

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILE 8672

1223 SCOMM 46: HOUSE SPEC. COMMITTEE ON OIL AND GAS 1985-86

ALASKA DEPARTMENT OF NATURAL RESOURCES - DIVISION OF OIL AND GAS
SUMMARY STATISTICS
COOK INLET GAS PRICE DISPUTE
AVERAGE MONTHLY SALES VOLUMES - JULY 1984 THROUGH JUNE 1985

Date: 1/14/86

FIELD Producers (% of field owned)	PURCHASER	% of FIELD on sale by sale basis	SALES VOLUMES (MCF) 1/	EFFECTIVE ROYALTY INTEREST	ROYALTY VOLUME (MCF)	VALUE REPORTED FOR ROYALTIES 2/	PRODUCER/ PURCHASER BASE CONTRACT VALUE 2/ 7/	EFFECTIVE DATE	EXPIRATION DATE
DELUGA RIVER FIELD									
CHEVRON (33.33%)	ENSTAR	2.11%	37,790	0.07555	2,855	\$1.0000	\$2.0300 9/	12/20/82	10/1999
ARCO (33.33%)	ENSTAR	2.11%	37,790	0.07555	2,855	\$1.0000	\$2.0300 9/	12/20/82	10/1999
SHELL (33.33%)	ENSTAR	2.11%	37,790	0.07555	2,855	\$1.0000	\$2.0300 9/	12/20/82	10/1999
AGEA (100.00%) W-214-35	ENSTAR	0.45%	8,122	0.07555	614	\$1.0000	\$2.0300 9/	12/20/82	10/1999
SUB TOTAL		6.77%	121,492		9,179				
CHEVRON (33.33%)	CHUGACH	28.70%	515,065	0.07555	38,913	\$0.2103	\$0.2103	5/14/65	1/1990 3/
ARCO (33.33%)	CHUGACH	28.70%	515,065	0.07555	38,913	\$0.2103	\$0.2103		
SHELL (33.33%)	CHUGACH	28.70%	515,065	0.07555	38,913	\$0.2103	\$0.2103		
AGEA (100.00%) W-214-35	CHUGACH	7.13%	127,863	0.07555	9,660	\$0.2103	\$0.2103		
SUB TOTAL		93.23%	1,673,058		126,400				
TOTAL DELUGA RIVER FIELD		100.00%	1,794,550		135,579				
KENAI FIELD									
UNION (50%)	APL-ANCHORAGE	10.28%	845,622	0.020688	17,494	\$1.9500 8/	\$0.6220 6/	5/13/60	12/92 3/
UNION (50%)	APL-CHEV NIK	0.19%	15,888	0.020688	329	\$1.9500 8/	\$0.6220		
UNION (50%)	UNION-CHEV	0.19%	15,518	0.020688	321	\$1.9500 8/	\$0.6220	2/5/81	INDEFINITE
UNION (50%)	CITY OF KENAI	0.25%	20,590	0.020688	426	\$0.3000	\$0.3000	5/17/66	6/1986
UNION (50%)	RENTAL GAS	4.50%	370,334	0.020688	7,661	\$1.9500 8/	\$0.0700	1/17/66	1/1995 3/
UNION (50%)	ADDITIONAL RENTAL	2.37%	194,981	0.020688	4,034	\$1.9500 8/	\$0.3800		
UNION (50%)	UNION CHEMICAL	40.73%	3,352,041	0.020688	69,347	\$1.9500 8/	\$0.6130	11/1/77	1998
TOTAL UNION SHARE		58.51%	4,814,973		99,612				
MARATHON (50%)	APL-I	14.38%	1,183,535	0.020688	24,485	\$1.9500 8/	\$0.6220 6/	12/1992	3/
MARATHON (50%)	APL-II	4.48%	368,603	0.020688	7,626	\$2.0550	\$2.0800 9/	12/16/82	12/1997 3/
MARATHON (50%)	APL-NIKISKI	0.19%	15,888	0.020688	329	\$2.0550 4/	\$0.6220		
MARATHON (50%)	CITY OF KENAI	0.25%	20,590	0.020688	426	\$2.0550 4/	\$0.3000		6/1986
MARATHON (50%)	RENTAL GAS	4.50%	370,242	0.020688	7,660	\$0.2100	\$0.2100		1/1995 3/
MARATHON (50%)	ADDITIONAL RENTAL	2.36%	194,450	0.020688	4,023	\$0.3800	\$0.3800		
MARATHON (50%)	TOKYO UTILITIES	15.32%	1,261,073	0.020688	26,089	\$2.2795	\$4.7590 5/		6/1/89
TOTAL MARATHON SHARE		41.49%	3,414,390		70,637				
TOTAL KENAI FIELD		100.00%	8,229,363		170,249				
STERLING FIELD									
UNION (50%)	PENINSULA GREENHOUSE	50.00%	736	0.015546	11	\$0.4000	\$0.4000	10/27/61	
MARATHON (50%)	PENINSULA GREENHOUSE	50.00%	736	0.015546	11	\$2.0550 4/	\$0.4000		
TOTAL STERLING FIELD		100.00%	1,472		23				
MCARTHUR RIVER FIELD									
UNION/MARATHON (50% each)		0.47%	1,671	0.125	209	0.000	0.000		
UNION/MARATHON (50% each)	RENTAL GAS	1.48%	5,260	0.125	658	0.000	0.210		
UNION/MARATHON (50% each)	UNION CHEMICAL	87.56%	311,215	0.125	38,902	0.000	0.613		
UNION/MARATHON (50% each)		9.39%	33,375	0.125	4,172	0.000	0.000		
UNION/MARATHON (50% each)		1.10%	3,910	0.125	489	0.000	0.000		
TOTAL MCARTHUR RIVER FIELD		100.00%	355,431		44,429				
TRADING BAY FIELD									
Marathon 48.66%		48.66%	580	0.125	73	0.000	0.000		
Union 48.66%		48.66%	580	0.125	73	0.000	0.000		
Superior 1.34%		1.34%	16	0.125	2	0.000	0.000		
Tenaco 1.34%		1.34%	16	0.125	2	0.000	0.000		
TOTAL TRADING BAY FIELD		100.00%	1,192		149				

- 1/ ANNUAL VOLUME DIVIDED BY 12 MONTHS EQUAL AVERAGE MONTHLY VOLUME.
2/ ROYALTY AND CONTRACT VALUES ARE THE MOST CURRENT IN EFFECT AS OF JANUARY 1986.
PRODUCTION AND HAVE NOT BEEN ADJUSTED FOR BTU CONTENT.
3/ QUANTITY TERM COULD OPERATE TO EXTEND OR SHORTEN THE CONTRACT PERIOD.
4/ PRICE REPORTED BY MARATHON IS BEING PAID UNDER PROTEST.
5/ CONTRACT PRICE IS A GROSS PRICE BEFORE TRANSPORTATION COSTS.

- 6/ CONTRACT PRICE TO GO TO \$0.27 MCF DURING 1986.
7/ BASE CONTRACT PRICE DOES NOT INCLUDE LESSEE TAX OBLIGATIONS PAID BY THE PURCHASER.
8/ VALUE AGREED TO BY SETTLEMENT.
9/ SPECIAL DELIVERABILITY CHARGE OF \$0.35/MCF MAY ALSO BE EFFECTIVE.

\$1.95 settlement

TESTIMONY OF

CHUGACH ELECTRIC ASSOCIATION, INC.

BEFORE THE HOUSE SPECIAL COMMITTEE ON OIL & GAS

JANUARY 30, 1986

GOOD AFTERNOON MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. MY NAME IS LARRY MARKLEY. I AM THE DIRECTOR OF GOVERNMENT AND MEMBER AFFAIRS FOR CHUGACH ELECTRIC ASSOCIATION. I APPRECIATE THE OPPORTUNITY TO BE HERE TODAY AND TO SHARE THESE VERY BRIEF COMMENTS WITH YOU. BECAUSE WE BECAME AWARE OF H.B. 495 ONLY LATE YESTERDAY, WE OR OTHER UTILITIES MAY HAVE FURTHER COMMENTS ONCE WE HAVE HAD THE TIME TO FULLY ANALYZE THE DETAILS OF THE BILL.

WE WANTED TO TAKE THE OPPORTUNITY TO TESTIFY HERE TODAY, BECAUSE CHUGACH AND OTHER RAILBELT UTILITIES ARE VERY INVOLVED THIS SESSION WITH ISSUES RELATED TO ROYALTY VALUATION. WE WILL ALSO BE TESTIFYING AT THE HEARING ON FEBRUARY 10 BEFORE THIS COMMITTEE AND THE HOUSE AND SENATE NATURAL RESOURCES COMMITTEES IN SUPPORT OF S.B. 309, WHICH WOULD TIE THE VALUE OF ROYALTY GAS TO LONG-TERM CONTRACT PRICES. WE SIMILARLY SUPPORT TWO HOUSE BILLS, H.B. 403 AND H.B. 425, WHOSE INTENTS ARE THE SAME.

OUR CONCERN WITH H.B. 495 FOCUSES ON SECTION 38.16.010(a). ALTHOUGH WE SUPPORT THE STATE MAXIMIZING OUR NATURAL RESOURCES FOR THE BENEFIT OF ALL OUR CITIZENS, ACTIONS SUCH AS THE DNR'S REVALUATION LAST SPRING OF THE ROYALTY PRICE FOR BELUGA GAS HAS A SIGNIFICANT IMPACT ON THE COST OF ELECTRICITY FOR CONSUMERS FROM HOMER TO FAIRBANKS. THESE ARE THREE-QUARTERS OF ALASKA'S POPULATION. I HAVE PROVIDED EACH OF YOU WITH AN INFORMATION PACKET THAT DETAILS THIS ISSUE FURTHER.

WHILE OUR INITIAL REVIEW INDICATES THAT SECTION 38.16.010(a) OF H.B. 495 IS NOT INCONSISTENT WITH THE INTENT OF S.B. 309,

H.B. 403 OR H.B. 425, WE BELIEVE IT WOULD BE CLEARER IF THE ABOVE SECTION WERE MODIFIED TO REFLECT THIS. WE WOULD BE HAPPY TO WORK WITH THE COMMITTEE IN THIS REGARD.

EQUALLY IF NOT MORE IMPORTANT THAN THE IMMEDIATE PRICE INCREASE TO RAILBELT CONSUMERS FROM THE BELUGA ROYALTY GAS REVALUATION, IS THE FACT THAT DNR'S ACTION INTRODUCES A REAL ELEMENT OF UNCERTAINTY, FOR UTILITIES AND OTHERS. THIS UNCERTAINTY CREATES PROBLEMS BOTH IN LONG-TERM FINANCING OF POWER SUPPLY PROJECTS AND IN OUR EFFORTS TO ENSURE RATE STABILITY. THERE IS AN UNRESOLVED POLICY QUESTION REGARDING VALUATION OF STATE RESOURCES, AND IT NEEDS A THOROUGH PUBLIC REVIEW AND MEANINGFUL INVOLVEMENT OF THE LEGISLATURE.

ROYALTY VALUE IS ESTABLISHED BY LONG-TERM CONTRACT PRICE. THIS APPROACH IS FOLLOWED IN OTHER STATES, SUCH AS OKLAHOMA AND LOUISIANA, WHICH RECOGNIZE THAT ROYALTY RESOURCES OFTEN HAVE LITTLE OR NO VALUE INDEPENDENT OF LONG-TERM CONTRACTS.

IN FACT, IT WAS CHUGACH'S SUCCESS IN NEGOTIATING STABLE LONG-TERM CONTRACTS FOR BELUGA GAS THAT ALLOWED US TO MAKE THE COMMITMENT TO BUILD OUR MAJOR GENERATION PLANT THERE IN THE MID-1960'S. WITHOUT THESE CONTRACTS, THAT GAS FIELD MIGHT STILL LIE UNDEVELOPED. ADDITIONALLY, IT IS IMPORTANT TO NOTE THAT UNDER THE EXISTING OIL AND GAS LEASES, DNR IS PERMITTED, ON ONLY SIX MONTHS' WRITTEN NOTICE, TO TAKE ITS ROYALTY SHARE IN-KIND AND SELL IT DIRECTLY TO A WILLING PURCHASER. NOTHING WE SUPPORT WOULD CHANGE THAT.

I THANK YOU AGAIN FOR THE OPPORTUNITY TO TESTIFY HERE TODAY, AND
I URGE YOU TO CONSIDER THE IMPORTANT PROBLEMS RAISED BY DNR's
ACTION LAST SPRING AND TO SUPPORT LEGISLATION TYING ROYALTY VALUE
TO LONG-TERM CONTRACT PRICE. CHUGACH AND OTHER RAILBELT
UTILITIES WILL BE HAPPY TO SUPPLEMENT THESE COMMENTS AND OUR
INFORMATION PACKET AS YOU WISH. WE WILL BE TESTIFYING IN GREATER
DETAIL ON FEBRUARY 10.

:test.86

IMPACTS OF STATE ROYALTY GAS INCREASE ON RAILBELT CONSUMERS

Alaskans from Fairbanks to Homer face utility bill increases as a result of the Alaska Department of Natural Resources' decision to drastically raise the price of royalty gas in Cook Inlet. For Chugach Electric Association consumers in the Anchorage area, the impacts will be nearly \$3 million a year.

DNR's action was taken with virtually no advance notice to the parties involved, to the public or to the State Legislature. Litigation was initiated by the three producers against DNR on the revaluation in April 1985. Chugach is also involved in the litigation.

There are two major aspects of this issue: The additional costs to utility consumers of DNR's actions and, perhaps more important, the fundamental policy question of how royalty valuation is established.

On March 18, 1985, the Department of Natural Resources (DNR) issued a formal notice to the three Beluga River gas field producers -- ARCO, Shell and Chevron -- informing them that DNR would no longer accept royalty payments based on long-term contract price but would require payments based on the "prevailing market value."

This value was initially determined by DNR to be \$2.05 per thousand cubic feet (mcf), based on a Shell-ENSTAR (APL II) contract signed in December 1982. By contrast, Chugach currently pays \$.26/mcf for its Beluga gas, under long-term contracts on which the DNR had based its royalty price for the past 17 years.

Based on the \$2.05/mcf figure, the annual increase to Chugach retail and wholesale consumers would be approximately \$2.8 million. Even under a recent settlement offer by the state which would value the royalty gas at \$1.50/mcf, the impact would be approximately \$1.9 million annually.

Chugach negotiated its Beluga contracts in good faith and at arms length in 1965, and renegotiated with the producers in 1973. The contracts extend to 1998 or whenever 373 billion cubic feet (bcf) of gas is used, whichever comes first. That means the overall impact of the Beluga royalty revaluation alone could total more than \$30 million to consumers.

Additional financial impacts on Chugach consumers have resulted or could result from actions similar to or related to the Beluga royalty revaluation. Those actions are:

- a possible revaluation, identical to the state's, by the other Beluga royalty gas owners (the federal government and Cook Inlet Region, Inc.);
- the recent \$8.5 million settlement by ELSTAR relative to royalty gas from the Kenai field (raising ENSTAR's Kenai royalty price from \$.66 to \$1.95, and including retroactive payments);
- an increase in the cost of power purchased from Anchorage Municipal Light & Power, which was substantially impacted by the ENSTAR increase, and
- a possible increase in state gas severance taxes based on the Beluga royalty gas revaluation.

If all these actions occur, the impact on Chugach consumers would be approximately \$6 million annually -- the equivalent of about a 6 percent rate increase. Attachment A details the impacts.

Financial impacts also will be felt in the Fairbanks area, because Chugach has been selling wholesale power to Golden Valley Electric Association and Fairbanks Municipal Utility System over the Anchorage-Fairbanks intertie. ML&P also is selling power to Golden Valley. Golden Valley has estimated that its consumers will save more than \$600,000 this winter alone through purchases of power from Chugach and ML&P.

Copper Valley Electric Association also is concerned, because the Glennallen-based cooperative wants its consumers from Glennallen to Valdez to be intertied with the Railbelt utilities and reap the benefits of less expensive power.

Approximately three quarters of the state's estimated 560,000 residents live in the Railbelt between Fairbanks and Homer. Chugach serves nearly half the state's population through sales to its own retail consumers and those of Matanuska Electric Association, Homer Electric Association and the City of Seward. Thus, residents of the Matanuska and Susitna Valleys and on the Kenai Peninsula are directly affected.

In addition to the cost increases associated with the existing gas contracts, there is another major -- and perhaps even more important -- impact of DNR's royalty revaluation decision.

This is what could be called the uncertainty factor. If DNR is ultimately successful in setting royalty prices on what it determines to be the prevailing market value of a resource, utilities, producers and other purchasing parties will have no assurance of what future royalty gas components will be. This injects a real measure of insecurity into long-term gas contracts and, for Chugach at least, into power supply planning and ratemaking.

The uncertainty factor is an important public policy question for the state and is one that may well eclipse the cost-increase aspect of any given royalty lease revaluation. It could be argued that settling the price dispute over a specific revaluation without first resolving the underlying policy question is getting the horse before the cart.

It is important to note that although DNR's gas and oil lease form has given rise to dispute and litigation in many instances over the years, DNR has failed to propose regulations defining important lease terms. Proposed regulations would at least allow for a public discussion of the policy questions.

To resolve the problem raised by the state's royalty gas revaluation, Chugach is supporting passage of S.B. 309, or similar bills H.B. 403 and H.B. 425. Each of these bills would require DNR to tie royalty valuation to long-term contract price, thereby resolving the underlying policy question. A copy of each of the bills is attached.

Uncertainty in long-term price for royalty gas raises problems for Chugach and other utilities both in terms of long-term financing for generation projects and in efforts to ensure electric rate stability. Tying royalty price to long-term contract price allows DNR to continue to manage the state's resources for maximum value, while recognizing that these resources do not have a value independent of long-term contracts. DNR would still be permitted, on only six months' written notice, to take its royalty share in kind and sell it directly to a willing purchaser.

ATTACHMENT A

CHUGACH ELECTRIC ASSOCIATION, INC. Rate Impacts Due to Market Valuation of Royalty Gas

January 10, 1986

	<u>Retail:</u> <u>Dollars</u>	<u>Retail:</u> <u>Percent</u>	<u>Wholesale:</u> <u>Dollars</u>	<u>Wholesale:</u> <u>Percent</u>	<u>Total:</u> <u>Dollars</u>	<u>Total:</u> <u>Percent</u>
Current revenues	\$63,200,000		\$35,800,000		\$99,000,000	
Impacts:						
The state's Beluga royalty revaluation from \$.26/mcf to \$2.05/mcf	1,501,164	2.38	1,278,769	3.57	2,779,933	2.81
Possible federal/CIRI Beluga revaluation (based on state's \$2.05/mcf figure)	1,000,776	1.58	852,513	2.38	1,853,289	1.87
ENSTAR settlement	420,853	0.67	358,505	1.00	779,358	0.79
ML&P rate increase (resulting from ENSTAR settlement)	337,500	0.53	287,500	0.80	625,000	0.63
Possible state gas severance tax increase (based on state's Beluga royalty revaluation)	<u>87,100</u>	<u>0.14</u>	<u>74,196</u>	<u>0.21</u>	<u>161,296</u>	<u>0.16</u>
	\$3,347,393	5.30	\$2,851,483	7.97	\$6,198,876	6.26

Introduced: 3/4/85
Referred: Resources

1 IN THE SENATE

BY FAIKS, KELLY AND V.FISCHER

2

SENATE BILL NO. 309

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FOURTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6

For an Act entitled: "An Act relating to the royalty value of a natural

7

gas lease on state land; and providing for an effective

8

date."

9

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10

* Section 1. FINDING. The legislature finds that to provide for the

11

utilization, development and conservation of gas resources for the maximum

12

benefit of the people of the state, the value of production of gas for

13

purposes of computing the royalty reserved to the state must be based

14

primarily on the contract price of gas rather than the current market value

15

of the gas. This will encourage stable markets, promote investment, assure

16

reasonable energy prices and provide the maximum benefit to the people of

17

the state.

18

* Sec. 2. AS 38.05.180 is amended by adding a new subsection to read:

19

(aa) Notwithstanding other provisions of this section, if the

20

royalty share of natural gas reserved to the state under a lease

21

issued under (f) of this section is taken in value, the value of

22

production sold under a long-term sales contract may not be greater

23

than the price received for the production under the long-term sales

24

contract unless it is shown by clear and convincing evidence that the

25

long-term contract price was unreasonably low at the time of contract.

26

* Sec. 3. This Act applies to leases issued before or after the effective

27

date of this Act.

28

* Sec. 4. This Act takes effect immediately in accordance with AS 01.-

29

10.070(c).

Introduced: 4/26/85
Referred: House Special Committee
on Oil & Gas, Resources and Finance

1 IN THE HOUSE

BY FIGNALBERI

2 HOUSE BILL NO. 403

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FOURTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to the royalty value of a natural
7 gas lease on state land; and providing for an effective date."
8

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. FINDING. The legislature finds that to provide for the
11 utilization, development and conservation of gas resources for the maximum
12 benefit of the people of the state, the value of production of gas for
13 purposes of computing the royalty reserved to the state must be based
14 primarily on the contract price of gas rather than the current market value
15 of the gas. This will encourage stable markets, promote investment, assure
16 reasonable energy prices and provide the maximum benefit to the people of
17 the state.

18 * Sec. 2. AS 38.05.180 is amended by adding a new subsection to read:

19 (aa) Notwithstanding other provisions of this section, if the
20 commissioner issues a gas lease under (f) of this section and the
21 royalty value of the production of gas removed or sold from the lease
22 is measured by a long-term contract price, the commissioner may not
23 adjust the long-term contract price to reflect the current market
24 value of gas if the commissioner determines the current market value
25 price adjustment would result in an increase in the consumer price of
26 the gas or unless the commissioner determines in a written finding
27 supported by clear and convincing evidence that the long term contract
28 price is unreasonably low.

29 * Sec. 3. This Act applies to leases issued before or after the

1 effective date of this Act.

2 * Sec. 4. This Act takes effect immediately in accordance with AS 01.-

3 10.070(c).

Introduced: 5/4/85
Referred: House Special Committee
on Oil & Gas and Resources

1 IN THE HOUSE

BY PEARCE

2

HOUSE BILL NO. 425

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FOURTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6

For an Act entitled: "An Act relating to the royalty value of a natural
gas lease on state land; and providing for an effective date."

8

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. AS 38.05.180 is amended by adding a new subsection to
11 read:

12 (aa) Notwithstanding other provisions of this section, the value
13 of the production of natural gas taken in value and sold under a lease
14 issued under (f) of this section may not exceed the long-term contract
15 price for the natural gas unless it is established by clear and convincing
16 evidence that the long-term contract price was unreasonably
17 low at the time of contract.

18 * Sec. 2. This Act applies retroactively to leases issued before the
19 effective date of this Act.

20 * Sec. 3. This Act takes effect immediately in accordance with AS 01.-
21 10.070(c).

ALASKA PUBLIC UTILITIES COMMISSION

The primary areas of concern regarding the Alaska Public Utilities Commission (APUC) for Chugach and other cooperatives are (1) the impacts of APUC action on the financing options of cooperatives, (2) the scope of the APUC's authority, (3) the delay in APUC decision making and (4) composition of the Commission itself.

Following is a synopsis of each of the four areas.

It should be stressed that Chugach is opposed to any elimination of the APUC, has articulated this position on numerous occasions and is moderate among electric cooperatives as to the degree of changes which should occur. Chugach does join most other utilities in Alaska in the belief that the APUC should focus its role and resources on the basic areas for regulation, and not on the details of day-to-day utility management. In the cooperatives' case, the APUC should not function as a "super" board of directors.

1. Financing Impacts

Chugach expects that funding from or access to the Rural Electrification Administration (REA) will be sharply reduced in the near future. Steps must be taken to make electric cooperatives more acceptable credit recipients from commercial lending sources. If a banker is going to make loans to any business, especially in the large amounts needed by electric utilities for generation and distribution expansion, the banker must be certain that the business has stable and reliable revenues. It is common for the financial community to do a careful analysis of the regulatory environment before making loans to regulated utilities.

As Chugach and other cooperatives increase their dependency on the private financial market, it is important that the regulatory environment not be one which limits access to financing or adversely impacts on the cost of that financing. In recent years, the APUC has abrogated the price component of Chugach's wholesale contracts and ordered the refund of other utilities' permanent rates. Actions of this type can cause great concern within the financial community.

2. Scope of APUC Authority

The APUC serves as a regulatory body for about half the public utilities operating in Alaska. In recent years, the APUC has broadened the scope of its oversight and regulatory

practices, and is becoming increasingly involved in details of day-to-day management.

The authors of the APUC enabling legislation granted the Commission far-reaching powers, ones that often exceed other regulatory agencies in Alaska, and then mandated that these powers be "liberally construed." No such broad grants of power were given to other commissions.

The APUC has drafted voluminous proposed service and safety regulations with far-reaching implications for day-to-day operations of the electric utilities. Many of these proposed regulations contradict existing utility tariff and would override policy decisions made by utilities regarding their own operations. APUC involvement in utility functions has a cost impact to utilities, both in responding to APUC requests and in the delays these increasing wide-reaching inquiries create.

3. Regulatory Delay

Regulatory delay can be a costly and serious problem for all utilities. Last year a review of the open and pending APUC dockets revealed that approximately 100 cases opened between 1982 and 1983 remain open. Many other state agencies operate under very tight time limits, and Alaska's judges and justices have their pay withheld if they fail to rule on pending cases in a timely manner. Although there are many reasons for delay, the APUC currently has no mandate to act expeditiously.

4. Composition of the Commission

Because of their number and the complexity of their operations, electric utilities are of a strong mind that at least one seat on the commission ought to be designated for an electrical engineer. This is currently not the case, nor has it been so in recent years. Proposed language would mandate that two of the five Commission seats be held by graduate engineers, one an electrical engineer and the other an engineer (not necessarily electrical) with public utility experience.

RIGHT-OF-WAY RELOCATION COSTS

Chugach Electric Association supports the House Transportation Committee Substitutes for House Bill 159 and House Bill 160, which deal with relocation of utility facilities from airports, other public facilities and highways.

The two bills originally would have made affected utilities responsible for all relocation costs, but were favorably amended on April 11, 1985, by the Transportation Committee at the request of the Alaska Rural Electric Cooperative Association and other utilities.

The amendments require the Department of Transportation to pay relocation costs if (1) utility facilities existed before the date of enactment or (2) if utility permits or regulations so specified for facilities constructed after the date of enactment. Utilities would pay relocation costs in all other cases. Currently, relocation costs are borne by the state unless otherwise agreed to by utilities.

The bills were referred to the House Finance Committee, where they await action at the 1986 session.

Offered: 4/11/85
Referred: Finance

Original sponsor: Rules/Governor

1 IN THE HOUSE BY THE TRANSPORTATION COMMITTEE
2 CS FOR HOUSE BILL NO. 159 (Transportation)
3 IN THE LEGISLATURE OF THE STATE OF ALASKA
4 FOURTEENTH LEGISLATURE - FIRST SESSION

5 A BILL
6 For an Act entitled: "An Act relating to utilities and encroachments in
7 state airports, public facilities, and highways; and
8 providing for an effective date."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. AS 02.15 is amended by adding new sections to article 2 to
11 read:

12 Sec. 02.15.102. USE OF AIRPORTS FOR UTILITIES. A utility facil-
13 ity may be constructed, placed, or maintained across, along, over,
14 under, or within a state airport only in accordance with regulations
15 adopted or procedures prescribed by the department and only if au-
16 thorized by a written permit issued by the department.

17 Sec. 02.15.104. RELOCATION OF UTILITY FACILITIES INCIDENT TO
18 AIRPORT PROJECTS. (a) If, incident to the construction of an airport
19 project, the department determines and orders that a utility facility
20 located across, along, over, under, or within a state airport must be
21 changed, relocated, or removed, the utility owning or maintaining the
22 facility shall change, relocate, or remove it in accordance with the
23 order, within a reasonable time set by the department in the order.

24 (b) If the utility facility is not changed, relocated, or re-
25 moved in accordance with the order, any permit authorizing the facil-
26 ity issued by the department under AS 02.15.102 becomes invalid and
27 the facility will be considered an unauthorized encroachment subject
28 to the provisions of AS 02.15.114.

29 (c) The cost of change, relocation, or removal, as defined in

1 AS 02.15.260, ordered under (a) of this section is to be paid as
2 follows:

3 (1) by the department as a cost of airport construction, if
4 the utility facility is installed or authorized under a utility
5 permit, or a regulation after the effective date of this Act;

6 (2) by the department as a cost of highway construction if
7 the facility is installed before the effective date of this Act;

8 (3) by the utility in all other cases unless the commis-
9 sioner finds it is in the public interest for the cost to be paid by
10 the department.

11 Sec. 02.15.106. ENCROACHMENT PERMITS. An encroachment may be
12 constructed, placed, changed, or maintained across or within an air-
13 port, but only in accordance with regulations or procedures adopted by
14 the department. An encroachment may not be constructed, placed, main-
15 tained, or changed until it is authorized by a written permit issued
16 by the department, unless the department provides otherwise by regula-
17 tion.

18 Sec. 02.15.108. RELOCATION OR REMOVAL OF ENCROACHMENT. If,
19 incidental to the construction or maintenance of a state airport the
20 department determines and orders that an encroachment previously
21 authorized by written permit must be changed, relocated, or removed,
22 the owner of the encroachment shall change, relocate, or remove it
23 within a reasonable time set by the department in the order. The cost
24 of the change, relocation, or removal shall be paid as provided in
25 AS 02.15.104(c). If the owner does not change, relocate, or remove an
26 encroachment within the time set by the department, the encroachment
27 will be considered an unauthorized encroachment subject to the pro-
28 visions of AS 02.15.114.

29 Sec. 02.15.110. UNAUTHORIZED ENCROACHMENTS. If an unauthorized

1 encroachment exists in, on, under, or over a state airport the depart-
2 ment may require the removal of the encroachment, at the expense of
3 the owner, in the manner provided in AS 02.15.112 - 02.15.114.

4 Sec. 02.15.112. NOTICE OF REMOVAL OF UNAUTHORIZED ENCROACHMENT.
5 Notice shall be given the owner, occupant, or person in possession of
6 an unauthorized encroachment, or to another person causing or per-
7 mitting the encroachment to exist, by serving upon any of them a
8 notice demanding the removal of the encroachment within a time limit
9 set by the department. The notice shall describe the encroachment
10 with reasonable certainty as to its character and location. Service
11 of the notice may be made by certified mail.

12 Sec. 02.15.114. REMOVAL AT OWNER'S EXPENSE AFTER NONCOMPLIANCE;
13 REMOVAL EXPENSE. After a failure of the owner of an unauthorized
14 encroachment to comply with a notice or order of the department under
15 AS 02.15.104, 02.15.108, or 02.15.112, the department may remove the
16 encroachment, or cause it to be removed. The owner of the unauthor-
17 ized encroachment shall pay to the department

18 (1) the expense of the removal of the encroachment;

19 (2) all costs and expenses paid by the state as a result of
20 a claim or claims filed against the state by third parties for damages
21 due to delays because the encroachment was not changed, removed, or
22 relocated according to the order of the department; and

23 (3) costs and expense of suit.

24 * Sec. 2. AS 02.15.260 is amended by adding new paragraphs to read:

25 (15) "cost of change, relocation, or removal" means the
26 entire cost incurred by the utility properly attributed to the change,
27 relocation, or removal of a facility, less the costs for improvements
28 or upgrading over and above the cost of a functionally equal facility;
29 if a facility is to be relocated and replaced with new equipment,

1 there shall also be subtracted from the entire cost the salvage value
2 derived from the old facility;

3 (16) "encroachment" includes a tower, pole, poleline, pipe,
4 pipeline, driveway, private road, fence, billboard, stand or building,
5 or structure or object of any kind that is or has been placed in, on,
6 under, or over a portion of an airport;

7 (17) "utility" includes a corporation, company, individual,
8 or association of individuals, or a lessee, trustee, or court-appointed
9 receiver, that owns, operates, manages, or controls a line, plant,
10 pipeline, or system for furnishing, producing, generating, transmitting,
11 or distributing power, electricity, communications, telecommunications,
12 water, gas, oil, petroleum products, coal or other mineral
13 slurry, steam, heat, light, chemicals, air, sewage, drainage not
14 connected with airport drainage, irrigation, or similar products
15 including publicly owned fire and police signal systems and street
16 lighting systems that directly or indirectly serve the public or a
17 segment of the public; "utility" also includes a corporation, company,
18 individual, or association of individuals, or a lessee, trustee, or
19 court-appointed receiver that owns, operates, manages, or controls a
20 system for furnishing transportation of goods or persons by means of a
21 railway, tramway, cableway, conveyor, flume, canal, tunnel, pipeline,
22 or a similar means;

23 (18) "utility facility" includes poles, plants, lines,
24 trenches, bridges, utilidors, tunnels, pipelines, and any other system
25 for furnishing, producing, generating, transmitting, or distributing
26 power, electricity, communications, telecommunications, water, gas,
27 oil, petroleum products, coal or other mineral slurry, steam, heat,
28 light, chemicals, air, sewage, drainage not connected with an airport
29 drainage system, irrigation, or another substance; "utility facility"

1 also includes a system for furnishing transportation of goods or
2 persons by means of a railway, tramway, cableway, conveyor, flume,
3 canal, tunnel, pipeline, or a similar means.

4 * Sec. 3. AS 19.25.200 is amended to read:

5 Sec. 19.25.200. ENCROACHMENT PERMITS. (a) An encroachment may
6 be constructed, placed, changed, or maintained across or along a
7 highway, but only in accordance with regulations adopted by the
8 department. An [NO] encroachment may not be constructed, placed,
9 maintained, or changed until it is [DULY] authorized by a written
10 permit issued by the department, unless the department provides
11 otherwise by regulation.

12 (b) The provisions under (a) of this section do not apply to a
13 mailbox or a newspaper box attached to a mailbox.

14 * Sec. 4. AS 19.45.001(12) is repealed and reenacted to read:

15 (12) "utility" includes a corporation, company, individual,
16 or association of individuals, or a lessee, trustee, or court-appointed
17 receiver, that owns, operates, manages, or controls a line, plant,
18 pipeline, or system for furnishing, producing, generating, transmitting,
19 or distributing power, electricity, communications, telecommunications,
20 water, gas, oil, petroleum products, coal or other mineral
21 slurry, steam, heat, light, chemicals, air, sewage, drainage not
22 connected with highway drainage, irrigation, or similar products
23 including publicly owned fire and police signal systems and street
24 lighting systems that directly or indirectly serve the public or a
25 segment of the public; "utility" also includes a corporation, company,
26 individual, or association of individuals, or a lessee, trustee, or
27 court-appointed receiver that owns, operates, manages, or controls a
28 system for furnishing transportation of goods or persons by means of a
29 railway, tramway, cableway, conveyor, flume, canal, tunnel, pipeline,

1 or a similar means;

2 * Sec. 5. AS 19.45.001 is amended by adding a new paragraph to read:

3 (14) "utility facility" includes poles, plants, lines,
4 trenches, bridges, utilidors, tunnels, pipelines, and any other system
5 for furnishing, producing, generating, transmitting, or distributing
6 power, electricity, communications, telecommunications, water, gas,
7 oil, petroleum products, coal or other mineral slurry, steam, heat,
8 light, chemicals, air, sewage, drainage not connected with a highway
9 drainage system, irrigation, or another substance; "utility facility"
10 also includes a system for furnishing transportation of goods or
11 persons by means of railway, tramway, cableway, conveyor, flume,
12 canal, tunnel, pipeline, or a similar means.

13 * Sec. 6. AS 35.10 is amended by adding new sections to read:

14 ARTICLE 6. UTILITIES AND ENCROACHMENTS IN PUBLIC FACILITIES.

15 Sec. 35.10.210. USE OF PUBLIC FACILITIES FOR UTILITIES. A
16 utility facility may be constructed, placed, or maintained across,
17 along, over, under, or within a state public facility only in accor-
18 dance with regulations adopted or procedures prescribed by the depart-
19 ment and only if authorized by a written permit issued by the depart-
20 ment.

21 Sec. 35.10.220. RELOCATION OF UTILITY FACILITIES INCIDENT TO
22 PUBLIC FACILITY PROJECTS. (a) If, incident to the construction of a
23 public facility project, the department determines and orders that a
24 utility facility located across, along, over, under, or within a state
25 public facility must be changed, relocated, or removed, the utility
26 owning or maintaining the facility shall change, relocate, or remove
27 it in accordance with the order, within a reasonable time set by the
28 department in the order.

29 (b) If the utility facility is not changed, relocated, or

1 removed in accordance with the order, a permit authorizing the utility
2 issued by the department under AS 35.10.210 becomes invalid and the
3 facility will be considered an unauthorized encroachment subject to
4 the provisions of AS 35.10.270.

5 (c) The cost of change, relocation, or removal, as defined in
6 AS 35.25.020, ordered under (a) of this section is to be paid as
7 follows:

8 (1) by the department as a cost of public facility con-
9 struction, if the utility facility is installed or authorized under a
10 utility permit or a regulation after the effective date of this Act;

11 (2) by the department as a cost of highway construction if
12 the facility is installed before the effective date of this Act;

13 (3) by the utility in all other cases unless the commis-
14 sioner finds it is in the public interest for the cost to be paid by
15 the department.

16 Sec. 35.10.230. ENCROACHMENT PERMITS. An encroachment may be
17 constructed, placed, changed, or maintained across or within a public
18 facility, but only in accordance with regulations or procedures adopt-
19 ed by the department. An encroachment may not be constructed, placed,
20 maintained, or changed until it is authorized by a written permit
21 issued by the department, unless the department provides otherwise by
22 regulation.

23 Sec. 35.10.240. RELOCATION OR REMOVAL OF ENCROACHMENT. If,
24 incidental to the construction or maintenance of a state public facil-
25 ity, the department determines and orders that an encroachment pre-
26 viously authorized by written permit must be changed, relocated, or
27 removed, the owner of the encroachment shall change, relocate, or
28 remove it within a reasonable time set by the department in the order.
29 The cost of the change, relocation, or removal shall be paid as

1 provided in AS 35.10.220(c). If the owner does not change, relocate,
2 or remove an encroachment within the time set by the department, the
3 encroachment will be considered an unauthorized encroachment and
4 subject to the provisions of AS 35.10.270.

5 Sec. 35.10.250. UNAUTHORIZED ENCROACHMENTS. If an unauthorized
6 encroachment exists in, on, under, or over a state public facility,
7 the department may require the removal of the encroachment, at the
8 expense of the owner, in the manner provided in AS 35.10.260 - 35.10.-
9 270.

10 Sec. 35.10.260. NOTICE OF REMOVAL OF UNAUTHORIZED ENCROACHMENT.
11 Notice shall be given the owner, occupant, or person in possession of
12 an unauthorized encroachment, or to another person causing or per-
13 mitting the encroachment to exist, by serving upon any of them a
14 notice demanding the removal of the encroachment within a time limit
15 set by the department. The notice shall describe the encroachment
16 with reasonable certainty as to its character and location. Service
17 of the notice may be made by certified mail.

18 Sec. 35.10.270. REMOVAL AFTER NONCOMPLIANCE; REMOVAL EXPENSE.
19 After a failure of the owner of an unauthorized encroachment to comply
20 with the notice or order of the department under AS 35.10.220, 35.10.-
21 240, or 35.10.260, the department may remove the encroachment, or
22 cause it to be removed. The owner of the unauthorized encroachment
23 shall pay to the department

24 (1) the expense of the removal of the encroachment;

25 (2) all costs and expenses paid by the state as a result of
26 a claim or claims filed against the state by third parties for damages
27 due to delays because the encroachment was not changed, removed, or
28 relocated according to the order of the department; and

29 (3) costs and expense of suit.

1 * Sec. 7. AS 35.25.020 is repealed and reenacted to read:
2 Sec. 35.25.020. DEFINITIONS. In this title, unless the context
3 requires otherwise,
4 (1) "construction" or a derivative of the term "construc-
5 tion" means construction, reconstruction, alteration, improvement, or
6 major repair;
7 (2) "cost of change, relocation, or removal" means the
8 entire cost incurred by the utility properly attributed to the change,
9 relocation, or removal of a facility, less any costs for improvements
10 or upgrading over and above the cost of a functionally equal facility;
11 if a facility is to be relocated and replaced with new equipment,
12 there shall also be subtracted from the entire cost any salvage value
13 derived from the old facility;
14 (3) "department" means the Department of Transportation and
15 Public Facilities;
16 (4) "encroachment" includes a tower, pole, poleline, pipe,
17 pipeline, driveway, private road, fence, billboard, stand or building,
18 or a structure or object of any kind that is or has been placed in,
19 on, under, or over a portion of a public facility;
20 (5) "maintenance" means the preservation of each type of
21 facility as nearly as possible in its original condition as construct-
22 ed, or as improved;
23 (6) "public building" means a building owned or controlled
24 and held by the state for government or public use;
25 (7) "public facility" or "public work" means a structure or
26 project constructed or maintained by the department except airports
27 and highways, and includes public buildings, boat harbors, port facil-
28 ities, dikes, jetties, and breakwaters;
29 (8) "utility" includes a corporation, company, individual,

1 or association of individuals, or a lessee, trustee, or court-appointed
2 ed receiver, that owns, operates, manages, or controls a line, plant,
3 pipeline, or system for furnishing, producing, generating, transmitting,
4 or distributing power, electricity, communications, telecommunications,
5 water, gas, oil, petroleum products, coal or other mineral
6 slurry, steam, heat, light, chemicals, air, sewage, drainage not
7 connected with public facility drainage, irrigation, or similar products
8 including publicly owned fire and police signal systems and
9 street lighting systems that directly or indirectly serve the public
10 or a segment of the public; "utility" also includes a corporation,
11 company, individual, or association of individuals, or a lessee,
12 trustee, or court-appointed receiver that owns, operates, manages, or
13 controls any system for furnishing transportation of goods or persons
14 by means of a railway, tramway, cableway, conveyor, flume, canal,
15 tunnel, pipeline, or a similar means;

16 (9) "utility facility" includes poles, plants, lines,
17 trenches, bridges, utilidors, tunnels, pipelines, and any other system
18 for furnishing, producing, generating, transmitting, or distributing
19 power, electricity, communications, telecommunications, water, gas,
20 oil, petroleum products, coal or other mineral slurry, steam, heat,
21 light, chemicals, air, sewage, drainage not connected with a public
22 facility drainage system, irrigation, or another substance; "utility
23 facility" also includes a system for furnishing transportation of
24 goods or persons by means of a railway, tramway, cableway, conveyor,
25 flume, canal, tunnel, pipeline, or a similar means.

26 * Sec. 8. This Act takes effect immediately in accordance with AS 01.-
27 10.070(c).

Offered: 4/11/85
Referred: Rinance

Original sponsor: Rules/Governor

1 IN THE HOUSE BY THE TRANSPORTATION COMMITTEE
2 CS FOR HOUSE BILL NO. 160 (Transportation)
3 IN THE LEGISLATURE OF THE STATE OF ALASKA
4 FOURTEENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act relating to relocation of utilities; and
7 providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 19.25.020(c) is amended to read:

10 (c) The cost of change, relocation, or removal necessitated by
11 highway construction is a cost of highway construction to be paid [BY
12 THE STATE] in accordance with AS 19.45.001(4) as follows:

13 (1) by the department as a cost of highway construction, if
14 the utility facility is installed or authorized under a utility permit
15 or a regulation after the effective date of this Act;

16 (2) by the department as a cost of highway construction if
17 the facility is installed before the effective date of this Act;

18 (3) by the utility in all other cases unless the commis-
19 sioner finds it is in the public interest for the cost to be paid by
20 the department [, NOTWITHSTANDING THE TERMS OR PROVISIONS OF ANY
21 EXISTING PERMIT, AGREEMENT, REGULATION OR STATUTE TO THE CONTRARY].

22 * Sec. 2. This Act takes effect immediately in accordance with AS 01.-
23 10.070(c).

KENAI PENINSULA-ANCHORAGE INTERTIE

Chugach Electric Association supports construction of a new transmission circuit between the Kenai Peninsula and Anchorage.

Specifically, Chugach joins other Railbelt utilities in supporting immediate funding for a feasibility study for the intertie. The feasibility study should begin this year, to ensure that the new circuit is ready when the Bradley Lake project becomes operational. To facilitate the feasibility study for the intertie, Chugach has budgeted \$75,000 this year as part of a \$150,000 contribution by Railbelt utilities. The remaining cost of the feasibility study is to come from the Alaska Power Authority (APA).

The APA has estimated the cost of the feasibility study at \$625,000, although that figure could probably be reduced substantially. The \$625,000 was included in the APA's proposed Fiscal 1986 budget, but was deleted entirely by the State Office of Budget and Management in the final budget.

Despite a contrary conclusion in the Bradley Lake feasibility study, the 90-megawatt capacity of that hydroelectric project cannot all be used on the Kenai Peninsula. Hence, a new Kenai-Anchorage intertie will be needed. A fact sheet on Kenai Peninsula generation capacity in 1990 is attached. The Bradley Lake feasibility study underestimated the generation capacity on the Kenai Peninsula by approximately 55 megawatts, by not including the 40-megawatt Soldotna Unit No. 1 (soon to begin operation) and by underestimating existing capacity by 15 megawatts.

The only existing transmission link between Anchorage and the Kenai Peninsula is a 115-kilovolt Chugach line, which would not be adequate to serve the Bradley Lake project. The existing Chugach line is 25 years old, undersized and vulnerable to the elements. Nearly every year, the line is affected by avalanches, mudslides or high winds in the mountains near Turnagain Arm. Because of the terrain, repair work can be very difficult and time-consuming during severe weather. It is likely a new, higher-voltage circuit would bypass the high-risk areas by including a submarine cable crossing of Turnagain Arm.

Anchorage Municipal Light & Power, Matanuska Electric Association, Homer Electric Association and the Fairbanks electric utilities as well as Chugach will directly benefit from a new intertie. All the utilities support immediate state participation in a feasibility study for the intertie. State funding should be a priority item for the APA and the 1986 legislature.

NEED FOR NEW KENAI PENINSULA-ANCHORAGE TRANSMISSION CIRCUIT

GENERATION CAPACITY ON THE KENAI PENINSULA -- 1990:

<u>Owner</u>	<u>Capacity (megawatts)</u>
Chugach Electric Association	100
Alaska Electric G&T Cooperative *	40
Bradley Lake Project **	<u>90</u>

TOTAL: 230

Projected Kenai Peninsula Demand -- 1990

Homer Electric Association	85
Chugach Electric Association (including the City of Seward)	<u>30</u>
	115

Capacity of existing Chugach 115-kV transmission line between Kenai Peninsula and Anchorage ***	<u>55</u>
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Kenai Peninsula generation capacity that can be used on the peninsula or trans- mitted to Anchorage	<u>(170)</u>
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Excess Kenai Peninsula capacity (that cannot be used on the peninsula)	60
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* Scheduled for service in early 1986 (Soldotna Unit No. 1)

** Scheduled for service in 1990

*** Assuming entire capacity of the line is available



RECORDS CERTIFICATION



I, the undersigned, an employee of the State of Alaska, do hereby certify that the microfilm images on this microform are accurate reproductions of the original records of the State of Alaska as accumulated during the regular course of business, and that it is the established policy and practice of this State to microfilm its records and to dispose of the original records after microfilm reproductions have been made.


Signature of Camera Operator


Date

SCOMM

#46:25

5-Feb-86

Royalty-In-Kind Contract Terms
For Current Contracts
AS OF FEBRUARY 1, 1986

Filename: C:\Contract dwj

COMPETITIVE SALE CONTRACTS			PURCHASE PRICE (Base Price Plus Bid Premium)	Price Re-opener	Letter of Credit	Length of Contract	Provision for retroactive Amerada Hess adjustment	State option to purchase residual oil or return oil
Company	Unit	Quantity(1) (% & Bbls)						
Chevron	Prudhoe Bay	8.0001% 15,000 BPD	(1)\$17.95	No	60 Days	4/1/85- 3/31/86	no	no
Texaco	Prudhoe Bay	13.3334% 25,000 BPD	(1)\$17.56	No	60 Days	4/1/85- 3/31/86	no	no
U.S. Oil	Prudhoe Bay	5.3332% 10,000 BPD	(1)\$17.96	No	60 Days	4/1/85- 3/31/86	no	no
U.S. Oil	Kuparuk River	8.8888% 2,778 BPD	(1)\$17.10865	No	90 Days	10/1/85- 3/31/86	no	no
U.S. Oil	Kuparuk River	13.3332% 4,167 BPD	(1)\$17.10865	No	90 Days	10/1/85- 3/31/86	no	no
U.S. Oil	Kuparuk River	13.3332% 4,167 BPD	(1)\$17.10865	No	90 Days	10/1/85- 3/31/86	no	no
Union	Kuparuk River	13.3332% 4,167 BPD	(1)\$17.10865	No	90 Days	10/1/85- 3/31/86	no	no
Chevron	Kuparuk River	17.7776% 5,556 BPD	(1)\$17.10865	No	90 Days	10/1/85- 3/31/86	no	no

(1) Price per barrel billed in January 1986. Price is adjusted monthly to reflect changes in posted prices of West Texas sour crude, with a floor price of the volume weighted average of the producers' reported netback prices.

Royalty-In-Kind Contract Terms
For Current Contracts
AS OF FEBRUARY 1, 1986

Filename: C:\Contract dwj

NEGOTIATED CONTRACTS

Company	Unit	Quantity(1) (% & Bbls)	Price Plus Applicable Premium	Price Re-opener	Letter of Credit	Length of Contract	Provision for retroactive Amerada Hess adjustment	State option to purchase residual oil or return oi
MAPCO	Prudhoe Bay	18.6667% 35,000 BPD	(2)Exhibit B + field costs (3)(\$17.61921)	No	No	11/1979- 12/2003	yes(4) (6)	no
Tesoro	Prudhoe Bay	24.533% 46,000 BPD	(2)In-value + field costs (3)(\$17.41648)	No	Yes 60 days	1/1/1983- 1/1/1995	yes (7)	yes
Tesoro	Prudhoe Bay	13.867% 26,000 BPD	(2)In-value + \$.35 Bbl + field costs (3)(\$17.76648)	Yes-six years after date of 1st delivery, every two years thereafter	Yes 60 days	10/1/1985- 1/1/1995	yes (7)	yes
Chevron	Prudhoe Bay	9.6% 18,000 BPD	(2)In-value + \$.30 Bbl + field costs (3)(\$17.71648)	Yes-every two years	Yes 60 days	5/30/1984- 1/1/1995	yes (7)	yes
GVEA	Prudhoe Bay	2.667% 5,000 BPD	(2)In-value + \$.30 Bbl + field costs (3)(\$17.71648)	no	Yes 60 days	7/1/1985 - 6/30/1995	yes (7)	no
PetroStar/ Chevron (pending Legislative approval)	Kuparuk River	19.198% 6,000 BPD (2,000 P/S, 4,000 Chv) with option for 500/b Petro Star increase to 6,500 BPD total	(2)PBU in value + \$.35 premium for P/S; \$.50 premium for Chv + Kuparuk field costs - (Kuparuk P/L tariff and TAPS quality bank adjustment)	Yes-every two years	Yes P/S 60 days; Chv 90 days	12/1/1986- 9/30/1996	yes(5) (8)	no

(1) Due to field fluctuations and decline, all quantities for the purchase of royalty oil are expressed as a percentage of daily royalty oil production. However, Mapco receives 35,000 bpd regardless of fluctuating production.

(2) Prudhoe producers' prices as initially reported for royalty purposes. These prices will be subsequently adjusted to reflect the outcome of Amerada Hess litigation. In-value was \$17.41648 in December 1985, Exhibit B was \$17.61921. Prudhoe field costs were \$0.70.

(3) Price per barrel billed in January, 1986.

(4) Mapco's Exhibit B is a pre-payment towards the final resolution of Amerada Hess.

(5) Petro Star agrees to escrow \$1.12 per barrel of royalty oil purchased, as a pre-payment towards the final resolution of Amerada Hess.

(6) Interest on retroactive payment is prime rate then charged by Chemical Bank of NY + 1 1/4%.

(7) Interest on retroactive payment is higher of: 1) prime rate at Bank of America, SFO + 3%; or (2) rate of return as is realized from time to time in the investment of the State of Alaska's general fund.

(8) Interest as specified in Amerada Hess settlement or judicial resolution.

STATE OF ALASKA 1986 LEGISLATIVE SESSION

FISCAL NOTE

Revision Date : 2-26-86

REQUEST

Bill/Resolution No. : HB 559
 Title : Kuparuk Royalty Oil Sale
to Petrostar/Chevron
 Sponsor : Governor
 Requestor : Oil & Gas
 Date of Request : 02-25-86

FISCAL DETAIL

Agency Affected : Natural Resources
 BRU : Petroleum Management
 Components : _____

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL	0	0	0	0	0	0
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REVENUE	0	1,151.1	1,067.4	1,067.4	907.3	771.5
---------	---	---------	---------	---------	-------	-------

FUNDING : (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS :

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : Attach a separate page if necessary

Note: Revenue computations by calendar year instead of fiscal year.

See attached

Prepared by : Jim Eason *[Signature]* Phone : 762-4246
 Division : Oil & Gas Date : 2-26-86

Approved by Commissioner : Wm D Arnold, Deputy Date : _____
 Agency : Natural Resources

Distribution (by Agency preparing fiscal note):

Legislative Finance
 Legislative Sponsor,
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

ANALYSIS
Fiscal Note HB 559

Approval of the proposed Petrostar/Chevron will result in the state's receipt of approximately \$7.5 million in premium payments over the term of the contract. Approximately 16,756,670 barrels of oil will be delivered under the contract, with Chevron's respective share being 11,171,002 barrels, and Petrostar's share being 5,585,668 barrels. Chevron will pay a premium above the "in value" amount of \$.50 per barrel, while Petrostar's premium will be \$.35 per barrel for its net barrels. Chevron's share of this premium will total \$5,585,501 over the life of the contract (contract ends September 30, 1996), and Petrostar's respective contribution will be \$1,954,984. All amounts calculated are expressed in "nominal" dollars, and the analysis assumes contract deliveries commence December 1, 1986 and ends September 30, 1996.

Revenue Projects

Calendar Year

92	655.5
93	592.0
94	528.8
95	475.4
96	<u>323.0</u>
Total	7,539.4

Shell Western discovers oil, gas in Beaufort Sea

Story
page
A-10

Today's
New York
Stocks

Home Local

The Anchorage Times

72nd year/58 pages

TUESDAY EVENING, FEBRUARY 25, 1986

25¢

Marco resigns, flees

Alaskans hail new regime

by Richard Pyle
Associated Press

MANILA, Philippines — A defeated Marco resigned as president of the Philippines today, slipping away in the Manila night and setting off an explosion of joyous celebration among his countrymen.

U.S. involvement
— page A-10

"Cory! Cory!" Filipinos chanted in tribute to new President Corazon Aquino as they demonstrated by the thousands across the capital. A mob rampaged through Malacanang Palace, from which Marco governed for 20 years.

Marco, who fled aboard American helicopters to the U.S. Air Force's nearby Clark Air Base, was brought down by a combination of a "people's power" uprising, military revolt and U.S. pressure.

First official word of his resigna-



Young
authors
make
their own
books

ALASKA LIFE
— page C-1



KAKM

RESIDENCY STATUS
OF PETRO STAR INC. EMPLOYEES

AS OF JANUARY 1, 1986

Walter Alexander	10 years	
Fred Ambuehl	3 years	
Alan Armbruster	12 years	
Karen Boswood	10 years	
Earl Burgess	23 years	
Robert Burgess	23 years	
Douglas Chapados	Lifetime	Resident
Greg Davis	Lifetime	Resident
Sandra Davis	Lifetime	Resident
Jo Ann Ford	Lifetime	Resident
Walter Gore	2 years	
Andy Greenblatt	10 years	
Kent Herman	9 years	
Stephen Lewis	17 years	
Ken Lincoln	28 years	
Kristi Linse	5 years	
Patricia Marcopulos	5 years	
Steve Moeller	15 years	
Jim Morris	12 years	
Dawn Mullin	2 years	
Shawn Mullin	2 years	
John Peep	9 years	
Lars Peterson	2 years	
Loretta Porter	Lifetime	Resident
Kathy Rogers	23 years	
Dee Roberts	22 years	
Mark Stack	Lifetime	Resident
Julie Wright	Lifetime	Resident

MAJOR CONTRACTORS USED BY PETRO STAR INC.
SINCE FORMATION

AAA Communications	Fairbanks
Acme Electric	Fairbanks
Airtite Insulation	Fairbanks
Aerolaska	Fairbanks
Alaska Aerofuel	Fairbanks
Alaska Contracting	Fairbanks
Alaska Controls	Anchorage
Alaska Freighters	Fairbanks
Alaska West Express	Fairbanks
Aurora Drilling	Fairbanks
Aurora North Fuels	Fairbanks
C&S Mechanical	Fairbanks
CATCO	Anchorage
Chase Arctic Pumping & Thawing	Fairbanks
City Electric	Fairbanks
D-8 Construction	Fairbanks
Daniel Construction Co.	Anchorage
Dycon, Inc.	Fairbanks
Earth Movers	Fairbanks
Fairbanks Machine & Steel	Fairbanks
Fairbanks Pumping & Thawing	Fairbanks
Filco Oil & Gas	Fairbanks
Forward Alaska Joint Venture	Anchorage
Frontier Transportation	Fairbanks
Hector's Welding	Fairbanks
Industrial & Commercial Const.	Fairbanks
Jackovich	Fairbanks
Kittrell Plumbing	Fairbanks
Lynden Transport	Fairbanks
Na-Con Services	Redmond, Wa.
NC Machinery	Fairbanks
OceanTech	Anchorage
Rampart Floors	Fairbanks
Ray's Electric	Fairbanks
Schuchart & Associates	Seattle
Seattle Boiler Works	Seattle
Sims Mechanical	Fairbanks
Steel Fabricators	Anchorage

STATE OF ALASKA



POUCH V
JUNEAU, ALASKA 99811
(907) 465-4941

HOUSE SPECIAL COMMITTEE ON OIL AND GAS

HB 559

Agreement for the sale and purchase of state royalty oil
between the State of Alaska and Petro Star, Inc. and
Chevron U.S.A., Inc., dated December 9, 1985

Relationship between Petro Star and Chevron. Chevron will sell the royalty oil it purchases under the contract to Petro Star at TAPS Pump Station #1, and will repurchase the oil at the TAPS terminus at Valdez.

Petro Star will use as refinery charge Chevron's volume of royalty oil sold under the contract. After Petro Star processes the oil there will remain a portion of oil or oil products which will be shipped through TAPS, and sold by Petro Star to Chevron at Valdez. The quantity will approximate Chevron's purchase volume under the royalty oil contract.

Volume. Approximately 6,500 barrels per day (bpd) of Kuparuk River Unit royalty oil, of which a maximum of 2,500 bpd will be sold to Petro Star and about 4,000 bpd will be sold to Chevron. Petro Star initially will take approximately 2,000 bpd, and will have the option to increase its take by Nov. 1, 1987 to the maximum quantity of approximately 2,500 bpd.

Price. The total price to be received by the state consists of the following:

1. The Prudhoe Bay in value price.
2. A 35 cent per barrel premium for Petro Star.
3. A 50 cent per barrel premium for Chevron.

Petro Star matched the highest premium offered by any existing in-state refiner, and Chevron offered the highest premium for export purchase.

Price Adjustments. Petro Star has agreed to escrow \$1.12 per barrel in an interest-bearing account to be credited against future Amerada Hess adjustments. The department has agreed to a ceiling retroactive Amerada Hess price adjustment of \$2.50 per barrel of royalty oil purchased.

Price Adjustments (Continued). The tariff charge for the Kuparuk Pipeline and the applicable TAPS quality bank adjustment are deducted from the sale price of the oil.

Price Reopener. Any time after two years from the date of first delivery of royalty oil to Petro Star and Chevron, the state or either of the purchasers may exercise the price reopener clause upon giving a one month written notice. Two years after a new purchase price becomes effective, that price will be subject to renegotiation under the price reopener provision of the contract.

Term. Delivery of oil will commence the first day of the first month seven months after the contract is approved by the legislature and the governor. The contract terminates Sept. 30, 1996.

In-State Processing and Best Efforts. Petro Star will process not less than 85% of the total royalty oil sold under the agreement. Petro Star also agrees to use its "best efforts" to produce and market in Alaska an amount of refined petroleum products from its refinery near North Pole, not less in volume than 23% of the total royalty oil sold under the agreement.

Reporting. Petro Star will be required to provide the department a quarterly statement showing the quantity of refined products it produced and marketed in Alaska over that period.

Security. Petro Star will provide a letter of credit worth 60 days of oil, and Chevron will provide a letter of credit worth 90 days of oil. In the event of default by Petro Star, Chevron agrees to purchase Petro Star's volume on five days notice.

Default. Should Chevron default in its share of the agreement, Petro Star could continue to receive its portion of oil under the agreement. Petro Star could also increase its take of oil to include all or part of the Chevron volume upon agreement with the commissioner to meet specified requirements.

Should Petro Star default, continuation of the disposal to Chevron would be at the commissioner's discretion, and would be contingent on Chevron's agreement to process the oil at its Nikiski refinery.

In-State Benefit Analysis. Petro Star is its own distributor of refined products, having purchased North Pole Fuel. Petro Star has also received financial backing from the Arctic Slope Regional Corporation in exchange for an ownership interest of 30 percent in the company.

In-State Benefit Analysis (Continued). Petro Star officials say the company is marketing much of its present refinery production at prices lower than those charged by MAPCO. Refinery production, based on crude oil purchased under contract from Sohio, is about 1,000 bpd. Examples of lower market prices include heating oil sales to five rural villages and to construction companies operating on the North Slope. Petro Star officials also believe that recent favorable changes in MAPCO's product prices, which are said to be at a three-year low, were influenced by their company's prospective and present operations.

While the price discounts mentioned by Petro Star are only on the order of pennies per gallon, a one cent decrease in the price of a gallon of refined product that could be made from 1,000 bpd translates to an annual consumer savings of about \$153,000.

However, the extent to which a royalty oil disposal to Petro Star may maintain or extend these price reductions cannot be readily determined. DNR anticipates no more than modest favorable impacts on the price of refined products as a result of the sale to Petro Star.

The department's decision to proceed with this contract is largely based on the need to foster regional competition among in-state refiners and provide additional in-state benefits that result from in-state refining, and to provide equity of access to royalty oil among existing refiners.

BILL SHEFFIELD
GOVERNOR



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

The Honorable Ben Grussendorf
Speaker of the House
Alaska State Legislature
P.O. Box V
Juneau, AK 99811

Dear Representative Grussendorf:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill that provides for legislative approval of a royalty oil contract between the state, Petro Star, Inc. and Chevron U.S.A., Inc. for the sale of Kuparuk River royalty oil. Also transmitted with this bill is a copy of the resolution of the Alaska Royalty Oil and Gas Development Advisory Board recommending approval of that contract, along with a letter from the Department of Law forwarding the resolution to you. This resolution is being transmitted in accordance with AS 38.06.040(a)(3) and AS 38.06.070(c).

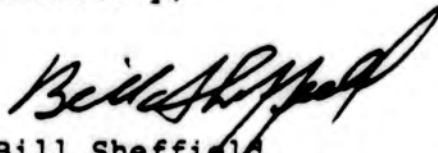
The contract is also described in the findings issued by the Department of Natural Resources on December 9, 1985. Copies of these findings have been made available to the legislature and the public for review.

A bill approving the contract is being introduced for legislative approval for two reasons. First, as a matter of comity, I respect the legislature's desire to have a direct voice in major disposals of royalty oil. Therefore, although this and the previous administration have consistently taken the position that the statutory requirement of legislative approval of royalty oil contracts (AS 38.06.055) is unconstitutional, the contract itself contains provisions requiring approval by the legislature before it takes effect.

Second, this legislation would ratify the royalty oil contract. This ratification would cure any procedural defect

that may have occurred in the process of entering into this contract. Although we believe that all necessary steps have been taken, the statutes and regulations governing the disposal of royalty oil represent often-conflicting desires and goals -- both procedural and substantive. For example, the statutes provide that the legislature is to approve a royalty oil contract only by "enacting legislation" (AS 38.06.055(a)), but also refer to a Royalty Board recommendation to be submitted to the legislature at the time a "resolution approving the proposed sale ... is introduced in the legislature" (AS 38.06.070(c)). Since legislative approval by enactment of legislation is required as a matter of contract, I believe that it is prudent to present this contract for legislative approval and ratification.

Sincerely,

A handwritten signature in dark ink, appearing to read "Bill Sheffield", written in a cursive style.

Bill Sheffield
Governor

142559

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

January 14, 1986

REPLY TO:

☒ 1031 W 4th AVENUE
SUITE 200
ANCHORAGE, ALASKA 99501
PHONE: (907) 276-3550

☐ 1st NATIONAL CENTER
100 CUSHMAN ST.
SUITE 400
FAIRBANKS, ALASKA 99701
PHONE: (907) 452-1568

☐ POUCH K - STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3600

The Honorable Ben F. Grussendorf
Speaker of the House of Representatives
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Reference: "An Act Relating to the Sale and Purchase of Royalty
Oil from the Kuparuk Unit between the State of Alaska
and Petro Star, Inc. and Chevron U.S.A. Inc.

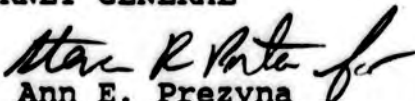
Dear Mr. Speaker:

In accordance with AS 38.06.040(a)(3), I am forwarding for your consideration the resolution of the Alaska Royalty Oil and Gas Development Advisory Board which recommends that the legislature approve the referenced sale of royalty oil to Petro Star and Chevron U.S.A.

If we can be of further service, please do not hesitate to call.

Sincerely,

HAROLD M. BROWN
ATTORNEY GENERAL

By: 
Ann E. Prezyna
Assistant Attorney General

AEP/ma

RECEIVED

Department of Law

JAN - 3 1986

Office of the Attorney General
Anchorage Branch
Anchorage, Alaska

The Alaska Royalty Oil and Gas Development Advisory Board

Resolution 85-2

On or about October 23, 1985, the director of the division of oil and gas ("director") provided the Alaska Royalty Oil and Gas Development Advisory Board with the preliminary notice of sale, preliminary findings, and proposed contract for a long-term sale of up to about 6500 barrels per day of Kuparuk River Unit royalty oil to Petrostar, Inc. and Chevron U.S.A. Inc.

This proposed sale has been discussed at several public meetings held by the board during 1985. At the February 20 meeting, Petrostar representatives testified in support of a royalty oil sale. On March 26, staff of the Alaska Department of Natural Resources (DNR) reported to the board on the status of a solicitation for purchasers of state royalty oil. At the April 12 meeting, DNR presented a status report on the solicitation, which was released April 1. On July 25, DNR presented to the board a recapitulation of the responses to the solicitation. At the meetings of the board held September 26-27 and October 7, the board received public testimony on a proposed sale of Kuparuk royalty oil to Petrostar and Chevron. On October 30, the director made a presentation to the board on the Petrostar-Chevron contract proposed in DNR's October 23 preliminary findings; the board also received public testimony on the proposed contract. The last two meetings were held by teleconference in Anchorage, Fairbanks, Valdez, and Juneau.

DNR's final findings on the proposed sale and the contract were sent to the board on December 9, 1985. On December 19, the board met to develop and vote on its recommendations to the legislature on the proposed sale.

Based on the board's review of the agreement for the sale and purchase of royalty oil between the State of Alaska and Petrostar and Chevron, DNR's findings and determinations regarding the proposed sale, and the testimony received at public meetings of the board, the board is of the opinion that the proposed disposition of Kuparuk River Unit royalty oil to Petrostar and Chevron meets the requirements of AS 38.06 and 3 AAC 56. The board recommends that the Fifteenth Alaska Legislature approve the agreement for the sale and purchase of royalty oil from the Kuparuk River Unit to Petrostar and Chevron, dated December 9, 1985.

Dated: December 19, 1985

[Signature]
[Signature]

Laurie S. Cunningham
[Signature]

HB 559

1 IN THE HOUSE

BY THE RULES COMMITTEE BY
REQUEST OF THE GOVERNOR

2 HOUSE BILL NO.

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 FOURTEENTH LEGISLATURE - SECOND SESSION

5 A BILL

6 For an Act entitled: "An Act approving the sale of Kuparuk River Unit
7 royalty oil by the State of Alaska to Petro Star,
8 Inc. and Chevron U.S.A., Inc.; and providing for an
9 effective date."

10 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

11 * Section 1. The "Agreement for the Sale and Purchase of State Royalty
12 Oil" between the State of Alaska and Petro Star, Inc. and Chevron U.S.A.,
13 Inc., dated December 9, 1985, is approved and ratified.

14 * Sec. 2. This Act takes effect immediately in accordance with AS 01.-
15 10.070(c).
16
17
18
19
20
21

12/10 memo
HB 559
BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF LAW

POUCH K - STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 468-3800

OFFICE OF THE ATTORNEY GENERAL

January 22, 1986

M E M O R A N D U M

TO: Honorable Bill Sheffield
Governor

FROM: *Harold M. Brown*
Harold M. Brown
Attorney General

RE: Attached bill on Petro Star/
Chevron royalty oil contract
Our file: 377-094-86

Attached is a bill (prepared for both House and Senate introduction), requested by the Department of Natural Resources (DNR), which provides for legislative approval and ratification of a royalty oil contract between the state and both Petro Star Inc. and Chevron U.S.A. Inc. for the sale of Kuparuk River royalty oil. This contract is the result of negotiations with the companies over the past year. If you prefer not to introduce this bill in both houses, DNR would prefer that it be introduced in the Senate.

Also attached are copies of the resolution of the Alaska Royalty Oil and Gas Development Advisory Board recommending that the legislature approve this sale of royalty oil. These copies are attached to original letters forwarding the Royalty Board's resolution to the Speaker of the House and the President of the Senate. In accordance with AS 38.06.040(a)(3) and AS 38.06.070(c), this resolution and the appropriate letter should be transmitted with each bill at the time of introduction.

If you only introduce the bill in the Senate, it should not be necessary to send the separate Department of Law letter and copy of the board's resolution to the Speaker of the House. However, it might be wise to do so as a courtesy.

A draft transmittal letter, explaining the bill in more detail, is also attached.

HMB:SRP:ma

cc w/enc.: Hon. Esther Wunnicke, Commissioner
Department of Natural Resources

113559

D R A F T

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill that provides for legislative approval of a royalty oil contract between the state, Petro Star, Inc. and Chevron U.S.A., Inc. for the sale of Kuparuk River royalty oil. Also transmitted with this bill is a copy of the resolution of the Alaska Royalty Oil and Gas Development Advisory Board recommending approval of that contract, along with a letter from the Department of Law forwarding the resolution to you. This resolution is being transmitted in accordance with AS 38.-06.040(a)(3) and AS 38.06.070(c).

The contract is also described in the findings issued by the Department of Natural Resources on December 9, 1985. Copies of these findings have been made available to the legislature and the public for review.

A bill approving the contract is being introduced for legislative approval for two reasons. First, as a matter of comity, I respect the legislature's desire to have a direct voice in major disposals of royalty oil. Therefore, although this and the previous administration have consistently taken the position that the statutory requirement of legislative approval of royalty oil contracts (AS 38.-06.055) is unconstitutional, the contract itself contains provisions requiring approval by the legislature before it

takes effect.

HB 559

Second, this legislation would ratify the royalty oil contract. This ratification would cure any procedural defect that may have occurred in the process of entering into this contract. Although we believe that all necessary steps have been taken, the statutes and regulations governing the disposal of royalty oil represent often-conflicting desires and goals -- both procedural and substantive. For example, the statutes provide that the legislature is to approve a royalty oil contract only by "enacting legislation" (AS 38.06.055(a)), but also refer to a Royalty Board recommendation to be submitted to the legislature at the time a "resolution approving the proposed sale ... is introduced in the legislature" (AS 38.06.070(c)). Since legislative approval by enactment of legislation is required as a matter of contract, I believe that it is prudent to present this contract for legislative approval and ratification.

Sincerely,

Bill Sheffield
Governor

STATE OF ALASKA 1986 LEGISLATIVE SESSION FISCAL NOTE

Revision Date: 1-31-86

REQUEST HB 559 #1
 Bill/Resolution No.: 377-094-86
 Title: An act approving the sale of
royalty oil to Petro Star
 Sponsor: Governor
 Requestor: Governor
 Date of Request: 1/29/86

FISCAL DETAIL
 Agency Affected: Natural Resources
 BRU: Petroleum Management
 Components: Petroleum Management

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL						
----------------	--	--	--	--	--	--

REVENUE						
----------------	--	--	--	--	--	--

FUNDING : (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS :

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

ANALYSIS : Attach a separate page if necessary

The contract will result in routine billing and accounting functions which can be absorbed in the existing operation.

Prepared by: Rod Maurant *Ram* Phone: 465-2424
 Division: Management Date: 1-31-86
 Approved by Commissioner: Wm D. Smith, Deputy Date: 1/31/86
 Agency: Natural Resources

Distribution (by Agency preparing fiscal note):

Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

STATE OF ALASKA 1986 LEGISLATIVE SESSION

FISCAL NOTE

REQUEST HB 559 #2
 Bill/Resolution No. : _____
 Title : An Act approving the sale of
royalty oil to Petro Star and Chevron
U.S.A.
 Sponsor : Rules Committee at the request
 Requestor : of the Governor
 Date of Request : 1/28/86

Revision Date : _____

FISCAL DETAIL
 Revenue
 Agency Affected : _____
 BRU : _____
 Components : operating

EXPENDITURES/REVENUES : (Thousands of Dollars)

OPERATING	FY 86	FY 87	FY 88	FY 89	FY 90	FY 91
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING		-0-	-0-	-0-	-0-	-0-

CAPITAL						
---------	--	--	--	--	--	--

REVENUE						
---------	--	--	--	--	--	--

FUNDING : (Thousands of Dollars)

GENERAL FUND		-0-	-0-	-0-	-0-	-0-
FEDERAL FUNDS						
OTHER						
TOTAL		-0-	-0-	-0-	-0-	-0-

POSITIONS :

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS : Attach a separate page if necessary

Prepared by : _____ Phone : _____
 Division : _____ Date : _____
 Approved by Commissioner : [Signature] Date : 1/28/86
 Agency : Dept. of Revenue

Distribution (by Agency preparing fiscal note)

Legislative Finance
 Legislative Sponsor
 Requestor
 Office of Management and Budget
 Impacted Agency(ies)

FINAL FINDINGS AND DETERMINATION
TO SELL KUPARUK RIVER UNIT ROYALTY OIL
TO PETRO STAR, INC. AND CHEVRON U.S.A., INC.

December 9, 1985

INTRODUCTION

On September 16, 1985 the Department of Natural Resources issued a document entitled Analysis and Recommendations for Disposition of State Royalty Oil (Analysis). The Analysis reviewed the state's competitive royalty oil sale of December 11, 1984 (1984 Competitive Sale) and evaluated negotiated royalty oil disposal options resulting from the department's Solicitation for Proposals(s) to Purchase Prudhoe Bay and/or Kuparuk River Unit Royalty Oil of April 1, 1985 (Solicitation). After considering comments from the Alaska Royalty Oil and Gas Development Advisory Board (Royalty Board), legislators and many members of the public, the Commissioner of Natural Resources determined that the state's interests would be best served by a negotiated long-term sale to Petro Star, Inc. (Petro Star) and Chevron U.S.A., Inc. (Chevron), and additional short-term competitive sales.

A preliminary finding and public notice for a competitive sale of Prudhoe Bay Unit Royalty Oil was published October 17, 1985. The document entitled Preliminary Findings and Determination to sell Kuparuk River Unit Royalty Oil to Petro Star, Inc. and Chevron U.S.A., Inc. (Preliminary Findings) was published with a preliminary notice on October 23, 1985.

The department proposes to sell approximately 6,500 barrels per day (bpd) of royalty oil from the Kuparuk River Unit. A maximum of 2,500 bpd will be sold to Petro Star and about 4,000 bpd will be sold to Chevron, with both sales occurring under a single long-term, noncompetitive contract. In accordance with AS 38, the Department of Natural Resources must determine whether this disposal serves the state's best interest and make other findings before the sale may take place. This final finding describes the proposed sale and analyzes its potential effects.

BACKGROUND

A long-term royalty oil disposal to Petro Star (an in-state refiner located in North Pole) has been discussed at several public meetings held by the Royalty Board during 1985. At the February 20 meeting, Petro Star representatives testified in support of a royalty oil sale. On March 26, the department reported to the Royalty Board on the status of the state's planned Solicitation. At the April 12 meeting, the department presented a status report on the Solicitation, which was released April 1. A recapitulation of the responses to the Solicitation was presented at the Royalty Board meeting of July 25.

In its response to the department's Solicitation, Petro Star originally requested an 11-year contract for 4.266% of Prudhoe Bay Unit royalty oil production, or about 8,000 bpd. At the time the department's Analysis was released (September 13, 1985), tentative agreement had been reached for a long-term contract with Petro Star on terms similar to Petro Star's original proposal. However, that tentative agreement was subject to Petro Star making a satisfactory disposition of the return oil barrels.

Oil which has been processed through a refinery, but is not retained as refined product, is known as residual oil. Residual oil can be injected into the Trans Alaska Pipeline System (TAPS), where it becomes commingled with TAPS crude stream. Residual oil added to the TAPS crude stream is called "return oil". The department was aware that a substantial volume of return oil would result from a long-term disposal to Petro Star.

At a September 16, 1985 meeting of the House Special Committee on Oil and Gas, several legislators encouraged the department to pursue a "net sale" to Petro Star that would relieve it of the obligations related to the return oil barrels. The department investigated this possibility, and concluded that it would be feasible to make a "net sale" to Petro Star if satisfactory arrangements could be made by the department for the return oil barrels.

It was suggested that Petro Star's return oil could be offered in future short-term competitive sales. The department determined that it was preferable to dispose of the return oil barrels in a long-term contract running in tandem with the Petro Star contract, rather than leaving those barrels uncommitted. There is presently too much uncertainty regarding future competitive sales to ensure satisfactory disposal through that mechanism.

The department then asked Chevron whether it would be willing to purchase Petro Star's return oil barrels under the same terms that Chevron had offered in response to the department's Solicitation. Chevron was selected because it offered the highest premium (50¢/barrel) of any company responding to the Solicitation and was willing to meet the standard financial and security terms requested by the department in the Solicitation. Chevron indicated its tentative agreement with this proposal, and the royalty board was advised of this development at its meeting September 26.

At the Royalty Board meetings of September 26-27 and October 7, the Royalty Board received public testimony on the proposed sale of royalty oil to Petro Star and Chevron. On October 30, the Director of the department's Division of Oil and Gas made a presentation to the Royalty Board on the Petro Star-Chevron contract proposed in the Preliminary Findings; the Royalty Board also received public testimony on the proposed contract.

Under the contract, a maximum of approximately 6,500 bpd of Kuparuk River Unit royalty oil will be sold to Petro Star and Chevron. Chevron will have a maximum quantity of approximately 4,000 bpd, and Petro Star a maximum quantity of approximately 2,500 bpd. These volumes will be expressed and sold as a percentage of unit production. The exact percentages will be determined after approval of the contract next year since production from the Kuparuk River Unit is fluctuating at this time. Petro Star initially will take approximately 2,000 bpd, and will have the option to increase its take by November 1, 1987 to the maximum quantity of approximately 2,500 bpd. Chevron

will sell its royalty oil volume from this contract to Petro Star at Pump Station 1, and Petro Star will sell its return oil to Chevron at Valdez.

The differences between the contract form which accompanies this finding and the proposed contract form presented with the Preliminary Findings reflect a consideration of the comments received and the issues raised both by the department and board members at the Royalty Board meeting of October 30, 1985.

SUMMARY OF PROPOSED CONTRACT TERMS

1. Price: The total price per barrel to be received by the state in this negotiated disposal is the sum of the following components:
 - (a) The amount the state would have received for a barrel of Prudhoe Bay royalty oil taken at that time in value (in money);
 - (b) a premium of 35¢ per barrel for Petro Star and 50¢ per barrel for Chevron;
 - (c) Kuparuk field costs;
 - (d) additional sums upon the resolution of State of Alaska, et al v. Amerada Hess Corp., et al (Superior Court for the State of Alaska, First Judicial District at Juneau) (Amerada Hess);
 - (e) less, the tariff charge for the Kuparuk Pipeline and the applicable TAPS quality bank adjustment.
2. Term: Delivery of oil will commence the first day of the first month seven (7) months after the contract is approved by the Legislature and the Governor. The contract terminates September 30, 1996.

3. Quantity and Source: The contract allows for a maximum volume of approximately 6,500 barrels per day (bpd), expressed as a percentage of daily royalty oil from the Kuparuk River Unit. Petro Star will purchase a maximum of approximately 2,500 bpd and Chevron will purchase approximately 4,000 bpd.
4. Point of Delivery: Purchasers will take delivery at the Central Production Facility meter into the Kuparuk Pipeline.
5. In-State Processing and Best Efforts: Petro Star will process not less than 85% of the total royalty oil sold under the agreement. Petro Star also agrees to use its "best efforts" to produce and market in Alaska an amount of refined petroleum products from its refinery near North Pole, Alaska not less in volume than 23% of the total royalty oil sold under the agreement.
6. Security: Petro Star will provide a letter of credit worth sixty (60) days of oil, and Chevron will provide a letter of credit worth ninety (90) days of oil. In the event of default by Petro Star, Chevron agrees to purchase Petro Star's volume on five days notice. In addition, Petro Star will execute an escrow agreement to cover future payments of additional amounts that may be owed upon final resolution of the Amerada Hess litigation. Petro Star has agreed to escrow \$1.12 per barrel to be credited against future Amerada Hess adjustments.
7. Relationship between Petro Star and Chevron: Petro Star will use as refinery charge Chevron's volume of royalty oil sold under the contract. After Petro Star processes the oil there will remain a portion of oil or oil products which will be shipped through TAPS, and sold by Petro Star to Chevron at Valdez. The quantity will approximate Chevron's purchase volume under the royalty oil contract.

IN-STATE BENEFIT ANALYSIS

Petro Star was incorporated during October of 1984 by a group of private Alaska investors. The company was formed to produce refined petroleum products for marketing within the Interior and on the North Slope of Alaska. Since incorporation, Petro Star has received additional financial backing from the Arctic Slope Regional Corporation in exchange for an ownership interest of 30 percent in the company.

At the time of Petro Star's response to the department's Solicitation, Petro Star had exercised an option to purchase a 6,000 bpd topping plant and two 1,000 bpd topping plants. The 6,000 bpd plant is located adjacent to TAPS at North Pole, and commenced refining heating oils on September 5, 1985 using North Slope crude purchased from Sohio. Eventually, aviation gasoline is also to be refined. Petro Star is its own distributor of refined products, and plans to emphasize rural markets.

On October 20, 1985, a fire at the Petro Star refinery idled the plant. The refinery commenced operations again on November 23, 1985. The department does not anticipate any impact on the proposed disposal as a result of that event.

The primary bases for this long-term negotiated sale are: 1) to receive a market price for royalty oil; and 2) to encourage in-state processing of royalty oil and the attendant benefits (primarily jobs, increased tax base, and competition from refined product suppliers that may lead to lower product prices for consumers). An in-state benefit analysis of the Petro Star proposal (and of the other responses to the Solicitation which proposed to process royalty oil in-state) was provided in the Analysis, and is updated here.

The prospective in-state benefits of the disposal to Petro Star arise from reduced refined product prices and the primary and secondary economic effects of the refinery operation. Since the publication of the Analysis, Petro Star

and others have made the department aware of MAPCO's substantial shipments of jet fuels to Anchorage in recent years, and the department acknowledges that a new Fairbanks refinery need not lead to excess capacity in the region. However, the conclusion of the Analysis with respect to price impacts remains valid. For the reasons discussed in the Analysis, the Department anticipates no more than modest favorable impacts on the price of refined products as a result of a sale to Petro Star.

However, Mr. Steve Lewis of Petro Star indicated at the Royalty Board meeting of October 7, 1985 that significant price competition has occurred since the construction of the Petro Star refinery. Petro Star officials say the company is marketing much of its present refinery production (about 1,000 bpd) at prices lower than those charged by MAPCO. Examples cited include heating oil sales to five rural villages and to construction companies operating on the North Slope. According to Mr. Lewis, Petro Star currently serves the total fuel needs of the Anaktuvuk Pass area at favorable prices. Petro Star officials also believe that recent favorable changes in MAPCO's product prices, which are said to be at a three-year low, were influenced by their company's prospective and present operations. While the price discounts mentioned by Petro Star are only on the order of pennies per gallon, a one cent decrease in the price of a gallon of refined product that could be made from 1,000 bpd translates to an annual consumer savings of about \$153,000. However, the extent to which a royalty oil disposal to Petro Star may maintain or extend these price reductions cannot be readily determined.

The second area of prospective in-state benefits resulting from a disposal of royalty oil to Petro Star relates to the spinoff effects of the refinery operation. The direct benefits would stem from payroll, property taxes, state corporate taxes, and profits if held in-state. All Petro Star profits are expected to be held in state. These cash infusions in turn lead to multiplier effects. Actual project-specific multiplier estimates for other projects, such as Beluga coal development or the Dow-Shell petrochemical proposal examined in 1981, vary from 0.6 to 3.0. Actual project-specific multiplier effects can only be ascertained by extensive surveys or actual development.

The Analysis indicates that the in-state benefits presented there are overstated because of the displacement effects of excess capacity. However this statement may not be applicable in light of the earlier mentioned acknowledgement that a new Fairbanks refinery need not lead to excess capacity in the region. The table below provides some in-state benefit measures for the Petro Star refinery. The table reflects clarifications provided by Petro Star since the publication of the Analysis. A 1.5 capital investment multiplier is used for discussion purposes, as it falls within the expected range for this type of project.

CONSTRUCTION BENEFITS

Capital Investment	Capital Investment in Alaska	Capital Investment Multiplier at 1.5	Total Construction Benefits
initially \$6.9 million	\$5.7 million	\$8.5 million	\$14.2 million

ANNUAL POST-CONSTRUCTION BENEFITS

Payroll	Property Taxes	Profits	State Corporate Profits Tax	Known Total	1.5 Multiplier	Total Known Benefit
\$600,000 (11 persons)	\$36,000	Unknown but in-state	undeter- mined	\$636,000	\$954,000	\$1,590,000

The benefits estimated above for the construction of the refinery itself, which cannot be ascribed to a prospective long-term royalty oil contract, are shown for information purposes only. The annual post-construction benefits reflect the effect of the refinery's continued operation. These benefits are not entirely traceable to a long-term royalty oil contract with Petro Star, since continued operation of the refinery does not depend on royalty oil. Nevertheless, this sale to Petro Star would help ensure the continuation of spinoff benefits resulting from operation of the Petro Star refinery. Those benefits would include the 15-member work force of the distribution company

North Pole Fuel, which has been purchased by Petro Star. Further, refinery projects offering more substantial in-state benefits frequently depend on royalty oil for construction as well as operation. All of the spinoff benefits identified above could have been attributable to a long-term disposal had Petro Star been dependent on royalty oil to begin construction and operations. The department's preference for new refinery proposals which are not dependent on royalty oil was made known to Petro Star prior to the construction of the Petro Star refinery. Consequently, the qualifiers to the spinoff benefits shown above are largely a result of that preference. Petro Star is the only proposal for new in-state refining that has proven by actually building and operating a refinery that is not dependent on royalty oil. The department regards this evidence of economic viability more highly than the tentative nature of spinoff benefits arising from speculative projects which are dependent on royalty oil.

COMMENTS RECEIVED

The department received only one written comment in response to the Preliminary Notice and Findings. In a letter dated November 8, 1985, the Tesoro Alaska Petroleum Company (Tesoro) expressed concern to the Commissioner about the effect of this long-term disposal on the future availability of royalty oil to meet the needs of in-state refiners. Tesoro said that in eight years, the state's total volume of royalty oil will be less than its current sales to in-state refiners. Consequently, Tesoro stated that "any additional long term-commitments by the state will mean deeper cutbacks in future crude supply to present Alaska refineries" and that "there is already refining capacity in Alaska which exceeds the state-wide demand for petroleum products." Tesoro also believed that the disposal could set a precedent that would make it difficult for the state to deny similar awards to "anyone who can secure a simple, inexpensive plant, buy a few barrels of crude, and declare himself an in-state refiner." Tesoro concluded that regularly scheduled competitive royalty oil sales would serve the best interests of Alaskans while maximizing state oil revenues. While the department

appreciates and shares Tesoro's concern about the future availability of royalty oil to meet the needs of in-state refiners, and has addressed this topic in the Analysis, the Commissioner has nonetheless concluded that the disposal will best serve the state's interests. That conclusion is based on the need to foster regional competition among in-state refiners and provide additional in-state benefits that result from in-state refining, and to provide equity of access to royalty oil among existing refiners.

DISCUSSION OF SPECIFIC CONTRACT PROVISIONS

Because the contract entails the sale of state royalty oil to two parties it contains several provisions different from other long-term state contracts. Those provisions and other changes are discussed below.

QUANTITY OPTIONS

The quantity of oil to be sold under the long-term contract is expressed as a percentage of daily Kuparuk River Unit royalty oil production. The sales quantity will initially be about 6,000 bpd. Chevron will purchase about 4,000 bpd and Petro Star will purchase about 2,000 bpd.

The royalty oil contract gives Petro Star the option to increase its purchase amount from about 2,000 bpd to 2,500 bpd. The total quantity sold under the contract will be about 6,500 bpd if Petro Star purchases its maximum. Should Petro Star not exercise this option by November 1, 1987, the total quantity could be reduced to either the maximum daily quantity purchased by Petro Star prior to November 1, 1987 or the Petro Star refinery's maximum thruput capacity at that time, provided it does not exceed 6,500 bpd.

Petro Star and Chevron may each accept less than their contractual maximum quantities by giving a nine-month notice to the state. Petro Star and Chevron may also permanently reduce their contractual maximum quantities by giving a similar nine-month notice to the state. If either Petro Star or Chevron give notice that it wishes to accept delivery of less than its maximum quantity without permanently reducing its maximum quantity, a penalty will be assessed against it based on the difference between the maximum quantity and the actual volume it accepts. Also, if either of the purchasers permanently decreases its maximum quantity by 50 percent or more, the department may, subject to certain conditions, terminate the sale of royalty oil to the other purchaser.

Several circumstances, including the standard provisions covering default, could lead to the termination of royalty oil sales to one of the purchasers. The royalty oil agreement, as it relates to the remaining purchaser, may continue under specific conditions. Petro Star could continue its portion of the agreement or increase its take to include all or part of the Chevron volume upon agreement with the Commissioner to meet specified requirements. Continuation of the disposal to Chevron would be in the Commissioner's discretion and would be contingent on Chevron's agreement to process the oil at its Nikiski refinery. The contract provisions for these eventualities are more fully described in a following section entitled "Price Reopener".

PETRO STAR/CHEVRON AGREEMENT

Chevron has agreed to sell the royalty oil it purchases under the contract to Petro Star at TAPS Pump Station #1, and to repurchase the oil at the TAPS terminus in Valdez. This will enable Petro Star to run its refinery at full capacity and retain its purchase volume in the form of refined products. Once processed, the oil not retained by Petro Star (return oil) is expected to equal the approximately 4,000 bpd initially purchased by Chevron. That volume will be reinjected into TAPS at the Petro Star refinery site. Return oil shipped through TAPS becomes intermingled with unprocessed crude oil so that when the return oil emerges at Valdez it is identical to the TAPS common

stream crude oil. Petro Star, as the shipper, will be liable for the payment of the TAPS quality bank differential based on the resulting degradation of the common-stream crude oil.

Chevron and Petro Star have entered into a separate contract between themselves which covers the details of their buy-sell agreement. That contract has been added as an attachment to the state royalty oil contract (Exhibit A).

Return oil, on which the state might otherwise retain an option, would not result from the proposed disposal due to the arrangements contemplated under the contract. Should there be any change in the arrangement between Petro Star and Chevron, all affected parties will negotiate toward agreement upon a market price option for the state on whatever return oil may exist under any new arrangement. The state may terminate the royalty oil agreement if a material change in the terms of the arrangement between Petro Star and Chevron precludes Petro Star from economically using Chevron's volume as refinery charge.

At the Royalty Board meeting of October 30, 1985, the fact that residual oil rather than return oil would result from a termination of Petro Star's portion of the agreement was raised. This would occur since Chevron's Nikiski refinery is not positioned to inject residual oil into TAPS. Consequently, the section of the contract form which addresses the state's market price option over return oil (2.13) has been amended to include residual oil. This alteration includes the insertion of a phrase in section 2.14 which explicitly grants the state a market price option over Chevron's residual oil should Petro Star's portion of the agreement be terminated.

IN-STATE PROCESSING REQUIREMENTS

The contract contains a number of in state processing requirements for Petro Star. Petro Star agrees to process not less than 85 percent of the total

volume of royalty oil sold under the contract. Petro Star also agrees to retain at least 20 percent of that volume in the form of refined products. These percentage requirements are less stringent than those contained in royalty contracts held by other in-state refiners. The lower percentages are necessary to accommodate Petro Star's small refinery and its recent commencement of operations and marketing.

In addition, Petro Star agrees under the contract to use its "best efforts" to produce and market a volume of refined products in Alaska equal to not less than 23 percent of the total volume of royalty oil sold. To monitor that effort, Petro Star will be required to provide the department a quarterly statement showing the quantity of refined products it produced and marketed in Alaska over that period.

These provisions are similar to the in-state processing requirements contained in the long-term royalty oil contracts with Tesoro Alaska Petroleum Company and Chevron.

PRICE

The contract contains a unique price term. Although the contract will sell Kuparuk River Unit royalty oil, the price term will be based on Prudhoe Bay Unit oil as adjusted for the differences between the two fields. This price term is possible since Kuparuk River Unit and Prudhoe Bay Unit oil are intermingled in TAPS, creating a single royalty crude stream available for disposal by the state. The TAPS quality bank adjustment compensates for the difference in quality between Prudhoe Bay and Kuparuk River crude oils. The Kuparuk pipeline tariff compensates for the locational differences between the sources of these crude oils.

The price of the Kuparuk royalty oil to be sold under the contract will be equal to the amount that the state would receive from its Prudhoe Bay lessees for a like volume of Prudhoe Bay royalty oil taken in value at that time, plus

the Kuparuk River Unit field cost allowance which the state is billed when taking Kuparuk royalty oil in kind, plus a per barrel premium of 35¢ from Petro Star and 50¢ from Chevron. To properly compensate the purchasers for the quality and transportation cost differential between Kuparuk royalty oil and the Prudhoe Bay-based price, two deductions will be made to that price. These are the Kuparuk Pipeline tariff and the TAPS quality bank adjustment charge for injecting Kuparuk oil into the TAPS crude oil stream.

In addition, Petro Star and Chevron will be liable to the state for retroactive adjustments to the Prudhoe Bay in value price resulting from resolution of the Amerada Hess litigation. Those retroactive price adjustments will apply to all royalty oil purchased under the agreement. To assure the purchasers a limit to their liability for Amerada Hess retroactive price adjustments, the department has agreed to a ceiling retroactive price adjustment of \$2.50 per barrel of royalty oil purchased. This sum represents a negotiated ceiling, and is not any party's estimate of litigation results.

At the Royalty Board meeting of October 30, 1985, the department announced a possible alteration to the interest rates specified in the Amerada Hess provision of the proposed long-term royalty contract with Petro Star and Chevron. This issue arose from Chevron's desire to renegotiate the provision which specifies the interest rate that would be applied to additional amounts that may be owed by the purchaser upon final resolution of the Amerada Hess litigation. Originally this term specified that the applicable interest rate would be the higher of the prime rate plus 3 percent or the rate of return realized on the State general fund. Under the alteration proposed by Chevron and agreed to by the department, the purchaser would pay the interest rate which will be explicitly or implicitly included in the resolution of the Amerada Hess litigation.

This alteration was found acceptable to the department in light of Chevron's concerns, which arose from the fact that the interest rates expected to emerge from a settlement of the Amerada Hess litigation will likely differ from the interest rate originally specified in the proposed long-term contract. Depending on when a resolution to the Amerada Hess litigation occurs, this

situation could lead to settlement amounts which are substantially different than the settlement amount arising from a resolution of that litigation. This amendment appears in section 2.3 (Price of the Royalty Oil) of the contract.

SECURITY

The department ordinarily requires from royalty oil purchasers an irrevocable letter of credit equal to 90 days' worth of oil. This requirement has been a feature of all royalty oil disposals since the competitive sale of December 11, 1984, with the exception of the Prudhoe Bay royalty oil offered at that sale. The exception occurred because the department devised a "put call" option which enabled the letter of credit requirement for that oil to be reduced to 60 days. The Findings and Determination to Conduct a Competitive Sale of Prudhoe Bay and Kuparuk River Unit Royalty Oil, of October 17, 1984 discusses both the put call option and the eventualities which necessitate the requirement for a letter of credit.

The contract requires the standard 90-day letter of credit from Chevron for the quantity to be purchased by the company. Chevron also has agreed to a "backup" arrangement with the state under the contract. Under that provision, Chevron will accept delivery of any volume of royalty oil upon which Petro Star may default, with only a five day notice required from the state. The purchase price for that volume would be the Petro Star purchase price. The backup sale would continue only until the Commissioner returned the oil to in value.

The additional security provided by the backup arrangement with Chevron has allowed for the letter of credit requirement for Petro Star to be reduced to 60 days. The Petro Star letter of credit will provide financial protection for the state beyond the date the department may become aware of any possible performance failure on the part of Petro Star. The backup arrangement with Chevron, which would be activated in that event, replaces the additional 30 days of coverage ordinarily required by the department.

AMERADA HESS ESCROW ACCOUNT

Upon a review of the responses to the department's Solicitation, the department became concerned with the ability of some respondents to pay the state retroactive price adjustments stemming from resolution of the Amerada Hess litigation. The amounts which may be entailed by those retroactive price adjustments (to be determined at an unknown time) over a long-term royalty oil disposal could be substantial. Consequently, the department suggested escrow arrangements with some respondents, including Petro Star, during the first review of the responses to the Solicitation. During the later negotiations with Petro Star, an escrow amount of \$1.12 per royalty oil barrel purchased was found acceptable by the department. Under the contract, Petro Star will establish an interest-bearing escrow account in that amount for the purpose of making payments to the state for any retroactive price adjustments resulting from a resolution of the Amerada Hess litigation.

PRICE REOPENER

Any time after two years from the date of first delivery of royalty oil to Petro Star and Chevron, the state or either of the purchasers may exercise the price reopener clause contained in the contract by giving a one month written notice. If a new purchase price is agreed to by the state and the affected purchaser within three months of the notice to reopen, the new purchase price will become effective one month after that agreement. Two years after a new purchase price becomes effective, that price will be subject to renegotiation under the price reopener provision of the contract. If a new purchase price is not agreed to by the state and the affected purchaser within three months of the notice to reopen, that purchasers' portion of the agreement may be terminated by either the state or the purchaser upon nine months written notice.

The requirements to continue the remaining purchaser's portion of the agreement differ for Petro Star or Chevron. Were the agreement to be

terminated with respect to Petro Star, the state may, upon nine months written notice, terminate the agreement with Chevron. Should the department elect to continue the sale of royalty oil to Chevron under the proposed contract, the volume sold, which would not exceed approximately 4,000 bpd, must be processed at the Chevron refinery in Nikiski.

If Chevron's portion of the agreement were terminated, the sale of royalty oil to Petro Star could continue under the contract only under the following conditions. The sales volume could remain the same or could be expanded to include all or part of the quantity formerly purchased by Chevron. The price to Petro Star for any expanded quantity of oil will be Chevron's purchase price, including the per barrel premium of 50¢. Petro Star must also agree to expand its security and in-state processing obligations to correspond to the new total daily volume to be purchased. This would include an increased letter of credit, equal to 90 days' worth of the new daily volume to be purchased, and Amerada Hess escrow account payments corresponding to that volume. Further, Petro Star and the department must successfully complete negotiations for an amendment to the contract which provides the state an option to repurchase Petro Star's return oil at a market-based price.

Should the exercise of any of the options described in this section result in an appreciable reduction of the consideration received by the state for the continued sale of royalty oil, the approval of the Alaska State Legislature will be required.

For more information, see Article VII (Default or Termination) of the proposed contract.

LOCAL HIRE

Like the state's other long-term royalty oil contracts with in-state refiners, the contract contains a provision concerning local hire. The preferential hiring clause states in part, "Purchaser agrees to hire and employ Alaska

residents and Alaska companies to the extent they are available, willing and qualified for all work performed in Alaska under or in connection with this Agreement, including but not limited to construction and operation of facilities to refine or otherwise use the Royalty Oil." "Alaska resident" is defined as an individual who has lived in the state for one year at the time of hiring. It is understood under the arrangements initially contemplated, that Chevron will not be performing work in Alaska in connection with this contract. If this provision is determined to be unconstitutional, then, by signing the contract Petro Star agrees to hire and employ Alaskan residents and Alaska companies to the extent such preferential hiring is determined to be constitutional.

The issue of local hire with respect to Petro Star was raised at the Royalty Board meeting of September 26, 1985 by Mr. Kevin Dougherty, who represented the Alaska AFL-CIO and the Alaska State District Council of Laborers. Mr. Dougherty remarked that approximately one half of the employees contracted to construct the Petro Star refinery were from out of state. Mr. Dougherty also noted that the annual employee salary indicated in the Analysis for Petro Star was much lower than the corresponding figures shown for the proposed Arctic Energy refinery.

Mr. Steve Lewis of Petro Star did not agree to the payroll figures implied in the Analysis. Mr. Lewis further stated that the issue of local hire should not be confused with union hire and that all Petro Star employees were Alaska residents. Mr. Lewis also disputed the assertion that only one half of the refinery's construction work force was comprised of Alaska residents.

In a letter to the Royalty Board dated September 27, 1985, Mr. Dougherty stated that his comment with respect to Petro Star's construction work force was based on information provided by the workers on that project. Mr. Dougherty also added that his payroll figures were taken directly from the Analysis. The latter discrepancy was traced to the number of employees shown for Petro Star in the Analysis, which has been corrected in this document.

PRELIMINARY FINDINGS AND DETERMINATIONS

1. Competitive bidding is waived.

I have determined in accordance with AS 38.05.183(a) and 11 AAC 03.030 that the best interest of the state does not require competitive bidding for this disposal. Petro Star is the only existing in-state refiner which does not purchase state royalty oil under negotiated, long-term contract(s). In order to realize the objectives implied by many of the considerations listed in AS 38.05.182-183 and AS 38.06.070 and to obtain the benefits for Alaska consumers that accrue from in-state refining, the department has waived competitive bidding for this disposal, which is partially based on factors other than the cash value offered. The contract for a long-term royalty oil sale to Petro Star and Chevron follows a formal "Solicitation for Proposals", to which eleven firms responded, and a six-month public review and comment process.

2. The sale to Petro Star and Chevron is in the best interest of the State.

Under AS 38.05.183(e), a noncompetitive sale, exchange, or other disposal of royalty oil or gas taken in kind by the state may be awarded by the commissioner to the prospective buyer whose proposal offers maximum benefits to the citizens of the state.

In accordance with AS 38.05.183(a),(c) and (e), and 11 AAC 03.010(b) and (d), I find that taking royalty oil in kind and selling that oil to Petro Star and Chevron for use in-state is in the best interests of the state and that it will maximize benefits to state citizens. Applicable statutory criteria are discussed below.

- (a) The state is now highly dependent on oil revenues and will continue to depend on oil revenues in the future. The price term of the sale protects the state's interest by ensuring that revenues from this sale will exceed the in value alternative. AS 38.05.183(e)(1) and AS 38.06.070(a)(1).
- (b) The projected effects of this sale are brought about by the continued assurance of supply under a long-term existing contract. Petro Star has made an initial investment of more than \$6.9 million in its Alaska operations. The company has created 11 new jobs. The benefits related to local payrolls and to the purchase of local goods, services and supplies is more than \$1.6 million annually. AS 38.05.183(e)(2)-(3).
- (c) The local and regional needs of the Fairbanks area for petroleum products will be satisfied and local competition among refineries will be created. A one cent decrease in the price of each gallon of refined product that could be made from 1,000 bpd translates to an annual consumer saving of about \$153,000. On the conservative assumption that Petro Star would reduce its per gallon product price by one penny, the annual savings to the consumer would exceed \$380,000 at the refinery's expected capacity. AS 38.05.183(e)(4) and AS 38.06.070(a)(2).
- (d) The continued operation of Petro Star, with the attendant payroll and secondary benefits, will have a positive and desired effect on the citizens of the state. While this disposal likely will not result in new capital investment or development, it will enable the efficient use of existing investment and development. AS 38.06.070(a)(3).

- (e) The projected social impacts of a disposal to Petro Star are anticipated to be favorable. The benefits presently received from the operation of the Petro Star Refinery plus the supply of products through Petro Star's distribution system would continue. AS 38.06.070(a)(4).
- (f) Since most of the essential provisions of the proposed disposal to Petro Star relate to operation of its existing facilities and systems, the additional costs and responsibilities which could be imposed upon the state and affected subdivisions are likely to be minimal. AS 38.06.070(a)(5).
- (g) Local and regional consumption of refined petroleum products will be directly and favorably affected by the Petro Star/ Chevron disposal. Local labor markets will continue to benefit through employment opportunities at the Petro Star refinery. AS 38.06.070(a)(6).
- (h) Environmental effects resulting from the disposal will be negligible, if any, since the facility is already in existence. AS 38.06.070(a)(7).
- (i) The sale will help existing commercial private enterprise and patterns of investments by assisting in the continued operation of Petro Star. Further, Petro Star is the sole in-state refinery owned by Alaskans and Alaska companies. AS 38.06.070(a)(8).

In accordance with 11 AAC 03.060(b), the weight given to the applicable criteria in determining the maximum benefit to Alaska citizens must be addressed. In making this finding the Department first assured itself that the state would not lose money by making a disposal to Petro Star/Chevron. Once so assured, other benefits attendant to the disposal were examined. If the price offered did not assure the state at least what it would have received had it left the

oil in value then the sale would not, in the Department's view, serve the state's best interests. Petro Star matched the highest premium offered by any existing in-state refiner, and Chevron offered the highest premium for export purchase. Therefore great weight in this disposal was placed on AS 38.05.183(e)(1), the cash value offered. In addition to the cash value offered, great weight was given to the projected benefits of Petro Star using the oil in the state to directly benefit Alaska citizens.

3. The contract prices are acceptable.

Under 11 AAC 03.091(b) I find that in establishing the price of this royalty oil contract, the department has obtained a price at least equal to the volume weighted average of the current reported netback prices filed by the lessees for royalty purposes for those filing periods applicable to the term of the disposition, plus field costs incurred by the royalty share.

Petro Star will pay a \$.35 premium over the amount the state would receive from its Prudhoe Bay lessees for that amount of Prudhoe Bay royalty oil taken at that time in money (in value), plus Kuparuk field costs, less the Kuparuk Pipeline tariff charge and less the applicable TAPS quality bank adjustment. Chevron will purchase what would otherwise be Petro Star's return oil and will pay the state a \$.50 premium over the amount the state will receive from its Prudhoe Bay lessees for that amount of Prudhoe Bay royalty oil taken at that time in money (in value), plus Kuparuk field costs, less the Kuparuk Pipeline tariff charge and less the applicable TAPS quality bank adjustment. The in value component of the in value price bases for both Petro Star and Chevron will be retroactively adjusted upon resolution of the Amerada Hess litigation.

4. The Royalty Oil to be sold to Chevron is available for export.

In view of the department's most recent annual (1985) Historical and Projected Oil and Gas Consumption report, and the department's Findings and Determination documents for recent short-term royalty oil disposals, including the Supplemental Findings for the Competitive Royalty Oil Sale (November 28, 1984), I find under AS 38.05.183(d) and 11 AAC 03.010(e) that the volume of royalty oil to be sold to Chevron is surplus to the present and projected intrastate domestic and industrial needs for oil and is available for disposal and possible export from the state.

CONCLUSION

Under the terms of the proposed contract, the state would receive a market (litigation-adjusted) price for the royalty oil, while fostering in-state processing and attendant benefits. The satisfactory price terms, coupled with associated direct and secondary benefits for Alaska citizens, supports the decision to waive competitive bidding.

The foregoing facts and analysis support my preliminary finding that this disposal is in the best interests of the state and that it maximizes benefits to Alaska citizens.

Tay Brown

Kay Brown, Director
for Esther C. Wunnicke
Commissioner

December 6, 1985
Date

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DIVISION OF OIL & GAS
ANCHORAGE, ALASKA

AGREEMENT FOR THE SALE AND PURCHASE

OF

STATE ROYALTY OIL

PETRO STAR, INC.

CHEVRON U.S.A.

THE STATE OF ALASKA
Department of Natural Resources

December 9, 1985

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DOG 9-85
(PETRO STAR & CHEVRON/KUPARUK)
(Revised 11-85)
(DNR # 10-4017)

AGREEMENT FOR THE SALE AND
PURCHASE OF ROYALTY OIL

THIS AGREEMENT, entered into as of December 9, 1985
by and between THE STATE OF ALASKA ("Seller") PETRO STAR, INC., an Alaska
corporation, ("Purchaser Petro Star"), and CHEVRON U.S.A. INC., a Pennsylvania
corporation, ("Purchaser Chevron").

ARTICLE I
DEFINITIONS

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

1.1 "Commissioner" means the Commissioner of the Alaska Department
of Natural Resources or her designee.

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

1.3 "Leases" means the oil and gas leases which are subject to the
terms of the Unit Agreement.

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

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

1.6 "Oil" or "crude oil" shall have the same meaning as the word "oil" under the Unit Agreement.

1.7 "Point of Delivery" shall have the meaning set out in Section 2.5.

1.8 "Purchaser" means either Petro Star, Inc., or Chevron U.S.A. Inc., or both, unless one particular Purchaser is designated.

1.9 "Prudhoe Bay Lessees" means the lessees of the oil and gas leases subject to the Prudhoe Bay Unit Agreement effective April 1, 1977, as amended from time to time.

1.10 "Prudhoe Bay Royalty Oil" means Royalty Oil received from the Prudhoe Bay Lessees.

1.11 "Royalty Oil" means the oil which Seller may take in kind (amount) as its royalty under the Leases whether or not Seller has elected to take or is taking that royalty in kind.

1.12 "Daily Royalty Oil" means the quantity of Royalty Oil produced by the Lessees each day.

1.13 "Settlement Agreement" means the Agreement for Settlement of Cleaning, Dehydration and Transportation Charges Applicable to Royalty Oil Taken From the Kuparuk River Unit, effective as of December 13, 1981, and attached to the Unit Agreement as Appendix I.

1.14 "TAPS" means the Trans Alaska Pipeline System.

1.15 "Unit. Agreement" means the Kuparuk River Unit Agreement effective as of December 1, 1981, by and between Seller and the Lessees, as amended from time to time.

ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity. Seller agrees to sell to Purchaser Petro Star, and Purchaser Petro Star agrees to buy from Seller, that amount of oil equal to _____ % of the Daily Royalty Oil ("Maximum Quantity"). Seller agrees to sell to Purchaser Chevron, and Purchaser Chevron agrees to buy from Seller, that amount of oil equal to _____ % of the Daily Royalty Oil ("Maximum Quantity"). Promptly after the effective date of this Agreement, Seller will determine the actual percentages, which will be the percentages that on the date of initial nomination would result in a Maximum Quantity for Purchaser Petro Star that on the Date of First Delivery would approximate 2500 bpd and a Maximum Quantity for Purchaser Chevron that on the Date of First Delivery will approximate 4000 bpd. However, unless Purchaser Petro Star notifies Seller in writing within five (5) days after the effective date of this Agreement, Seller will initially nominate for Purchaser Petro Star the percentage that Seller estimates will on the Date of First Delivery approximate 2000 bpd.

Upon at least nine (9) months' written notice to Seller, Purchaser may increase or decrease the amount of Daily Royalty Oil to be tendered by Seller at the Point of Delivery, provided that the amount tendered by Seller under this Agreement shall not exceed the Maximum Quantity. If by November 1, 1987 Purchaser Petro Star has not begun to take the Maximum Quantity of oil, Seller, at its option and discretion, may permanently decrease the Purchaser Petro Star's Maximum Quantity to either (1) the greatest percentage of Daily Royalty Oil tendered by Seller to it before that time or, (2) the maximum amount of oil that can be processed at Purchaser Petro Star's refinery, located at North Pole, Alaska. Purchaser may permanently decrease its Maximum Quantity under this Agreement upon nine (9) months' written notice to Seller.

It is understood and agreed that the volume of Daily Royalty Oil available to Seller will vary and may be interrupted from time to time, and depends upon a variety of factors, including the rate of production from the Leases. Seller disclaims and Purchaser waives any representation, covenant or warranty, express or implied, as to the specific quantity, or the total or daily, monthly, average, or aggregate volume of Oil to be sold or tendered under this Agreement. Seller shall hold Purchaser harmless from all liens, encumbrances and valid adverse claims that may affect the Oil at the time the Oil is tendered to Purchaser.

If Seller stores Royalty Oil pursuant to the Kuparuk River Unit Emergency Storage Agreement dated December 15, 1981, and attached as Appendix II to the Unit Agreement, (the "Storage Agreement"), or otherwise, or if Seller recovers stored Royalty Oil, the quantity of Oil to be sold and purchased under this Agreement shall be calculated as if no Royalty Oil was stored or recovered.

2.2 Quality. The Oil sold shall be the same quality as the Royalty Oil delivered by the Lessees to Seller at the Point of Delivery. It is understood and agreed that the quality of the Oil sold may vary from time to time. Seller disclaims, and Purchaser waives, any guarantee, representation, or warranty, either express or implied, of the merchantability, fitness for use, or suitability for any particular use or purpose, or otherwise, of any of the Oil delivered under this Agreement or as to any specific, average or overall quality or characteristic of Oil to be sold or tendered under this Agreement.

2.3 Price of the Royalty Oil. The price payable by Purchaser Petro Star for Oil tendered under this Agreement ("Petro Star Purchase Price") shall be equal to the amount that Seller actually would receive from its Prudhoe Bay Lessees for that amount of Prudhoe Bay Royalty Oil taken at that time in money (in value), plus 35¢ per barrel and plus the Kuparuk Field Cost Allowance incurred by the Oil as determined under the Settlement Agreement, less the tariff charge for the Kuparuk Pipeline and less the applicable TAPS quality bank adjustment.