

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2638 SCOMM 117 JOINT SPECIAL COMMITTEE ON MERGERS, 1999-2000

those requirements. BP or ARCO (as the case may be), will offer to sell the surplus ship or ships to other ANS producers on reasonable commercial terms. If BP or ARCO does not own the ship or ships, it will not object to arrangements by another ANS producer to acquire the ship or ships from the owner. Further, in the event that the purchaser of the ship or ships seeks ship operation services from the Alaska Tanker Company, Inc., BP will not object. Nothing in this paragraph requires BP or ARCO to assume any liability of another ANS producer concerning any of these transactions.

J. Natural Gas.

1. During the period after the merger is completed through December 31, 2003, BP and Arco shall negotiate in good faith to make available to third parties at a commercially reasonable fair market price or transportation charge that is mutually agreeable to BP and Arco, the third party and the State, Alaska North Slope natural gas in sufficient quantities to support a qualified treatment and transmission project to domestic and/or international markets. A qualified treatment and transmission project must have the demonstrated ability to:

- a. obtain project construction financing;
- b. provide reasonable financial security with respect to a long term 100% take or pay arrangement if the project requires a long term gas sales commitment from the producer(s) (including, if commercially reasonable, an assignment or other back-to-back pass-through of the purchaser's take-or-pay commitment from a creditworthy ultimate purchaser); and
- c. obtain necessary approvals from other field interest owners.

2. BP and ARCO shall make reasonable efforts to assist in obtaining the approvals specified in subparagraph 1.c.

3. The delivery point for gas committed to the project will be the residue gas discharge point of the Low Temperature Separators at the Prudhoe Bay Central Gas Facility, or such other point as agreed by the parties.

4. During this period, BP and ARCO will give fair consideration to all reasonable approaches, projects and plans proposed by the State, joint interest owners and others, including LNG projects developed or proposed by the newly established port authority, the gas sponsor group, Yukon Pacific Corporation and any others, pipelines to the lower 48 including those currently proposed, gas-to-liquids projects, and any other reasonable approach, project or plan for the commercialization of North Slope gas. In giving fair consideration to these various approaches, projects and plans, BP and ARCO will consider, among other things, (a) achieving the highest total project wellhead value for the State and for the sellers over the life of the project(s) and (b) other potential benefits to Alaska such as bringing gas infrastructure for the delivery of North Slope gas to communities in Alaska. BP and ARCO will meet and confer with project sponsors on reasonable request. Not less than every six months during this period, BP and ARCO will provide the Commissioner of Natural Resources with a report that identifies the

name of the contact person for each project sponsor which contacted BP and ARCO during the prior 6 month period and the general nature and current status of the sponsor's project, subject to confidentiality requirements of the sponsor.

5. The obligation to negotiate with third parties does not preclude BP and ARCO from proceeding with their own project or projects to commercialize Alaska North Slope gas.

6. The obligations imposed by this section terminate before December 31, 2003 if BP and ARCO enter into a contract or contracts before that date committing Alaska North Slope gas to a qualified treatment and transmission project or projects for volumes that in the aggregate would constitute BP and ARCO's share of a Major Gas Sale under Article 26, Section 26.002 of the Prudhoe Bay Unit Operating Agreement or if the Board of Directors of BP and ARCO sanction the construction of such a project or projects before that date.

7. The parties agree that the terms of paragraph I.J. of this Charter shall be enforceable exclusively by arbitration between the State and BP and ARCO under the rules of the American Arbitration Association.

II. BP and ARCO's Environmental and Community Commitments.

A. North Slope Environmental Commitments. After the merger is completed, BP and ARCO will take the following steps to improve and protect the environment on the North Slope.

1. Cleanup of Abandoned Sites. BP and ARCO will take a leadership role in the assessment and environmental clean up of the North Slope "orphan sites" identified in Exhibit D1 (as currently written and as modified in accordance with the terms of this paragraph II.A.1.), and will spend \$10,000,000 (or such greater amount as may be created by ADEC funding requests under paragraph II.A.7.) in performance of this commitment. In carrying out this role, BP and ARCO will consult with the Alaska Department of Environmental Conservation (ADEC) concerning site goals, standards and methods and will substantially complete the assessment and cleanup to the standards approved by ADEC under applicable law within six years after the merger is completed. In addition, BP and ARCO will work cooperatively with ADEC to develop a joint database of North Slope contaminated and solid waste "orphan sites" which includes the nature and location of the sites, the responsible parties and the relative priority for cleanup of each site based upon preliminary evaluation of the risk of harm to human health and the environment posed by the site. BP and ARCO will meet and confer with ADEC from time to time thereafter to arrange for priority re-ordering and substitutions and additions to Exhibit D1 as requested by ADEC, subject to the availability of funding in the spending amount identified above and to the further requirements that there is no known viable responsible party for any substitute or additional site and the site has been wholly vacated. The parties recognize that the available funding in the amount identified

above may not be sufficient to assess and cleanup in full all sites identified in Exhibit D1 now or as it may be amended, and nothing in this subparagraph II.A.1. shall preclude the State from pursuing other parties for reimbursement or from seeking other funding sources for additional assessment or cleanup on any orphan site.

2. Cleanup of Abandoned Empty Barrels. BP and ARCO will require contractors conducting seismic or exploration work for them to collect and deliver abandoned empty barrels to BP or ARCO operations for handling, to inventory and map locations of empty barrels and barrels containing product, and to report any visible signs of ground contamination associated with the barrels. BP and ARCO will periodically report to ADEC regarding this effort and provide ADEC with the inventory lists, maps and reports which are developed.

3. Cleanup of Existing BP and ARCO Sites. BP and ARCO will assess and clean to the standards approved by ADEC under applicable law the contaminated sites listed on Exhibit D2. BP and ARCO will work cooperatively with ADEC and the land manager to develop cleanup plans and schedules to complete required assessment and cleanup activities at these sites. Assessment and cleanup activities at sites which are currently accessible will be substantially completed by year-end 2005 for the sites listed as "high" priority sites in Exhibit D2 and by year-end 2007 for the remainder. Sites which due to operational restrictions cannot be fully cleaned until facility or equipment abandonment will be identified by BP, ARCO and ADEC for completion according to a mutually agreed schedule. Nothing in this paragraph is intended to eliminate or supercede any other obligations BP or ARCO may have to assess, cleanup or restore these or any other sites.

4. Closure of Inactive Reserve Pits. BP and ARCO will comply with the requirements of 18 AAC 60.440 with respect to their inactive reserve pit sites and will close the inactive reserve pits subject to the Order dated May 3, 1993 in *Natural Resources Defense Council Inc. v. ARCO Alaska, Inc.*, No. A88-287 CIV (D. Alaska) as amended within the designated time period established by the court in that matter, and will close other ARCO and BP inactive reserve pits listed on Exhibit D3A by the end of 2007 (except that in the event of currently unprojected operational delay affecting any BP site, that site may be completed on a separate mutually agreed schedule). BP and ARCO will close the ARCO and BP inactive reserve pits listed on Exhibit D3B according to a mutually agreed schedule that ends a reasonable period after work on the D3A sites has been completed.

5. Commitment to North Slope Spill Response. BP and ARCO will support, at their proportionate share, an independent professional North Slope spill response organization, such as Alaska Clean Seas or a substantially equivalent organization, and will encourage the fullest possible participation in this organization by all North Slope producers. BP and ARCO will support and vote in favor of funding to the North Slope oil spill response organization for an Arctic spill response research and development program (jointly agreed to by the spill response organization, BP, ARCO and ADEC) at

an average annual level of not less than \$200,000 during the 10 year period following completion of the merger.

6. Commitment to Corrosion Monitoring. BP and ARCO will, in consultation with ADEC, develop a performance management program for the regular review of BP's and ARCO's corrosion monitoring and related practices for non-common carrier North Slope pipelines operated by BP or ARCO. This program will include meet and confer working sessions between BP, ARCO and ADEC, scheduled on average twice per year, reports by BP and ARCO of their current and projected monitoring, maintenance and inspection practices to assess and to remedy potential or actual corrosion and other structural concerns related to these lines, and ongoing consultation with ADEC regarding environmental control technologies and management practices.

7. Additional Expenditure Commitment. BP and ARCO will pay or spend up to an aggregate total of \$500,000 each year during the 10 year period following completion of the merger for any combination of the following as requested annually in writing by the ADEC Commissioner: additional orphan site assessment or cleanup in excess of cap established in subparagraph 1; additional Arctic spill response research and development in excess of amount established in subparagraph 5; and/or an expert or experts chosen by ADEC to provide expert advice to ADEC regarding pipeline corrosion and/or other pipeline structural issues.

8. Payment of Unspent Funds. In the event that BP and ARCO fail to spend (or support and vote in favor of spending in the case of arctic spill response research and development) in the full amounts provided for under paragraphs II.A.1. (\$10,000,000), II.A.5. (\$2,000,000) or II.A.7. (\$5,000,000) when and as required in those paragraphs, then BP and ARCO will pay any unspent or unsupported balance as directed by the ADEC Commissioner.

B. Marine Environmental Commitments.

1. Renewed Commitment to OPA 90. BP and ARCO renew their commitment that neither of them will seek to be relieved of the vessel retirement or replacement requirements of the federal Oil Pollution Act of 1990 ("OPA 90"), nor will either of them lobby for a reduction in its current requirements, nor will they take any other action to extend the retirement dates of the non-double-hulled tankers in their combined fleet beyond the currently scheduled retirement dates. In the event that any trade association or other group of which BP or ARCO is a member takes a different or contrary position, BP and ARCO will, upon notification and request by ADEC, issue a statement clarifying that BP and ARCO do not join in that different or contrary position, and reaffirming the position stated in the first sentence of this paragraph.

2. Replacement Vessels. In furtherance of their continuing commitment to meet or exceed the OPA 90 standards and timetable, BP and ARCO will complete the purchase and delivery of the three ARCO Millennium class tankers on current order to replace

single hulled tankers now used in the combined ANS fleet, and will order and purchase additional tankers to meet their combined ANS fleet requirements on average one year earlier than required by OPA 90, with the expected result that the combined ANS fleet (including both owned and chartered vessels) will be entirely double-hulled by mid-year 2007. These additional purchased tankers will each have safety related attributes substantially equivalent to or better than Millennium or Cape class tankers, including new build double-hulls (wholly new construction), main power plant redundancy, twin propellers, twin rudders, twin independent sets of steering gear, and proven electronics (including navigation, course tracking, collision alarms, engine room monitoring, cargo and ballast monitoring, and fire and safety systems). In addition, BP and ARCO will continue to support a ship escort response vessel system for Prince William Sound at current or better levels of effectiveness.

3. Marine Operations. After the merger is completed, BP and ARCO will continue to encourage and support the company operating ANS tankers for them in using a performance management program for the regular review of its practices related to its management and operations including a safe environment, training and qualifications, and vessel operation, maintenance and management procedures. The parties expect this program will include meet and confer working sessions between the operating company and ADEC, scheduled on average once per year, reports at those working sessions by the operating company of their current and anticipated management and operations practices, ongoing consultation between the operating company and ADEC regarding ANS trade tanker management and operations practices, and the involvement of BP and ARCO in those sessions and consultations on a monitoring basis. In addition, BP and ARCO will encourage the operating company to allow the opportunity for ADEC to observe, and to be provided a copy of the written results of, management and vessel audits performed as part of a certification or re-certification process for the International Maritime Organization's International Safety Management Code or for the International Standards Organization.

C. Continued Commitment to Alaska Hire.

1. Alaska Hire Program. BP and ARCO agree that, after the merger is completed, they will continue with and extend their commitment to the people of Alaska to utilize a voluntary program to employ residents of Alaska and to use Alaska businesses. It is expected by the parties that this program will include the attributes that:

a. BP and ARCO will comply with all valid federal, State and local hiring laws in hiring Alaska residents and contractors and will not discriminate against Alaska residents or contractors, and within the constraints of law will employ Alaska residents and contractors to the extent they are available and qualified;

b. When recruiting for new hires, BP and ARCO will advertise for available positions locally and use Alaska job service organizations to notify the Alaskan public;

c. BP and ARCO will use best efforts to contract with Alaska firms and fabricate modules in Alaska whenever feasible (in determining feasibility, BP and ARCO will consider commercial, health, safety, and environmental conditions and requirements to ensure maintenance of BP and ARCO's operational standards); and

d. BP and ARCO will, to the extent permitted by law, encourage its contractors to employ, and train when necessary, residents of Alaska.

2. Reporting. BP and ARCO agree to submit to the Director, Division of Oil and Gas, for transmission to the Department of Labor, an annual report that details the specific measures that they and their contractors and subcontractors have taken or are planning to take to recruit qualified Alaska residents for available jobs, describes on-the-job training opportunities, and describes their efforts to use Alaska businesses for work in connection with their leases and associated activities. BP and ARCO will also furnish the Department of Labor a quarterly report regarding their employment of Alaska residents. The report will include statistical data concerning the number of resident personnel hired within the previous year.

3. Construction. The program and reporting described in this paragraph are intended to be fully consistent with the 1996 amendments to paragraphs 41 (1980 leases) and 31 (1983 lease) of the Northstar Unit leases between the State and BP.

4. Alaska Native Recruitment, Training and Hire. BP and ARCO further acknowledge their continuing support for the recruiting, training and hiring of Alaska Natives and the parties' common understanding of the desirability of providing Alaska's first citizens opportunities to participate in the economic benefits of oil and gas development, most of which takes place in rural Alaska.

D. Community Charitable Commitment. Within three months after the merger is completed, BP and ARCO will establish a charitable entity dedicated to funding organizations and causes within Alaska. The entity will provide 30% of its giving to the University of Alaska Foundation and the remainder to general community needs. Funding decisions by the entity will be made by BP and ARCO, with the advice of a board of community advisors. BP and ARCO will provide ongoing funding to this entity in an amount that is equal to .2% of BP's and ARCO's combined aggregate net Alaska liquids production after royalty times the price for WTI. Specific entity funding levels will be calculated annually, on the same date each year, referencing the liquids production and the average NYMEX WTI prompt month settlement price for the 12 months immediately preceding the calculation.

E. Annual Report. Once every year beginning in March 2001, and continuing thereafter for the term of this Charter, BP and ARCO will provide the State and the public with a written report describing BP and ARCO's performance of the commitments in this Section II during the prior calendar year. Public distribution will be accomplished by posting the report on a company internet site and such other reasonable means of public distribution as BP and ARCO may choose. The report provided for under subparagraph

II.C.2. will satisfy this paragraph II.E. as well with respect to its subject matter so long as that report is also publicly distributed, and timing differences will be disregarded so long as the II.C.2 report is provided and distributed according to the schedule applying to subparagraph II.C.2.

III. Alaska's Commitments.

The State of Alaska finds that this Charter adequately addresses the concerns raised by the State during its merger review, that this Charter will provide for greater competition, diversity, corporate responsibility, renewal and growth in the exploration, development and production of Alaskan North Slope oil and gas and is by virtue of these significant benefits in the best interest of Alaska and its people. The State accordingly agrees that, in exchange for BP's and ARCO's fulfillment of their obligations under this Charter, it will not seek to enjoin the merger or seek additional orders or judgments under AS 45.50.580 related to a claim that the merger is unlawful under AS 45.50.568.

IV. BP Amoco, p.l.c.'s Commitments.

BP Amoco, p.l.c. acknowledges that, after the merger is completed, it will be the ultimate parent company of the BP and ARCO corporate entities owning the Alaska assets which are the subject of this Charter and which accordingly are the primary parties with the State of Alaska herein. In order to provide further assurance to the State that the commitments made in this Charter by these primary parties are fulfilled in all respects, BP Amoco, p.l.c. guarantees that (1) these BP and ARCO corporate entities, or such other BP/ARCO Group companies to which the obligations under this Charter are assigned or otherwise transferred, will remain fully capable during the term of this Charter to fulfill all commitments made by them herein and (2) if for any reason a commitment made by them in this Charter goes unfulfilled past the time performance is due, BP Amoco, p.l.c. will cause that performance to be otherwise fulfilled.

V. General Provisions.

A. Definitions. As used in this Charter: "State" and "State of Alaska" means the State of Alaska, through its Governor, Attorney General and Commissioners of Natural Resources and Revenue; "BP" means BP Exploration (Alaska) Inc.; "ARCO" means ARCO Alaska, Inc.; "merger" means the proposed merger between BP and ARCO's parent companies; the merger is "completed" on the earliest of the date of closing, the effective date of the merger, or the first day after ARCO parent stock is exchanged for BP parent stock; "sell" and "transfer" mean divest; "gross working interest production" means BP and ARCO's share of actual liquid hydrocarbon production, including any State royalty share; "well data" includes, in digital and analog format, any mud log, lithology log, wireline well logs, conventional core and sidewall core descriptions, repeat formation tester, log curve, directional survey, velocity survey, vertical seismic profile, geologic markers, test result, test summary, porosity and permeability data, biostratigraphic data, palynology and paleontology data, geochemical data, vitrinite reflectance data, petrographic data, and

completion reports, regarding onshore or offshore exploration acreage west of the Canning River onshore and west of and including the Kuvlum prospect offshore; "seismic data" includes all seismic and ancillary data required to interpret or reprocess a seismic survey including digital files in standard exchange formats containing survey and location data, original field records, final stack and migrated processed data, final stacking and migration velocities, and a report describing the acquisition and processing of the data, regarding onshore or offshore acreage west of the Canning River onshore and west of and including the Kuvlum prospect offshore; "fair market" as used in paragraph I.J.1. will be determined with reference to the well-head netbacks pertinent to the available market(s) reasonably accessed by North Slope gas.

B. Enforcement. This Charter is governed by Alaska law. The parties agree that, except as provided in paragraphs I.J.7. and V.C., it may be enforced as a contract by (a) the Attorney General (for Alaska) and (b) its authorized representatives (for BP and ARCO) in any state or federal court in Alaska, the commitments made in this Charter may be specifically enforced, a trustee may be appointed by the court in such an action to effectuate any property transfers not accomplished as committed, and the court may also order any other appropriate remedy consistent with law. If BP, ARCO and the Federal Trade Commission enter into a consent decree or other agreement related to the merger, the terms of that decree or agreement that relate directly to or affect Alaskan assets or activities within or touching Alaskan waters may be incorporated by the State into this Charter by reference, and are enforceable by the State as though fully set forth herein. BP and ARCO acknowledge that they are subject to the personal jurisdiction of any state or federal court within the State of Alaska for the purposes of enforcing the terms of this Charter. BP Amoco, p.l.c. consents to the jurisdiction of any state or federal court within the State of Alaska for the purposes of enforcing its commitments under section IV of this Charter. No action alleging a failure of performance under this Charter may be commenced more than four years after the alleged failure, and no action alleging a failure of performance under this Charter may be commenced in any event after January 15, 2009, except that an action as provided in the final sentence of paragraph V.C. may be commenced through January 15, 2011.

C. Enforcement of Section II. Commitments. In the event that BP and ARCO fail to perform their commitments under subparagraph II.A.8. or paragraph II.E., the State may bring an action to enforce those provisions. The other provisions of Section II of this Charter are corporate citizenship commitments to the Alaskan community at large. The parties do not intend for these other commitments of Section II to be enforced by lawsuits, and no right of action is created with respect to them.

D. Construction. This Charter may be amended only in writing by the principals to this agreement or their successors. This Charter will be binding on the parties and their respective successors and assigns, and is not intended to confer any rights or remedies upon any other persons (as used herein, "assigns" includes a transferee of substantially all of the assets of BP or ARCO but does not otherwise include a transferee of property, under this Charter or otherwise). Except as otherwise provided in this Charter, nothing

herein shall be construed to impose a duty or obligation on BP or ARCO to make any additional agreements with or concessions to any other governmental or regulatory body. Where an act required of BP or ARCO under this Charter is subject to regulatory approval or action, the time limits stated in this Charter will be deemed extended as may be necessary to accommodate the time involved in securing those regulatory approvals if BP and ARCO have acted with reasonable diligence in obtaining those approvals.

E. Reporting, Notice and Access to Records.

1. BP and ARCO will submit an initial compliance report at the time they execute this Charter and will submit additional compliance reports beginning thirty (30) days from the date when this Charter is entered, and every thirty (30) days thereafter until the divestitures required under Section I have been completed or a trustee is appointed. Such reports will be in writing and each such report shall include, for each person who during the preceding thirty (30) days made an offer, expressed an interest or desire to acquire, entered into negotiations to acquire, or made an inquiry about acquiring any ownership interest in all or any portion of the divestiture assets, the name, address, and telephone number of that person and a detailed description of each contact with that person during that period. BP and ARCO will maintain full records of all efforts made to divest the assets under Section I.

2. BP and ARCO will notify the State of any proposed divestiture within two (2) business days following execution of a letter of intent or agreement for sale of the assets under Section I. The notice shall set forth the details of the proposed transaction and list the name, address, and telephone number of each person not previously identified who offered or expressed an interest in or desire to acquire any ownership interest in the divestiture assets. Within ten (10) days after receipt of the notice, the State may request additional information concerning the proposed divestiture, the proposed Purchaser, and any other potential Purchaser. BP Amoco and ARCO will furnish the additional information within ten (10) days of the receipt of the request. Within twenty (20) days after receipt of the notice or within ten (10) days after receipt of the additional information, whichever is later, the State will notify BP and ARCO in writing if it objects to the proposed divestiture. If the State fails to object within the period specified, or if the State provides notice that it does not object, then the divestiture may be consummated. If the State objects, the proposed divestiture may not be accomplished unless ordered by a court of competent jurisdiction.

3. For the purpose of determining or securing compliance with this Charter, and subject to any legally recognized privilege and reasonable notice, the State will be permitted access during office hours to inspect and copy all books, ledgers, accounts, correspondence, memoranda, and other records and documents in the possession or under the control of BP or ARCO relevant to BP or ARCO's compliance with this Charter. Subject to the reasonable convenience of BP and ARCO, and without restraint or interference from them, the State may interview their directors, officers, employees, and agents regarding any such matters. No information or documents

obtained by the State under this paragraph shall be divulged by any representative of the State to any person other than a duly authorized representative of the Attorney General, except in the course of legal proceedings to which the State is a party, or for the purpose of securing compliance with this Charter, or as otherwise required by law.

F. Effectiveness. This Charter shall be effective as of the date it is entered as written above. This Charter shall remain fully effective thereafter, except in the event that the merger agreement between BP and ARCO's parent companies is terminated, then any party may terminate this Charter by written notice to all other parties, in which event this Charter shall become null and void and of no effect, as if it were never entered.

G. Attorneys Fees. Within 30 days of the effective date of this Charter, BP and ARCO will pay the State \$1,512,198 as reimbursement for its attorney's fees and costs reasonably incurred in connection with the merger through the date of this Charter. In addition, BP and ARCO will make supplemental payments to reimburse the State for reasonable attorney's fees and costs incurred by the State related to Charter implementation and compliance between the date of this Charter and 12 months after the merger is completed. These supplemental payments will be made within 30 days after the State submits a reasonably supported written request to BP and ARCO for reimbursement.

H. Warranty of Authority. Each of the persons signing below on behalf of a corporate party represents and warrants that he has the authority to execute this Charter on behalf of the party for which he signs. Each of the persons signing below on behalf of the State represents and warrants that he holds the office shown and is authorized to exercise the powers of that office on behalf of the party for which he signs. In addition, BP and ARCO specifically warrant and represent that they are fully authorized and able to make, and to ensure the performance of, the commitments made herein and that, with respect to any Alaska assets currently owned by affiliates, they have taken or will take such steps as are necessary to ensure that the commitments they make herein are accomplished.

[TEXT CONTINUED ON NEXT PAGE]

I. Other Obligations Not Reduced. Nothing in this Charter is intended to reduce, eliminate or supersede any other obligations BP or ARCO may have under any State or federal law or regulation.

Signatures:

STATE OF ALASKA

by Tony Knowles
Tony Knowles, Governor

by Bruce Botelho
Bruce Botelho, Attorney General

by John Shively
John Shively, Commissioner of Natural Resources

by Wilson Condon
Wilson Condon, Commissioner of Revenue

BP EXPLORATION (ALASKA) INC.

by Richard Campbell
Richard Campbell, President

ARCO ALASKA, INC.

by Kevin O. Meyers
Kevin Meyers, President

BP AMOCO, p.l.c.

by John Browne
John Browne, CEO

by Rodney Chase
Rodney Chase, Deputy CEO

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STATE OF ALASKA

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Tony Knowles, Governor

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Bruce Botelho, Attorney General

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John Shively, Commissioner of Natural Resources

by _____
Wilson Condon, Commissioner of Revenue

BP EXPLORATION (ALASKA) INC.

by _____
Richard Campbell, President

ARCO ALASKA, INC.

by _____
Kevin Meyers, President

BP AMOCO, p.l.c.

by  _____
John Browne, CEO

by _____
Rodney Chase, Deputy CEO

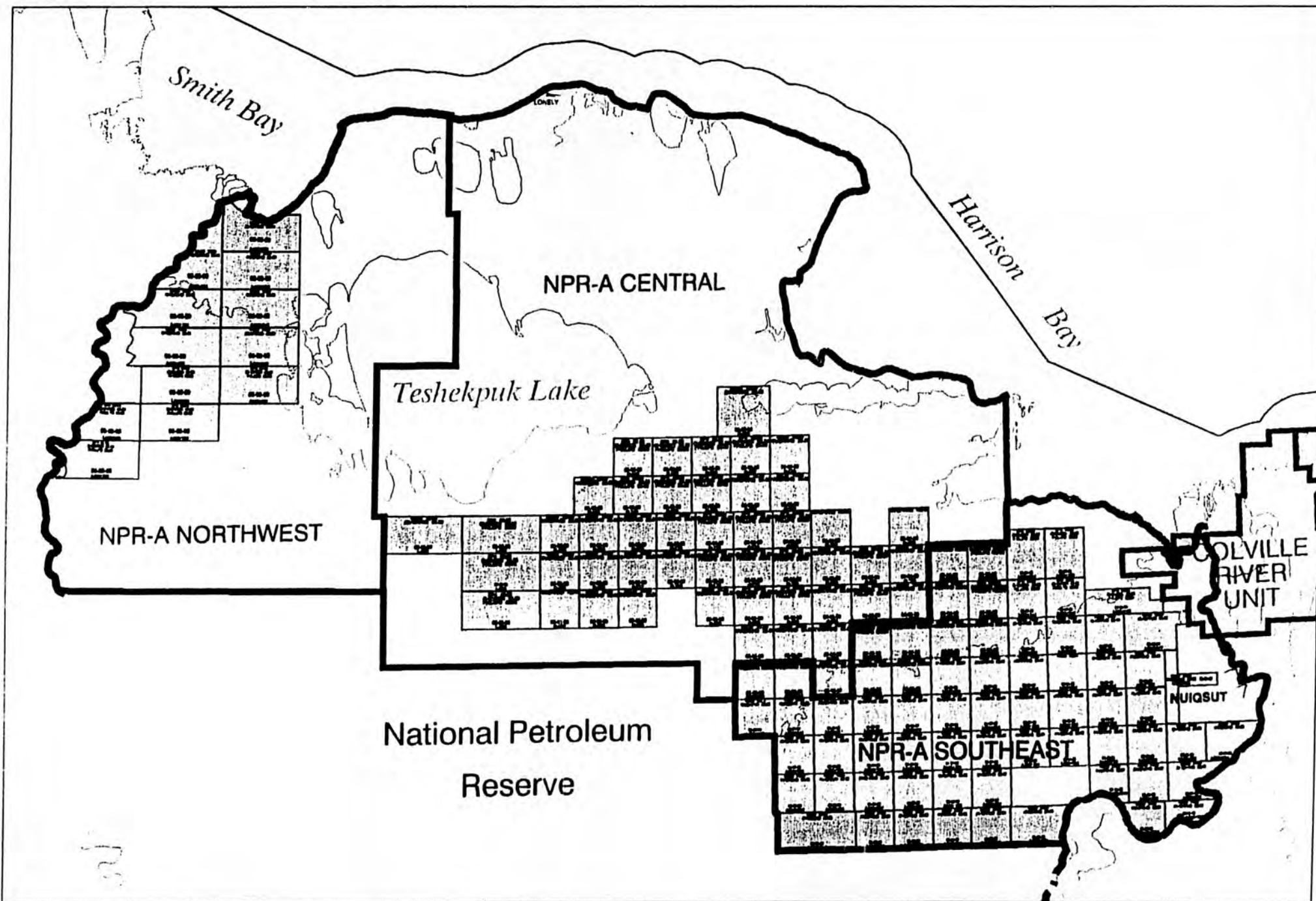
EXHIBITS

Potential New Northeast NPR-A Operating Areas

<i>Project Area</i>	<i>BP & ARCO Lease Holdings</i>				
NPR-A Northwest	AA081730	AA081734	AA081849	AA081852	
	AA081731	AA081733	AA081850	AA081853	
	AA081732	AA081848	AA081851	AA081854	
NPR-A Central	AA081727	AA081756	AA081765	AA081830	AA081840
	AA081728	AA081757	AA081766	AA081831	AA081841
	AA081729	AA081758	AA081813	AA081833	AA081842
	AA081747	AA081759	AA081824	AA081834	AA081843
	AA081748	AA081760	AA081825	AA081835	AA081844
	AA081749	AA081761	AA081826	AA081836	AA081845
	AA081752	AA081762	AA081827	AA081837	AA081846
	AA081754	AA081763	AA081828	AA081838	AA081855
	AA081755	AA081764	AA081829	AA081839	AA081856
NPR-A Southeast *	AA081742	AA081773	AA081787	AA081801	AA081816
	AA081743	AA081774	AA081788	AA081802	AA081817
	AA081744	AA081775	AA081789	AA081803	AA081818
	AA081745	AA081776	AA081790	AA081804	AA081819
	AA081746	AA081777	AA081791	AA081805	AA081820
	AA081750	AA081778	AA081792	AA081806	AA081821
	AA081751	AA081779	AA081793	AA081807	AA081822
	AA081753	AA081780	AA081794	AA081808	AA081823
	AA081767	AA081781	AA081795	AA081809	AA081832
	AA081768	AA081782	AA081796	AA081810	AA081847
	AA081769	AA081783	AA081797	AA081811	AA081857
	AA081770	AA081784	AA081798	AA081812	AA081858
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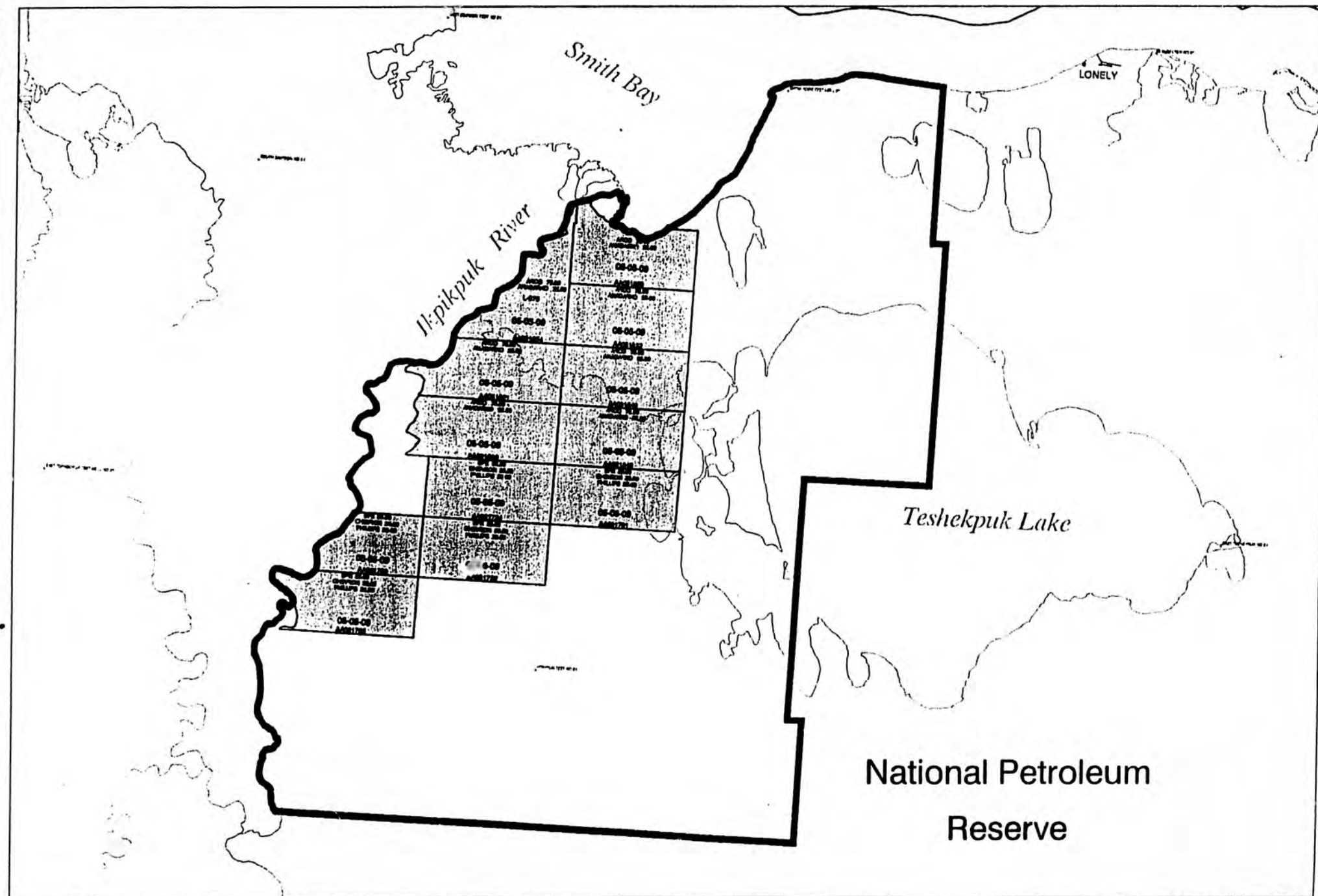
EXHIBIT A AREAS





NPR-A NORTHWEST

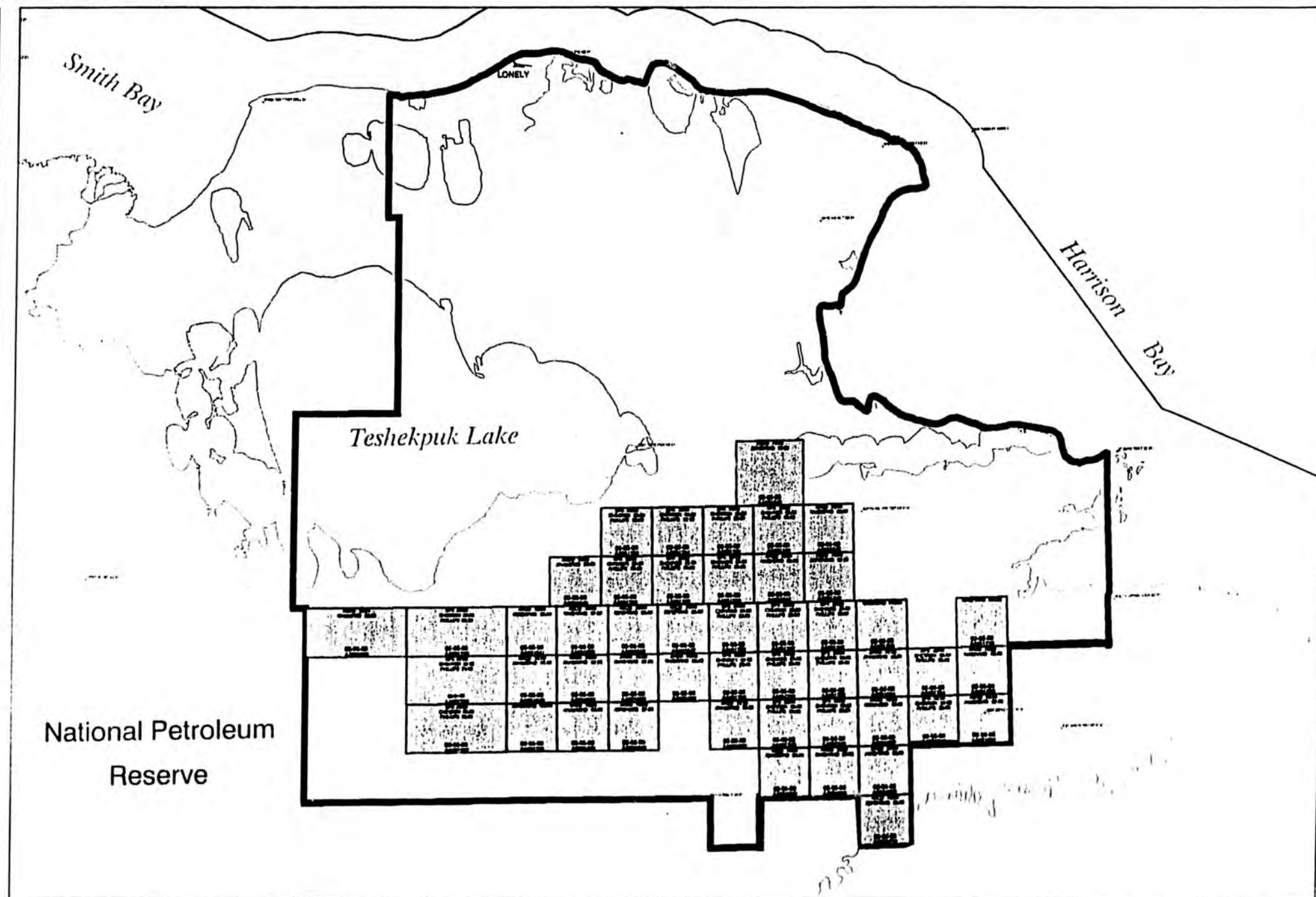
Exhibit A





NPR-A CENTRAL

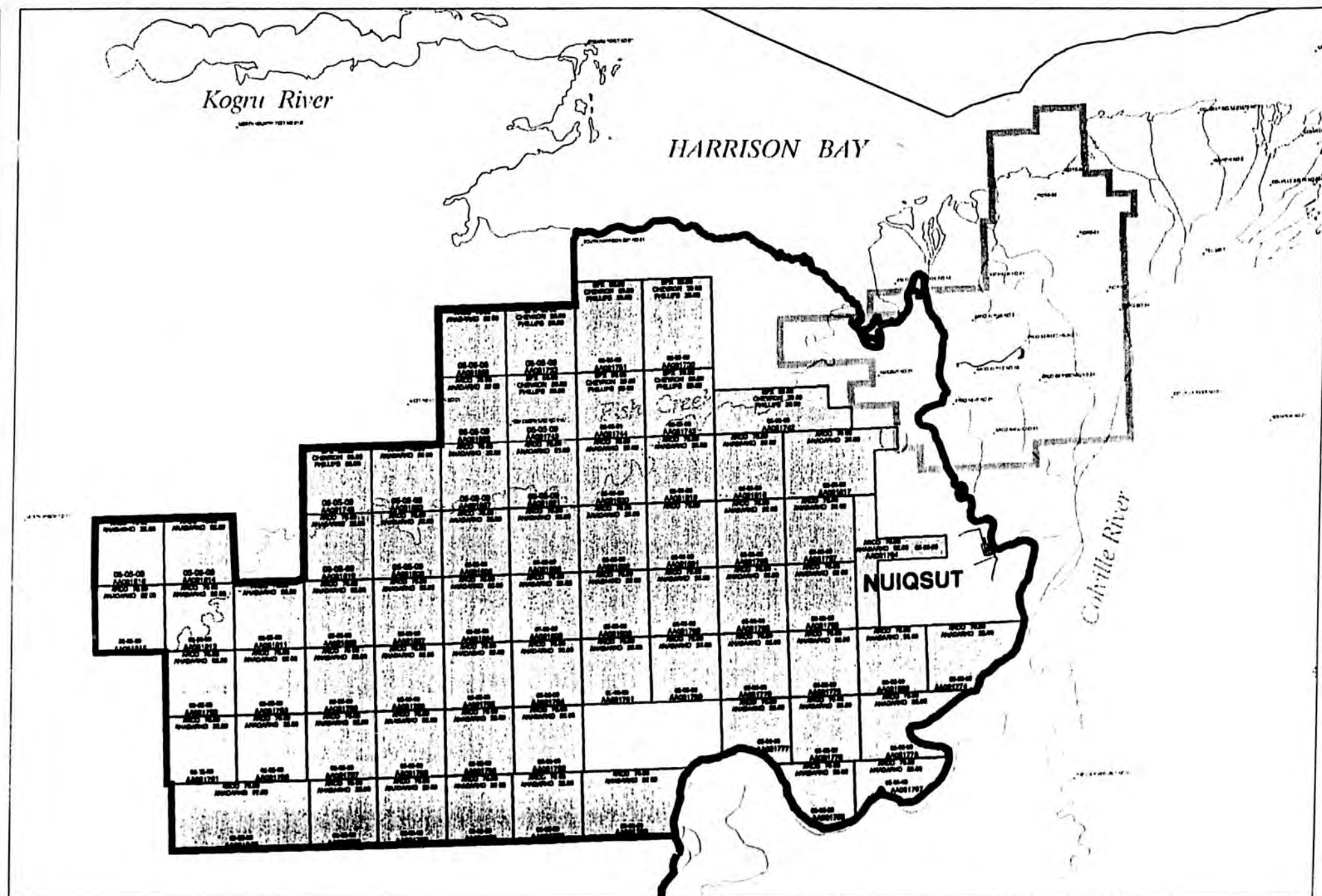
Exhibit A





NPR-A SOUTHEAST

Exhibit A

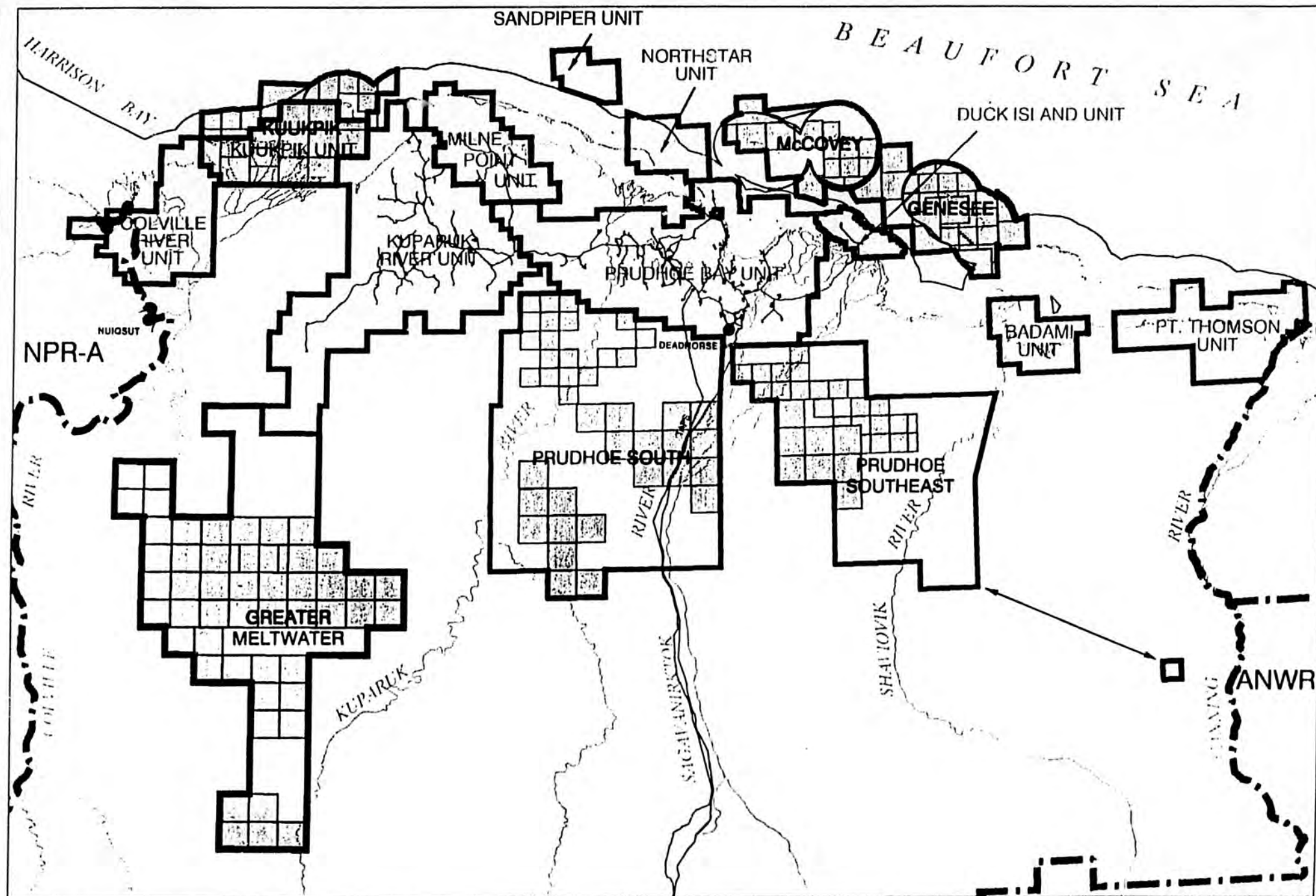


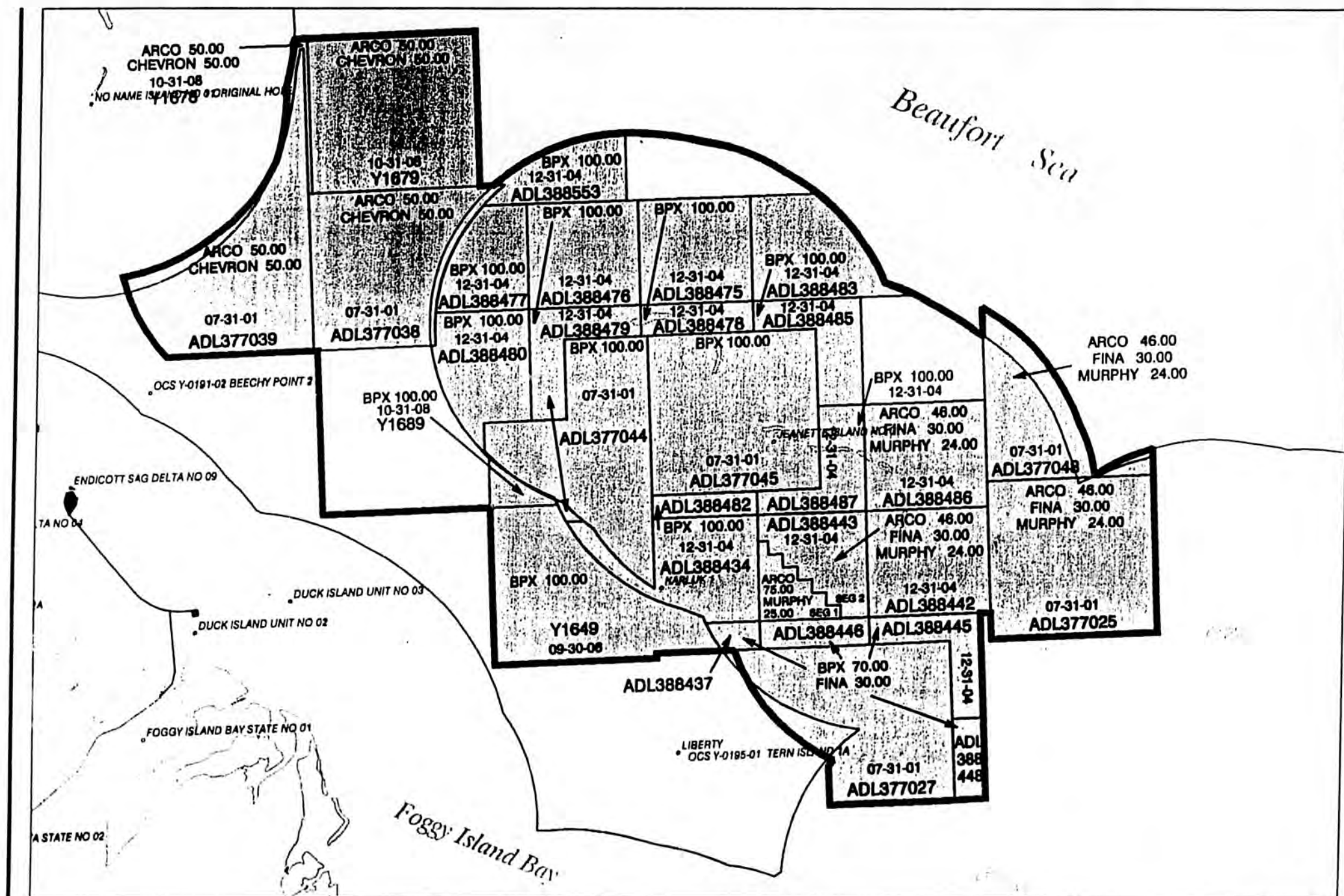
Potential New North Slope Operating Areas

Project Area	BP & ARCO Lease Holdings				
Genesee	AK ADL 377025	AK ADL 377048	AK ADL 388446	AK ADL 388479	AK ADL 388487
	AK ADL 377027	AK ADL 388434	AK ADL 388448	AK ADL 388480	AK ADL 388553
	AK ADL 377038	AK ADL 388437	AK ADL 388475	AK ADL 388482	OCS-Y-1649
	AK ADL 377039	AK ADL 388442	AK ADL 388476	AK ADL 388483	OCS-Y-1678
	AK ADL 377044	AK ADL 388443	AK ADL 388477	AK ADL 388485	OCS-Y-1679
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	AK ADL 375005	AK ADL 375026	AK ADL 375045	AK ADL 380019	AK ADL 385179
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EXHIBIT B AREAS

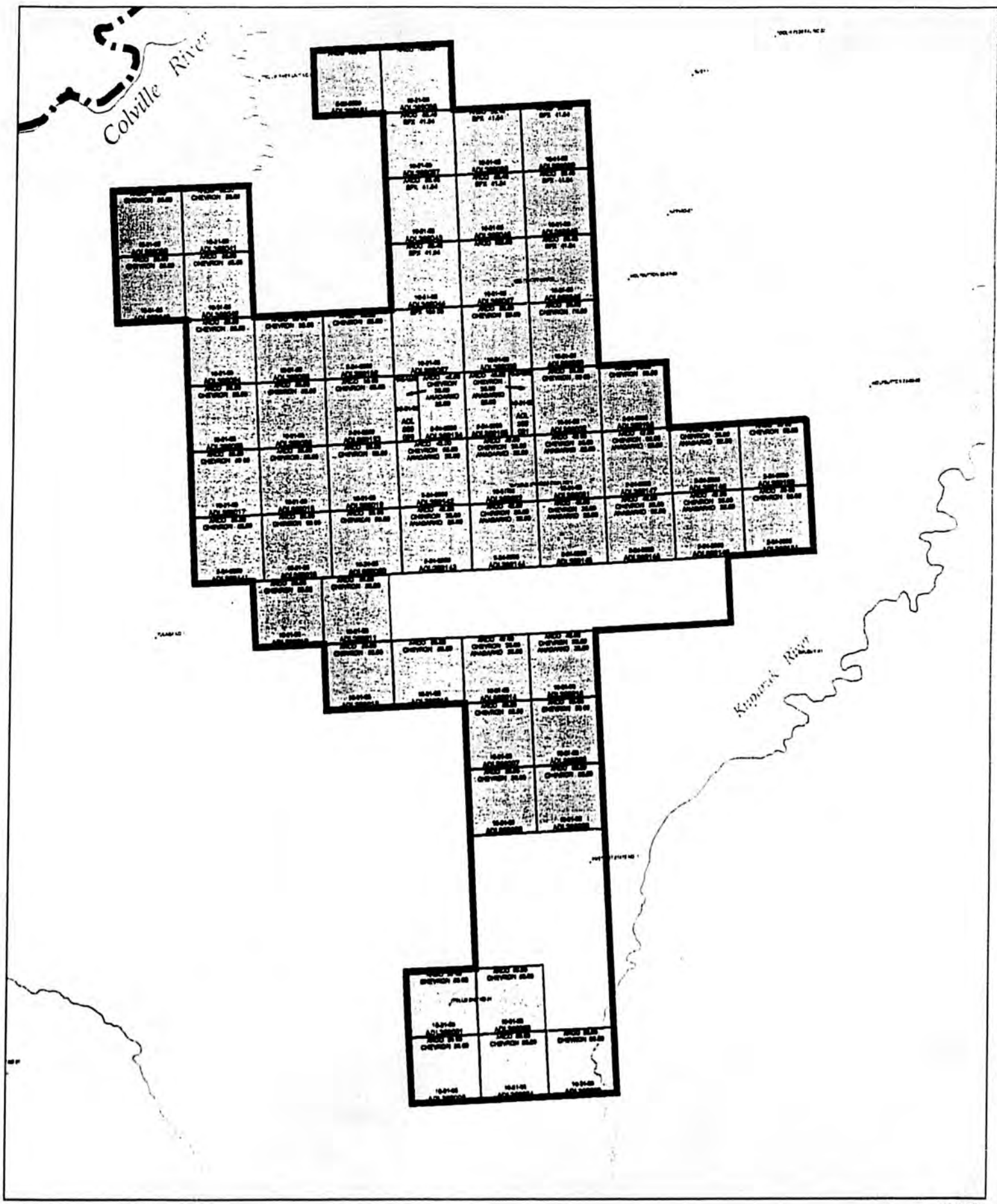






GREATER MELTWATER

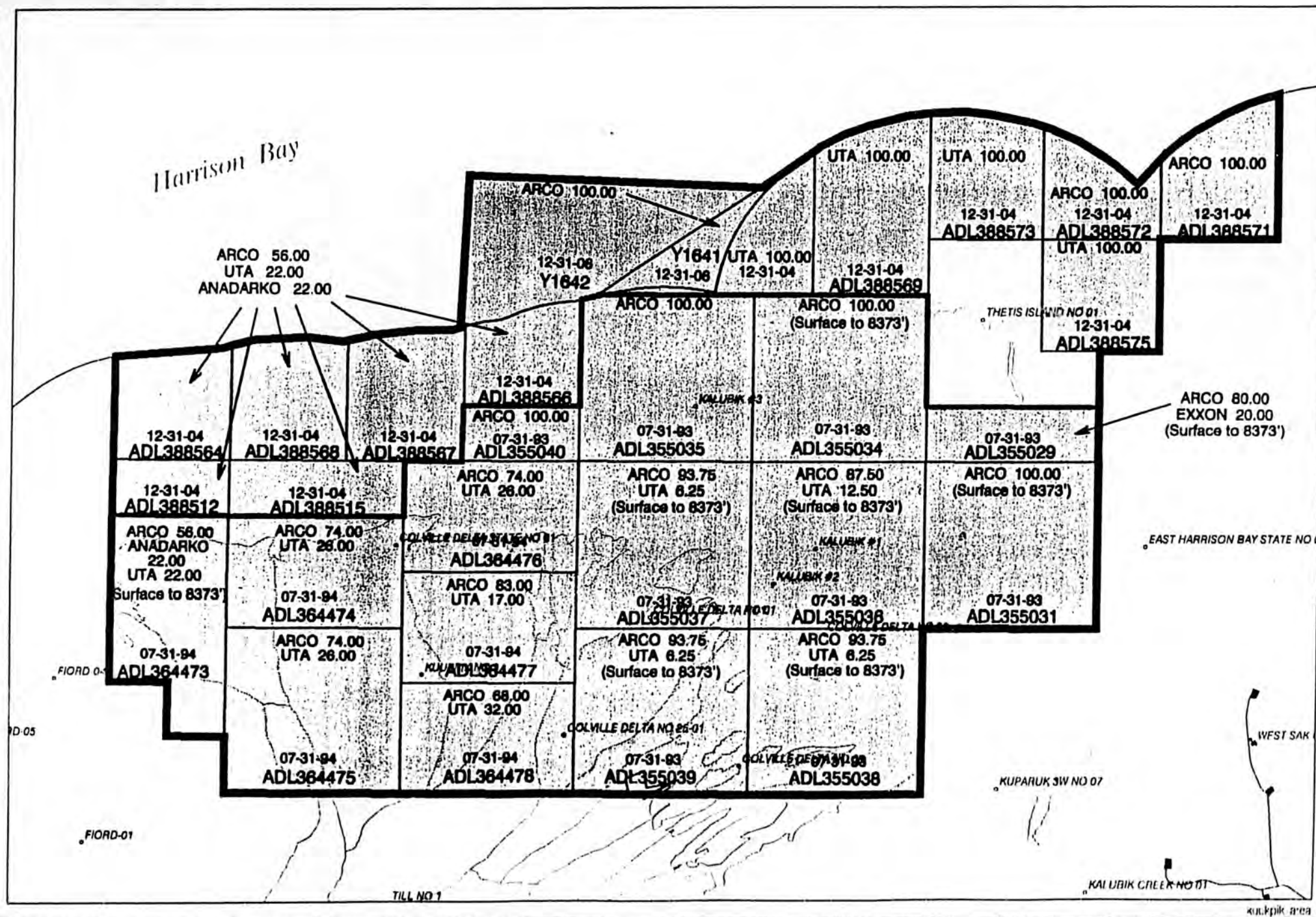
Exhibit E





KUUKPIK AREA

Exhibit B





McCOVEY AREA

Exhibit B

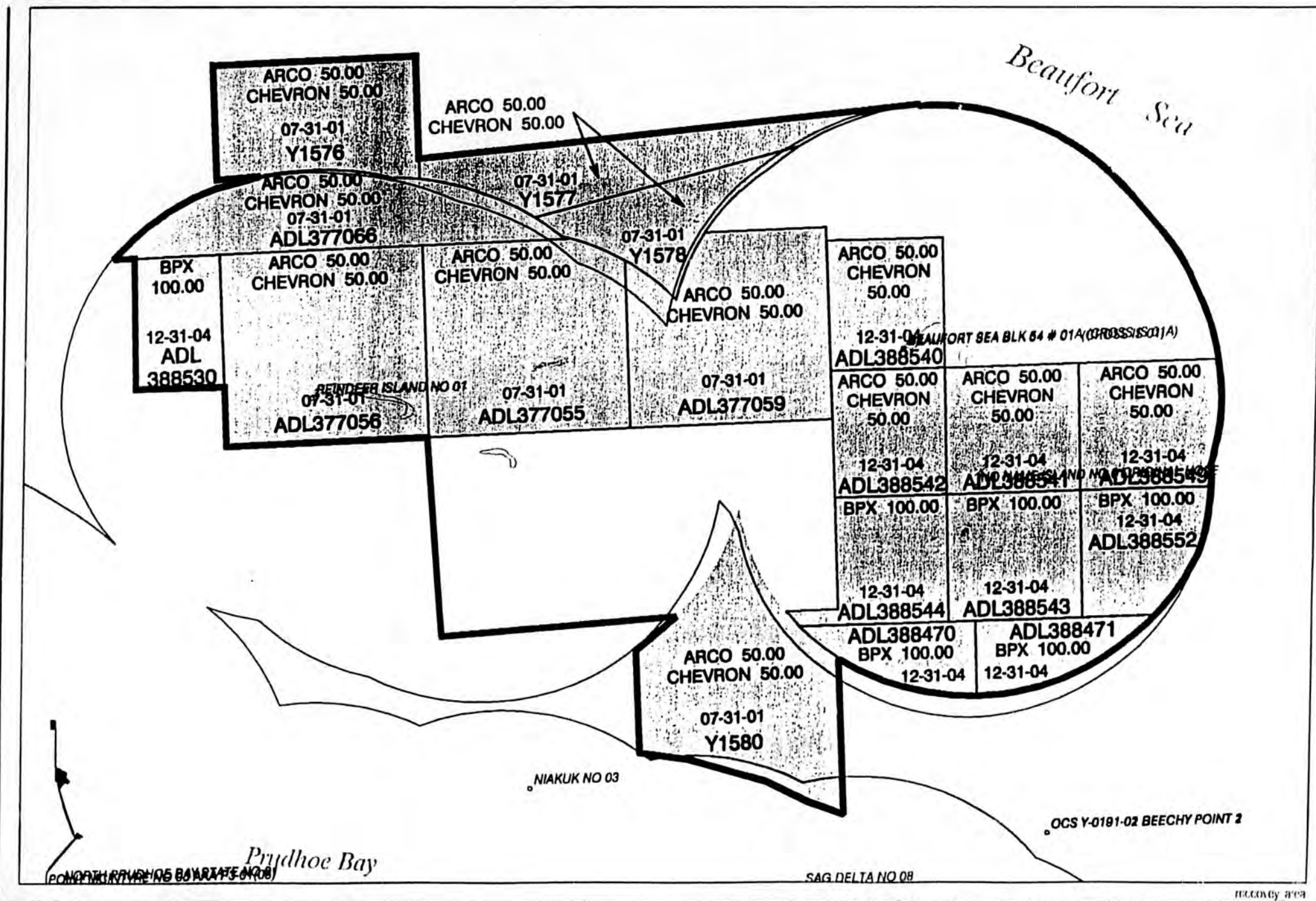
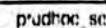




Exhibit B



FORM PURCHASE CONTRACT

DELIVERIES BY PRODUCER

QUALITY: Alaska North Slope (ANS) crude oil.

QUANTITY: Approximately _____ [not to exceed 10,000] barrels per day, with volumes equivalent to [Producer's] _____ % working interest in the _____ Unit, Alaska.

CONTRACT TERM: Effective _____ through _____ [5 year period].

DELIVERY: Title and risk of loss shall pass to [BP] as the crude oil passes from _____ Pipeline Company through the Inlet flange of Trans Alaska Pipeline System at TAPS Pump Station No. 1 (the "PS#1 Delivery Point"), or as the crude oil passes through the ship's flange at Valdez, at the Seller's option.

PRICE:

A. For purchases at PS-1, [BP] agrees to pay [PRODUCER] a price calculated as the volume weighted average sales price for the State's sales under its North Slope RIK sales contracts, *plus* or *minus* an adjustment to account for the differences, if any, in quality between the purchased crude at the PS#1 Delivery Point and the weighted average quality of the RIK crude at the PS#1 Delivery Point calculated in accordance with the TAPS quality bank methodology. RIK sales prices for deliveries other than at PS#1 will be adjusted to an ANS PS#1 price using pipelines tariffs and quality bank adjustments upstream of PS#1 before weight averaging.

B. For purchases at Valdez, [BP] agrees to pay [PRODUCER] the aforesaid price *plus* any TAPS tariffs paid by [PRODUCER] *plus* any TAPS quality bank adjustments paid by [PRODUCER] and *minus* any TAPS quality bank adjustments received by [PRODUCER] with respect to the purchased crude.

C. Retroactive revisions billed to RIK purchasers by the State will be considered retroactive revisions to the sales price in this contract, and subject to the same adjustments. In the event that no RIK sales are made in a month, and this contract is in effect, the RIK price will be replaced by the price calculated by the State as the average value it received for RIV in that month, as provided under paragraph I.G. of the Charter for North Slope Development, subject to the same adjustments as above.

INVOICES: Pricing will be provisional due on the 20th of the month following the month of delivery. The prior month's RIK sales prices and, if pertinent, TAPS tariff and quality bank adjustment for the month of delivery will be used in the provisional invoice. (For example, the provisional Invoice for January 1999 production would use December 1998 RIK sales prices, tariff and quality bank adjustment.) Provisional Invoices will be actualized after actual RIK sales prices, tariffs and quality bank adjustments are determined.

FORM PURCHASE CONTRACT

PROVISIONS APPLICABLE FOR BOTH PARTIES

PAYMENT: Payment shall be made by check of immediately available federal funds on the 20th of the month following the month of delivery.

Payments due on Saturday shall be paid the preceding Friday, and payments due on Sunday shall be paid the following Monday. Similarly, payments due on a federal bank holiday shall be paid the preceding business day except when a federal bank holiday falls on a Monday, when payment shall be due the following day.

GENERAL PROVISIONS: BP's Standard General Provisions, copy attached.

SIGNATURES:

[PRODUCER]

by _____

[BP]

by _____



BP OIL

PART 2

BP OIL SUPPLY COMPANY

**Common Terms and Conditions for the Sale
and Exchange of Alaskan North Slope Crude Oil**

Effective November 1, 1991

INDEX

- ARTICLE 1: QUANTITY
- ARTICLE 2: QUALITY
- ARTICLE 3: QUANTITY AND QUALITY CLAIMS
- ARTICLE 4: QUANTITY AND QUALITY DETERMINATION FOR ANS DELIVERED BY VESSEL
- ARTICLE 5: QUANTITY AND QUALITY DETERMINATION, EXCEPT FOR ANS DELIVERED BY VESSEL
- ARTICLE 6: DELIVERY SPECIFICATIONS FOR ANS DELIVERED BY VESSEL
- ARTICLE 7: DELIVERY SPECIFICATIONS, EXCEPT FOR ANS DELIVERED BY VESSEL
- ARTICLE 8: PRICE AND PAYMENT
- ARTICLE 9: PRICE AND/OR EXCHANGE DIFFERENTIAL REOPENER OR TERMINATION DUE TO UNITED STATES GOVERNMENTAL ACTION
- ARTICLE 10: REOPENER NOTICE
- ARTICLE 11: SUPPLIER/PURCHASER REGULATIONS
- ARTICLE 12: ROYALTY OIL
- ARTICLE 13: FORCE MAJEURE
- ARTICLE 14: ALLOCATION
- ARTICLE 15: ASSIGNMENT
- ARTICLE 16: WARRANTIES
- ARTICLE 17: WAIVER
- ARTICLE 18: NON-PERFORMANCE
- ARTICLE 19: GOVERNING LAW
- ARTICLE 20: NOTICES
- ARTICLE 21: CRUDE OIL EXCHANGE IMBALANCE SETTLEMENT
- ARTICLE 22: TAXES
- ARTICLE 23. ENTIRE AGREEMENT
- ARTICLE 24: DEFINITIONS

ARTICLE 1. QUANTITY

The quantity of crude oil shall be the amount specified in Part 1 of the Agreement. There shall be no operational tolerance unless specified in Part 1 of the Agreement.

ARTICLE 2. QUALITY

Section 2.1. Quality

All crude oil delivered hereunder shall be consistent with normal stream quality for the type of crude specified in Part 1 of the Agreement, and acceptable to the carriers involved.

Section 2.2. Change in the Quality of Crude Oil

Seller shall give Buyer a prompt written notice of any sudden and unforeseen significant change in the quality of crude oil at Seller's source of supply which would render it impossible to deliver with the qualities specified in Part 1 of the Agreement.

ARTICLE 3. QUANTITY AND QUALITY CLAIMS

Any and all claims either as to a shortage in quantity or a defect in quality with respect to any delivery of crude oil hereunder shall be made by the claiming party in writing to the other party within 90 days after delivery of such crude oil and shall include documentation supporting the claim (provided however, no claim shall be made hereunder for any indirect, special, incidental, or consequential damages). If no such written notice of claim is received within 90 days after delivery of the crude oil to the Buyer, the claim shall be deemed to have been waived.

Upon either party's receipt of a valid claim notice by the other party, the Parties shall make best efforts to resolve the claim within 30 days of said receipt. If resolution cannot be reached during the 30 day time period, the Parties shall jointly select an independent arbitrator to decide the dispute and the cost of the arbitrator's services shall be shared equally by the parties. The arbitrator shall have expert knowledge for determination of the matter in question and findings shall be based on actual evidence available, including retests if samples were retained.

ARTICLE 4. QUANTITY AND QUALITY DETERMINATION FOR ANS DELIVERED BY VESSEL

Section 4.1. Independent Inspection

The quantity and quality of the ANS crude oil delivered by Seller to Buyer shall be determined by a U.S. Customs approved independent petroleum inspector. Said inspector shall be mutually acceptable to both Parties and the

cost of the inspection service shall be shared pro-rata between Buyer and Seller at their individual contract rate. The independent inspector shall prepare certificates of quantity and quality, and provide copies of such to the Buyer and Seller. The inspector's determinations as to quantity and quality recorded on the certificates shall be conclusive and binding upon both Parties (except in cases of manifest fraud or error). Seller shall arrange for inspection.

Section 4.2. Quantity Determination

The gross quantity of ANS crude oil delivered hereunder shall be determined by one of the following methods beginning preferentially with:

- (a) Calibrated positive displacement meter measurements;
- (b) Manual shore tank gauge measurements taken before or after delivery into such shore tanks. Insofar as possible, tanks shall be settled for a minimum of 6 hours before gauging. Lines between the ship's flange and receiving tank shall be proven to be full before discharge; or
- (c) Closed measurement devices, such as sonic tape devices as available on the vessel. Sonic tape shall be provided by and certified accurate by the inspectors.

Neither party may require a corroboration of the volume measurements thus obtained, using any other method of ANS crude oil volume measurement without the written consent of the other party. Volumes shall be reported in barrels, and temperature corrections to 60°F shall be made in accordance with Table No. 6A of the latest revision of the Petroleum Measurement Tables of the American Society for Testing Materials and the Institute of Petroleum (ASTM D1250, IP 200).

Section 4.3. Quality Determination

The quality of ANS crude oil delivered hereunder shall be determined by one of the following methods beginning preferentially with:

- (a) A continuous sample collected by a U.S. customs approved flow proportioned in-line sampler as the ANS crude oil discharges from the vessel; or
- (b) Water cuts and a composite sample made up of running all-level samples taken from each of the vessel's tanks upon arrival at the delivery port. This method shall not be used for vessels equipped with an Inert Gas System (IGS) unless such vessels are also equipped with valves that permit hand measurement and thieving without lifting the inert gas blanket or releasing the blanket pressure; or
- (c) Water cuts and a composite sample (made up of upper, middle and lower samples) taken from the shore tanks both

taken immediately before and no sooner than 6 hours after the delivery into such shore tanks.

Notwithstanding the above, in case the ANS crude oil volume measurements are done using closed measurement devices, then in that case, the quality determination shall be made using method(s) that do not require lifting the inert gas blanket.

ARTICLE 5. QUANTITY AND QUALITY DETERMINATION, EXCEPT FOR ANS DELIVERED BY VESSEL

Section 5.1. In-Line and In-Tank Transfer of Common Stream Crude Oil

The quantity and quality of common stream crude oil to be transferred in-line or in-tank into a third party facility or via a third party common carrier shall be evidenced by the third party's delivery ticket.

Section 5.2. Independent Inspection

If either party requests in writing to the other party that an independent petroleum inspector be present at the time of delivery, the quantity and quality of the crude oil delivered by Seller to Buyer shall be determined by an independent petroleum inspector. Said inspector shall be mutually acceptable to both Parties and the cost of the inspection service shall be shared pro-rata between Buyer and Seller at their individual contract rate. The independent inspector shall prepare certificates of quantity and quality, and provide copies of such to the Buyer and Seller. The inspector's determinations as to quantity and quality recorded on the certificates shall be conclusive and binding upon both Parties (except in cases of manifest fraud or error). Seller shall arrange for inspection. The Parties may each have a representative present to witness all gauges, tests, and measurements.

Section 5.3. Measurements and Tests

The quantities, quality, and gravities of crude oil delivered hereunder shall be determined in accordance with generally accepted industry practices in effect at the time and place of delivery for the receiving carrier.

Volumes shall be reported in barrels, and temperature corrections to 60°F shall be made in accordance with the latest revision of the Petroleum Measurement Tables of the American Society for Testing Materials and the Institute of Petroleum (ASTM D1250, IP 200).

All quality measurements and tests shall be made in accordance with the latest ASTM or ASME-API (Petroleum PD Meter Code) published methods then in effect, whichever apply. Volume and gravity shall be adjusted to 60°F for each

barrel on the basis of the latest American edition of ASTM-API Petroleum Measurement Tables.

ARTICLE 6. DELIVERY SPECIFICATIONS FOR ANS DELIVERED BY VESSEL

Section 6.1. Delivery

Delivery of ANS crude oil shall be from a vessel arranged for by Seller to a safe berth reachable on her arrival and of sufficient depth for the vessel, provided the vessel can proceed thereto, lie at, and depart therefrom always safely afloat. Buyer warrants that conditions at the facility conform to those previously approved by Seller. Said berth shall be provided by the Buyer free of all charges (including but not limited to: line handling, set-upon gangways, cargo port fees, wharfage, dockage, and quay dues), at the Buyer's designated marine terminal facilities. Any additional costs incurred to make the berth and channels thereto and therefrom safe for the vessel, or as required by governmental or port authorities (including but not limited to additional tugs and pilots), are for the Buyer's account.

The date that the Seller tenders NOR (as described in Section 6.6), and not the actual discharge date, shall be deemed to be the date that determines the Seller's compliance or non-compliance with its contractual delivery period obligation as set forth in Part 1 of the Agreement.

Section 6.2. Title and Risk of Loss

Title to, and risk of loss, damage, contamination, deterioration, and evaporation of the ANS crude oil delivered hereunder shall pass to Buyer as the ANS crude oil passes the flange connection between Seller's vessel and the Buyer's receiving hose, at which point Seller's responsibility shall cease.

Any and all loss of or damage to the oil and/or environment during discharge arising out of negligence of the Buyer or terminal operator shall be borne solely by the Buyer.

Section 6.3. Scheduling and Nominations

The Buyer shall nominate in writing to Seller both a minimum 5 day arrival date range, which may be any 5 consecutive days during the delivery period named in Part 1 of the Agreement, and a port in which Buyer desires to take delivery of the ANS crude oil. Buyer shall furnish all port information, including draft, delivery port restrictions, terminal procedures, and any non-customary requirements of the port authorities.

If the Agreement date occurs on or is prior to the 12th day of the month prior to delivery, Buyer shall provide said nominated arrival date range to Seller no later than 15 days prior to the beginning of the month in which delivery is to be made. If the Agreement date occurs after the 12th day of the

month prior to the month of delivery, the Buyer shall provide said nominated arrival date range to Seller no later than 3 business days after the Agreement date. Upon the receipt of Buyer's nominated arrival date range, Seller shall provide Buyer with a scheduled 3 day arrival date range in writing no later than 10 days prior to the first day of the scheduled 3 day date range. Seller shall make all reasonable efforts to provide a scheduled three day date range which corresponds to the nominated date range but shall not be obligated to do so. Seller may not change the scheduled 3 day date range without the Buyer's prior written approval.

The Buyer shall ensure that appropriate facilities and personnel are available for the receipt of the Seller's declaration of the scheduled 3 day date range between 9:00 am and 5:00 pm, local time for the Seller's address as set forth in Part 1 of the Agreement. Nomination/scheduled date ranges shall be based on the local time zone and working days at the discharge terminal.

Section 6.4. Failure to Follow Nomination Procedures

If Buyer has not provided the minimum 5 day arrival date range and port nomination as set forth in Section 6.3, Buyer shall not be relieved of its obligation to purchase ANS crude oil under the Agreement. In that event, Seller shall use its best efforts to schedule its vessels to meet nominations that are subsequently submitted by Buyer. In the absence of timely nominations, as set forth in Section 6.3, Seller shall, at any time after the due date for nominations, notify the Buyer in writing that a delivery vessel and/or 3 day arrival date range has been scheduled by Seller to meet Buyer's delivery requirements, no later than 10 days prior to the first day of the scheduled 3 day date range. Any additional direct costs, including but not limited to demurrage, deadfreight and vessel deviation, incurred by Seller in meeting Buyer's nominations as subsequently submitted, shall be for Buyer's account.

Section 6.5. Discharge Revisions

Buyer may not change the discharge port, the scheduled 3 day arrival date range, or require multiple berth/port discharge without Seller's written approval, and Seller shall not be obligated to honor said change but shall make reasonable efforts to accommodate the change. Buyer shall be responsible for the cost of all vessel deviation and incremental lightering or other costs directly associated with any such change. Upon Buyer's request, Seller shall provide Buyer with the best available estimate of additional costs. Seller shall subsequently make all reasonable efforts to minimize such costs.

Section 6.6. Laytime

Upon arrival at customary anchorage or place for such

purposes at the port of discharge (berth or no berth), the master or his agent shall give notice of readiness by letter, facsimile, telex, wireless, or telephone stating that the vessel is ready to discharge cargo ("tendering of NOR"). If the vessel tenders NOR within the scheduled 3 day date range, the vessel shall await its proper turn and laytime shall commence upon the expiration of 6 hours after the tendering of NOR, or upon the vessel's arrival in berth, whichever occurs first.

If the vessel tenders NOR before the scheduled 3 day date range, laytime shall commence upon the expiration of 6 hours after tendering of NOR but not prior to 0001 hours local time of the first day of the scheduled 3 day date range, or upon vessel's arrival in berth, whichever occurs first. If the vessel arrives after the scheduled 3 day date range, the vessel shall be berthed as soon as possible, in its proper turn with other such vessels, and laytime shall commence upon the vessel's arrival in berth. In the event that the vessel arrives later than the fifth day of the month following the delivery period named in Part 1 of the Agreement, Buyer shall have the right to terminate the Agreement. Termination shall be subject to Seller receiving Buyer's written termination notice no later than 0001 hours on the eighth day of the month following the delivery period named in Part 1 of the Agreement.

Time consumed due to cargo gauging and sampling of vessel or shore, including time spent to perform and gauge line displacements, shall count as used laytime, or if the vessel is on demurrage, as time on demurrage.

Laytime, or if the vessel is on demurrage, time on demurrage shall cease upon disconnection of cargo hoses following completion of discharge. If the vessel is delayed in excess of 2 hours after such disconnection of cargo hoses solely for Buyer's purposes, laytime, or if the vessel is on demurrage, time on demurrage shall be deemed to have continued without interruption from the disconnection of cargo hoses until the termination of such delay.

36 running hours shall be allowed as laytime for discharging a full cargo (including crude oil washing and/or cargo stripping, if performed), and a pro rata amount of hours shall be allowed for discharging partial cargoes subject to a minimum of 12 running hours. If the vessel is simultaneously discharging to more than one Buyer, each Buyer shall be liable for incurred demurrage on a pro rated volume basis. Time used shifting between berths, unless at the request of Seller, shall count as laytime, or if the vessel is on demurrage, as time on demurrage.

Time consumed due to any of the following shall not count as laytime, or if the vessel is on demurrage, as time on demurrage when spent or lost:

- (a) On an inward passage from anchorage or other waiting

place, even if lightering has taken place at the anchorage, to the discharge berth, including awaiting tide, tugs/pilots until the vessel's arrival in berth; or

(b) Due to the vessel's condition or breakdown or inability to discharge the cargo, or due to any other reason attributable to the vessel, her owners, her master, officers, or the crew; or

(c) Due to prohibition of discharging at any time by the Owner or operator of the vessel, unless such prohibition is caused by unsafe conditions at the berth and/or channels thereto and therefrom; or

(d) In ballasting or bunkering not concurrent with discharging; or

(e) As a result of a strike, lockout, stoppage, or restraint of labor, of the vessel, or tugboats or pilots, except when all of the aforesaid are owned by or otherwise are under Buyer's direct control.

Section 6.7. Demurrage

Demurrage shall be paid, as provided herein, per running hour and pro rata for a part thereof for all the time that laytime as specified above is exceeded by the time taken to discharge cargo (including crude oil washing and/or cargo stripping) and the time which, under the provisions of this Agreement, counts as laytime or time on demurrage.

Any and all demurrage claims (and supporting documentation) incurred under these provisions, shall be sent by BP Oil Supply Company (or its affiliate or its appointed agent) to its initial Buyer within 90 days of completion of cargo discharge. In the event that such Buyer has resold the cargo, Buyer, and any other subsequent resellers of the cargo, shall send a copy of said demurrage claim and supporting documentation to its respective buyer within 5 days of its receipt of said demurrage claim and supporting documentation.

Valid demurrage charges between Seller and the Buyer shall be paid by the Buyer no later than 60 days from receipt of such demurrage claim and supporting documents. Any Buyer agreement with a third party, or Buyer's inability to collect demurrage from said third party, for whatever reason, shall not be an excuse, waiver, or defense to a claim for payment to Seller. Demurrage charges shall be presumed to be valid if not objected to in writing by Buyer within 45 days of receipt of invoice. If valid demurrage claims are not paid within 60 days from receipt of invoice, Seller shall charge interest on the unpaid balance for each day payment is delinquent at 2 percentage points above the accrued Prime Interest Rate as quoted in the Wall Street Journal.

In the event demurrage is incurred and the Parties are unable to agree on the applicable tanker market spot level, then each party shall refer the matter to an independent tanker broker

active in the U.S. coastwise trade. Each independent tanker broker so designated shall give a written opinion on the spot market level, and the level used shall be the arithmetic average of the two levels.

Section 6.8. Demurrage Rates

The rate of demurrage shall be the demurrage rate provided in the American Tanker Rate schedule current as of the date of commencement of loading for a vessel of the size employed in the delivery multiplied by the spot market level current as of the date of commencement of discharging for a vessel of the size employed in the delivery eligible to trade permanently in the United States coastwise trade.

Section 6.9. Demurrage Rate Reductions

The rate of demurrage shall be reduced to one-half (1/2) of the amount stated in Section 6.8 above per running hour for demurrage incurred as a result of any of the following:

(a) Fire, explosion, breakdown, or failure of machinery or equipment in or about the receiving facility; or

(b) Severe weather and/or sea conditions, including fog; or

(c) Prohibition of discharging by Port Authorities, including awaiting daylight restriction, unless such prohibition is caused by the receiving facility's failure to comply with applicable laws or regulations; or

(d) Strike, lockout, or stoppage of Buyer or terminal operator labor/personnel.

Section 6.10. Vessel Lightering

Costs of lightering to the customary arrival draft of the originally scheduled port shall be for Seller's account. This draft shall be determined by the approach channel areas, including seasonal variations of the discharge terminal. Costs of further lightering required to accommodate specific berth constraints shall be for Buyer's account.

ARTICLE 7. DELIVERY SPECIFICATIONS, EXCEPT FOR ANS DELIVERED BY VESSEL

Section 7.1. Delivery

Seller shall deliver the quantity of crude oil to Buyer into the delivery facilities named in Part 1 of the Agreement.

Section 7.2. Alternate Delivery via Book Transfer/Net Scheduling

The Parties may mutually agree to reduce the number of redundant in-line transfers by effecting delivery for the same type of crude oil at the same location during the same

delivery period through a book transfer/net scheduling of redundant sales sequences. Alternate delivery may be made through the book transfer/net scheduling of circular sales sequences as determined by the Parties or through a third party book transfer/net scheduling agent which is mutually recognized as such by the Parties. The Parties agree that delivery is effected upon the issuance of each party's written confirmation of a book transfer/net scheduling and/or the third party's documentation evidencing a book transfer/net scheduling.

Section 7.3. Title and Risk of Loss

Title to and risk of loss, damage, contamination, deterioration, and evaporation of the crude oil delivered hereunder shall pass from Seller to Buyer as the crude oil is delivered into the delivery facilities named in Part 1 of the Agreement; or, in the case of an in-line transfer, when the transfer order is written by appropriate authorized personnel of the carrier; or, in the case of a book transfer/net scheduling, upon the issuance of documentation evidencing the parties' mutual agreement of the book transfer/net scheduling.

ARTICLE 8. PRICE AND PAYMENT

Section 8.1. Price

The price shall be the price as set forth in Part 1 of the Agreement, calculated in U.S. Dollars per barrel. No gravity adjustment shall apply unless specified in Part 1 of the Agreement.

Section 8.2. ANS Payment

Buyer shall pay the full ANS crude oil purchase price without deductions, discounts, or offsets on or before 5 days after the date of completion of discharge, or 10 days after tendering of NOR, whichever occurs first, for each delivery of ANS crude oil under the Agreement. Payment shall be made to Seller's bank via telegraphic transfer in immediately available funds against Seller's Commercial Invoice and, a copy of the independent inspector's report evidencing actual delivery quantities if said report is required by this Part 2.

If payment due date falls on a Saturday or a New York bank holiday other than Monday, payment shall be effected on the preceding day. If payment due date falls on a Sunday or a Monday New York bank holiday, payment shall be effected on the next business day. If payment is late, Seller shall charge interest on the unpaid balance for each day payment is delinquent at 2 percentage points above the accrued Prime Interest Rate as quoted in the Wall Street Journal from the payment due date.

In the event that the actual discharge quantity is unavailable at the time of invoicing, Seller shall invoice, and Buyer shall make payment against Seller's provisional invoice on the

payment due date, on a provisional basis for the ANS crude oil quantity as scheduled and invoiced by the Seller. An adjusted invoice shall be sent by Seller as soon as the actual quantities are determined. Any resultant underpayment shall be paid immediately by Buyer to Seller and any resultant overpayment shall be immediately refunded by Seller to Buyer. Interest on any underpayment or overpayment shall be calculated from the payment due date using the accrued 30 day commercial paper rate as quoted in the Wall Street Journal on the payment due date.

Section 8.3. Exchange Crude Oil Payment

Buyer shall pay the full exchange crude oil purchase price without deductions, discounts, or offsets on or before the 20th day after the end of the delivery month to Seller's bank via telegraphic transfer in immediately available funds against Seller's Commercial Invoice and documentation from the pipeline carrier or shipper evidencing actual delivery quantities and/or documentation evidencing a book transfer. If payment due date falls on a Saturday or a New York bank holiday other than Monday, payment shall be effected on the preceding day. If payment due date falls on a Sunday or a Monday New York bank holiday, payment shall be effected on the next business day. If payment is late, Seller shall charge interest on the unpaid balance for each day payment is delinquent at 2 percentage points above the accrued Prime Interest Rate as quoted in the Wall Street Journal from the payment due date.

Section 8.4. Financial Security

If specified in Part 1 of the Agreement, Buyer must provide Seller with financial security for payment in one of the following forms of security:

(e) An irrevocable Letter of Credit, in a form acceptable to Seller and in conformity with Seller's procedures and requirements (including adequate coverage of load tolerances). The amount of the Letter of Credit shall be in an amount equal to the total purchase price of crude oil being purchased on the said date of delivery plus a total purchase price load tolerance of either (i) 10% for crude oil delivered by pipeline, or (ii) 10% for ANS delivered by vessel to either a U.S. West Coast or Hawaii location, or (iii) 15% for ANS delivered by vessel to a location other than the U.S. West Coast or Hawaii. The issuing bank must be approved by Seller in advance of the opening of the Letter of Credit. All bank charges, including but not limited to issuing, confirming, advising, and negotiating fees, shall be for Buyer's account.

If securing payment for ANS crude oil, the Letter of Credit must be received by Seller at least 5 business days prior to the date of commencement of discharge of each delivery of ANS crude oil under the Agreement.

If securing payment for exchange crude oil, the Letter of Credit must be received by Seller at least 3 business days prior to the U.S. domestic pipeline scheduling day for the month of delivery.

(b) Payment prior to delivery, whereby Buyer shall make payment to Seller in an amount equal to the full purchase price of the scheduled delivery quantity (the "pre-payment"), less accrued interest from the pre-payment date to the payment due date. Interest on the pre-payment shall be calculated from the pre-payment date to the payment due date, 365 days per year convention, using the accrued 30 day commercial paper rate as quoted in the Wall Street Journal from the pre-payment due date.

Upon the receipt of actual delivery quantities and subsequent invoice balancing, any underpayment by Buyer, or refund to Buyer if that be the case, shall be paid by the close of business on the next business day via telegraphic transfer in immediately available funds.

If securing payment for ANS crude oil, the pre-payment must be received by Seller at least 5 business days prior to the date of commencement of discharge of each delivery of ANS crude oil under the Agreement.

If securing payment for exchange crude oil, the pre-payment must be received by Seller at least 3 business days prior to the U.S. domestic pipeline scheduling day for the month of delivery.

Section 8.5. Failure to Provide Financial Security

In the event that the Buyer is required by Part 1 of the Agreement, and fails to provide financial security under the conditions outlined herein, Seller retains the right to withhold delivery of crude oil and/or terminate the Agreement. Termination as a result of failing to provide financial security shall be effective upon the receipt by the Buyer of the Seller's written termination notification. Any and all delay, demurrage, storage, or other charges arising out of Buyer's failure to provide financial security as outlined herein, shall be borne solely by Buyer.

ARTICLE 9. PRICE AND/OR EXCHANGE DIFFERENTIAL REOPENER OR TERMINATION DUE TO UNITED STATES GOVERNMENTAL ACTION

In the event there is any action of the U.S. federal, state or local government which places a measurable economic or onerous burden on (or precludes the realization of a significant benefit by) either party, as it relates to the Agreement, and when the Agreement is either an evergreen term contract or a spot contract involving more than one cargo of ANS, either party may initiate a renegotiation of the price, or the exchange differential if so specified in the Agreement, by

delivering a written Reopener Notice to the other party provided, however, that such Reopener Notice shall be delivered promptly after the announcement and/or publication of such action in the Federal Register or the equivalent state or local publication or in any prominent newspaper or magazine of general circulation in the crude oil industry. Terms of negotiation shall be according to Article 10 of this Part 2 of the Agreement, except if the governmental action occurs later than 30 days from the effective date of the Reopener Notice, then termination would occur at the effective date of the governmental action.

ARTICLE 10. REOPENER NOTICE

The effective date of any Reopener Notice shall be the date written notice thereof is received by the party to whom it is directed. The Parties agree to negotiate in good faith for a period not to exceed 30 days following the effective date of any Reopener Notice in order to establish a new price/exchange differential. During such period of renegotiation, the price/exchange differential in existence on the effective date of the Reopener Notice shall remain in effect.

If the Parties are able to agree upon a new price/exchange differential during the aforesaid 30 day period, such new price/exchange differential shall become effective at the time agreed to by the Parties and shall be evidenced by a duly authorized amendment, in writing, to the Agreement.

If the Parties are unable to agree upon a new price/exchange differential within such 30 day period, then either party may terminate the Agreement at the end of the 30 day period by delivering written notice of termination to the other party no later than 35 days following the effective date of the Reopener Notice.

In the event either party delivers such notice of termination, either party may then elect, by delivering an additional written notice within 5 days after receipt of the foregoing termination notice, to continue this Agreement for a period from the 31st day up to but not beyond the 90th day following the effective date of the Reopener Notice at the price/exchange differential last proposed in writing by the other party. Such last proposed price/exchange differential must have been proposed in good faith during the negotiations.

ARTICLE 11. SUPPLIER/PURCHASER REGULATIONS

Section 11.1. Mutual Intentions as to Termination

The Parties hereby agree that under any "freeze" of supplier/purchaser relationships imposed under any future governmental regulation which requires the consent of either or both Parties to the termination of such relationships, such consent to termination shall be given by either party at the request of the other should the Agreement terminate or be terminated in whole or in part in accordance with the termination provi-

sions provided herein. In order to implement the foregoing under governmental regulations, the Buyer hereby agrees to include a similar provision in any contract for resale of the ANS crude oil delivered to it under the Agreement.

Section 11.2. Supplier/Purchaser Relationship

The Parties agree that except as set forth in the Agreement, no obligation to buy, sell or exchange oil has been established. The parties further agree that the Agreement does not form a supplier-purchaser relationship similar in form or substance to that concept as previously defined under Department of Energy Regulations pursuant to the Emergency Petroleum Allocation Act of 1973, as amended. In the event any such similar conceptual relationship were to be mandated and enforced in the future, whether pursuant to federal, state, or local law, and whether on a retroactive and/or prospective basis, it is agreed by the Parties that either party, without limiting its other rights may immediately cancel the Agreement by giving written notice to the other.

ARTICLE 12. ROYALTY OIL

In the event the State of Alaska or the U.S. Government elects to take in-kind all or any portion of its royalty share of ANS crude oil produced from the Prudhoe Bay Unit, or from any other production which at that time constitutes BP Oil Supply Company's supply of ANS crude oil, BP Oil Supply Company at its option may reduce accordingly the quantity of ANS crude oil to be exchanged or sold by it hereunder, with a corresponding reduction in the quantity of crude oil to be exchanged by the Buyer to BP Oil Supply Company hereunder. BP Oil Supply Company shall notify Buyer of any action by the State of Alaska or the United States Government as soon as BP Oil Supply Company learns of such action. Any reduction in quantity under this provision shall not begin prior to the date the State of Alaska or the United States Government receives title to and takes delivery of its royalty share of ANS crude oil in-kind.

ARTICLE 13. FORCE MAJEURE

Any delays in or failure of performance by either party, except in respect to the obligation to make payments under the Agreement, shall not constitute default hereunder if and to the extent such delays or failure of performance are caused by occurrence(s) beyond the reasonable control of the party affected. If such incidents occur, which by the exercise of due diligence such party is unable to prevent, then "Force Majeure" shall be declared. Force Majeure occurrences include but are not limited to: acts of God or the public enemy, sabotage, war, mobilization, revolution, civil commotion, riots, strikes, lockouts, fires, accidents, or breakdowns, floods, hurricanes or other actions of the elements, acts in furtherance of the International Energy Program, restrictions or restraints imposed by law, rule or regulations or other actions of governmental authorities.

Quantities affected by any declarations of Force Majeure shall be deleted from supply obligations for the period in question and need not be made up unless and to the extent otherwise mutually agreed in writing by the Parties. In any such event, the party claiming Force Majeure shall notify the other party in writing and, if possible, of the extent and duration thereof and shall exercise due diligence to prevent, eliminate or overcome such cause where it is possible to do so and resume performance at the earliest possible date.

Notwithstanding the above, and in the event that the Agreement is an exchange of crude oil, the Parties shall have the rights and obligations described below in the circumstances described below:

(a) If, because of Force Majeure, the ANS Seller is unable to deliver part or all of the quantity of ANS crude oil the ANS Seller is obligated to deliver hereunder, the ANS Buyer (referred to as the "Exchange Partner" in this Article 13) shall have the right but not the obligation to reduce its deliveries of the exchange crude oil to the ANS Seller hereunder by an amount not to exceed the exchange ratio multiplied by the number of barrels of ANS crude oil that the ANS Seller fails to deliver.

(b) If, because of Force Majeure, the ANS Seller is unable to receive and take delivery for the full quantity of exchange crude oil to be delivered by the Exchange Partner hereunder, the Exchange Partner shall have the right but not the obligation to reduce its receipts of ANS from the ANS Seller hereunder by an amount not to exceed the ANS Seller's shortfall.

(c) If, because of Force Majeure, the Exchange Partner is unable to deliver part or all of the quantity of exchange crude oil to be delivered by the Exchange Partner hereunder, the ANS Seller may, at its option, nevertheless provide the full quantity of ANS crude oil to be delivered by it to the Exchange Partner hereunder, or reduce the quantity to be delivered to the Exchange Partner hereunder by not more than the inverse of the exchange ratio multiplied by the number of barrels of crude oil that the Exchange Partner fails to deliver hereunder.

(d) If, because of Force Majeure, the Exchange Partner is unable to receive and take delivery of the full quantity of ANS crude oil to be delivered by the ANS Seller hereunder, the ANS Seller shall have the right but not the obligation to reduce its receipts of exchange crude oil from the Exchange Partner hereunder by an amount not to exceed the exchange ratio multiplied by the Exchange Partner's shortfall hereunder.

ARTICLE 14. ALLOCATION

Buyer expressly agrees and accepts that in case of a reduction in the total supply of ANS crude oil available to BP Oil

Supply Company due to Force Majeure or any act or omission by a government, or an agreement between governments or by a cartel of oil production nations or by the effect of any governmental laws, regulations, decrees, guidelines, request or for any other reason, BP Oil Supply Company may first satisfy its needs and those of its affiliates before allocating any remaining available supply of ANS crude oil. Under no circumstance whatsoever, shall BP Oil Supply Company be required to purchase additional quantities of crude oil to fulfill contractual requirements hereunder. Should BP Oil Supply Company so purchase additional crude oil from other sources, it shall not be required to allocate the such crude oil to Buyer.

ARTICLE 15. ASSIGNMENT

Neither Seller nor Buyer may assign its rights and obligations under the Agreement, in whole or in part, to any party without the written consent of the other party, except that each party may assign such rights and obligations to any affiliate, without the written consent of the other party. A written notice of such assignment shall be given by the assignor to the other Parties to the Agreement. No such assignment shall relieve the assignor of its obligations under the Agreement.

ARTICLE 16. WARRANTIES

Seller expressly warrants that at the time of delivery the Seller shall hold full and unencumbered legal and equitable title to the crude oil sold by it hereunder and that Seller shall have full right, authority and power to transfer and convey such title to Buyer and to effect delivery of the crude oil to Buyer.

The Seller further warrants that the crude oil has been produced, handled, and transported to the delivery point, in accordance with the laws, rules and regulations of all local, state, or federal authorities having jurisdiction thereof.

The Seller further warrants that the crude oil delivered hereunder shall conform to the description of physical attributes and volumes stated under Part 1 of the Agreement. **OTHERWISE THERE ARE NO GUARANTEES OR WARRANTIES, EXPRESSED OR IMPLIED, OF MERCHANTABILITY, FITNESS OR SUITABILITY OF THE CRUDE OIL FOR ANY PARTICULAR PURPOSE. THERE ARE NO OTHER ORAL OR WRITTEN GUARANTEES OR WARRANTIES.**

ARTICLE 17. WAIVER

The delay or failure on the part of either party here to insist upon specific performance of one or more terms and conditions hereunder, shall not be constituted as a waiver of any such terms and conditions, rights and privileges. No waiver by either party of any of the terms or conditions of the

Agreement shall be construed as a waiver of any subsequent breach of the same or any other terms and conditions.

ARTICLE 18. NON-PERFORMANCE

Section 18.1. Definitions

As relates to Article 18 of this Part 2 of the Agreement, the Parties hereto acknowledge that the term "Forward Contract" means this Agreement or any other written agreement between the Parties for the purchase, sale, or exchange of crude oil that is a forward contract as defined in the U.S. Federal Bankruptcy Code or applicable banking laws or regulations, (b) the term "Contract Value" of any Forward Contract means the product of the number of barrels of crude oil covered by that Forward Contract multiplied by the price per barrel of the crude oil specified in that Forward Contract, and (c) the term "Market Value" of any Forward Contract at any time means the product of the number of barrels of crude oil covered by that Forward Contract multiplied by the then current market price per barrel for that type of crude oil covered thereby for delivery at the delivery date or in the delivery period specified in that Forward Contract, as determined by the Performing Party in any commercially reasonable manner.

Section 18.2. Liquidation

Notwithstanding any other provisions of this or any other commodity contract between the Parties, in the event (each a "default") either party ("the Defaulting Party") shall (a) default in the payment or performance, when due, of any obligation to the other party under the Agreement or any other Forward Contract(s), or (b) file a petition or otherwise commence or authorize the commencement of a proceeding or case under any bankruptcy, insolvency, reorganization, or similar law for the protection of creditors, or have any such petition filed or proceeding or case commenced against it and it is not successful in having such petition, proceeding, or case dismissed within 60 days, or (c) have a liquidator, administrator, receiver or trustee appointed with respect to it or any substantial portion of its property or assets, or (d) become bankrupt or insolvent, however evidenced, or be unable to pay its debts as they fall due, or (e) fail to provide adequate security for, or assurances of its ability to perform, all of its obligations under the Agreement or any other Forward Contract(s), within 48 hours of a demand therefor when the other party has reasonable grounds for insecurity;

then in any such default the other party (the "Performing Party") shall have the right to liquidate the Agreement and any and all Forward Contracts then outstanding at any time or from time to time thereafter by:

(i) Closing out each Forward Contract being liquidated at its Market Value at the time of liquidation, so that each such Forward Contract is cancelled and a settlement payment in a

amount equal to the difference between such Market Value and the Contract Value of such Forward Contract shall be due to the Buyer under that Forward Contract if such Market Value exceeds such Contract Value and to the Seller under such Forward Contract if the opposite is the case; and

(ii) Discounting each amount then due under clause (i) to the present value as at the time of liquidation (to take account of the period between the date of liquidation and the date on which such amount would have otherwise been due pursuant to the relevant Forward Contract) at the applicable Commercial Paper rate for that period as determined by the Performing Party in any commercially reasonable manner; and

(iii) Setting off or aggregating, as appropriate, any or all settlement payments, and (at the election of the Performing Party) any or all other amounts owing between the parties hereunder or under any Forward Contract, so that all such amounts are aggregated and/or netted to a single liquidated amount payable by one party to the other.

The net amount due after any such liquidation shall be paid by the close of business on the next business day via telegraphic transfer in immediately available funds.

Section 18.3. Set Off

The Performing Party's rights under this Article shall be in addition to, and not in limitation or exclusion of, any other rights which the Performing Party may have (whether by operation of law or otherwise), including any rights and remedies under the Uniform Commercial Code. If a default occurs, the Performing Party may (at its own election) from time to time set off any or all amounts which the Defaulting Party owes to it, whether or not then due (expressly excluding any contracts for off-exchange commodity transactions pursuant to 17CFR 32.4, as amended, and the Commodity Exchange Act of 1936, as amended) against any or all amounts which it owes to the Defaulting Party, whether or not then due (expressly excluding any contracts for off-exchange commodity transactions pursuant to 17CFR 32.4, as amended, and the Commodity Exchange Act of 1936, as amended), provided that any amount not then due which is included in such setoff shall be discounted to present value as at the time of setoff (to take into account the period between the date of setoff and the date on which such amount would have otherwise been due) at the applicable Commercial Paper rate for that period as determined by the Performing Party in any commercially reasonable manner.

Section 18.4. Indemnification

The Defaulting Party shall indemnify and hold the Performing Party harmless from any and all costs and expenses of collection, including reasonable attorneys fees, incurred in the exercise of any remedies hereunder; provided however,

no claim shall be made hereunder for any indirect, special, incidental, or consequential damages.

ARTICLE 19. GOVERNING LAW

THE AGREEMENT AND ALL TRANSACTIONS HEREUNDER SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF OHIO, U.S.A. (WITHOUT REFERENCE TO ANY CONFLICT OF LAW RULES). EACH PARTY EXPRESSLY SUBMITS TO THE JURISDICTION OF THE STATE OF OHIO, U.S.A. AND TO THE VENUE OF FEDERAL AND STATE COURTS SITUATED IN THE CITY OF CLEVELAND AND AGREES TO ACCEPT SERVICE OF PROCESS BY REGISTERED MAIL.

ARTICLE 20. NOTICES

Any notice required hereunder shall be sent in writing by certified mail, telefax, or telex, to the address specified in Part 1 of the Agreement. The effective date of a notice shall be the date of receipt by the addressee. Changes of contacts or addresses of either party shall be notified immediately in writing to the other party.

ARTICLE 21. CRUDE OIL EXCHANGE IMBALANCE SETTLEMENT

Section 21.1. Intent

In the event that the Agreement is an exchange of crude oil, the Parties undertake to exchange equal amounts of crude oil as set forth in the Agreement and shall make best efforts to keep delivery quantities equal on a monthly basis. In the event that the quantities actually delivered during the term of the Agreement are not equal, the Parties agree to balance the quantity as set forth in this Article 21.

Section 21.2. Imbalance Definitions

As relates to Article 21 of these Terms and Conditions, "Imbalance Buyer" shall be considered as the party that delivered a greater amount of crude, "Imbalance Seller" shall be considered as the party that delivered a lesser amount of crude, and the "Imbalance" shall be the difference between the nominal delivery volume of exchange crude oil as described in Part 1 of the Agreement, and the actual delivery volume of ANS as described in Part 1 of the Agreement. The Imbalance of less than 5000 net U.S. barrels shall be treated as a net sale hereunder without further physical delivery.

Section 21.3. Imbalance Crude Type

The Imbalance crude type shall be domestic sweet crude oil as delivered by Arco Pipe Line Company at Cushing, OK.

Section 21.4. Imbalance Delivery

Delivery of the Imbalance shall be subject to the following provisions as applicable:

(a) ANS Term Agreements with ANS delivered by Vessel or Pipeline

The Imbalance Seller shall deliver the Imbalance ratably into the facilities of Arco Pipe Line Company at Cushing, OK no later than the third calendar month immediately following the date the written notice of termination is received by the non-terminating party.

(b) ANS Spot Agreements with ANS delivered by Vessel

The Imbalance Seller shall deliver the Imbalance ratably into the facilities of Arco Pipe Line Company at Cushing, OK. If the ANS, as described in the Agreement, completes delivery prior to the 5th business day, inclusive, before the U.S. crude oil pipeline scheduling day that occurs during the calendar month in which the ANS is delivered, the Imbalance shall be delivered during the month immediately following the month in which the ANS is delivered. If the ANS, as described in the Agreement, completes delivery after the 5th business day, inclusive, before the U.S. crude oil pipeline scheduling day that occurs during the calendar month in which the ANS is delivered, the Imbalance shall be delivered during the second month immediately following the month in which the ANS is delivered.

(c) ANS Spot Agreements with ANS delivered by Pipeline

The Imbalance Seller shall deliver the Imbalance ratably into the facilities of Arco Pipe Line Company at Cushing, OK during the month immediately after the Imbalance is determined.

Section 21.5. Imbalance Price

In the event that domestic sweet crude oil delivered into Arco Pipe Line Company at Cushing, OK is one of the exchange crude oils in Part 1 of the Agreement, the Imbalance price shall be the price for domestic sweet crude oil delivered into Arco Pipe Line Company at Cushing, OK, as defined in Part 1 of the Agreement, applicable for the last delivery month in which the Agreement is in effect. In the event that domestic sweet crude oil delivered into Arco Pipe Line Company at Cushing, OK is not one of the exchange crude oils in Part 1 of the Agreement, the price shall be an average market price for the type of crude delivered during the delivery period as mutually agreed in writing between the Parties.

Section 21.6. Imbalance Payment

The payment for the Imbalance shall be subject to the provisions of Article 8 of this Part 2 of the Agreement.

ARTICLE 22. TAXES

Other than income or franchise taxes, any tax, license, inspection or other fee levied by any governmental authority upon, or which is measured by, or is incident to, or is a result of the transaction herein provided for shall be borne solely by Buyer whether paid directly to the governmental authority or as reimbursement to Seller. Any such reimbursement to Seller shall be due and payable to Seller by Buyer upon written demand (invoice) by Seller.

ARTICLE 23. ENTIRE AGREEMENT

Part 1 and Part 2 of the Agreement constitute the entire agreement between the Parties hereto regarding the subject matter hereof and supersede any and all prior negotiations, representations, or agreements related thereto, either written or oral. No changes, alterations, or modifications to Part 1 and/or Part 2 of the Agreement shall be effective unless agreed to in writing by an authorized representative of the Parties. The Article and Section headings have been included in this Agreement for convenience of reference only and shall not control or affect its construction or interpretation in any respect.

ARTICLE 24. DEFINITIONS

Where used in the Agreement, the terms listed hereunder shall have the following meanings:

- (a) The "Agreement" is defined as the contract between the Parties relating to the purchase, sale, or exchange of ANS crude oil, and is comprised of Part 1 and Part 2. Part 1 is the document in which certain specific items have been agreed between the Parties including without limitation the volume, price and the delivery period of crude oil sold, purchased, or exchanged. Part 2 is comprised of these Common Terms and Conditions for the Sale and Exchange of ANS Crude Oil, Effective November 1, 1991 as set forth herein.
- (b) The term "Buyer" refers to the party receiving crude oil and the term "Seller" refers to the party delivering crude oil. Buyer and Seller are collectively referred to as the "Parties".
- (c) The term "barrel" means 42 United States gallons of 231 cubic inches at 60° Fahrenheit.
- (d) The term "day" means a calendar day.
- (e) The term "month" means a calendar month.
- (f) The term "barrels per day" means barrels per calendar day.
- (g) Every reference to money or price pertains to United States currency.
- (h) The term "net outturn" means FOB destination.
- (i) The term "S&W" means sediment and water.
- (j) The term "ANS" means Alaskan North Slope crude oil and the term "exchange crude oil" means a non-ANS crude oil as set forth in Part 1 of the Agreement.
- (k) The term "delivery ticket" means a shipping/loading document(s) which states information regarding the crude oil.

delivered, including without limitation the type and quality, the delivered volume quantity, the method of measurement, the corrected specific gravity, temperature, and S&W content.

(l) The term "commercial invoice" means a statement which includes without limitation the date(s) of the delivery; the location(s) of delivery; the volume(s); price(s); the specific gravity and gravity adjustments to the price(s) (where applicable); and the terms of payment.

(m) The term "delivery month" means the month in which crude oil is to be delivered as set forth in Part 1 of the Agreement.

(n) The term "affiliate" of a party shall mean a person, corporation or other entity that directly or indirectly (i) controls, or (ii) is controlled by, or (iii) is under common control with, such party.

(o) The term "exchange ratio" means the number of barrels of the exchange crude oil divided by the number of barrels of ANS crude oil as set forth in Part 1 of the Agreement.

(p) The term "spot agreement" means an agreement with a delivery period of one month or less in duration as set forth in Part 1 of the Agreement.

(q) The term "term agreement" means an agreement with a delivery period greater than one month in duration as set forth in Part 1 of the Agreement.

(r) The term "arrival in berth" means finished mooring when at sea terminal, or all-fast when alongside a wharf, or when barge lighter or lightering vessel is alongside when lightering.

**CHARTER FOR DEVELOPMENT
of the Alaskan North Slope
EXHIBIT D.1**

<u>Site Name</u>	<u>Facility Owner</u>	<u>Landowner</u>	<u>Location</u>	<u>Priority</u>
Lupin River Explosives	unknown	ADNR	12 miles SE of Happy Valley	N/A
May Creek	unknown	ADNR	SW of Happy Valley	N/A
Aufeis Unit #1	unknown	BLM*	between Kuparuk an Toolik Rivers	N/A
Echooka	unknown	ADNR	Cache One Lake - 30 m. E of Sagwon	N/A
Pt. Storkenson #1	unknown	ADNR	Hamilton Bros site on coast of Pt. Storkenson	N/A
Toolik River	unknown	ADNR	10 miles W. of Franklin Bluffs airstrip	N/A
Service City Pad	unknown	ADNR	Prudhoe Bay	High
Arctic Coiled Tubing	unknown	ADOT&PF	Deadhorse	High
Deadhorse Hotel Pad	unknown	ADOT&PF	Deadhorse	High
Block 900 lots 9 & 10	unknown	ADOT&PF	Deadhorse	High
Former Cold Weather Contr., B70 L5A	unknown	ADOT&PF	Deadhorse	High
East Kuparuk Unit #1	unknown	ADNR	near Umiat	N/A
West Kavik	unknown	ADNR	near ANWR	N/A
Deadhorse lease tract	CR Lewis	ADOT&PF	Deadhorse	High

* state selected

**CHARTER FOR DEVELOPMENT
of the Alaskan North Slope
EXHIBIT D2**

<u>Site Name</u>	<u>Facility Owner</u>	<u>Landowner</u>	<u>City</u>	<u>Priority</u>
ARCO 100% Pad	ARCO Alaska, Inc.	ADNR	Deadhorse	High
ARCO Alaska crude oil topping unit	ARCO Alaska, Inc.	ARCO	Deadhorse	High
ARCO Drill Site 2	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	High
ARCO Drill Site Maint. Pad	ARCO Alaska, Inc.	ARCO	Prudhoe Bay	High
ARCO Kuparuk 2U Drill Site Spill	ARCO Alaska, Inc.	ADNR	Kuparuk	High
ARCO Pad 10 East OU Dock Bioventing	ARCO Alaska, Inc.	ARCO	Prudhoe Bay	High
Drill Site L-2 Bioremediation	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	High
Point McIntyre PM-1	ARCO Alaska, Inc.	ADNR	Pt. McIntyre	High
ARCO Itkillik River Unit #1	ARCO Alaska, Inc.	ADNR	Colville River	High
ARCO C Pad Stoddard Solvent Site	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	Medium
ARCO Building U5A	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	Medium
ARCO CPF-1 Recycle Facility	ARCO Alaska, Inc.	ADNR	Kuparuk	Medium

**CHARTER FOR DEVELOPMENT
of the Alaskan North Slope
EXHIBIT D2**

<u>Site Name</u>	<u>Facility Owner</u>	<u>Landowner</u>	<u>City</u>	<u>Priority</u>
ARCO EOA Fire Training Area	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	Medium
ARCO Kuparuk CPF1 Divert Tank A	ARCO Alaska, Inc.	ADNR	Kuparuk	Medium
ARCO Kuparuk Lab Service	ARCO Alaska, Inc.	ADNR	Kuparuk	Medium
ARCO Pad 3 (East End)	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	Medium
Kuparuk Construction Co. (Camp?)	ARCO Alaska, Inc.	ADNR	Kuparuk	Medium
Warm Storage Fac @Drill Site Maint.	ARCO Alaska, Inc.	ARCO	Prudhoe Bay	Medium
Geofoam Pad	ARCO Alaska, Inc.	ADNR	Deadhorse	Medium
Kuparuk Ind. Cntr Facility Drum Pit	ARCO Alaska, Inc.	ADNR	Kuparuk	Low
Sand Dunes Landfill - ARCO Alaska	ARCO Alaska - 2 -, Inc.	ADNR	Prudhoe Bay	Low
Kuparuk River State 1	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	
North Prudhoe Bay State No. 1	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	
West Sak 24	ARCO Alaska, Inc.	ADNR	Kuparuk	

**CHARTER FOR DEVELOPMENT
of the Alaskan North Slope
EXHIBIT D2**

<u>Site Name</u>	<u>Facility Owner</u>	<u>Landowner</u>	<u>City</u>	<u>Priority</u>
West Sak 3	ARCO Alaska, Inc.	ADNR	Kuparuk	
West Mikkelsen Unit 2	ARCO Alaska, Inc.	ADNR		
West Mikkelsen #1	ARCO Alaska, Inc.	ADNR		
West Sak 2	ARCO Alaska, Inc.	ADNR	Kuparuk	
Northwest Eileen 1 & 2	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	
West Sak SWPT #1	ARCO Alaska, Inc.	ADNR	Kuparuk	
Toolik Fed 1	ARCO Alaska, Inc.	ADNR		
Lake State 1	ARCO Alaska, Inc.	ADNR	Prudhoe Bay	
Hemi Springs Unit 3	ARCO Alaska, Inc.	ADNR	Kuparuk	
West Sak 26	ARCO Alaska, Inc.	ADNR	Kuparuk	
BP Milne Point CFP Turbine Module	BP Exploration (Alaska), Inc.	ADNR	Milne Point	High

**CHARTER FOR DEVELOPMENT
of the Alaskan North Slope
EXHIBIT D2**

<u>Site Name</u>	<u>Facility Owner</u>	<u>Landowner</u>	<u>City</u>	<u>Priority</u>
MPU CFP Unlined Relief Pit	BP Exploration (Alaska), Inc.	ADNR	Milne Point	High
Milne Pt. E Pad Reserve Pit	BP Exploration (Alaska), Inc.	ADNR	Milne Point	Medium
Milne Pt. A Pad Reserve Pit	BP Exploration (Alaska), Inc.	ADNR	Milne Point	
Prudhoe Bay WOA D Pad	BP Exploration (Alaska), Inc.	ADNR	Prudhoe Bay	
Niakuk #4 Island	BP Exploration (Alaska), Inc.	ADNR	Prudhoe Bay	
West Kuparuk State 3-11-11	BP/Mobil	ADNR	Prudhoe Bay	

CHARTER FOR DEVELOPMENT
of the Alaskan North Slope
Exhibit D.3.A
Production Reserve Pits

Company	Well Site Name
BP Amoco	A Pad WOA, 3 sumps
BP Amoco	B Pad WOA, 3 sumps
BP Amoco	C Pad WOA, 4 sumps
BP Amoco	D Pad WOA, 3 sumps
BP Amoco	E Pad WOA, 2 sumps
BP Amoco	F Pad WOA, 2 sumps
BP Amoco	G Pad WOA, 2 sumps
BP Amoco	Gathering Center 1
BP Amoco	Gathering Center 2
BP Amoco	Gathering Center 3
BP Amoco	H Pad WOA, 3 sumps
BP Amoco	J Pad WOA, 3 sumps
BP Amoco	K Pad WOA, 3 sumps
BP Amoco	M Pad WOA, 3 sumps
BP Amoco	N Pad WOA, 3 sumps
BP Amoco	Q Pad WOA, 1 sump
BP Amoco	R Pad WOA, 3 sumps
BP Amoco	S Pad WOA, 2 sumps
BP Amoco	T Pad WOA, 1 sump
BP Amoco	U Pad WOA, 2 sumps
BP Amoco	X Pad WOA, 2 sumps
BP Amoco	Y Pad WOA, 2 sumps
BP Amoco	Z Pad WOA, 2 sumps
BP Amoco	Milne Point A Pad
BP Amoco	Milne Point B Pad
BP Amoco	Milne Point C Pad
BP Amoco	Milne Point D Pad
BP Amoco	Milne Point E Pad
ARCO	Drill Site 1
ARCO	Drill Site 2
ARCO	Drill Site 4
ARCO	Drill Site 5
ARCO	Drill Site 6
ARCO	Drill Site 7
ARCO	Drill Site 9
ARCO	Drill Site 11
ARCO	Drill Site 12
ARCO	Drill Site 13
ARCO	Drill Site 14
ARCO	Drill Site 15
ARCO	Drill Site 16
ARCO	Drill Site 17

Company	Well Site Name
ARCO	Drill Site 18
ARCO	NGI
ARCO	WGI
ARCO	Drill Site 1A
ARCO	Drill Site 1B
ARCO	Drill Site 1C
ARCO	Drill Site 1D
ARCO	Drill Site 1E
ARCO	Drill Site 1F
ARCO	Drill Site 1G
ARCO	Drill Site 1H
ARCO	Drill Site 1L
ARCO	Drill Site 1Q
ARCO	Drill Site 1R
ARCO	Drill Site 1Y
ARCO	Drill Site 2A
ARCO	Drill Site 2B
ARCO	Drill Site 2C
ARCO	Drill Site 2D
ARCO	Drill Site 2E
ARCO	Drill Site 2F
ARCO	Drill Site 2G
ARCO	Drill Site 2H
ARCO	Drill Site 2T
ARCO	Drill Site 2U
ARCO	Drill Site 2V
ARCO	Drill Site 2W
ARCO	Drill Site 2X
ARCO	Drill Site 2Z
ARCO	Drill Site 3A
ARCO	Drill Site 3B
ARCO	Drill Site 3C
ARCO	Drill Site 3F
ARCO	Drill Site 3H
ARCO	Drill Site 3I
ARCO	Drill Site 3J
ARCO	Drill Site 3K
ARCO	Drill Site 3M
ARCO	Drill Site 3N
ARCO	Drill Site 3Q
ARCO	Lisburne L-1
ARCO	Lisburne L-2
ARCO	Lisburne L-3
ARCO	Lisburne L-4
ARCO	Lisburne L-5

**CHARTER FOR DEVELOPMENT
of the Alaskan North Slope
Exhibit D.3.B
Exploration Reserve Pits**

Company	Well Name
BP Amoco	East Ugnu #1
BP Amoco	Sag Delta #1
BP Amoco	Sag Delta #2 10-11-16 Sag Delta 2A
BP Amoco	Prudhoe Bay Unit Term C
BP Amoco	(Eileen) West End 21-11-12
BP Amoco	Milne Point 18-1
BP Amoco	Milne Point M Pad
BP Amoco	Milne Point N Pad
BP Amoco	Put River 1-10-14
BP Amoco	Put River 11-10-14
BP Amoco	Put River 12-10-14
BP Amoco	Put River 19-10-15 (PBU 19-10-15)
BP Amoco	Put River 24-10-14
BP Amoco	Put River 33-12-13
BP Amoco	Getty State #1
BP Amoco	West Sak 14
BP Amoco	West Sak 9
ARCO	Coville # 1
ARCO	N Prudhoe Bay St # 1
ARCO	Pt McIntyre 01
ARCO	Pt McIntyre 02
ARCO	Toolik Fed # 1
ARCO	West Sak 25571 18
ARCO	West Sak River St # 03
ARCO	Beechey PT ST 1 Beechey PT ST 2
ARCO	Delta ST 1
ARCO	Delta ST 2
ARCO	East Bay State 1
ARCO	Gyr 1

**CHARTER FOR DEVELOPMENT
of the Alaskan North Slope
Exhibit D.3.B
Exploration Reserve Pits**

ARCO	Hemi Springs St 1
ARCO	Highland St 1
ARCO	Itkillik River Unit 1
ARCO	Kavik Unit 3
ARCO	KRU Ugnu SWPT-1
ARCO	KRU W Sak SWPT-1
ARCO	Kuparuk River State 1
ARCO	Kuparuk Riv Unit 02-OB1 (UGNU DS2-OB1)
ARCO	Kuparuk Riv Unit 1B-05
ARCO	Kuparuk Riv Unit WT-02
ARCO	Kuparuk Riv Unit WT-03
ARCO	Kuparuk Riv Unit WT-04
ARCO	Kuparuk River Unit CPF 01-A (CPF-1)
ARCO	Kuparuk River Unit CPF #2 (CPF-2)
ARCO	Lake St 1
ARCO	Little Twist Unit 1
ARCO	NW Eileen St 1
ARCO	N W Eileen St 2
ARCO	Nora Federal 1
ARCO	Pingut St 1
ARCO	Pipeline State # 1
ARCO	Prudhoe Bay Unit Term-A
ARCO	Prudhoe Bay Unit TR T-3C
ARCO	Prudhoe Bay Unit PWDW1-1 (Flow Station # 1)
ARCO	Prudhoe Bay Unit PWDW-2 (Flow Station 2)
ARCO	Prudhoe Bay Unit PWDW3-1 (Flow Station 3)
ARCO	Put Riv St 1
ARCO	Ravik St 1
ARCO	S E Eileen ST # 1 S E Eileen St # 2
ARCO	Sag Delta #6

**CHARTER FOR DEVELOPMENT
of the Alaskan North Slope
Exhibit D.3.B
Exploration Reserve Pits**

ARCO	Sag Riv St	1
ARCO	Schrader Unit	1
ARCO	South Bay State	1
ARCO	South Point State	1
ARCO	Susie Unit	1
ARCO	Toolik Fed	2
ARCO	Toolik Fed	3
ARCO	Ugnu	1
ARCO	West Beach St	1
	West Beach St	1-A
ARCO	West Beach St	2
ARCO	West Beach St	3
ARCO	West Beach St	4
ARCO	West Mikkelsen St	1
ARCO	West Mikkelsen Unit	2
ARCO	West Sak 25517	25
ARCO	West Sak 25519	17
ARCO	West Sak 25523	16
ARCO	West Sak 25548	11
ARCO	West Sak 25590	15
ARCO	West Sak 25606	13
ARCO	West Sak 28242	24
ARCO	West Sak Riv St	01
ARCO	West Sak Riv St	02
ARCO	West Sak Riv St	B-10
ARCO	West Sak Pilot Pad	

Oil and Gas Audit

Memo

TO: Wilson L. Condon
Commissioner of Revenue

From: Dan E. Dickinson
Director of Oil and Gas Audit

Date: January 13, 2000

RE: Effect of the Proposed Arco/BP Acquisition on Fall Revenue Forecast

I. INTRODUCTION

On December 2, 1999 the State and BP Amoco signed the Charter for the Development of the Alaska North Slope, setting forth the conditions upon which the State would support BP Amoco's proposed takeover of Arco. On December 8, 1999 the Department of Revenue released its biennial revenue forecast. The report-in-hand, prepared by the Oil & Gas Audit Division of the Department of Revenue, discusses the effects of the proposed merger on the forecasted revenues. An important assumption underlying the forecast, as well as this analysis, was that the merger, if it occurred, would follow the plan outlined in the charter.

However, the merger now appears to be stalled before the Federal Trade Commission (FTC) in Washington. Either FTC or BP may take actions contrary to the key assumptions underlying the forecast. We have decided to go ahead and release this report, even though it must be viewed as a work in process. Some of the steps proposed to win FTC approval may well affect state revenue. I have speculated on some of these effects in this report. However, absent specific actions, I believe it is premature to perform specific analyses. We will of course supplement this report if and when there are changes on the merger front.

The State of Alaska, in its roles as sovereign and landowner, realizes revenue from the oil and gas industry through four mechanisms:

1. Oil and gas production/severance taxes – which are dependent on crude production levels and the value of the crude;
2. Oil and gas royalties – which are also dependent on production levels and the value of the product;
3. Oil and gas property taxes; and
4. Income taxes on the oil and gas industry.

Forecasts of these four revenue sources constitute the oil and gas portion of the department of revenue's biannual revenue forecasts. The division has analyzed each of these, as well as the underlying factors that affect them – value of crude oil, production and transportation costs, and production volumes – to try to understand the effect of the merger on Alaska's future revenue. **Based on this analysis, the division's conclusion is that the most likely effect from the merger on the first three revenue sources will be immaterial.** The division is unable to estimate the potential effect on state income tax from corporations in the oil and gas business.¹

¹ The department used its standard procedure without making any adjustments for the proposed merger or Charter to forecast state income tax revenue from corporations in the oil and gas business because it has proven very difficult, if not impossible, to forecast the discreet effects of the merger with any level of confidence. On the one hand, forecasters combined prior year returns from the merging companies and analyzed the resulting tax liability. This analysis suggests that income tax revenues may fall as a result of the merger. On the other hand, the purpose of the merger is to increase profitability, which ought to translate into increased taxable income and increased income tax revenue. While these effects may not precisely cancel each other out, they argue against making adjustments, in either direction, to our standard forecast procedure.

Why so little effect? There are three reasons:

1. The merger – either as originally proposed or as modified by the Charter – will not affect the anticipated production volume from currently known resources. The department's forecast of oil revenue – currently the primary source of Alaska's unrestricted revenue – has always been based on projected taxes and royalties for the anticipated production volumes from both 1) currently producing oil and gas fields and 2) discovered but not yet developed oil and gas reserves. Following a convention the department adopted more than 30 years ago, it has not included any revenues from future oil and gas discoveries in the fall revenue forecast. The department does not expect volume produced from already discovered resources to vary significantly in the near future as a result of the merger.
2. Neither the proposed merger nor the Charter will alter the value of ANS in destination markets or the average transportation costs to move ANS to those markets. As a result, there should be no effect on projected royalty or production tax revenue.²
3. The value of oil and gas property and, thus, the revenue derived from the property tax, will be unaffected by who owns the assets that are being taxed.

As noted, the elements that most affect total revenue from oil and gas are production volume and production value, which are determined by the price of crude oil and the costs of getting it to market. Part II of this report deals with production volume issues, which were critical components of the negotiation of the Charter as well as our analysis of how the merger might affect the forecast. Part III focuses on the market value of ANS crude and the cost of transporting ANS to its market destination, two issues critical to forecasting the two largest revenue sources: production tax and royalties.

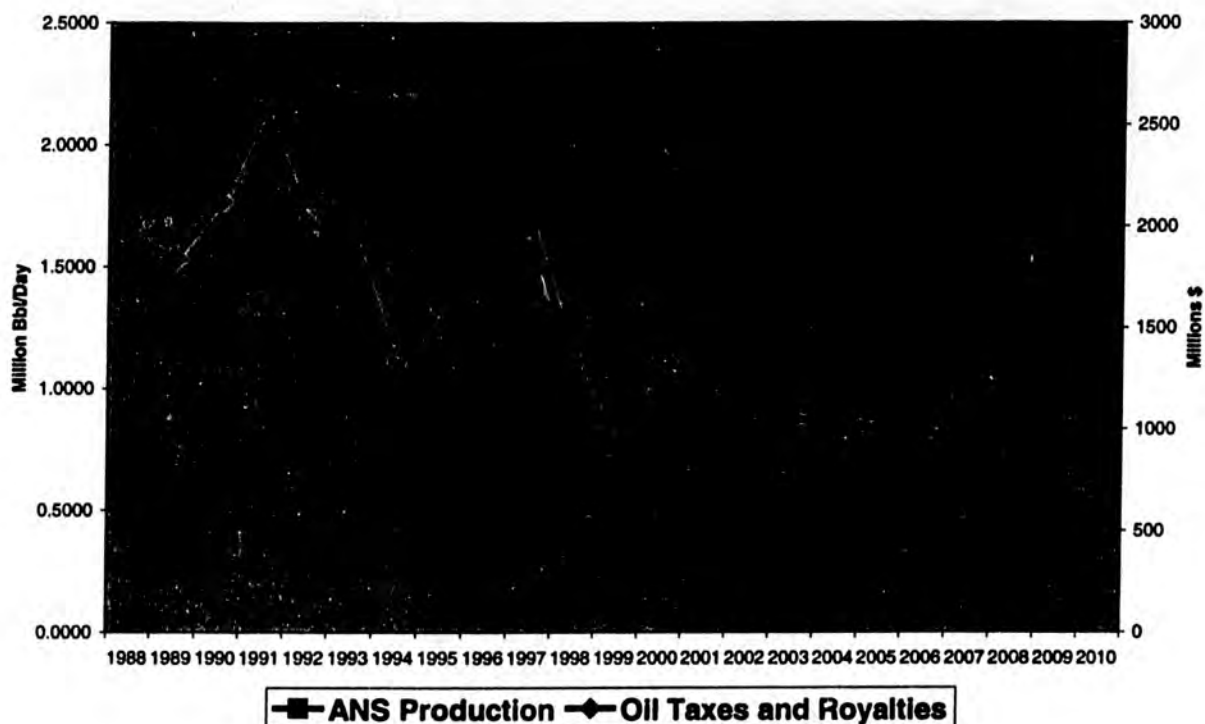
Finally, in Part IV, the revenue sources and the implications of the merger on them are discussed in more detail.

² If, however, the FTC were to condition approval of the proposed merger on terms that would shift the value of our oil resources from the upstream production sector downstream to West Coast refineries, the state's royalty and production tax revenue would certainly be reduced. This possibility is not reflected in the department's forecast.

II. PRODUCTION VOLUME

Over the long term, increases in state revenues from the oil industry will only result from exploration efforts that find and produce barrels to replace the declining production of the Prudhoe Bay and Kuparuk fields. Chart 1 below compares the total annual general fund revenue from oil (the right-hand axis) to the total production of ANS (left-hand axis). From 1988 through 1999, actuals are shown, and, although at times revenue increased despite a fall in production, the underlying trend is clear. The years 2000 through 2010 are presented as a forecast, and again, the relationship between revenue and volume is clear.

Oil Production and Oil Taxes and Royalties



The department's biannual revenue forecasts are based on fields currently producing or already discovered and about to come on line. These forecasts make no allowance for the role of future discoveries. As our consulting engineer points out, while production from satellite fields can be brought online within two years, production from new stand-alone fields is at best five to six years away. Traditionally it takes about a decade to bring a new discovery on line, although the industry is trying to cut that time significantly. However, an exploration season, a delineation season, and three years to design, fabricate, and install production

facilities add up to five years as the shortest possible time frame.³ All the production in the department's forecast comes from projects on line or in the works, and analysts believe nothing else is likely inside the next five years. In fact, with one minor exception, the long-range forecast does not include any new production from fields coming on line after 2005.⁴

In the long run, although the department believes that a merger undertaken with the divestitures required by the Charter will lead to more barrels being produced than a merger without divestitures, analysts cannot reliably predict how many barrels the new competition will produce. In any case, because the department limits its forecast to discovered barrels, the merger's potential effect on future exploration and development is not relevant.

There is general agreement that North Slope producers will engage in the activities required for new production only if they can keep costs in line with worldwide cost structures. Controlling costs is critical to long-term production. The analytic question posed by the merger was how the state ought to act to best facilitate industry efforts to control costs.

Basic economic theory tells us that a monopoly is efficient *in the short run* because it eliminates needless duplication and overhead and cuts down per-unit fixed costs. However, that same theory holds that *over the long run*, monopolies tend to become inefficient because they are sheltered from competition. With no competition, the monopoly's costs grow unchecked because they can be passed on to consumers. Because there is no competitive challenge, the monopoly does not need to innovate.

Analogous reasoning applies to the North Slope.⁵ Over the short term, a North Slope dominated by BP might generate lower costs, higher netbacks, and higher production. However, the state's negotiators concluded the best long-term guarantee for innovation, cost-cutting, and resulting future additional production was diversity and competition from other North Slope players. This is the long-term path the state opted for in the Charter and the rationale behind the required divestitures.

BP argued that it should not be required to divest, because the merger could create such large cost savings. BP claimed that, if the state did not interfere with the merger, it could slash unnecessarily duplicated North Slope costs and afford to reinvest \$5 billion in Alaska over the next five years, increasing production over that same period by 150,000 barrels per day. Those short-term cost savings, BP assured state negotiators, would translate directly into reinvestment and more barrels.

³ Furthermore the 'invest as you learn' approach to developing new fields suggests that it is unlikely there will be simultaneous parallel development at several separate fields by the same firm.

⁴ The production forecast includes some already discovered offshore production, which the department assumes will use existing production facilities coming on line in 2008 at roughly 15,000 barrels per day.

⁵ Analogous reasoning does not apply downstream. In the market where ANS is sold it constitutes less than half of the crude. Furthermore, that market is accessible by every major water-borne crude stream. The department does not believe BP is a monopolist supplier of crude. Again, the Department's forecast does not include the possibility that the FTC will conclude that BP is a monopolist.

The state did not accept BP's argument and insisted on divestiture, thus inviting new operators to the North Slope. As a result, it appears that North Slope production will still be saddled with the costs of two Anchorage office buildings, two legal departments, two marketing departments, and the like. It will not be as efficient, in the short run, as a combined BP/Arco that was not required to divest any holdings. Nevertheless, in the long run, these extra costs, required by reason of multiple North Slope operators, should be offset by the other efficiencies that competition brings.

When considering cost-control and its subsequent effect on production volume, it is important to focus on the role played by the operator rather than focusing on ownership percentages. The operator is hired by the owner or owners to run the field. The main responsibility for cost-control, innovation, and introducing efficiencies rests with the operator. An owner looks over the operator's shoulder and can sometimes even veto ideas it does not like. However, the operator runs the field. Prior to the merger, BP as operator was responsible for 37 percent of the production (Greater Endicott, Greater Milne Point, and half of Prudhoe Bay) while Arco, as operator, was responsible for 63 percent of the production (Greater Kuparuk, Greater Point McIntyre and the other half of Prudhoe Bay). After the changes in operatorship anticipated by the Charter take effect, BP, as operator, will be responsible for 72 percent of the production, and the new operators the other 28 percent. In short, the Charter largely perpetuates today's operating pattern, where one operator is responsible for about two-thirds of the production. To the extent that the percent of operations controlled by a single operator matters for cost-control, there will be little change from the current situation resulting from merger and divestiture.

On the other hand, Prudhoe Bay is one of the few places in the world with responsibilities split between two operators: Arco on the East Side and BP on the West Side. In the early eighties, each side produced more than 700,000 barrels per day. Industry analysts believe that it no longer makes sense to have two operators at Prudhoe now that its total production has fallen below 600,000 barrels per day. Many believe two operators at Prudhoe Bay simply add unnecessary costs to the operations there. For this reason, the Charter would not dilute BP's plan for a single Prudhoe operator and hoped-for cost savings at Prudhoe Bay.

II. CALCULATING ANS WELLHEAD VALUE FOR ROYALTY AND PRODUCTION TAXES

Royalties and production taxes have many differences that will be explored in Part IV below, but they have an essential similarity in that for both the amount due to the state is a function of wellhead value, calculated as a "netback." The starting point for the netback is the destination market, where the market value of the crude oil (ANS) is established. Then the value is "netted back" – by subtracting out the costs of 1) tanker transportation from Valdez to the destination market, 2) transportation of the oil through TAPS from the North Slope to Valdez, and 3) if necessary, getting the crude oil from the farther reaches of the North Slope to the inlet of TAPS. What is left over is "wellhead value," the basis for royalties and production taxes due the State. The higher the wellhead value, the more oil revenue the state collects.

The elements that determine the wellhead value, and how they may be affected by the proposed merger, are discussed below.

A. Market Value

Alaska's fiscal system is designed to get a fair market value for the state's oil in both the royalty and production tax contexts. For the past decade, fair market value for deliveries to the US West Coast has been measured by the ANS spot price.⁶

The bulk of the ANS is delivered to the U.S. West Coast. As a rule, Arco and Exxon have delivered most of their ANS to their own refineries. Producers with smaller shares of production generally sell their crude to one of the larger producers up-stream. As a result, BP has been the main merchant marketer of oil. Since the "spot price"⁷ reflects deals reported in the marketplace, BP's market performance is a major driver of that price. As a seller, BP tries to achieve the highest price possible. BP's interests have been aligned with those of the state in this regard, as both benefit from high ANS crude prices.

⁶ In the administration of the production tax, Prevailing Value is defined by the ANS spot price. Two of the three major royalty settlement agreements use the ANS spot price as a destination value, provided it falls within a range defined by a basket of six crudes. The final major royalty settlement agreement defines the destination value using this same basket – in which the ANS spot price is weighted at 18%.

⁷ The spot price is a daily assessment of deals being done in the market. At least four different organizations, Reuters, Telerate, Platts and OPIS give daily ANS quotes. These quotes have become accepted by both buyers and sellers in the industry, to the point where deals will be concluded based on a yet to be published set of ANS spot prices.

A special problem arises when the market becomes thin, and very few deals are made or reported. At the moment, most of the spot sales are made by BP. But after the merger, BP will have fewer, not more barrels for sale. Why? What is now Arco's production will continue to flow to what are now Arco's refiners. But BP must divest 175,000 bbls a day that it currently sells (or would sell, since this figure includes not-yet producing Alpine field). Of course, BP moves a lot of crude in long term contracts – sales that show up in the spot market at most once, when the deal is struck. If the party acquiring the 175,000 bbls is a merchant marketer, then the spot market may continue to be viable. But if not, or if BP commits most of its oil in long term contracts, or meets other FTC demands that get it out of the crude market, the market may become too thin, and the reported spot price unreliable.

The state and the FTC agree that BP has a great deal of influence on the spot price of ANS. But far from being concerned that BP will use its power to manipulate the spot price of the ANS upward, the state needs to be more concerned that the merger will give BP an incentive to manipulate the spot price of ANS downward.⁸ Analysts label this BP's "perverse incentive."⁹

If state officials become concerned that the spot price is no longer the appropriate marker, the state has the ability to change the applicable regulations and reopen royalty settlement agreements, to protect value. In forecasting future revenues, the department will always use fair market value.

B. Netback Costs

As noted, the costs of transporting crude oil are offset against the ANS market value to determine the netback value upon which taxes and royalties are based. These costs include both marine and pipeline transportation. Other costs, including overhead and production operations on the North Slope, are generally excluded from royalty and severance tax netbacks or included on a formulaic basis. Thus, increases or decreases in transportation costs will affect state revenue, while increases or decreases in other types of costs will not have an effect on revenue under current formulas and agreements. Each of these types of costs and the post-merger factors that may affect them will be discussed in more detail below. The department's forecast is based on an assumption that **no significant changes will occur in these costs as a result of the merger under the conditions of the Charter for Development. As a result, there will be no effect on the netback value of Alaska oil or the revenue stream from that oil.**

⁸ BP can actually increase its total take from ANS by using a low spot price to lower the severance taxes and royalties due to the State. With the merger, BP acquires a large number of internally refined barrels. Even though those barrels are never sold, the taxes and royalties BP owes the State for those barrels are still calculated using the ANS spot price. As the spot price increases, BP gets more revenue from the barrels that it actually sells, but it has higher tax and royalty costs on all of its barrels. There comes a point when the added tax and royalty bill from high spot prices on the internally refined barrels overwhelms the cash effect of moving BP's sales barrels at a higher sales price. At that point BP's incentive changes from raising spot prices to lowering spot prices and the interests of the state and BP are no longer aligned.

⁹ Ironically, some of the solutions being explored by the FTC and BP could easily establish a situation where BP would have this perverse incentive. The FTC is trying to reduce BP's market power by reducing the number of barrels in sells in the spot market even as the state seeks to have BP maximize the number of barrels it sells in the spot market. Since BP makes money from all aspects of the oil business, it may decide that giving up money as a merchant marketer is a price worth paying for the merger to go through. But the state sees no such trade-off.

1. Netback Costs--Tankers

ANS moves from Valdez to the West Coast on a fleet of "Jones Act" tankers, i.e., tankers built, owned and operated by U.S. companies. The market for these tankers is very restricted, and every Jones Act tanker appropriate for transporting crude oil and larger than 55,000 DWT is already in the ANS trade. Arco owns a fleet of five tankers. BP, as a "foreign-owned" corporation, cannot own Jones Act vessels and leases eleven ships from American owners.

It is generally accepted, and confirmed here, that Arco has lower transportation costs to the West Coast than BP. Some observers have predicted that the total post-merger transportation costs of the combined companies will increase, thus leading to a decrease in revenue to the state. However, despite the merger, we believe that essentially the same Jones Act fleet will be hauling ANS. The merged entity should have transportation costs to the West Coast very close to the average of the two if it continues to use the vessels currently in the ANS trade. As an example, suppose there were two companies, each with a tanker of equal size, and it cost \$1 per barrel to ship on one tanker and \$2.00 per barrel to ship on the other. If the two companies merged, the average shipping cost would be \$1.50. Thus in the calculation of costs, a merger would not affect the actual average netback or marine transportation costs. If a new player required by divestiture acquires some of the vessels, again, the overall average fleet cost will be the same -- it will just be divided up differently between royalty and tax payers. In other words, there should be no net effect on the transportation deduction. BP argues that there will be a synergy from combining the fleets, and that post-merger, average costs may be lower. However, most of the savings are likely to be in overhead, which, as discussed below, may have very little effect on the netback.

Why are Arco's marine costs lower? Mostly because it hauls its crude to its own refineries in Puget Sound and Los Angeles and it has been able to optimize the design of its fleet with those two ports in mind. BP, on the other hand, is a seller of ANS, and it must make deliveries wherever a customer has a refinery. BP has a wider range of ports it visits, and it has several customers in the San Francisco area. In general, Puget Sound is the least expensive destination to reach, Los Angeles the next, and, finally, the San Francisco Bay area, where lightering -- reloading the crude onto smaller vessels -- is required. In addition, frequently BP must discharge a portion of a load in one port and the balance of the load in another port. Having to make multi-port discharges adds significantly to the average per barrel cost. Again, the department assumes that if the distribution of destinations stays roughly the same after the merger, then average costs should remain unchanged.

Looking not at West Coast costs, but at the overall netback illustrates another reason for Arco's lower average shipping cost. BP ships ANS to the Far East. BP has pledged to use Jones Act vessels for these shipments, which means for them, shipping to the Far East is relatively expensive.¹⁰ (That is not to suggest that if the Far East placements were discontinued and that crude went to the West Coast that BP's average netback would increase; in fact, it would more likely decrease due to downward pressures on prices that the extra crude would create.) We project that the volume of Far East placements will not change over the short run as a result of the merger.

¹⁰ While the law allowing export called for American-flagged and American-crewed ships, it did not require American-built vessels.

Analysts anticipate that the current fleet will be replaced by new double-hulled tankers earlier than the schedule set by the Oil Pollution Act of 1990 (OPA 90). It is perhaps worth mentioning that these tankers are more expensive than the old 1970's era single-hulled tankers they are replacing. Many tankers must be replaced in 2006-2008. The department's model, used to help shape the state's negotiations with BP, starts replacing older tankers earlier, rather than assuming that a large number of different shipyards would build all the required tankers in a short time. Thus, the model parallels BP's promise in the Charter to replace older tankers one year sooner than required by OPA 90.

2. Netback Costs--Overhead

The state has fought for decades over what constitutes allowable actual transportation costs. In general, it has been successful in limiting the effect of overhead and indirect costs on royalty and severance tax netbacks. As mentioned, these are precisely the kinds of costs that BP intends to cut to make the new operation more efficient. When the costs that flow into the royalty or severance tax netback are cut, the netback goes up. However, the converse is also true – when costs are cut that did not flow into the netback, the netback does not increase. In fact, there may even be an incentive for cost cutters to cut non-allowable costs because they are fully aware that BP gets the entire benefit of those cuts. When it cuts a cost that formed part of the royalty or tax netback, on the other hand, BP will have to share those cost savings with the state.

3. Netback Costs--Upstream

Similarly, the costs of the production operation on the North Slope do not, for the most part, affect royalties or severance taxes. Except for common carrier pipelines, costs upstream of TAPS are either deducted on a formulaic basis or not permitted to reduce royalty or tax value at all.¹¹

C. Pipeline Transportation - Trans-Alaska Pipeline (TAPS)

As discussed earlier, state revenue from the oil industry comes in four types. Each type is structured differently and focuses on a different aspect of the industry, which provides the state with a balance in its revenue stream and a "hedge" against a major decline in any one aspect of the industry. For example, the claim is often made that a large reduction in the TAPS tariff would lead to **increased** severance tax and royalty revenues for the state because the netback adjustment to the market price would be less. This is only half the picture. If there are "obscene" profits in TAPS, the income tax and the property tax (which uses the present value of all future net income (not revenue) to arrive at an assessed value for TAPS) each take their piece of those profits. A reduction in the TAPS tariff would therefore lead to a partially offsetting **decrease** in income and property tax revenues for public finances. In fact, **almost half of the increase in production tax and royalty would be offset by a decrease in income and property tax.** Furthermore, because of the way the property tax is divided

¹¹ If the State determines that those upstream costs have changed, i.e. if post-merger BP is able to introduce cost savings in production, it may want to try to revisit some of the formulas.

between the state and municipalities, about one third of the net increase in state revenue would come from the pockets of the pipeline municipalities rather than from the industry. This was one reason the state's negotiators did not require a reduction in the tariff.

III. REVENUE EFFECTS

As noted, the State of Alaska receives revenue from the oil industry in four ways: through the property tax, royalties from production on state land, the production or severance tax, and the income tax on oil and gas producers and pipelines. Before the discussion of each of these, however, two other factors are worth mentioning.

A. Additional Factors Affecting Revenue to the State of Alaska

1. State As a Stockholder

The state's most immediate exposure to the effects of the proposed merger is through ownership of BP Amoco and Arco stock, though this ownership played no role in the state's negotiating strategy. As of October 31, 1999, the State of Alaska, through both treasury-managed funds and the Permanent Fund, owned \$100 million of BP stock. When BP shares fell by 9 percent from 57¾ to 52¼ in the first week of November, the state lost about \$9 million. Over the following week BP's price rebounded by 14 percent, up to over 60, giving the state over \$10 million in additional investment earnings. None of the other effects discussed below will happen nearly that fast. The State of Alaska should not forget that it is a financial investor as well as sovereign and landowner.

2. Industry Job's Impacts on State Revenue

Neither an increase nor a decrease in industry employment will affect state revenues because the state's fiscal system does not include a personal income tax¹² or sales tax. Therefore, increased (or decreased) personal income or even resulting changes in purchasing power associated with the level of employment in the oil industry have no effect on state revenues. Although there may be very large effects on Alaska's overall economic health, with ripples that move from the oil sector to affect all other private sectors of the economy, the state as revenue collector is often situated similarly to the corporations in the oil patch. In this context, jobs can be thought of as costs that take away from the bottom line, whether it is the corporation's profit or the state's revenue. In other words, however relevant employment levels may be to the overall economic health of Alaska's economy, they are not pertinent to the state's fiscal picture in the absence of a broad-based revenue source tied to personal income or consumption. In fact, the costs of providing governmental services generally increase with increased employment, while revenues do not.

B. Oil and Gas Property Tax (AS 43.56)

The department's revenue forecast does not anticipate any increases or decreases in revenue from the property tax in the near future. Under the provisions of AS 43.56, the state levies a 20 mill tax on all oil and gas property in Alaska. Municipalities can also levy their local mill rate against the same property, and the taxes paid to the municipalities become a credit against

¹² The state also lacks a broad-based business income tax. In 1997 there were 70,525 business registered to do business in Alaska. Of those, 62,598 choose a corporate form (proprietorship, partnership, or S corporation) not subject to income tax in Alaska.

the state tax. In FY 1999, the state and municipalities collected \$270 million¹³ from oil and gas property taxes.

The amount of tax collected is independent of who owns the assets. If increased industry activity in a post-merger period results in increased assets in the state, the tax base will increase. If cost cutting means cutting back on assets in Alaska, the tax base will decrease. However, it may take years for either the decreasing or increasing scenario to play out.

The vast majority of the taxable property consists of production facilities on the North Slope. The next biggest piece of taxable property is TAPS. The Department of Revenue's regulations (15 AAC 56.100 (c)) call for the use of "standard appraisal methods such as replacement cost less depreciation, capitalization of estimated future net income, analysis of sales or other acceptable methods" in determining the value of a pipeline. For over twenty years, the state has relied on the income model, which sets a value for the pipeline using the present value of "estimated future net income." Currently, TAPS' value is assessed at just over \$3 billion, based on the income that the pipeline owners will receive under the TAPS Settlement Methodology (TSM), which will be in effect until 2008. The department believes the merger will have no direct quantifiable effect on property tax.

C. Royalties from Oil and Gas Production on State Land (AS 38.05)

The North Slope fields are on state land, and the state as landowner gets 12.5 percent (and in some instances more) of the oil produced in exchange for granting the companies the right to produce that oil. The state collected over \$517 million in oil and gas royalties in FY 1999.¹⁴ Royalties are determined by a contract between the landowner and the producer. The department does not anticipate a significant change in royalty returns to the state as a result of the merger. The merger should have little effect on either market behavior or the costs of transportation, the elements that determine the value on which royalties are calculated.

In the early 1990s Arco and BP each reached a separate resolution with the state about how they would calculate their royalties, including how allowable costs would be determined. These resolutions included different transportation allowances that resulted in Arco deducting a much lower transportation cost than BP. This has led some to conclude that applying BP's higher transportation rate will reduce royalties to the state in the post-merger period.

While there may be some reduction, fleet synergies may also lend to a reduction in costs and an increase in royalties. Both the Arco and the BP formulas were intended to approximate the respective company's actual costs to be deducted in the royalty netback. To the extent that either party to the respective settlement believed it did not, the state or the company could ask to renegotiate the formula. In December 1998, Arco exercised its right to reopen the royalty formula because of its view that its allowed transportation charges did not reflect its true costs. Also in 1998, the state requested a reopening of BP's destination value formula.

¹³ Of this, \$48.8 million was state revenue and the rest went to the municipalities.

¹⁴ Of this, \$348 million was unrestricted revenue, while the rest was divided between the Constitutional Budget Reserve (CBRF), the Permanent Fund, and the School Fund.

Both those negotiations were suspended pending the resolution of the larger merger issue. Both reopener processes are subject to binding arbitration in the event that the parties are unable to reach agreement, and both incorporate retroactive revisions back to the time of the reopener. Thus, any comparison between Arco and BP wellhead values since 1999 is a comparison of interim figures, representing two ways of approximating royalty value, both of which will be retroactively revised -- and neither of which currently represents a meeting of the minds between industry and the state. Over the long term, state royalty cost deductions will be what the state and the industry can negotiate and, if those negotiations fail, whatever an arbitrator finds fair. In either case, they will closely track the company's or companies "actual costs."

E. Production (Severance) Tax (AS 43.55)

The state has imposed a tax on oil production in the State of Alaska. For most oil the rate is 15 percent of the 87.5 percent left over after the royalty has been withdrawn, times the Economic Limit Factor (ELF). The ELF currently averages about 80 percent, so the effective tax on all barrels is about 10 percent. The State raised \$395 million in severance taxes from the oil industry in FY 1999.¹⁵ Production taxes are essentially levied on the same netted-back wellhead value as royalties.

Based on preliminary evaluations, the acquisition should have no effect on production taxes. As long as the oil is delivered to the same market, and the assets used to ship it are the same, there will be little, if any, change.

F. Income Taxes on Oil and Gas Producers and Pipelines (AS 43.20.072)

The state has an income tax of 9.4 percent with special rules that apply only to companies that have pipelines or oil production in the State of Alaska. In FY 1999, the State realized \$165 million in income tax from the petroleum industry.¹⁶ This tax is the hardest to analyze, both for our forecast and in terms of merger-related effects. As a result, we did not modify our standard forecasting process in the Department of Revenue's fall forecast to account for the effects of the merger. The merger may reduce state revenue, or it may increase state revenue. The available information is insufficient to support a change from our standard procedure.

Alaska's oil income tax uses a modified apportionment system. To build a bottom-up forecast of income tax revenue, the department first needs to know or project the total unitary income: how much the BPs, Arcos, Exxons, Mobils, and Amocos of the world make worldwide.¹⁷ This tells us how big the pie is. The larger and more diversified the business entity, the harder that projection becomes.

¹⁵ Of this \$371 million was unrestricted. The rest came from settled disputes and went into the CBRF.

¹⁶ Of this, \$145 was unrestricted and the rest came from settled disputes and went into the CBRF.

¹⁷ No annual returns from recently merged companies have yet been filed. The BP Amoco combination was effective in 1999, and the first full returns covering that period have not yet been filed.

Then, for modified apportionment, a forecaster needs to know, or project, each of three apportionment factors: the firm's extraction (or production), sales, and assets, for Alaska alone and for the rest of the world. The three factors are then averaged to arrive at an apportionment factor, which tells us how big a slice of the pie is taxable as Alaska income. The unitary income is then multiplied by the apportionment factor, and the result is taxable Alaska income. Needless to say, any bottom-up prediction of revenue from this tax is difficult, especially with reference to the post-merger period.

There are other difficulties associated with predicting this source of revenue. The income tax is a tax on what is left over after subtracting expenses from revenues. The three mechanisms already discussed -- property taxes, production or severance taxes, and royalties -- are all deductible expenses. First-order changes in those revenues will create second-order effects in the eventual income tax revenues. In addition, huge swings in unitary income can result from events outside Alaska, or changes in either the federal tax code or the tax code of some other jurisdiction in which oil companies are doing business.

Department of Revenue analysts do not apply a bottom-up analysis in forecasting incomes, but use three different techniques. First, they look at past and current quarterly estimated payments and analyze carry-forwards and refunds due to figure out the amount of tax expected in the next year. Second, they run a regression model that uses production times price to give a general forecast of income tax, assuming that the relationship between those factors will be the same in the future as in the past. A merger of two large entities such as BP and Arco is the classic example of a situation in which a regression developed from separate entities is not likely to be appropriate for the merged entities. Finally, for the more distant years, analysts step down from current year figures. The roundness of the projections suggests the accuracy of the forecast. The best that can be done is to estimate the general level of tax.

Alaska's taxable income can increase because either there is a bigger slice of smaller pie, a bigger slice of a bigger pie, or a smaller slice of a bigger pie. Alaska taxable income can decrease because either there is a smaller piece of a bigger pie, a smaller piece of a smaller pie, or a larger piece of a smaller pie. Neither a bigger slice or a bigger pie automatically means more revenue.

Auditors from the Division of Income and Excise Audit have analyzed prior income tax returns for the five companies involved in the completed or proposed mergers. In each of several years, analysts combined older returns of companies that had proposed merging. They compared the tax that would have been due from the combined returns with the sum of the taxes shown on the individual returns. Some of the combined returns generated less income tax than the sum of the individual returns. Other times the combined returns generated more income tax than the returns showed individually. The net effect of all the combining activity was a decrease in tax compared to the returns filed individually. Specifically when the five returns of merging firms were considered individually and then combined into pertinent groups of two and three, resulting income taxes fell by an average of \$20 million a year. That means the tax fell, not because unitary income fell, but because the State of Alaska took a smaller slice of the same sized pie. Although this may seem like a significant sum, it should not be considered a forecast of falling revenue. Combining companies is a very different proposition from combining the historical returns of separate companies. Companies merge to use the same assets to create more income. In a simplified world, more income would mean

more income tax. However, in the real world, total tax can fall even when net income stays the same. Because the merger will rearrange how assets, production, and sales are divided between Alaska and the rest of the world, we cannot predict how much of that income would be attributable to Alaska, and thus taxable by Alaska.

On the other hand, even though much of the potential merger-related cost savings will not result in increased wellhead values for the State of Alaska, it will result in increased unitary income. In fact, the whole billion dollars that BP hopes to achieve in cost-savings from its acquisition of Arco would feed into unitary income. However, if those cost savings resulted in a larger decrease in Alaskan assets than in worldwide assets, Alaska's return through the income tax would be smaller.

In conclusion, analysis of past returns suggests a merger might result in lower income tax revenues. The common-sense notion that the purpose of the merger is to increase income suggests that a merger might increase taxable income. These two effects are laid over the inherent difficulties associated with projecting modified apportionment income. The result is that we believe our current income tax projection is the best estimate of revenue, whether the merger occurs or not.

V. SUMMARY

Our analysis demonstrates that the state's revenues are determined not so much by who owns the barrels, but how many of them are produced. Consequently, for the short to medium term, we have tentatively projected no material change in state oil revenue resulting from the merger. I say tentatively because the FTC certainly might compel changes in the marketplace as a consequence of the merger that would reduce state revenue.

The goal of the Charter for Development of the Alaskan North Slope was to keep North Slope competition alive in the long term and create replacement barrels for the fields that drive our current production. It will be many years before our forecasts will begin to reflect whether that attempt was successful or not.

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

TONY KNOWLES, GOVERNOR

FEB 24 2000

P.O. BOX 110300
JUNEAU, ALASKA 99811-0300
PHONE: (907) 465-3600
FAX: (907) 465-2075

HAND DELIVERED

February 24, 2000

The Honorable Rick Halford
Alaska State Senate
State Capitol, Room 121
Juneau, AK 99811

Dear Senator Halford:

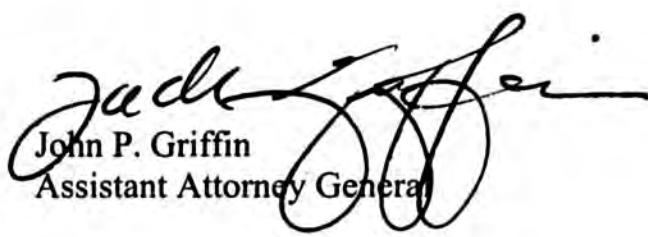
Attached to this letter is the "fiscal note on the merger," which was prepared by the Department of Revenue in accordance with the request of the Joint Special Committee on Mergers. Enclosed with this letter is a CD rom containing the data from our expert, Rick Warren-Bolton, that the Attorney General agreed to provide you in his letter of February 18, 2000. Most of the data is in SAS ("Statistical Analysis System") format, which I understand is the software used by most economists doing significant data analysis.

Please call me if you have questions.

Sincerely,

BRUCE M. BOTELHO
ATTORNEY GENERAL

By:


John P. Griffin
Assistant Attorney General

JPG:kh

Attachment: Fiscal Note

FISCAL NOTE

STATE OF ALASKA
2000 LEGISLATIVE SESSION

BILL NO. _____

Revision Date/Time (Note if correction) _____	Dept. Affected <u>Revenue/Natural Resources</u>
Title <u>BP Amoco/ARCO Acquisition</u>	BRU <u>N/A</u>
	Component <u>N/A</u>
Sponsor <u>N/A</u>	
Requester <u>N/A</u>	Component No. <u>N/A</u>

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0

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

CHANGE IN REVENUES ()	0.0	0.0	\$0-80,000	\$0-80,000	\$0-80,000	\$0-80,000
-------------------------------	------------	------------	-------------------	-------------------	-------------------	-------------------

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2000) cost: _____

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: (Attach a separate page if necessary)

We currently believe that the proposed BP/ARCO transaction will most likely not affect the State's projected revenue over the next five years. However, there is a small chance the proposed transaction could lead to a substantial increase in North Slope investment in the near term and a consequent increase in State revenue.

The "detailed analysis" of the revenue effect that the Administration anticipates will occur as a result of the BP Amoco/ARCO merger, which the Joint Special Committee on Mergers requests in Senator Halford's February 14 letter to Attorney General Botelho, is contained in the January 13 report of Dan

Prepared by: <u>Dan D. Dickinson, Director</u>	Phone <u>269-1033</u>
Division <u>Oil and Gas Audit Division</u>	Date/Time <u>2/24/00, 11:46 AM</u>
Approved by <u>Commissioner Wilson L. Condon, Commissioner</u>	Date <u>02/24/2000</u>
Agency <u>Department of Revenue</u>	

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ANALYSIS CONTINUATION

Dickinson, Director of the Oil and Gas Audit Division. That analysis was based on the assumption that there would be no additional production attributable to the merger. Mr. Dickinson's analysis identified "production" as the driving force behind any major effect of the merger on State revenues.

According to BP, their merger with ARCO would create synergies and efficiencies on the North Slope that would result in significant reductions in the cost of North Slope oil production operations. BP announced that it would use these cost savings to increase its planned investment in North Slope development. BP claimed this additional investment would, within two year's time, increase North Slope oil production 150,000 barrels a day above the level forecast by the Department of Revenue's Fall Revenue Forecast. If the average wellhead value of ANS over the first five years of increased production is \$10 per barrel and the State's combined royalty and tax share is approximately 20 percent, the additional State revenue attributable to the merger over those five years would be approximately \$400 million.

Under the Charter, BP and ARCO were required to make substantial divestitures of interests in producing fields, exploration acreage, and infrastructure to secure the benefits of robust competition in future North Slope lease sales and development. Nevertheless, the Charter was also crafted to permit the North Slope producers to capture most of the important synergies and efficiencies contemplated by the merger. Thus, we believe that if the Charter were implemented, the operators on the North Slope would be able to achieve most of the synergies and efficiencies BP originally anticipated. If these cost savings resulted in increased investment of the magnitude suggested by BP, it would be reasonable to anticipate receiving a maximum of \$400 million in additional state revenue over the five year period after increased production commences.

Given the concerns raised by the Federal Trade Commission about the proposed merger and the resulting litigation, the likelihood of the increased investment level on the North Slope has been significantly reduced. As a consequence, it is possible the proposed merger transaction will neither increase nor decrease the revenue we have forecast. This fiscal note, therefore, reflects a range of possible outcomes attributable to the merger.

ADDENDUM TO THE CHARTER FOR DEVELOPMENT Of the Alaskan North Slope

This **Addendum to the Charter for Development of the Alaskan North Slope** ("Addendum") is entered between the State of Alaska, BP, ARCO, BP Amoco p.l.c. ("BP Amoco"), and Phillips Petroleum Company ("Phillips") on March 15, 2000, to confirm their common interpretation of the Charter in connection with anticipated divestitures. Words and terms have the same meaning in this Addendum as in the Charter.

1. The parties agree that the sale of ARCO as a going concern will satisfy the commitments made by BP and ARCO in Charter paragraph I.A. (Sale of Current Production), paragraph I.B. (Sale of NPRA Lease Interests), paragraph I.C. (Sale or Relinquishment of State Leases), subparagraphs I.H.1.-3. (Divestiture of TAPS and Feeder Lines), and paragraph I.I. (Offer to Sell Excess Jones Act Ships).
2. The sale of "ARCO as a going concern" under this Addendum means transfer to Phillips or a Phillips subsidiary of (a) all of the stock in (i) ARCO (subject to the requirement that ARCO's owned assets at the time of any stock sale be substantially the same as at the time the Charter was entered) and (ii) ARCO's affiliates owning associated North Slope feeder pipelines and TAPS, as well as (b) associated ANS shipping capacity.
3. In the event of such a going concern sale, BP and ARCO may, where appropriate, provide for separate performance of the Charter commitments by BP and ARCO, so long as BP and ARCO each remain jointly and severally accountable for complete performance of their commitments under the Charter.
4. This Addendum does not change the notice and review provisions of Charter subparagraph V.E.2, or the commitments of ARCO, BP, and BP Amoco under any other Charter provision not specifically identified in paragraph 1 of this Addendum.
5. Phillips agrees that, if it is approved as the purchaser of ARCO as a going concern and completes that purchase, it will, subject to the terms of this Addendum, ensure ARCO's performance under the Charter to the same extent and in the same manner as BP Amoco has ensured the performance of BP and ARCO in Charter Section IV.
6. Subject only to the terms of this Addendum, the parties agree that the Charter is and will remain in full force and effect according to its terms.

State of Alaska

By _____
Tony Knowles, Governor

By _____
Bruce Botelho, Attorney General

BP Amoco, p.l.c.

By _____
Rodney Chase, Deputy CEO

Phillips Petroleum Company

By _____
J.J. Mulva
President and
Chief Operating Officer

BP Exploration (Alaska) Inc.

By _____
Richard Campbell, President

SCOMM

117:11

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General Counsel

2 RICHARD G. PARKER
3 Director, Bureau of Competition
Cal. Bar No. 62356

4 MOLLY S. BOAST
5 PHILLIP L. BROYLES
JOSEPH S. BROWNMEN
6 DAVID C. SHONKA
Attorneys for Plaintiff

7 Federal Trade Commission
8 600 Pennsylvania Ave, N.W.
Washington, D.C. 20580
9 (202) 326-2039

10
11 **IN THE UNITED STATES DISTRICT COURT**
FOR THE NORTHERN DISTRICT OF CALIFORNIA,
12 **SAN FRANCISCO DIVISION**

13 FEDERAL TRADE COMMISSION,
600 Pennsylvania Ave., N.W.
14 Washington, D.C. 20580

15 Plaintiff,

16 vs.

17 BP AMOCO, P.L.C.,
Brittanic House, 1 Finsbury Circus
18 London EC2M 7BA, England

19 and

20 ATLANTIC RICHFIELD COMPANY,
333 S. Hope Street
21 Los Angeles, California 90071

22 Defendants.
23

Civil No.

24 **COMPLAINT OF FEDERAL TRADE COMMISSION**
FOR A PRELIMINARY INJUNCTION PURSUANT TO
25 **SECTION 13(b) OF THE FEDERAL TRADE COMMISSION ACT**

26 Plaintiff, Federal Trade Commission ("FTC" or "Commission"), by its designated
27 attorneys, brings this action for a preliminary injunction under Section 13(b) of the Federal Trade

28 "FTC Complaint
for a Preliminary Injunction"

1 Commission Act, 15 U.S.C. § 53(b), to restrain and enjoin defendant BP Amoco p.l.c. ("BP"),
2 including its domestic and foreign agents, divisions, subsidiaries, affiliates, partnerships, or joint
3 ventures, from acquiring through merger or otherwise, any stock, assets, or other interest, either
4 directly or indirectly, of defendant Atlantic Richfield Company ("ARCO"). The proposed
5 merger of BP and ARCO, if allowed to proceed, may substantially lessen competition in the
6 markets for: crude oil sold to targeted West Coast refiners; all crude oil sold to West Coast
7 refiners; crude oil produced on the Alaska North Slope ("ANS crude oil"); bidding for
8 exploration rights on the Alaska North Slope ("ANS"); and oil pipeline and storage services into
9 and in Cushing, Oklahoma. BP and ARCO are, by far, the two largest producers of ANS crude
10 oil, the two largest suppliers of ANS crude oil to refineries in California and Washington, and the
11 two most successful competitors in bidding for oil and gas leases on the North Slope and in
12 exploring for and developing new producing oil fields on those properties. BP and ARCO also
13 have large interests in the oil pipeline and storage facilities that serve the crude oil marketing
14 center in Cushing, Oklahoma. The purpose of this action, pursuant Section 13(b) of the Federal
15 Trade Commission Act, is to maintain the status quo during the pendency of an administrative
16 proceeding challenging defendants' proposed merger, that will be commenced by the
17 Commission pursuant to Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45, and
18 Sections 7 and 11 of the Clayton Act, 15 U.S.C. §§ 18 and 21.

19 **I.**

20 **JURISDICTION**

21 1. Jurisdiction is based upon Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), and
22 upon 28 U.S.C. §§ 1337 and 1345. This is a civil action arising under Acts of Congress
23 protecting trade and commerce against restraints and monopolies, and is brought by an agency of
24 the United States authorized by Act of Congress to bring this action.

25 2. BP and ARCO are engaged in commerce, as "commerce" is defined in Section 4
26 of the FTC Act, 15 U.S.C. § 44, and Section 1 of the Clayton Act, 15 U.S.C. § 12. BP and
27 ARCO are engaged in, among other things, the production of crude oil in the State of Alaska and
28

1 the sale and delivery of that crude oil in the states of California, Oregon, Washington and
2 Hawaii.

3 **II.**

4 **VENUE**

5 3. Venue is proper under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), under 28
6 U.S.C. § 1391(b), (c), and under Section 12 of the Clayton Act, 15 U.S.C. § 22. BP and ARCO
7 transact business and are found within the Northern District of California. This action involves,
8 in part, the threatened loss of competition in the sale of crude oil to refineries located within the
9 Northern District of California. Defendant ARCO owns and operates gasoline service stations
10 located within the Northern District of California.

11 **III.**

12 **INTRADISTRICT ASSIGNMENT**

13 4. Assignment of this action to the San Francisco Division is proper. This action
14 involves, in part, the threatened loss of competition in the sale of crude oil to refineries located in
15 the San Francisco Bay area. Defendant ARCO owns and operates gasoline service stations
16 located within the counties encompassed by the San Francisco Division.

17 **IV.**

18 **THE PARTIES**

19 5. The Commission is an administrative agency of the United States Government
20 established, organized, and existing pursuant to the FTC Act, 15 U.S.C. § 41 et seq., with its
21 principal offices at 600 Pennsylvania Avenue, N.W., Washington, D.C. 20580. The Commission
22 is vested with authority for enforcing, inter alia, Section 7 of the Clayton Act and Section 5 of the
23 FTC Act.

24 6. Defendant BP is a corporation organized and existing under the laws of the United
25 Kingdom, with its principal place of business at Britannic House, 1 Finsbury Circus, London
26 EC2M 7BA, England. BP's principal business offices in the United States are located at BP
27 Amoco, Inc., 200 East Randolph Drive, Chicago, Illinois, 60601-7125.

7. Defendant ARCO is a corporation organized and existing under the laws of the State of Delaware, with its principal place of business at 333 S. Hope Street, Los Angeles, California 90071.

V.

SECTION 13(b) OF THE FTC ACT

8. Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), provides in pertinent part:

(b) Whenever the Commission has reason to believe --

(1) that any person, partnership or corporation is violating, or is about to violate, any provision of law enforced by the Federal Trade Commission, and

(2) that the enjoining thereof pending the issuance of a complaint by the Commission and until such complaint is dismissed by the Commission or set aside by the court on review, or until the order of the Commission made thereon has become final, would be in the interest of the public --

the Commission by any of its attorneys designated by it for such purpose may bring suit in a district court of the United States to enjoin any such act or practice. Upon a proper showing that, weighing the equities and considering the Commission's likelihood of ultimate success, such action would be in the public interest, and after notice to the defendant, a temporary restraining order or a preliminary injunction may be granted without bond. . . .

VI.

THE PROPOSED MERGER AND THE COMMISSION'S RESPONSE

9. On March 31, 1999, ARCO, BP and Prairie Holdings, Inc., a wholly-owned subsidiary of BP, entered into an Agreement and Plan of Merger pursuant to which ARCO would merge with Prairie Holdings through an exchange of stock, with ARCO being the corporation surviving the merger with Prairie Holdings, and become a wholly owned subsidiary of BP. At the time the proposed merger was announced on April 1, 1999, the transaction was valued at about \$26 billion.

10. On February 2, 2000, the Commission authorized the commencement of an action under Section 13(b) of the FTC Act to seek a temporary restraining order and a preliminary injunction barring the proposed merger during the pendency of administrative proceedings to be commenced by the Commission.

1 11. Defendant BP has advised the Commission that, in the absence of a court order to
2 the contrary, it will consummate the proposed merger.

3 12. In authorizing the commencement of this action, the Commission determined that
4 such an injunction is in the public interest and that it has reason to believe that the aforesaid
5 proposed merger would violate Section 7 of the Clayton Act because the merger may
6 substantially lessen competition and/or tend to create a monopoly in the relevant markets alleged
7 below.

8 **VII.**

9 **TRADE AND COMMERCE**

10 13. The Alaska North Slope is a major oil-producing region of the United States,
11 principally supplying oil refineries on the West Coast of the United States, specifically in
12 California and Washington. Over 90% of the crude oil produced on the North Slope is refined on
13 the West Coast of the United States and Hawaii.

14 14. The petroleum industry associated with the production and sale of ANS crude oil
15 involves several successive stages of commerce. At the pre-production stage, companies first
16 compete for oil and gas leases and the associated rights to engage in exploration and
17 development on lands principally owned by the State of Alaska and the United States
18 government. Exploration and development, if successful, are followed by production. With the
19 exception of a small amount of ANS crude oil that is used by refineries in Alaska, ANS crude oil
20 is then transported from the North Slope via the Trans-Alaska Pipeline System ("TAPS") to the
21 port of Valdez on Alaska's Prince William Sound, for tanker shipment to refineries on the West
22 Coast or elsewhere. All ANS crude oil production is commingled in TAPS, and all ANS crude
23 oil produced from any field is thus undifferentiated when it reached Valdez. Some of the West
24 Coast refineries are owned by integrated ANS producers such as ARCO and Exxon. Others are
25 independent refiners without crude oil production. ANS crude oil is sold on the spot market and
26 pursuant to term contracts to both independent and integrated refiners, some of which also use
27 crude oil produced in California.

1 the amount of ANS crude oil discovered, produced and available to refiners (including ARCO).

2 **A. Relevant Product Market**

3 19. Crude oil used by targeted West Coast refiners is a relevant product market and
4 line of commerce in which to analyze the competitive effects of this merger. Petroleum
5 refineries use crude oil as the principal input in making gasoline, diesel fuel, kerosene jet fuel,
6 asphalt, coke, and other refined petroleum products. There are no substitutes for crude oil as an
7 input into petroleum refineries or otherwise for the manufacture of petroleum-based fuels.

8 20. The principal sources of crude oil for refineries on the West Coast are Alaska and
9 California, although some West Coast refineries also use imported crude oil, principally from
10 Latin America. Although all ANS crude oil is substantially undifferentiated, different crude oils
11 have different gravity, sulfur, aromatics, metals and other characteristics. Changing crude oils in
12 a particular refinery may change both the refinery's overall products yields and the yield of
13 particular products. Therefore, refiners cannot freely substitute one crude oil for another, but
14 must make complex decisions, typically assisted by extensive computer linear programs that
15 solve many equations simultaneously, to evaluate the economics of crude substitution.

16 21. BP discriminates among its customers in the price it charges for ANS crude oil
17 based upon each customer's ability to shift to alternative sources of crude oil.

18 22. BP exercises monopoly power by selling ANS crude to individual customers at
19 different prices according to their "trigger points." Refiners with the least ability to substitute
20 away from ANS crude are targeted for the highest prices, while those with more flexibility to
21 substitute are charged lower prices. The difference between the prices charged to targeted
22 customers and the prices charged to the most favored customers is significant. The ability to set
23 ANS prices in this manner and price discriminate among customers demonstrates monopoly
24 power (the unilateral ability to raise price profitably) in the sale of crude oil to targeted West
25 Coast refineries.

26 23. BP also exercises monopoly power by charging targeted West Coast refiners
27 higher prices than it charges foreign customers. BP exports ANS crude to Asia at a lower price,

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1 net of transportation cost, than it could obtain by selling the same cargo on the West Coast. BP
2 exports ANS crude oil, even at a lower price, in order to restrict the supply of crude oil on the
3 West Coast and elevate its price to West Coast customers.

4 24. The production, sale, and delivery of all crude oil used by refiners on the West
5 Coast is also an appropriate relevant product market within which to assess the likely effects of
6 the proposed merger.

7 25. The production, sale, and delivery of ANS crude oil is also an appropriate relevant
8 product market within which to assess the likely effects of the proposed merger.

9 **B. Relevant Geographic Market**

10 26. The West Coast, and smaller areas therein, is a relevant geographic market and
11 section of the country in which to analyze the competitive effects of this merger. The refinery
12 customers affected by this merger are located on the West Coast (in the Los Angeles, San
13 Francisco and Seattle areas), and cannot practicably transfer their operations elsewhere.

14 **C. Concentration**

15 27. The proposed merger would substantially increase market concentration in all
16 three relevant markets.

17 **D. Effects of the Proposed Merger in Production and Delivery of Crude Oil**

18 28. The effect of the proposed merger, if consummated, may be substantially to lessen
19 competition in the production and sale of crude oil used by targeted West Coast refiners by,
20 among other things, eliminating ARCO as an effective competitor, eliminating substantial actual
21 competition between BP and ARCO, eliminating the likelihood of even greater competition
22 between BP and ARCO in the future, and increasing the market power that BP already is
23 exercising in the sale of crude oil to targeted West Coast refiners.

24 29. BP and ARCO are substantial actual and potential competitors in the production
25 of crude oil for West Coast refineries, specifically, ANS crude oil. BP and ARCO are the two
26 largest explorers, developers and producers of ANS crude oil. As alleged below, BP and ARCO
27 compete for exploration rights and to explore for, develop, and produce crude oil. The merger

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