SCOMM

#11:13

Alaska State Legislature

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Terry

11/11/75

The most interesting part of the hearing was El Paso's proposal to purchase our royalty gas. I will include the proposal for your file.

Bill

AGO 513572

Commissioner Guy R. Martin
Chairman, Alaska Royalty Oil and Gas
Development Advisory Board
Department of Natural Resources
Juneau, Alaska

20 June 1975

I have been authorized by the El Paso Company to make a formal proposal to purchase the State of Alaska's royalty gas which is excess to the State's needs in Alaska. The following is a draft Memorandum of Agreement which sets forth El Paso's proposal:

(Quote)

'WHEREAS, THE EL PASO COMPANY (El Paso), either singly or in conjunction with others is willing to construct and operate facilities to transport natural gas in a large diameter pipeline from the North Slope of Alaska across Alaska to a point on the south central coast, providing outlets for markets enroute, and thence by LNG tankers to markets in the lower forty-eight states ("The Alaska Project");

WHEREAS, the implementation of the plan contemplated by the Alaska Project is in the maximum interest of Alaska and the nation in coping with the critical energy shortage; and

WHEREAS, the State of Alaska ("the State") is entitled to take in kind its royalty share of natural gas produced on state-owned lands within Alaska ("Royalty Gas");

NOW THEREFORE, to the end that the Alaska Project may be realized and the State's objectives achieved, the parties hereto agree as follows:

1. El Paso agrees that the Alaska Project will be constructed and operated in a manner suitable to the handling of the State's Royalty Gas to to achieve its objectives herein set forth;

2. The State, having indicated a desire to make its Royalty Gas available for use within the state, will authorize such gas to be delivered to the Alaska Project for transportation to such points along the route of the pipeline as it shall designate;

AGO 513573

3. Those quantities of the State's gas determined by it to be surplus to its economic and sociological needs ("Surplus Gas") shall be sold to and purchased by El Paso at the terminus of the pipeline;

4. The charge for the transportation of the State's Royalty Gas shall be that fixed by the appropriate regulatory agency;

5. El Paso shall pay the State for the Surplus Gas at a rate equal to the highest price paid by any responsible purchaser from time-to-time for gas of which the State's Royalty Gas is a portion;

6. If from time-to-time the State shall have available to it additional quantities of Royalty Gas, El Paso agrees to transport and/or purchase such additional quantities of gas on the same terms and conditions set forth herein;

7. The term applicable to the purchase of the Surplus Gas shall be for a period of such years and for such amounts as shall be determined by the State to be surplus to its needs. The State agrees to quantify these amounts and to enter into a further definitive agreement to implement the Alaska Project within one month after signature of this agreement.

8. The State may withdraw any portion of its Surplus Gas from sale to El Paso whenever additional gas is made available to El Paso by others in a volume equal to that withdrawn by the State;

9. At the end of the term of the agreement which will be entered into pursuant to paragraph 7 herein, the State shall have the option to sell and El Paso agrees to purchase the volumes of such gas then determined by the State to be surplus to its economic and sociological needs for an additional term of similar duration and upon the same terms herein set forth;

10. The undertakings of both the State and El Paso are subject to the receipt of all requisite government approvals, provided, however, that either party shall have the right to cancel this agreement upon thirty (30) days written notice to the other party if El Paso's application to construct and operate the Alaska Project is denied by the Federal Power Commission, or if

to El Paso, or to the State, or conditions which render El Paso unable to perform its contract with the State; and

11. At the appropriate time, the State and El Paso will execute a definitive agreement which shall incorporate the general principles covered by this Memorandum of Agreement and which shall include other terms and conditions as may be required and agreed upon.

DATED this __________ day of __________________, 1975.

THE STATE OF ALASKA — EL PASO COMPANY

By: ______________________ By: ______________________

(End Quote)

Prompt execution of such an agreement will achieve the following:

A. Express to the Federal Power Commission the State's position on ownership of its royalty gas while being transported within Alaska.

B. Preserve the State's freedom to determine the best uses of its royalty gas within the State, while insuring a ready market for the surplus royalty gas.

C. Insure that the State receives the best price for its surplus royalty gas.

D. Demonstrate by affirmative action the State's support for the Trans-Alaska Gas Pipeline, thereby strengthening the position of El Paso in the current hearings before the Federal Power Commission.

AGO 513575

El Paso representatives, or requires additional data from El Paso, we are prepared to respond promptly.

Thank you for your consideration of our proposal.

JOHN C. BENNETT

VICE PRESIDENT

EL PASO ALASKA COMPANY

file copy

Sale by the State of Alaska of Rights to
Receive Future Production of Royalty Oil and Gas

State of Alaska legislation in 1974 provides a procedure with respect to the sale of the State's royalty oil and gas. The Commissioner of Natural Resources of the State can sell royalty oil and gas received in kind at the time of its production. He can also sell the State's rights to receive future royalty oil and gas production and receive payment for all or part of it now in the form of an advance sale.

Such sales must be made with the prior written approval of the Alaskan Royalty Oil and Gas Development Advisory Board and with the prior approval of the Legislature. These sales are not sales of oil or gas in place. The Constitution of Alaska prohibits sales in place.

If the State made a sale of its rights to receive future production of royalty oil or gas, the following questions come up:

1. How would such a deal be structured?

2. Would the State lose any of the increased market value of oil sold in this way between the time of sale and the time of production?

3. What portion of the State's royalty from Prudhoe Bay would have to be committed to the repayment of, say, $100 million, over a 3½ year period, commencing with the startup of production?

Structure of the Transaction

A transaction of this type would involve at least three parties--seller, buyer and a financial institution. The State of Alaska, as the Seller, would contract to sell oil to a Buyer and deliver it as it is produced. The Buyer would contract to buy the oil and would pay for

AGO 513577

it in advance. Since it is quite unlikely the Buyer would have money available for such an advance payment, he would very likely borrow it from a group of banks. The Seller and the banks can be readily identified. However, a Buyer cannot be so readily identified.

The Buyer could be an oil company who has use for the oil, however, it is doubtful that there are companies with the money available, or the willingness to incur the debt necessary for such an advance payment. Therefore, the Buyer would likely be a financial vehicle created for this purpose, perhaps a company owned by a charitable organization.

If the Buyer is owned by a charitable organization, the questions arise as to why it would be in such a transaction, and how it would use this oil. It would be in the transaction for the financial gain it would realize. It would probably enter into an agreement with another party, a fourth party in this transaction, to sell the oil as its agent. Such fourth party might well be the working interest owner of the properties from which the oil will be produced. This overall arrangement is outlined on the attached exhibit.

Market Value of Oil

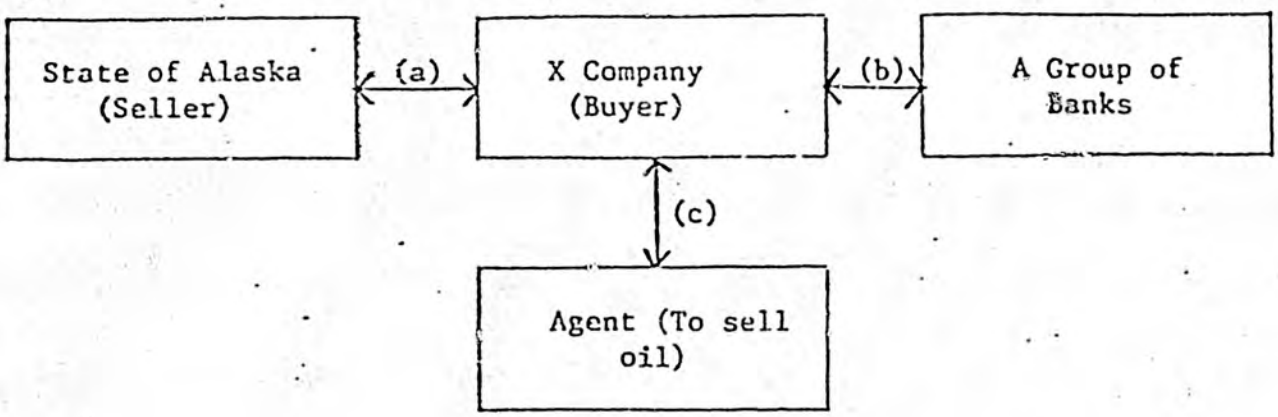
The State should lose nothing in terms of market value by making such a sale. The terms of the agreement would be somewhat as follows: "Seller agrees to sell to the Buyer that quantity of crude oil representing __ percent of its royalty interest in leases ______, ______, and ______, until the market value of that oil at the time it is produced is equal to $______." The quantity of oil to be delivered would include oil to cover interest for the use of the money which the Seller receives in advance and for any profits which the Buyer would make on the transaction. Such profits would be small in terms of the whole transaction.

Portion of Royalty Dedicated to the Sale

If a sale of $100 million of Prudhoe Bay royalty oil were made on July 1, 1976, and if production commenced at Prudhoe Bay on July 1, 1977, the advance could be paid out of about ~~15~~ 17 percent of the State's royalties during the period July 1, 1977 to December 31, 1980--that is, a period of three and one-half years. The ~~15~~ 17 percent applies to the State's royalty after payment of 2 percent into the Native Claims Fund. A wellhead value of the oil of $5 per barrel and a production rate of 600,000 barrels per day for the first six months and 1.2 million barrels per day thereafter have been assumed. With an assumed interest rate of 8 percent, the State would deliver 25.1 million barrels--20 million to repay principal and 5.1 to pay interest. Thus, about 20 percent of the ~~15~~ 17 percent dedication (or 3 percent) would go to interest.

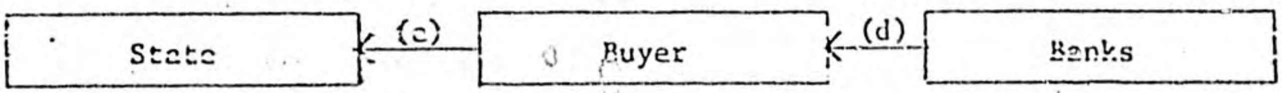
2/20/75

1. Agreements



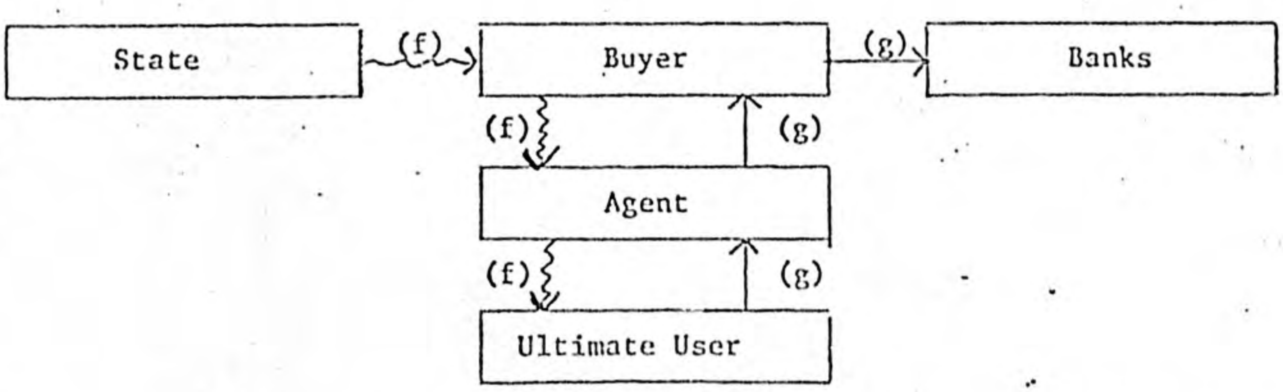
(a) State agrees to sell oil to Buyer.
(b) Buyer makes credit agreement with Banks.
(c) Buyer appoints agent to resell oil to ultimate user.

2. Flow of Money on 7/1/76 (e.g.)



(d) Banks lend money to Buyer.
(e) Buyer makes advance payment to State.

3. Delivery of Oil (⇝) and Flow of Money (→)--7/1/77 to 12/31/80



(f) State delivers oil to Buyer who resells and delivers it to the ultimate user, by using an agent to make the sale.
(g) User pays for the oil and Buyer repays the bank.

2/20/75

AGO 513580

AVERAGE FIRST SIX MONTHS, THEN 1.2 M B/D
(Millions)

		1976	1977	1978	1979	1980	1981
1.	Production (B/D)	0	0.6	1.2	1.2	1.2	1.2
2.	Wellhead Value Per Barrel (a)		$5	$5	$5	$5	$5
3.	State Income--No Advance Sale						
	Royalty (b)	0	69	274	274	274	274
	Severance (8%)	0	38	153	153	153	153
	Total	0	107	427	427	427	427
4.	Effect of Advance Sale on State's Royalty Income	+100	-10	-39	-39	-38	0
5.	State Income--With Advance Sale						
	Royalty (b)	100	59	235	235	236	274
	Severance (8%)	0	38	153	153	153	153
	Total	100	97	388	388	389	427

(a) Project Independence Blueprint of the Federal Energy Administration makes reference to "Minimum Acceptable Prices" of $5.16 to $6.15 per barrel at the wellhead to stimulate development in "special regions," (including the North Slope of Alaska). See Table B-1 in Part 2 of FEA publication dated November 1974 entitled "Task Force Report - Finance."

(b) Includes portion going to Native Claims.

2/20/75

AGO 513581