.10		\$607,508,676.78	
Volume Weighted Average Value:				\$19.11766
				+ \$.15/bbl
Price of Sale Oil:				\$19.26766

a/ Under the proposed contract, the state reserves the right to supply 100 percent of MAPCO's volume from just the Prudhoe Bay Unit Initial Participating Areas rather than include the production from the Greater Point McIntyre Areas, i.e., production processed through the Lisburne Production Center. This would imply that MAPCO would receive approximately 33.8 percent of the Prudhoe Bay Initial Participating Areas production. MAPCO will be notified 90 days in advance if the commissioner, in his sole discretion, chooses to exercise this right.

b/ Includes Larch, North Prudhoe Bay State and West Beach.

c/ Includes wells penetrating several smaller, unnamed reservoirs.

Like the current MAPCO and Tesoro contracts, the proposed contract price replaces the need for an escrow account and retroactive ANS Royalty Litigation⁵ adjustments that appear in MAPCO's 1978 contract. MAPCO's proposed contract will have a more certain purchase price, subject to only minor subsequent adjustments. The ANS Royalty Settlement Agreements concluded the ANS Royalty Litigation and provided an agreed-upon valuation method that did not exist when MAPCO's 25-year royalty oil contract was signed. MAPCO's new RIK contract will rely upon agreed-upon valuation methods in the ANS Royalty Settlement Agreements to establish a contract price. Except for certain related adjustments contemplated under the

⁵ ANS Royalty Litigation refers to the dispute between the state and the ANS lessees that was resolved in several settlement agreements (Case No. 77-847 Civil, June 1977).

settlement agreements with ARCO, BP, Exxon and the other PBU producers the MAPCO contract will not require an interim pricing method.

Previous RIK findings have described the so-called "displacement effect" and "competitive effect" that may occur with a state sale of RIK. Because the changes in the markets for ANS oil, these effects will be very minor.

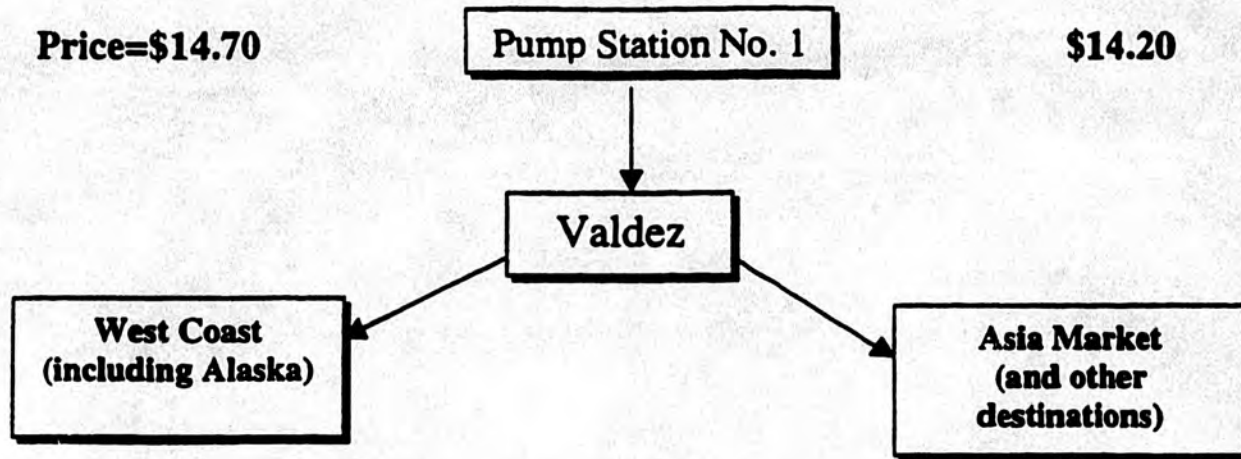
The "displacement effect" theorizes that any RIK sale by the state to in-state refiners will replace ANS sales by North Slope lessees to West Coast destinations including Alaska. Although the total volume of ANS sold on the West Coast is the same without a RIK sale, the producers must show in their royalty reports that a larger proportion of their oil is placed in destination markets where netback values are less than the West Coast. The West Coast destinations yield a higher royalty value than the other destinations. The average royalty value, weighted by oil volumes to each destination, is lower when the proportion of oil reported by the lessees going to the non-West Coast destination increases. This proportion of deliveries to the West Coast and other destinations is also reflected in the netback value reported for severance tax purposes. In this way, selling RIK decreases the state's revenues from both RIV royalties and severance taxes.

The potential for a "displacement effect" has diminished since the market of total ANS sold on the Gulf Coast has disappeared. The Gulf Coast's historically low royalty value contributed the biggest impact in calculating the displacement effect. There are now no more waterborne shipments of ANS to the Gulf Coast and the volumes shipped to the Mid-Continent or the Far East yield netbacks that are higher than the Gulf Coast netbacks.⁶

As shown in this example, (See Table 4) the displacement effect, is insignificant. The contract price is sufficient to compensate the state for any reduction in the royalty value of RIV oil.

⁶Alaska Department of Revenue, Fall 1997 Revenue Sources Book, Forecast and Historical Data. Anchorage, Alaska. p.19. ANS movements to destinations in the Far East, the Caribbean and the U.S. Mid-Continent represented just 5 percent of total ANS production in FY 1997.

TABLE 4: DISPLACEMENT EFFECT



If the North Slope producers take all of our royalty oil "in-value," their shipments will look like this:

$$\begin{array}{rclclcl}
 28,000 & + & 922,000 & + & 50,000 & = & 1,000,000 \\
 \text{(Mapco)} & & \text{(CA and WA)} & & \text{(Asia Market)} & & \text{(Total)}
 \end{array}$$

In percentage terms:

$$3\% + 92\% + 5\% = 100\%$$

The calculation of royalty value (and severance tax) is:

$$(\$14.70 \times 3\%) + (\$14.70 \times 92\%) + (\$14.20 \times 5\%) = \$14.67$$

If the state sells oil to Mapco, the producer's placements on the West Coast are reduced by 28,000 barrels. Their shipments will now look like this:

$$\begin{array}{rclclcl}
 0 & + & 922,000 & + & 50,000 & = & 972,000 \\
 \text{(Mapco)} & & \text{(CA and WA)} & & \text{(Asia market)} & &
 \end{array}$$

In percentage terms:

$$0\% + 95\% + 5\% = 100\%$$

The calculation of royalty value (and severance tax) is:

$$(\$14.70 \times 0\%) + (\$14.70 \times 95\%) + (\$14.20 \times 5\%) = \$14.67$$

In this example, the displacement effect has no effect on the state's royalty and severance tax revenue.

The "competitive effect" relies on the assumption that the price of ANS on the West Coast as reported in the producers' royalty value is higher than the price that would result from a purely competitive market. One North Slope producer dominates the ANS spot market and may be able to influence the price by its decision to transport oil to other destinations. When the state was selling nearly 210,000 barrels per day of RIK in 1986, (See Figure A-1) the state, as another seller in the market competing with the ANS producers, could conceivably contribute to a lower West Coast price. The "competitive effect" is probably immeasurable since ANS supply in the West Coast market is declining. Competitive market forces beyond the control of the ANS producers, including the state, now govern the price of ANS.

In-State Processing

In the proposed contract, MAPCO has agreed that 80 percent of the RIK it will purchase will be processed in the North Pole refinery. This clause is designed to prevent MAPCO from re-selling RIK to a third party and possibly profiting from a favorable price charged to MAPCO by the state. The in-state processing clause assures that the state will enjoy the benefits described in Section IV below.

Purchase Price Reopener

The contract provides no provision for either the state or MAPCO to renegotiate the price terms. Should the state pursue a price reopener as permitted by the ANS Royalty Settlement Agreements, the state is obligated only to inform MAPCO that negotiations have begun. MAPCO will pay based on whatever the Royalty Value the state and the producers may negotiate.

MAPCO also agrees that it will not intervene in any way in the negotiations or arbitration of a reopener between the state and the producers. If the new price terms that may result are disagreeable to MAPCO, it has the right to terminate the contract with one hundred days notice to cease deliveries.

Payments

The proposed contract has specified the timing and due dates associated with the Production Month Invoice, Initial Adjustments, and Subsequent Adjustments. The timing of these invoices and due dates have been shortened somewhat to reduce the state's exposure to default risk as described below.

The state has agreed that any subsequent adjustments rendered more than six years after the date of delivery will bear interest for only six years from the due date of the initial billing. However, this six-year interest limitation does not apply to adjustments that result from regulatory decisions, reopeners, court proceedings, or true-up audits that are commenced during the six-

year period. This provision appears in both the current one-year MAPCO contract and Tesoro's current three-year contract.

Termination Notice

The state requires at least one-hundred days notice of early termination of the contract or any reduction in the maximum quantity taken by MAPCO. This timing is based on the ANS Royalty Settlement Agreements and the PBU Agreement. Under the original PBU Agreement, the state has a right to "denominate" RIK deliveries with a six-month notice. However, under each of the ANS Royalty Settlement Agreements, the timing requirement was reduced to 90 days. The ANS Royalty Settlement Agreements provide that the lessees may claim *force majeure* if marine transportation is unavailable to transport any additional RIV for the first 90 days that the RIK has reverted back to the producers. During this up-to-90-day period that lessees could claim *force majeure*, the state must take full possession of its RIK and find customers to buy it and tankers to transport it. For this reason MAPCO must provide sufficient notice to terminate the contract or reduce its maximum quantity, up to six-months and ten days if necessary.

Late Payment Penalty

If MAPCO fails to make full payment of its monthly obligation within three business days following the receipt of the invoice, a five percent penalty will be imposed. In MAPCO's one year contract, the same late payment penalty applies.

Interest

Underpayments and overpayments are an unavoidable problem in any RIK sales contract. The contract price is based on Royalty Values calculated under provisions in the ANS Royalty Settlement Agreements that are subject to re-adjustments for true-up audits, regulatory decisions, reopeners, or court proceedings. Both the state and MAPCO agree to pay each other the statutory interest rate on readjustments made for overpayments or underpayments, respectively. The applicable rate is five percent over the annual rate charged member banks for advances by the 12th Federal Reserve Bank or 11 percent compounded quarterly, whichever is greater (AS 38.05.135(d)).

Local Hire

Like MAPCO's one-year contract and virtually every RIK contract to in-state refineries, the proposed contract requires that MAPCO agree to employ Alaska residents and Alaska companies to the extent they are available, willing and qualified for the applicable work performed in Alaska in connection with the Agreement. An Alaska resident is defined as one who has resided in Alaska for one year at the time of employment and "Alaska companies" means companies incorporated in Alaska or whose principal place of business is in Alaska. If

this provision is determined to be unconstitutional, then MAPCO agrees to hire Alaska residents to the extent that the constitution allows.

Security

The proposed contract requires an irrevocable stand-by letter of credit equivalent to the value of 75 days worth of RIK to secure the state in the event that MAPCO, for any reason, fails to pay its bills or to take delivery. The value of the letter of credit is calculated to protect the state from its exposure to "default risk" and "denomination risk." Default risk is the exposure the state faces if MAPCO fails to pay. Since MAPCO is billed on the first day of the month following the production month up to 39 days of RIK will be delivered to MAPCO before the state is in a position to declare the contract in default for failure to pay (See Table 5). In addition to the risk assumed by the state should MAPCO fail to pay, the state also runs a risk of losing full value of its RIK when it "denominates" the RIK volumes to RIV. As indicated above, the 90 day denomination notice period under the ANS Royalty Settlement Agreements plus 90 days should a lessee declare *force majeure* represents the amount of RIK oil subject to this risk. During this period, the state either has to organize a new RIK purchaser or negotiate with the lessees to take back the RIK. In either event, the state could be in a distress sale situation. The letter of credit instrument is intended to protect the state from losses for volumes delivered under the contracts or re-sold at a price less than the contract price.

The state's risk exposure is measured as follows:

Table 5: Calculation of MAPCO's Letter of Credit

		Days
Default Risk		
Days RIK tendered but not billed:		30
Days to Production Month Invoice:		2
Production Month Invoice Due:		3
Default Declared:		4
Total Default Exposure		39
Denomination Risk		
Volumes Subject to 90-day Denomination @ 100%	90 days	
Probability that 90-day notice rights invoked @ 100%	90 days	
Resale Value of denominated oil \$.80 on the \$1		
Number of days "at-risk" (20% X 90 days)		18
Volumes Subject to 90-day Force Majeure @ 100%	90 days	
Probability that 90-days notice rights invoked @ 100%	90 days	
Resale Value of denominated oil \$.80 on the \$1		
Number of days "at-risk" (20% X 90 days)		18
Total Denomination Exposure		36
Total Risk Exposure		75

The letter of credit is valued at the price of the RIK volume per day times the number of days of total risk exposure.

The proposed contract includes an alternative security provision if MAPCO so elects. This security provision requires that MAPCO provide the state with an irrevocable stand-by letter of credit for forty days of RIK oil, plus an irrevocable backup contract with a major oil company subject to approval by the Commissioner. The backup contract would assume MAPCO's full liability to the state to purchase RIK oil for a minimum of 90 days or a maximum of 180 days deliveries of RIK oil. Should MAPCO default, the state will draw from the 40 day letter of credit and the backup contract would immediately take effect for the RIK oil due MAPCO until the 90 day or 180 day (if producers invoke *force majeure* notice) denomination notice of the state's RIK oil became effective.

The concern for the state's exposure to default and denomination risk is driven by the state's previous experience. The security and other provisions of recent RIK contracts mitigate those risks. The Alpetco RIK sales contract, executed on February 22, 1978, a so-called in-state enhancement contract, was the worst performer recovering only 94.5% of the principal. Part of this difference were losses the state incurred on the royalty oil subject to "denomination risk." When Alpetco attempted to decrease its RIK purchases, the state realized only 78 percent of the contract price.

Over time, the Division has looked at some of the obvious problems with the Alpetco RIK contract and these problems have been mitigated or eliminated in the subsequent contracts. The proposed MAPCO contract avoids the following:

- Dispute clause that allowed Alpetco to unilaterally withhold any amounts Alpetco disputed without Alpetco's debt being called due and payable.

See MAPCO contract, page 15, line 11 (6.10 Disputed Payments) requires MAPCO to pay the full amount pending final resolution of the dispute.

- Ability to intervene in ANS Royalty Litigation allowed Alpetco the potential to disrupt the settlement if the state pursued litigation against Alpetco's parent company for claims.

See MAPCO contract, page 7, line 19 (2.5 Reopeners) stipulates that MAPCO shall not intervene or participate in any way regarding ANS Royalty Settlement Agreements or litigation with the lessees. This provision removes any leverage that MAPCO may have over the state.

- Failure to secure full value for its RIK oil resulted from the narrow marketing window imposed on the state when Alpetco could no longer take RIK volumes.

The MAPCO contract establishes the timing required for termination notices, notices to reduce the Maximum Quantity, and month-to-month deliveries volumes within the limits allowed in the ANS Royalty Settlement Agreements. The security clause requires a letter of credit and/or a backup contract so that the state can recover any losses due to premature denomination of RIK.

IV. In-State Benefit Analysis

The commissioner considered the effects of the sale of RIK on the economy of the state and the projected benefits of refining or processing the RIK in the state (under AS 38.05.183). In short, the terms of the proposed RIK sale should: (1) assure that the state receives at least as much value for the RIK as it would have received for RIV; and (2) encourage in-state processing of RIK together with the attendant economic and social benefits. These benefits are measured in terms of jobs, taxes, and economic competition among the state's refineries for their products. The conclusions reached in the best interest finding that accompanied the current one-year contract are still applicable. Some of the information has been updated here.

In the following discussion of in-state benefits, there is one caveat: the degree to which these effects may be attributable to the sale depends on how important the sale is to the continued operation and expansion of MAPCO's North Pole refinery. The state can offer a somewhat unique crude oil supply contract whose terms might not be available from any other seller. Presumably, MAPCO would continue operations without this contract, but there are direct benefits MAPCO may derive in dealing with the state. To the extent that these benefits are translated into jobs, taxes, and more vigorous refined-products competition, the people of the state also benefit. By the same token, the degree to which the sale may contribute to the ongoing operation and expansion of the refinery must also be taken into account when describing the environmental effects of the refinery's operation.

Economic Impacts

A \$70 million expansion and upgrade at the North Pole refinery is underway and will increase fuel production by 17,000 barrels per day. Recent upgrades at the North Pole refinery provide MAPCO the opportunity to expand its export markets in Western Canada and the Pacific Rim. In addition, the 1998 expansion will create 17 new jobs in North Pole and Anchorage.

MAPCO reports that it currently employs 120 people in the Fairbanks North Star Borough and 35 people in Anchorage who are directly associated with the North Pole refinery. In addition, MAPCO employs another 300 people statewide at their MAPCO express outlets.⁷ This translates as one-fourth of the manufacturing jobs in the Fairbanks North Star Borough competing largely with mining and construction jobs. For the most part, these are also high-wage jobs with a payroll in the Fairbanks North Star Borough of over \$9.4 million in 1994.⁸ Wages in the petroleum refinery and transportation sector averaged \$72,677 or more than twice the Fairbanks North Star Borough average. Income spent by workers in this sector contributes to an employment multiplier of over 2.5, i.e., for every job at MAPCO's North Pole refinery 2.5 jobs are created in the wider Fairbanks North Star Borough economy.

⁷ Communication with Keith Selby, MAPCO Alaska Petroleum, Inc. 1/23/98.

⁸ Lee Huskey, ISER. November 1995. "Table 2: The Fairbanks Petroleum Sector Private Industry Wage and Employment Effects," of the "The Petroleum Industry and the Fairbanks Economy" report.

MAPCO's statewide marketing and distribution of petroleum products activities, together with the refinery, employs a total of 455 people statewide with a payroll (including benefits) of over \$19.5 million in 1997.⁹

Consumption Effects

The market for crude oil and the market for retail petroleum products are different markets. While crude oil is a factor in the production of retail products (like electricity and labor), it is traded in a different market. Accordingly, lower prices of crude will not necessarily transfer immediately to a lower price for retail products. Wholesale product prices can move independently of ANS crude prices¹⁰ because of the other factors. These other factors include such influences as refinery outages, changing gasoline specifications, gasoline inventory levels, the previous month's wholesale price, and other energy market effects.

As with other in-state refiners, the presence of MAPCO in the state provides competition to outside fuel sellers who import products to Alaska. California suppliers can capture the difference in state highway gasoline taxes of 22 cents per gallon between markets in Alaska and California. For Washington, the difference is 15 cents. All other things being equal, this difference in government take provides a business opportunity for outside suppliers to sell gas in Alaska. The presence of local suppliers of retail products in competition with imported petroleum products adds price competition to the retail market. In the same manner, imported products offer competition to local suppliers.

The presence of MAPCO's North Pole refinery as a local product supplier with lower transportation cost to markets and situated next to a crude oil pipeline provides price competition to imported petroleum products. MAPCO's healthy market share of the gasoline and jet fuel trade indicates that imported products sellers must consider MAPCO's price in setting their own.

Two investigations conducted in the mid-1980's by the Alaska Attorney General's office supports the important role of competition in the level of in-state gasoline prices.¹¹ Both studies report that higher profit margins stem from weak competition. In 1985, only one in-state refinery produced motor gasoline throughout the entire calendar year. That refiner enjoyed a decrease in its price for most of its crude feedstock while wholesale prices were increased by an average of 6.5 cents per gallon.¹² The Attorney General's report concluded, "... the refineries are charging more for refined gasoline, even though they are paying less for the crude oil they use to make the gasoline." With only one refiner producing gasoline for the entire calendar year, there was little competitive pressure to reduce wholesale prices at a time when their largest cost input, the price of crude feedstock, decreased. MAPCO began refining motor gasoline in the last quarter of 1985 and has provided competition in that market.

⁹ Communication with Keith Selby, MAPCO Alaska Petroleum Inc., Anchorage, Alaska 1/26/98.

¹⁰ William W. Wade and Robert R. Trout. "Crab Gas Phase-In Price Spike: Collusion or Market Effects?" 1997

¹¹ Memo to M. Mike Miller, Chairman, House Judiciary Committee from Attorney General Norman C. Gorsuch. RE: Southeast Alaska Gasoline Price Investigation. May 13, 1985. Fairbanks Gasoline Report, February, 1986. An attachment to a memorandum to Governor Bill Sheffield from Attorney General Harold M. Brown, March 11, 1986.

¹² Fairbanks Gasoline Report, page 17.

This competition in the in-state gasoline sales market, along with other sellers, provides a dampening effect on prices. The effect of market competition on prices reported in the 1985 Attorney General's report explains that "The ...price difference [between wholesale prices in Anchorage and Southeast Alaska] appears to be due to a very low level of competition between wholesalers in Southeast Alaska, which permits higher profit margins."¹³ Insofar as state refineries and product wholesalers can compete, the consumer can enjoy lower prices than would be the case if competition did not exist.

Social Impacts

MAPCO paid 60 percent of the property tax revenues collected in 1996 by the City of North Pole. Until 1997, when the Ft. Knox Gold Mine came on line, MAPCO's North Pole refinery had the highest property assessment in the Fairbanks North Star Borough at \$94 million.¹⁴ MAPCO's tax contribution will grow as a result of the refinery expansion. No incremental effects on land use, impacts on the local social infrastructure, i.e., schools, public safety, roads, and other government services, are anticipated as a result of this sale.

Effect of Refinery Expansion

MAPCO's North Pole refinery is the largest refinery by volume in the state. Almost half of MAPCO's business is jet-fuel sales, and the company has about half the market at Anchorage International Airport which equals approximately 861,000 gallons per day in 1997. MAPCO's growth is being driven by the rapid expansion (about a 43% growth rate from 1995 levels), of jet-fuel sales in Anchorage as the growth in international air-cargo traffic continues. All of the additional jet fuel production due to the refinery expansion is projected to supplant foreign imports of jet fuel. Including purchased volumes, MAPCO supplies approximately 39% of the jet fuel used in Alaska. MAPCO's 1996 jet fuel production was 22,000 barrels per day or 924,000 gallons per day.¹⁵

Jet-fuel demand in Alaska has been growing at 7 to 8 percent a year and at least 4 percent growth is expected over the next few years.¹⁶ Total Alaska jet-fuel demand is about 55,000 barrels per day, with all but 14,000 to 15,000 barrels of that supplied by the four Alaska refineries, mostly by MAPCO. Over 80% of North Pole refinery's production is consumed in the state of Alaska. MAPCO markets more than 40,000 barrels per day of these refined products to Alaska, Western Canada and the Pacific Rim. MAPCO processes only Alaska North Slope crude oil. In addition, the refinery markets 64% of its gasoline production through MAPCO Express stores in Alaska.

MAPCO estimates that its retention (i.e. oil taken from TAPS at the North Pole refinery but not returned to the pipeline) will be approximately 45,000 barrels per day. In future years MAPCO will retain approximately 64,000 barrels per day to produce MAPCO's produce slate. See Table

¹³ Memo to M. Mike Miller, page 2.

¹⁴ Lee Huskey, ISER, November 1995. "Table 2: The Fairbanks Petroleum Sector Private Industry Wage and Employment Effects," of the "the Petroleum Industry and the Fairbanks Economy" report.

¹⁵ Communication with Keith Selby, MAPCO Alaska Petroleum Inc., Anchorage, Alaska 1/23/98.

¹⁶ 1996 MAPCO Petroleum Inc. Annual Report.

6 and Figure 2 titled "North Pole Refinery Total Retention and State Royalty Volumes" for the amounts by year. For every barrel of oil that MAPCO retains in its refinery, MAPCO returns two barrels of residual oil to the TAPS. (See Table 6 and Figure 3 titled "MAPCO's Projected Product Slate" for the types and percentages of refined products). After the 1998 expansion, the maximum crude distillation capacity or processing capacity of the North Pole refinery will rise to 210,000 barrels per day.

Quality Bank

MAPCO's expansion will increase its return flow by 63,000 barrels to a total of 159,000 barrels per day.¹⁷ This increased return flow to the pipeline degrades the crude oil stream. MAPCO compensates for this degradation by making increased payments to the TAPS Quality Bank.

Any effect on ANS crude price due to increased degradation of the pipeline stream is compensated by the Quality Bank. The quality bank methodology, theoretically, equalizes value between crude streams by billing relatively lesser value streams and compensating relatively higher value ones.

Environmental Impacts

Air quality issues: MAPCO has made timely a application and complied with all permit requirements required under Title V of the federal Clean Air Act amendments of 1990 and 1993 state legislation under which Alaska was delegated authority. MAPCO is in compliance with the applicable air quality regulations and Alaska Department of Environmental Conservation (ADEC) officials expressed no problems with the refinery.¹⁸

Industrial wastewater issues: MAPCO runs its treated discharges through filters then into the North Pole Wastewater System. This is done under the authority of a pretreatment permit. MAPCO sends monitoring information to ADEC through quarterly reports. MAPCO is in compliance with the applicable wastewater regulations.¹⁹

Contaminated site issue: MAPCO has an ongoing groundwater remediation program and is still cleaning contaminants from the aquifer. ADEC reports that MAPCO is fulfilling its responsibility and operating properly under the appropriate permits. When asked, ADEC responded that if the refinery ceased operation and discontinued the remediation program, it would be a detriment to the environment as natural degradation of remaining contaminants would be very slow.²⁰ However, even if the refinery abruptly ceased operations, MAPCO would remain liable as an operator or owner for any contamination that has occurred as a result of refinery operations.²¹

¹⁷ Communication with Keith Selby at MAPCO, Anchorage, Alaska 12/3/97.

¹⁸ Communication with Jack Coutts, Alaska Department of Environmental Conservation, 12/18/97.

¹⁹ Communication with Tim Wingerter, Alaska Department of Environmental Conservation, 12/18/97.

²⁰ Communication with Doug Bauer, Alaska Department of Environmental Conservation, 12/19/97.

²¹ Communication with Mary Lundquist, Alaska Attorney General's Office, 1/22/98.

TABLE 6

Table 6: Mapco's Projected Product Slate (Percent of Total Refinery Throughput)

	1994	1995	1996	1997	1998	1999-2003
Gasoline Blendstock	9	13	15	15	13	9
Gasoline	11	12	12	11	14	10
Jet Fuel	54	52	50	50	49	57
Diesel	19	19	17	18	18	19
Heavy Atm. Gas Oil	5	2	4	5	5	4
Asphalt	2	2	2	1	1	1
Total	100	100	100	100	100	100

MAPCO Refinery Retention (barrels per day)

Total Retention	38,000	42,000	46,000	44,000	45,000	64,000
State Royalty Volume	35,000	35,000	35,000	35,000	45,000	57,000

Figure 2: North Pole Refinery Total Retention and State Royalty Volumes

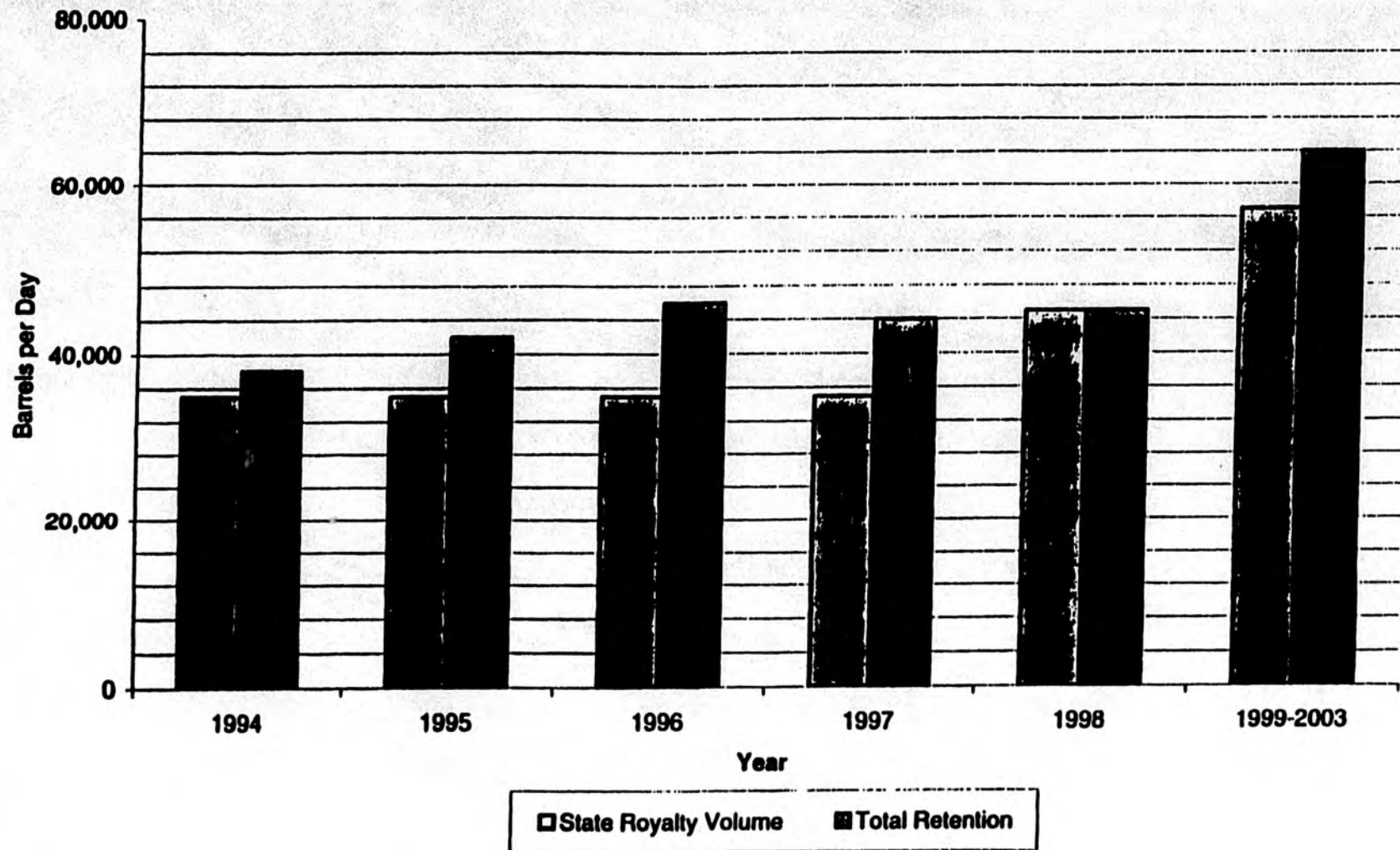
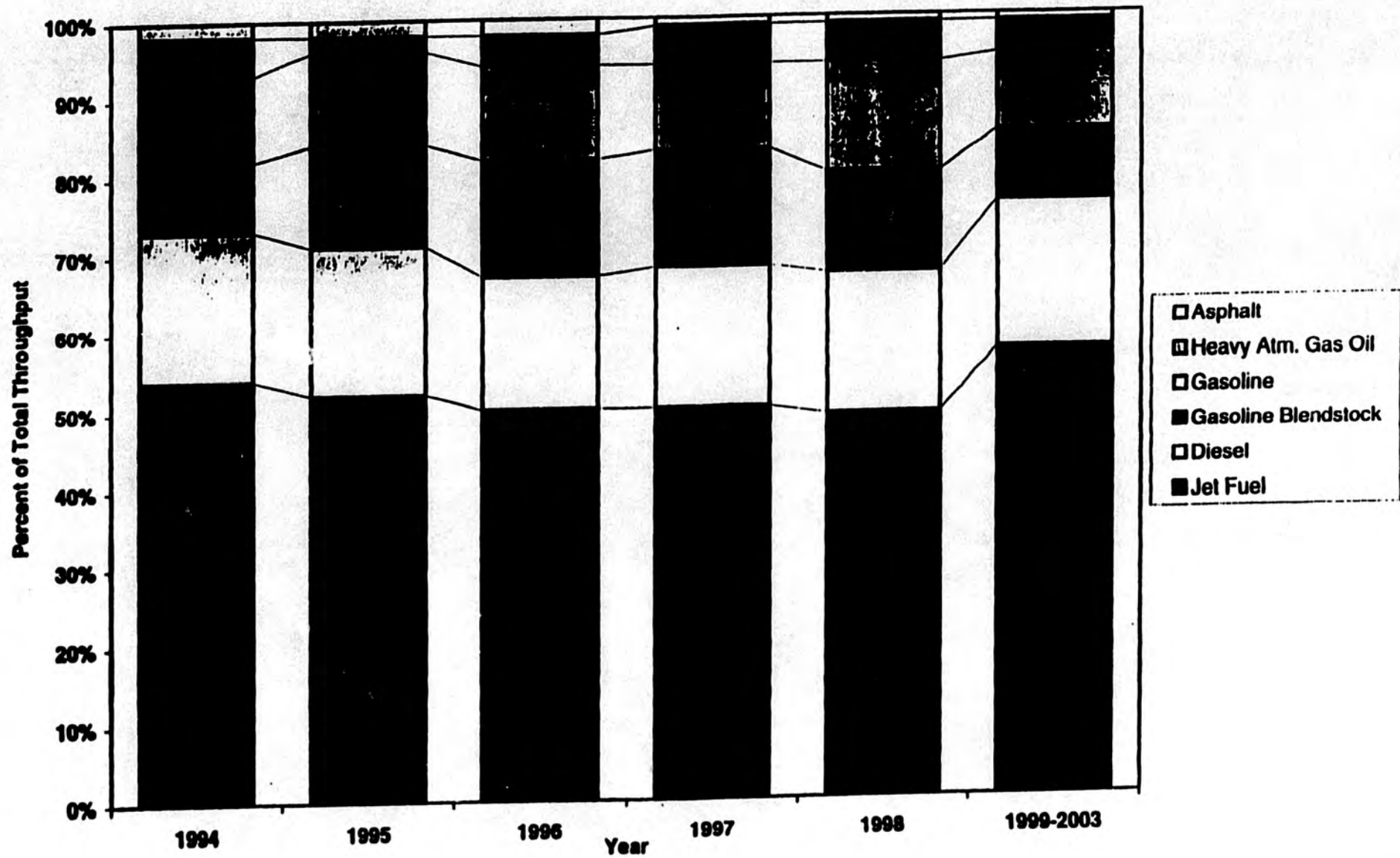


FIGURE 3: Mapco's Projected Product Slate



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V. Findings and Determination

In any disposition of RIK, the commissioner must conclude that the best interest of the state will be served by a non-competitive sale (AS 38.05.183(a)), and that, the non-competitive sale of RIK will be awarded to the prospective buyer whose proposal offers maximum benefits to the citizens of the state (AS 38.05.183(e)). The commissioner considered the criteria listed in AS 38.05.183(e) and AS 38.06.070(a). The criteria listed in AS 38.05.183(e) are: (1) the cash value offered; (2) the projected effects of the sale, exchange or other disposal on the economy of the state; (3) the projected benefits of refining or processing the oil in the state; (4) the ability of the prospective buyer to provide refined products or by-products for distribution and sale in the state with price or supply benefits to the citizens of the state; and (5) the criteria listed in AS 38.06.070(a). These are the same criteria that are to be considered by the Royalty Board in its review of the sale. The criteria listed in AS 38.06.070(a) are: (1) the revenue needs and fiscal condition of the state; (2) the local and regional requirements for petroleum products; (3) the desirability of localized capital investment, increased payroll, and secondary development effects; (4) the social impacts of the sale; (5) the additional costs to the state and local governments caused by the development related to the transaction; (6) the local and regional labor market; (7) environmental effects; and (8) the impact on existing private commercial enterprises and investment patterns. The commissioner also considered comments from the public received during the 30-day public notice period.

The applicable statutes and regulations are included in Appendix B.

Competitive Bidding is Waived

As commissioner of the Department of Natural Resources, I have determined in accordance with AS 38.05.183(a) and 11 AAC 03.030 that the best interest of the state may be served by a sale without competitive bidding. The state is currently selling 71 percent of its PBU royalty oil under MAPCO's long term and one-year contracts and Tesoro's three-year contract. In 1999, Tesoro's three-year and MAPCO's one-year contracts expire.

By 1999, MAPCO will purchase approximately 60 percent of ANS royalty oil under its 25 year contract and the proposed contract. The state will retain 40 percent of its royalty, approximately 65,000 barrels per day for future RIK dispositions. Tesoro indicated verbally to the department an interest in a new one-year contract beginning in 1999.²² The state will retain enough royalty oil to meet the needs of other RIK purchasers even with the proposed contract.

A copy of the Preliminary Finding and Determination was delivered to the Alaska Royalty Oil and Gas Development Board as notification under 11 AAC 03.040 that competitive bidding has been waived.

²² Communication with Ipe Chako, Tesoro Alaska Petroleum Company, December 12, 1997.

The Sale is in the Best Interest of the State

In accordance with AS 38.05.182 and AS 38.05.183, I find that taking RIK oil and selling by non-competitive bid to MAPCO for use at the North Pole refinery is in the best interests of the state. The proposed RIK contract meets the following criteria as set out in AS 38.05.183(e).

1. The cash value offered: The RIK price offered under the proposed contract exceeds the royalty value of RIV by \$.15 per barrel. Therefore, the requirements of AS 38.05.183(c) and 11 AAC 03.010(b) are satisfied. Furthermore, the sales price satisfies the definition of "market conditions" in 11 AAC 03.024(1) and (3).
2. The projected effects of the sale, exchange or other disposal on the economy of the state: The projected effects of the sale to MAPCO on the economy of the state are expected to be positive. The people of the state will benefit from the proposed sale to the extent that benefits of this sale can be translated into jobs, taxes, and more vigorous refined-products competition.
3. The projected benefits of refining or processing the oil in the state: The presence of MAPCO's North Pole refinery as a local product supplier with lower transportation cost to markets and situated next to a crude oil pipeline provides price competition to imported petroleum products. The consumer may enjoy lower gasoline prices than would be the case if competition did not exist because MAPCO, other refineries and product wholesalers compete for a share of the gasoline sales market.
4. The ability of the prospective buyer to provide refined products for distribution and sale in the state with price or supply benefits to the citizens of the state: MAPCO's North Pole refinery is the largest refinery by volume in the state. It has been in business in Alaska since the late 1970's, and provides a 50 percent share of the local market for diesel fuels, jet fuels and gasolines.
5. The criteria listed in AS 38.060.070(a): See discussion below.

In addition, I find that the sale offers maximum benefits to the citizens of Alaska. The proposed sale meets the following criteria:

1. The revenue needs and fiscal condition of the state: The state depends on oil revenue and will continue to depend on oil revenues in the future. The price term of the sale protects the state's interest by ensuring that revenues from this sale will exceed the in-value alternative. (AS 38.06.070(a)(1))
2. The local and regional requirements for petroleum products: There are local and regional economic benefits to be derived from the continued operation and expansion of the North Pole refinery. While the proposed contract may increase the financial viability of the refinery, the extent to which these benefits can be ascribed to the proposed contract cannot be predicted. As described above, MAPCO is an important

competitor in the market of refined petroleum products. Vigorous competition in fuel sales in the state may provide for lower consumer product prices. (AS 38.06.070(a)(2))

3. The desirability of localized capital investment, increased payroll, and secondary development effects: To the extent that the sale helps provide a consistent and economic supply of crude oil to the refinery, the sale will contribute to ongoing economic stability in the Fairbanks North Star region and maintain a healthy competitor in the in-state market for refined petroleum products. MAPCO is undertaking a \$70 million expansion program at the refinery. During the construction period of the refinery expansion, there will be short-term economic benefits of jobs and salaries. In addition, MAPCO will add 17 permanent jobs to the local economy. (AS 38.06.070(a)(3))
4. The social impacts of the sale: Both the Fairbanks North Star Borough and the state receive revenues from MAPCO as property taxes and corporate income and excise taxes. MAPCO contributes \$94 million to the local property tax base. With the planned expansion of the refinery, this contribution will grow. (AS 38.06.070(a)(4))
5. The additional costs to the state and local governments caused by the development related to the transaction: Additional costs incurred by the state and local governments as a result of this transaction will be minor. The refinery expansion will employ more people who will require social and education services and the Division of Oil and Gas will incur additional administrative expenses. (AS 38.06.070(a)(5))
6. The local and regional labor market: MAPCO provides direct jobs to 120 people in the city of North Pole and 35 people in Anchorage for their North Pole refinery operations and another 300 people statewide. It is number ten of the top-ten private sector employers in the Fairbanks North Star region. (AS 38.06.070(a)(6))
7. Environmental effects: Any environmental effects will result from the continued operation and expansion of the North Pole refinery, not from the proposed sale. The sale by itself will have no incremental effect. (AS 38.06.070(a)(7))
8. Impact on existing private commercial enterprises and investment patterns: Any impacts on existing private commercial enterprises and investment patterns could result from more competition in the product market and lower prices for products might result from this competition. (AS 38.06.070(a)(8))

Criteria Weights

According to 11 AAC 03.060(b), "In considering the criteria described in AS 38.05.183(e), the Commissioner stated which criteria applied to the proposed disposition and discussed the weight given to the applicable criteria in determining the maximum benefit to the state...."

In making this finding, the department first determined that the state would not lower the total oil revenue, including royalties and severance taxes, due the state by making a disposal to MAPCO. The department next examined the criteria to determine that the state would not create any unacceptable social or environmental impacts. Finally, the department looked at whether the disposal contributed to competition in the in-state refining industry and the extent to which that would lead to lower product prices.

Royalty Board

The preliminary finding and determination was submitted to the Royalty Board in compliance with AS 38.05.183(c) which provides that the commissioner may not waive competitive bidding of this sale of RIK unless prior written notice is given to the board. Under AS 38.06.070(c) the Royalty Board will make a full report to the legislature on each criterion set out in AS 38.06.070(a) and (b) for any disposition of royalty oil that requires legislative approval. The Royalty Board's report will be submitted for legislative review at the time a bill for legislative approval of this proposed royalty oil contract is introduced in the legislature.

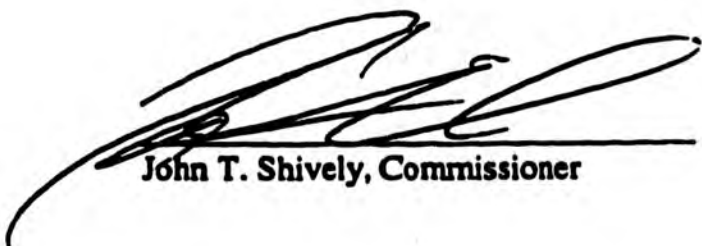
Legislative Approval

According to AS 38.06.055(c) the commissioner may not renew the current one-year contract with MAPCO without the prior approval of the legislature. By statute, the Royalty Board reviewed this sale and a written recommendation will be submitted to accompany a bill introduced in the legislature to approve the sale (AS 38.06.050).

Conclusion

Under the terms of the proposed contract, the state receives a fair value for the royalty oil, promote in-state processing, product competition and attendant benefits. The state will retain enough royalty oil to meet the needs of other RIK purchasers even with the proposed contract. The price terms are satisfactory, and the sale to MAPCO offers economic benefits to Alaska citizens.

The foregoing facts and analysis support the finding that this sale is in the best interest of the state and offers maximum benefits to Alaska citizens.



John T. Shively, Commissioner

3/5/98
Date

Appendix A: Summary of Previous North Slope Royalty Oil Sales

Volumes. Beginning in November 1979 and continuing to the present, the state has delivered North Slope RIK to fourteen companies in twenty negotiated contracts, two competitive sales, and one quasi-competitive sale. By December 1997, the state delivered over 529 million barrels or approximately 50 percent of its North Slope royalty crude oil through these contracts.

Negotiated royalty oil sales are defined as dispositions of royalty oil where a determination has been made that the best interest of the state does not require competitive bidding or that no competition exists. In every case the negotiated contracts were for sales of royalty oil to in-state refiners.

The state negotiates with a company the quantity, price and other terms of a short or long-term negotiated royalty oil sale. Short-term negotiated royalty oil sales are one year or less and do not require legislative approval. Long-term negotiated royalty oil sales are longer than one-year and legislative approval is required before the royalty oil contract becomes effective.

Figure A-1 shows the amount of royalty oil sold to these companies since the North Slope production began. The graph indicates that the amount of oil sold to each company has varied over the years. Tesoro and MAPCO have been the state's two most consistent customers.

Under various contracts through the 1980's Tesoro took approximately 218.8 million barrels of RIK.²³ The biggest of those contracts was a 10-year agreement that terminated in 1994. The crude oil purchased by Tesoro is refined at the Nikiski facility (capacity 72,000 barrels per day). Tesoro signed a one-year royalty oil supply contract for 27.2% or initially approximately 38,000 barrels per day of the state's royalty oil to begin deliveries after Tesoro's long-term RIK contract expired December 31, 1994. When Tesoro's one-year contract expired in December 1995, Tesoro signed a three-year RIK contract for 30% or an initial volume of approximately 39,000 barrels per day of the state's royalty oil. This contract expires at the end of December 1998.

The MAPCO and Golden Valley Electric Association (GVEA) purchases were refined at the MAPCO refinery in North Pole (capacity 159,000 barrels per day). MAPCO has the longest running contract for ANS RIK. Deliveries under its long-term contract began in November 1979 for 35,000 barrels per day. This contract will not expire until December 2003. In December 1997, MAPCO was issued a one-year RIK contract for 13,000 barrels per day. This contract expires at the end of November 1998. To date, MAPCO has received approximately 205.8 million barrels of RIK (including the GVEA volumes).

Chevron's RIK purchases were refined at its 18,000 barrels per day plant in Kenai, which ceased production in June 1991. The Petro Star's RIK was refined at its 14,000 barrels per day plant in North Pole. The new Petro Star Valdez Refinery Joint Venture (Petro Star JV), with a capacity of 40,000 barrels per day, was to be fully supplied with RIK purchased from the state from the

²³Includes Chevron exchange barrels

Kuparuk River Unit (76.18 percent of the royalty share). However, the contract lapsed automatically in December 1993 because Petro Star JV did not take any royalty oil.²⁴

Competitive and quasi-competitive sales contracts were entered into with several companies. In-state refineries, including Tesoro, refined some of the crude purchased in these sales, and some was exported from Alaska. The Alpetco purchases were exported.

Competitive royalty oil sales are where the state sold royalty oil in predetermined barrel lots for one-year or less through competitive bid. In these sales the buyers bid a fixed per barrel price for the oil that equaled or exceeded the state's volume weighted average of the lessees' reported RIV prices. In-state priority preferences are usually included as a provision of competitive royalty oil sales.

In the quasi-competitive sale the state's royalty oil was sold in predetermined barrel lots for less than one year through competitive bid using negotiated sale procedures. The quasi-competitive royalty oil sale called for interested parties to submit price bids to a standard form contract. The minimum bid per barrel equaled or exceeded the state's volume weighted average of the lessees' reported RIV prices. The selection of purchasers was based entirely on the premium offered. No in-state priority preferences were included as a part of this sale.

Figure A-2 illustrates the total amount of ANS royalty oil produced and the amount of that oil taken in-kind and sold by the state. In the early 1980s, after the first and second competitive royalty oil sales, the state sold nearly all of its royalty oil in-kind. From 1986 to 1990 the volume of oil the state sold in-kind remained relatively constant. From 1990 through 1993 the volume taken in-kind declined to approximately 26 percent of the state's North Slope royalty oil. In 1995 the volume of oil taken in-kind increased by 27.2% or 38,000 barrels per day when Tesoro signed a one-year RIK oil supply contract from the North Slope that began January 1995. After Tesoro's one-year RIK contract expired in December 1995, Tesoro began a new three-year contract for 30.0% of the state's royalty oil from the North Slope. This contract expires at the end of December 1998. In 1997, the state's RIK oil increased by 11.6% or 13,000 barrels per day when MAPCO signed a one-year RIK oil supply contract from the North Slope that began in December 1997. As of December 1997, deliveries of ANS RIK are approximately 82,000 barrels per day or 50.6 percent of the state's total North Slope royalty share.

Recent Developments. The status of the most recent contracts is shown in Table A-1. During the years of 1990 through 1994, the state took less of its oil in-kind than at any time since the last half of 1985. Beginning in 1995 to the present the state's RIK oil share increased with Tesoro signing one-year and three-year RIK contracts. At the end of 1997, the state's RIK oil share increased again when MAPCO began taking an additional 13,000 bpd under a new one-year RIK contract with the state. This one-year contract expires November 1998. In the future, the state's RIK oil share is likely to continue to increase under the proposed five-year contract to MAPCO.

²⁴Capacity figures are taken from Alaska Department of Natural Resources. Historical and Projected Oil and Gas Consumption. April 1997.

Major North Slope RIK Contracts to In-State Purchasers Since 1979

Purchaser	Contract	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046	2047	2048	2049	2050	2051	2052	2053	2054	2055	2056	2057	2058	2059	2060	2061	2062	2063	2064	2065	2066	2067	2068	2069	2070	2071	2072	2073	2074	2075	2076	2077	2078	2079	2080	2081	2082	2083	2084	2085	2086	2087	2088	2089	2090	2091	2092	2093	2094	2095	2096	2097	2098	2099	2100	2101	2102	2103	2104	2105	2106	2107	2108	2109	2110	2111	2112	2113	2114	2115	2116	2117	2118	2119	2120	2121	2122	2123	2124	2125	2126	2127	2128	2129	2130	2131	2132	2133	2134	2135	2136	2137	2138	2139	2140	2141	2142	2143	2144	2145	2146	2147	2148	2149	2150	2151	2152	2153	2154	2155	2156	2157	2158	2159	2160	2161	2162	2163	2164	2165	2166	2167	2168	2169	2170	2171	2172	2173	2174	2175	2176	2177	2178	2179	2180	2181	2182	2183	2184	2185	2186	2187	2188	2189	2190	2191	2192	2193	2194	2195	2196	2197	2198	2199	2200	2201	2202	2203	2204	2205	2206	2207	2208	2209	2210	2211	2212	2213	2214	2215	2216	2217	2218	2219	2220	2221	2222	2223	2224	2225	2226	2227	2228	2229	2230	2231	2232	2233	2234	2235	2236	2237	2238	2239	2240	2241	2242	2243	2244	2245	2246	2247	2248	2249	2250	2251	2252	2253	2254	2255	2256	2257	2258	2259	2260	2261	2262	2263	2264	2265	2266	2267	2268	2269	2270	2271	2272	2273	2274	2275	2276	2277	2278	2279	2280	2281	2282	2283	2284	2285	2286	2287	2288	2289	2290	2291	2292	2293	2294	2295	2296	2297	2298	2299	2300	2301	2302	2303	2304	2305	2306	2307	2308	2309	2310	2311	2312	2313	2314	2315	2316	2317	2318	2319	2320	2321	2322	2323	2324	2325	2326	2327	2328	2329	2330	2331	2332	2333	2334	2335	2336	2337	2338	2339	2340	2341	2342	2343	2344	2345	2346	2347	2348	2349	2350	2351	2352	2353	2354	2355	2356	2357	2358	2359	2360	2361	2362	2363	2364	2365	2366	2367	2368	2369	2370	2371	2372	2373	2374	2375	2376	2377	2378	2379	2380	2381	2382	2383	2384	2385	2386	2387	2388	2389	2390	2391	2392	2393	2394	2395	2396	2397	2398	2399	2400	2401	2402	2403	2404	2405	2406	2407	2408	2409	2410	2411	2412	2413	2414	2415	2416	2417	2418	2419	2420	2421	2422	2423	2424	2425	2426	2427	2428	2429	2430	2431	2432	2433	2434	2435	2436	2437	2438	2439	2440	2441	2442	2443	2444	2445	2446	2447	2448	2449	2450	2451	2452	2453	2454	2455	2456	2457	2458	2459	2460	2461	2462	2463	2464	2465	2466	2467	2468	2469	2470	2471	2472	2473	2474	2475	2476	2477	2478	2479	2480	2481	2482	2483	2484	2485	2486	2487	2488	2489	2490	2491	2492	2493	2494	2495	2496	2497	2498	2499	2500	2501	2502	2503	2504	2505	2506	2507	2508	2509	2510	2511	2512	2513	2514	2515	2516	2517	2518	2519	2520	2521	2522	2523	2524	2525	2526	2527	2528	2529	2530	2531	2532	2533	2534	2535	2536	2537	2538	2539	2540	2541	2542	2543	2544	2545	2546	2547	2548	2549	2550	2551	2552	2553	2554	2555	2556	2557	2558	2559	2560	2561	2562	2563	2564	2565	2566	2567	2568	2569	2570	2571	2572	2573	2574	2575	2576	2577	2578	2579	2580	2581	2582	2583	2584	2585	2586	2587	2588	2589	2590	2591	2592	2593	2594	2595	2596	2597	2598	2599	2600	2601	2602	2603	2604	2605	2606	2607	2608	2609	2610	2611	2612	2613	2614	2615	2616	2617	2618	2619	2620	2621	2622	2623	2624	2625	2626	2627	2628	2629	2630	2631	2632	2633	2634	2635	2636	2637	2638	2639	2640	2641	2642	2643	2644	2645	2646	2647	2648	2649	2650	2651	2652	2653	2654	2655	2656	2657	2658	2659	2660	2661	2662	2663	2664	2665	2666	2667	2668	2669	2670	2671	2672	2673	2674	2675	2676	2677	2678	2679	2680	2681	2682	2683	2684	2685	2686	2687	2688	2689	2690	2691	2692	2693	2694	2695	2696	2697	2698	2699	2700	2701	2702	2703	2704	2705	2706	2707	2708	2709	2710	2711	2712	2713	2714	2715	2716	2717	2718	2719	2720	2721	2722	2723	2724	2725	2726	2727	2728	2729	2730	2731	2732	2733	2734	2735	2736	2737	2738	2739	2740	2741	2742	2743	2744	2745	2746	2747	2748	2749	2750	2751	2752	2753	2754	2755	2756	2757	2758	2759	2760	2761	2762	2763	2764	2765	2766	2767	2768	2769	2770	2771	2772	2773	2774	2775	2776	2777	2778	2779	2780	2781	2782	2783	2784	2785	2786	2787	2788	2789	2790	2791	2792	2793	2794	2795	2796	2797	2798	2799	2800	2801	2802	2803	2804	2805	2806	2807	2808	2809	2810	2811	2812	2813	2814	2815	2816	2817	2818	2819	2820	2821	2822	2823	2824	2825	2826	2827	2828	2829	2830	2831	2832	2833	2834	2835	2836	2837	2838	2839	2840	2841	2842	2843	2844	2845	2846	2847	2848	2849	2850	2851	2852	2853	2854	2855	2856	2857	2858	2859	2860	2861	2862	2863	2864	2865	2866	2867	2868	2869	2870	2871	2872	2873	2874	2875	2876	2877	2878	2879	2880	2881	2882	2883	2884	2885	2886	2887	2888	2889	2890	2891	2892	2893	2894	2895	2896	2897	2898	2899	2900	2901	2902	2903	2904	2905	2906	2907	2908	2909	2910	2911	2912	2913	2914	2915	2916	2917	2918	2919	2920	2921	2922	2923	2924	2925	2926	2927	2928	2929	2930	2931	2932	2933	2934	2935	2936	2937	2938	2939	2940	2941	2942	2943	2944	2945	2946	2947	2948	2949	2950	2951	2952	2953	2954	2955	2956	2957	2958	2959	2960	2961	2962	2963	2964	2965	2966	2967	2968	2969	2970	2971	2972	2973	2974	2975	2976	2977	2978	2979	2980	2981	2982	2983	2984	2985	2986	2987	2988	2989	2990	2991	2992	2993	2994	2995	2996	2997	2998	2999	3000	3001	3002	3003	3004	3005	3006	3007	3008	3009	3010	3011	3012	3013	3014	3015	3016	3017	3018	3019	3020	3021	3022	3023	3024	3025	3026	3027	3028	3029	3030	3031	3032	3033	3034	3035	3036	3037	3038	3039	3040	3041	3042	3043	3044	3045	3046	3047	3048	3049	3050	3051	3052	3053	3054	3055	3056	3057	3058	3059	3060	3061	3062	3063	3064	3065	3066	3067	3068	3069	3070	3071	3072	3073	3074	3075	3076	3077	3078	3079	3080	3081	3082	3083	3084	3085	3086	3087	3088	3089	3090	3091	3092	3093	3094	3095	3096	3097	3098	3099	3100	3101	3102	3103	3104	3105	3106	3107	3108	3109	3110	3111	3112	3113	3114	3115	3116	3117	3118	3119	3120	3121	3122	3123	3124	3125	3126	3127	3128	3129	3130	3131	3132	3133	3134	3135	3136	3137	3138	3139	3140	3141	3142	3143	3144	3145	3146	3147	3148	3149	3150	3151	3152	3153	3154	3155	3156	3157	3158	3159	3160	3161	3162	3163	3164	3165	3166	3167	3168	3169	3170	3171	3172	3173	3174	3175	3176	3177	3178	3179	3180	3181	3182	3183	3184	3185	3186	3187	3188	3189	3190	3191	3192	3193	3194	3195	3196	3197	3198	3199	3200	3201	3202	3203	3204	3205	3206	3207	3208	3209	3210	3211	3212	3213	3214	3215	3216	3217	3218	3219	3220	3221	3222	3223	3224	3225	3226	3227	3228	3229	3230	3231	3232	3233	3234	3235	3236	3237	3238	3239	3240	3241	3242	3243	3244	3245	3246	3247	3248	3249	3250	3251	3252	3253	3254	3255	3256	3257	3258	3259	3260	3261	3262	3263	3264	3265	3266	3267	3268	3269	3270	3271	3272	3273	3274	3275	3276	3277	3278	3279	3280	3281	3282	3283	3284	3285	3286	3287	3288	3289	3290	3291	3292	3293	3294	3295	3296	3297	3298	3299	3300	3301	3302	3303	3304	3305	3306	3307	3308	3309	3310	3311	3312	3313	3314	3315	3316	3317	3318	3319	3320	3321	3322	3323	3324	3325	3326	3327	3328	3329	3330	3331	3332	3333	3334	3335	3336	3337	3338	3339	3340	3341	3342	3343
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Major North Slope RIK Contracts to In-State Purchasers Since 1979												
Purchaser	Period											Total RIK Volumes (Barrels)
Conduct												
General Competitive RIK Sale												
Cheney 4	4/85 - 3/98											5,703,996
Cheney 5, 6, 7	4/85 - 9/95											3,223,724
Beck	4/85 - 12/95											953,696
Trepano 1	4/85 - 12/95											2,887,172
Trepano 2	4/85 - 3/98											9,508,586
Union 2	4/85 - 8/95											1,136,522
US Oil & Refining - B	4/85 - 3/98											3,602,521
Total												27,198,211
General Competitive RIK Sale												
Cheney 8	10/85 - 3/98											954,349
Union 3	10/85 - 3/98											715,780
US Oil & Refining - 1, 2, 3	10/85 - 3/98											1,908,696
Total												3,578,825
Estimate of Total RIK Oil												707,285,105

Source: Alaska Department of Natural Resources, Division of Oil and Gas

**Figure A-2: Total ANS Royalty and RIK Sales
(includes New Mapco Contract)**

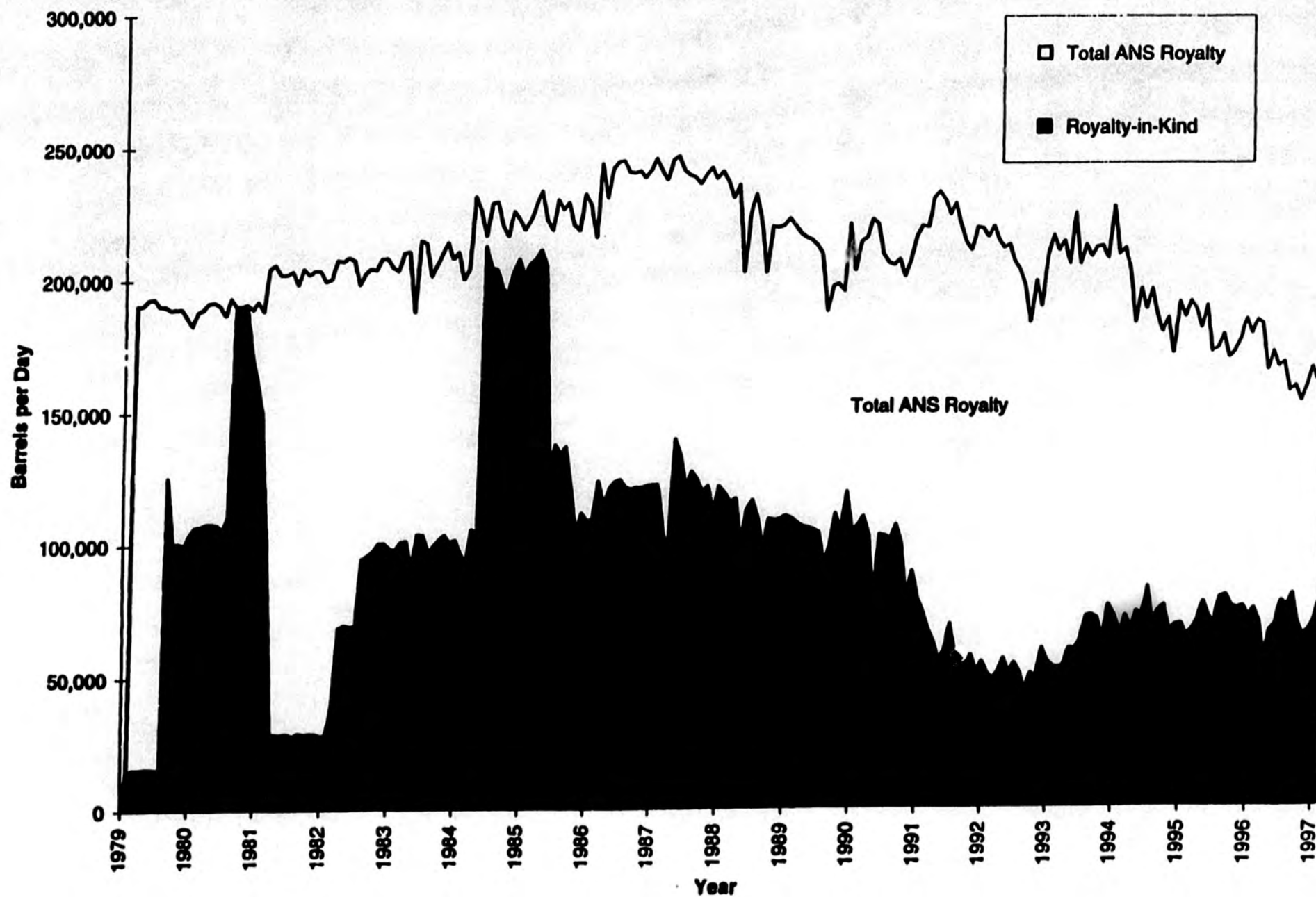
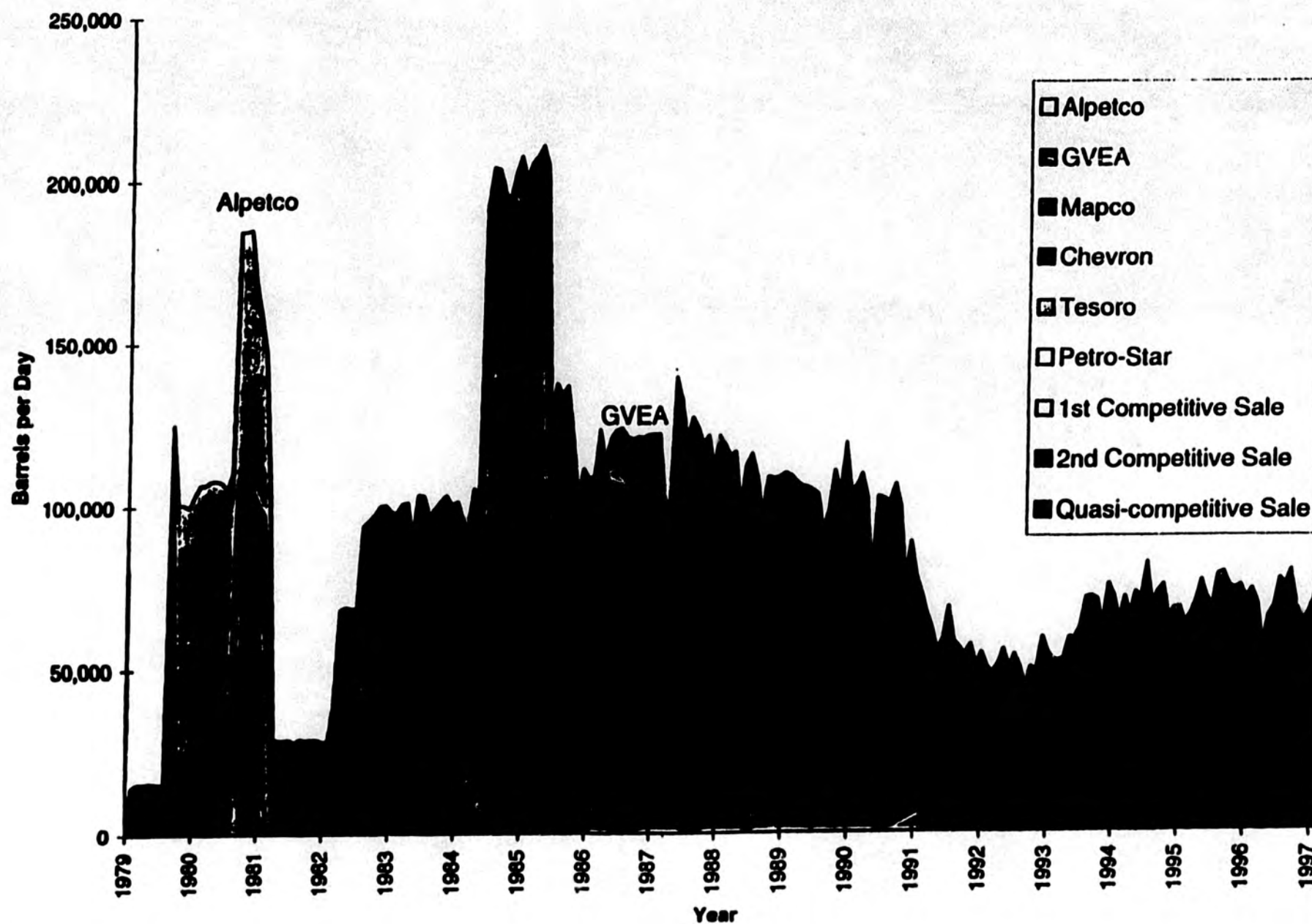


Figure A-1: RIK Volumes by Purchaser



1

Appendix B: AS 38.05.183(c) & (e), AS 38.06.050(c), AS 38.06.055, and AS 38.06.070(a)

AS 38.05.183(c). If the commissioner determines that a sale, exchange or other disposal of a mineral obtained by the state as a royalty under AS 38.05.182 or of a right to receive future mineral production under a state lease under this chapter shall be made otherwise than by competitive bid, and the Alaska Royalty Oil and Gas Development Advisory Board has been notified in writing of that determination, the commissioner shall make public in writing the specific findings and conclusions upon which that determination is based.

AS 38.05.183(e). When a sale, exchange or other disposal of oil or gas taken in kind by the state as its royalty share, or a sale, exchange or other disposal in whole or in part of a right to receive future royalty oil or gas, under a state lease under this chapter is made other than by competitive bid, the sale, exchange or other disposal shall be awarded by the commissioner to the prospective buyer whose proposal offers the maximum benefits to citizens of the state. The commissioner shall consider:

- (1) the cash value offered;
- (2) the projected effects of the sale, exchange or other disposal on the economy of the state;
- (3) the projected benefits of refining or processing the oil or gas in the state;
- (4) the ability of the prospective buyer to provide refined products or by-products for distribution and sale in the state with price or supply benefits to the citizens of the state; and
- (5) the criteria listed in AS 38.06.070(a).

AS 38.06.050(c). Competitive bidding in a sale, exchange or other disposition described in (a) of this section may not be waived by the commissioner of natural resources under AS 38.05.183 unless prior written notice of proposed waiver is given to the board.

AS 38.06.055. Legislative approval. (a) In addition to the recommendation by the board required under AS 38.06.050, the commissioner of natural resources may not enter into a sale, exchange, or other disposition of oil or gas or of the rights or waiver of the rights to receive future production of royalty oil or gas under AS 38.05.183 without the prior approval of the legislature. The legislature may approve a sale, exchange, or other disposition of oil or gas or of the rights or of a waiver of the rights to receive future production of royalty oil or gas only by enacting legislation. (b) The provisions of (a) of this section do not apply to

- (1) the sale, exchange, or other disposition of oil or gas for one year or less if the sale, exchange, or other disposition is entered into to relieve storage or market conditions;
- (2) contracts for the sale of state-owned royalty gas or oil that specify the sale and delivery of not more than
 - (A) 400 barrels of crude oil per day;
 - (B) 460 barrels of natural gas liquids per day; and
 - (C) 2,400 Mcf of natural gas per day.

(c) a sale, exchange, or other disposition of oil or gas under (b)(1) of this section may not be continued after the end of one year or renewed with the same party without the prior approval of the legislature under (a) of this section. This subsection does not apply to a sequential competitively bid sale of oil or gas made with the same party under (b)(1) of this section.

AS 38.06.070. Criteria. (a) In the exercise of its powers under AS 38.06.040(a) and 38.06.050 the board shall consider

- (1) the revenue needs and projected fiscal condition of the state;
- (2) the existence and extent of present and projected local and regional needs for oil and gas products and by-products, the effect of state or federal commodity allocation requirements which might be applicable to those products and by-products, and the priorities among competing needs;
- (3) the desirability of localized capital investment, increased payroll, secondary development and other possible effects of the sale, exchange or other disposition of oil and gas or both;
- (4) the projected social impacts of the transaction;
- (5) the projected additional costs and responsibilities which could be imposed on the state and affected political subdivisions by development related to the transaction;
- (6) the existence of specific local or regional labor or consumption markets or both which should be met by the transaction;
- (7) the projected positive and negative environmental effects related to the transaction; and
- (8) the projected effects of the proposed transaction upon existing private commercial enterprise and patterns of investments.

Appendix C: Comments and Responses on the Preliminary Finding and Draft Contract

The department sent either a copy of the preliminary finding and draft contract, or a notice announcing its availability to 200-person mailing list. In addition, advertisements were published in the Anchorage Daily News, Juneau Empire, Fairbanks Daily News-Miner, Kenai Peninsula Clarion and the Valdez Vanguard.

The department received three letters about the proposed sale. One letter from the Fairbanks Chamber of Commerce expressed support for the sale, while another letter from Prince Singka requested a copy of the draft contract. The last letter from Hal Whitley, owner of Wet Willy's Carwash in Fairbanks was addressed and presented to the Alaska Royalty Oil and Gas Development Advisory Board at a meeting of the Royalty Board on February 17, 1998. Copies of these letters follow.



Greater Fairbanks

Chamber of Commerce

250 Cushman Street, Suite 2D

Fairbanks, Alaska 99701-4665

907/452-7705

FAX: 907/456-6968

February 3, 1998

Ms. Nancy Jurgens
Division of Oil and Gas
ALASKA DEPT. OF NATURAL RESOURCES
3601 "C" Street, Suite 1380
Anchorage, AK 99503-5948

RE: Royalty Oil Sale to MAPCO

Dear Ms. Jurgens:

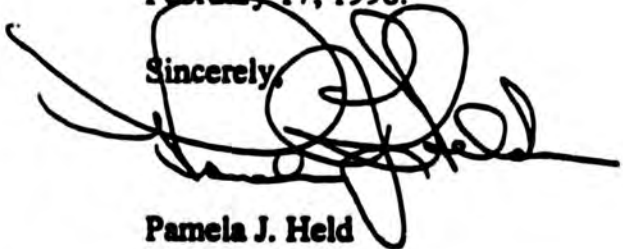
The Greater Fairbanks Chamber of Commerce is pleased to go on record in support of the proposed new royalty oil contract between the State of Alaska and MAPCO ALASKA PETROLEUM Inc. This 28,000 barrel per day contract for five years will supply the new \$70 million expansion of MAPCO's North Pole Refinery that is now under construction.

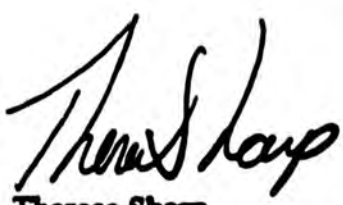
MAPCO will primarily refine additional jet fuel and diesel fuel with the crude oil purchased. The expanded production will help fuel Alaska's growing international air cargo business and the growing Alaska economy in general.

MAPCO plays a significant role in the economy of interior Alaska. They employ about 130 employees at the refinery, with an additional 15 new permanent employees to be added with the refinery expansion. MAPCO is the largest customer of the Alaska Railroad. They are one of the major customers of Golden Valley Electric Association. In addition, MAPCO supports a broad range of educational, cultural and other activities throughout Alaska.

We respectfully request that the Alaska Royalty Oil and Gas Development Advisory Board approve this contract and recommend legislative approval following the public hearing on February 17, 1998.

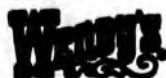
Sincerely,


Pamela J. Held
President/CEO


Therese Sharp
Chairwoman of the Board

CHAMBER BENEFACTORS

Dedicated to Fairbanks' Economic Future



Alaska pipeline

MAPCO





From the Desk of Hal C. Whitley
WET WILLY'S



Auto Wash, Inc. dba Wet Willy's Car Wash

1295 University Ave

P.O. Box 80047, Fairbanks, Alaska 99708

Phone: (907) 474-8585 • Fax: (907) 474-4343

To: Alaska Royalty Oil & Gas Dev. Advisory Board Fax: 907 562-5269
Attention: Nancy Jurgens
From: Hal Whitley
Contact #: 907 474-8686
Date: 2-17-98 Time: 12:30
No. of Pages: three (including cover sheet)

COMMENTS:

Pursuant to my call earlier today, I am sending you
my comments to be presented and read at today's
public hearing. In the event that this FAX is unclear,
please call so we can re-send it. Thanks for your
help in this matter.

Respectfully,

Hal Whitley

Pres. Auto Wash, Inc.

Auto Wash, Inc.
P.O. Box 80047
Fairbanks, AK 99708

To: Alaska Royalty Oil & Gas Development Advisory Board

The purpose of this fax today is to express my concern about the State of Alaska selling its crude oil to Mapco. Thank you for taking the time to read my comments today. I apologize for not being present as my business prevents me from leaving Fairbanks today.

I own and operate three small businesses here in Alaska, two of these offer retail gasoline for sale. All of the gasoline sold in Fairbanks originates from Mapco's refinery in North Pole (fifteen miles away) which is supplied by the crude oil from the Alaska Pipeline.

My concern is that for the past few months, Mapco's retail gasoline stations have been selling gasoline for approximately the same price our facility pays our supplier, Sourdough Fuel. Because our firm operates two differently branded stations and are supplied by two different "jobbers", we feel confident from our past twelve years of retail gasoline sales experience, that the "jobbers' price to us is fair.

Like all gasoline stations, we have the usual overhead, ie. labor, electricity, maintenance, pollution and liability insurance, not to mention the expense related to our capital investment.

In effect, Mapco's retail gasoline stations have taken away from its competition all of the price margin on gasoline sales in Fairbanks. In addition, because of Mapco's gas stations low gasoline prices, Mapco has effectively decreased substantially all of the gasoline volumes of the competing gasoline stations.

Between 1985 and 1990 I saw this same scenario play out in Wasilla, Alaska where our second facility is located. The overall effect there eliminated quite a few of the "Mom and Pop" gasoline stations. As a small businessman, I cannot stand idly by and watch this same "predatory pricing routine" happen again in Fairbanks.

I understand that Mapco has invested several million dollars in its North Pole refinery for the purpose of making a profit on fuel sales. I wholeheartedly agree with that undertaking. My plea to this board is to provide a "level playing field" for gasoline sales in Interior Alaska.

I feel that Mapco's total domination of gasoline sales in Fairbanks is blatantly unfair to competing retail gasoline facilities. I also feel that Mapco's monopoly of local gasoline sales is unfair to Alaska citizens.

I feel that it is unfair for the same company that refines state owned North Slope crude oil to be in direct competition with small retail gasoline stations. Small stations such as mine have no other source for gasoline other than Mapco.

I have tried to communicate my concerns about this "predatory pricing" situation to Mapco and to open up a dialogue with their firm to help remedy this problem, but I wasn't successful. I did finally receive a phone call from one of Mapco's attorneys who advised me that it was illegal for them or me to discuss fuel prices. He indicated he would send me a follow up letter, but I've never received it.

I have also tried to communicate my concerns to all of the state agencies, (State of Alaska Department of Commerce, Department of Revenue, Department of Law, Attorney General, Fair Business Practices Session, Oil & Gas Conservation Commission, Auditor Division Oil & Gas, and others) only to be told "the state doesn't have the financial resources to help you fight Mapco." The only suggestion I got from these state agencies was to hire my own attorney and fight Mapco on my own. As a small business with limited resources, this is not an option for us.

I feel that our state should create a "level playing field" for retail gasoline stations such as ours. Irregardless of which state agency is responsible for dealing with my concerns - the State of Alaska should be fair in how this North Slope crude oil is re-sold by Mapco around our state.

For the record, wholesale unleaded gasoline on the West Coast of the United States on February 6 of this year was \$.54 per gallon. The retail price on the west coast varies from \$.97 to \$1.07 per gallon. The average retail price today in Fairbanks is \$1.28 per gallon.

The "bottom line" is that there needs to be some kind of regulatory process in place that will stop the monopolistic practices that are ongoing with Mapco. Mapco should be held accountable for controlling the price of retail gasoline in Alaska.

I would appreciate hearing any suggestions that may help alleviate what we feel is an unfair business practice.

Hal C. Whitley



President Auto Wash, Inc.

Appendix D: Changes to the Preliminary Finding and Draft Contract

Article 7, Effective Date and Term of the draft contract, paragraph 7.1 Condition to Precedent to Effective Date was added. This paragraph was added to assure that after the contract is signed by the State and Mapco that the contract does not become effective and enforceable until the legislature approves it. This change necessitated a small change in the wording of the first paragraph of the contract.

No comments requested changes to individual provisions of the preliminary finding and none of the individual provisions were significantly changed. However, because of Williams Companies Inc. pending acquisition of MAPCO Inc. a paragraph was added to the background section of the preliminary finding.

AGREEMENT FOR THE SALE AND PURCHASE

OF

STATE ROYALTY OIL

to

MAPCO ALASKA PETROLEUM, INC.

THE STATE OF ALASKA
Department of Natural Resources

Dated as of March 6, 1998

SENATE BILL NO. 342
HOUSE BILL NO. 469

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