

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILE 8672

1224 SCOMM 45: HOUSE SPEC. COMMITTEE ON OIL AND GAS 1985-86⁸⁹

The price payable by Purchaser Chevron for Oil tendered under this Agreement ("Chevron 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 50¢ 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.

The in value component of each Purchase Price shall be determined by Seller based upon the reports submitted by the Prudhoe Bay Lessees for royalty purposes or, when those reports are unavailable, incomplete or inaccurate, upon information submitted by the Prudhoe Bay Lessees for production tax or other tax purposes as may be adjusted from time to time as provided in this Agreement. Purchaser shall be entitled only to review or request such material or information which is not confidential under state law or regulation.

The method, basis and amount of royalty due Seller when it takes its Prudhoe Bay Royalty Oil in value from its Prudhoe Bay Lessees is presently the subject of litigation in 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"). One of the issues involved is the proper method to be used by the Lessees in calculating the state's royalty when the royalty is payable in money (in value). Until there is a resolution of that dispute through judicial resolution or settlement, the Purchase Price will be based upon the calculation of an amount per barrel equal to the per barrel volume weighted average of the in value prices reported by the Prudhoe Bay Lessees to Seller for royalty purposes or, when the royalty reports are unavailable, incomplete, or inaccurate, upon information submitted by the Prudhoe Bay Lessees for production tax or other tax purposes, plus \$0.35 per barrel for Purchaser Petro Star and \$0.50 for Purchaser Chevron, and plus the Kuparuk Field Cost Allowance as determined under the Settlement Agreement, less the Kuparuk Pipeline tariff and less the applicable TAPS quality bank adjustment. Upon resolution of each of the various issues that are or will be involved in

Amerada Hess, adjustments will be made to previous payments in accordance with each resolution. However, Seller and Purchaser agree that any Amerada Hess adjustments in excess of \$2.50 per barrel will not be made. This sum represents a negotiated ceiling, and is not any party's estimate of litigation results.

If additional amounts are owed by Purchaser to Seller or by Seller to Purchaser under a final judgement or settlement resolving all or part of the issues in Amerada Hess which separately specifies principal and interest, interest will be paid on the principal component of the additional amounts in the manner and at the interest rate or rates specified in the judgement or settlement resolving each issue. If no interest rate is specified in the judgement or settlement or if interest is expressly included within a lump sum amount in the judgement or settlement, an interest component will be presumed to already comprise a portion of the additional amounts, and no separate interest will be paid.

Purchaser Petro Star will not voluntarily intervene or otherwise participate in Amerada Hess unless Seller expressly consents to that participation in writing. A settlement of Amerada Hess will be binding upon Purchaser whether or not Purchaser agrees with or consents to the terms of that settlement.

If any applicable law of the United States of America or any rule or regulation promulgated by a federal agency will, in the judgment of Seller, operate to prohibit or prevent Seller from receiving the full amount due under the above provisions, Purchaser's obligation to pay the amount of the Purchase Price in excess of the amount permitted will be suspended or adjusted to the minimum extent required for Seller to comply with that law, rule or regulation.

2.4 Purchase Price Reopener. Seller and each Purchaser shall have the right to reopen this Agreement with respect to each Purchaser's own volume, as to purchase price only. At any time after Purchaser receives Oil for two (2) years from the Date of First Delivery (as defined in Section 2.10), Seller or Purchaser may exercise the right to reopen by giving to the other party one (1) month prior written notice. Upon issuance and receipt of a notice to reopen, that Purchaser and Seller will promptly commence good faith negotiations in an attempt to establish a new purchase price. In the event that a new purchase price is not agreed to by that Purchaser and Seller within three (3) months after giving the notice to reopen, that Purchaser or Seller may terminate that Purchaser's portion of this Agreement upon nine (9) months written notice to the other. The purchase price for Oil tendered during any period pending termination shall be the price in effect immediately prior to giving the notice of intent to reopen. If a new purchase price is agreed to by that Purchaser and Seller, the new purchase price shall become effective for Oil tendered in the month following the Agreement on the new purchase price. Not less than two (2) years after the conclusion of the purchase price reopener process described above, that Purchaser or Seller may reopen that Purchaser's portion of this Agreement, as to purchase price only, by giving notice of intent to exercise the right to reopen. At that time, the purchase price reopener process described above will again be applicable.

2.5 Point and Time of Delivery. Simultaneously with receipt of its Royalty Oil from its Lessees, Seller shall tender the Oil to Purchaser at the point at which Seller receives the Royalty Oil from its Lessees. That point as presently agreed to by Seller and its Lessees in Section 2.3 of the Settlement Agreement is the Central Production Facility Meter into the Kuparuk Pipeline.

2.6 Passage of Title and Risk of Loss. Title and risk of loss to the Oil sold under this Agreement shall pass from Seller to Purchaser for all purposes when Seller tenders the Oil at the Point of Delivery.

2.7 Purchaser's Responsibility. Purchaser shall be responsible for the Oil after passage of title. Purchaser will indemnify and hold Seller harmless from and against any and all claims, costs, damages (including reasonably foreseeable consequential damages), expenses or causes of action arising from or in connection with any transaction or event which relates to the crude oil after title has passed to Purchaser.

2.8 Transportation Arrangements. Purchaser shall make all necessary arrangements for transporting the Oil sold under this Agreement from the Point of Delivery, including satisfaction of line fill obligations and storage tank bottom requirements of the Kuparuk Pipeline and Trans Alaska Pipeline System, if any. If and as requested by Seller, and at the time or times requested by Seller, Purchaser shall submit specific information concerning the arrangements it has made for transportation of the Oil sold under this Agreement through and away from Kuparuk Pipeline and the Trans Alaska Pipeline System and for the resale or other disposal of the Oil. Such information may include the specific tenders of Oil made to the Kuparuk Pipeline and Trans Alaska Pipeline System and identification of tankers which will transport the Oil. In addition, Purchaser will provide Seller, if and as requested by Seller, with satisfactory evidence or reasonable assurances of the existence and continuing validity of adequate arrangements for the transportation or disposal of the Oil subject to this Agreement. Failure to provide information, evidence or assurances requested will, at Seller's election by notice to Purchaser, be a material default under this Agreement.

2.9 Absolute Obligations. The obligations of Purchaser to accept, pay for, and arrange for the transportation of the Oil tendered or sold under this Agreement are absolute and will not be excused or discharged by the operation of any disability of Purchaser, event of force majeure, impracticability of performance, change in conditions, or any other reason or cause.

2.10 Date of First Delivery. The Date of First Delivery will be on the first day of the first month seven (7) months after the effective date specified in Article VI, unless Seller, in its sole discretion at the request of both Purchasers, sets an earlier date.

2.11 In-State Processing. Purchaser Petro Star agrees that not less than 85% of the Royalty Oil sold under this Agreement, averaged on a quarterly basis, shall be processed through Purchaser Petro Star's refinery near North Pole, Alaska, except as provided below. "Process" means producing refined petroleum products from the crude oil in significant quantities, but which quantities may not be less than 20% of the volume of Royalty Oil run through Purchaser Petro Star's refinery pursuant to this Agreement.

Purchaser Petro Star's obligation to process Royalty Oil in-state may only be suspended or excused under (1) the provisions of Articles VIII and XI, or (2) during refinery maintenance.

Seller may, at its option, waive the in-state processing requirement in whole or in part, if Seller is satisfied that Purchaser Petro Star is using its best efforts to process the Royalty Oil sold under this Agreement at Purchaser Petro Star's refinery and that the waiver would not be contrary to the underlying intent of the other provisions of this Agreement.

2.12 Best Efforts. (1) Purchaser Petro Star 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 Royalty Oil sold under this Agreement. Those refined petroleum products shall be comprised of at least LAGO and Kerosene. After each three (3) months of deliveries under this Agreement, Purchaser Petro Star shall promptly provide to the Seller an affidavit certified by Purchaser Petro Star stating the quantity of refined petroleum products produced and marketed in the State of Alaska from in-state processing of the Daily Royalty Oil sold under this Agreement for that period.

A determination of "best efforts" under this Article shall include consideration of Purchaser Petro Star's capabilities and the surrounding business circumstances. Purchaser Petro Star's obligation to use its best efforts includes reasonable, diligent, and good faith efforts, but shall not require Purchaser Petro Star to produce and market refined petroleum products in Alaska at a loss. "Best efforts" would, however, require Purchaser Petro Star to produce and market products in Alaska even though Purchaser Petro Star could make a greater profit by another disposition of the Royalty Oil or the products refined from that oil.

2.13 Option to Purchase Return Oil. After Purchaser Petro Star processes Royalty Oil, there will remain a portion of Oil or Oil products which may be shipped through TAPS ("Return Oil"). Return Oil shipped through TAPS becomes intermingled with unprocessed crude oil so that when the Return Oil is picked up in Valdez it is identical to the common stream crude oil shipped through TAPS. A shipper of Return Oil presently is, and may continue to be, liable for the payment of a quality bank adjustment differential based upon the resulting degradation of TAPS common-stream crude ("quality bank adjustment").

The total daily volume of Royalty Oil sold under this Agreement approximates Purchaser Petro Star's daily refinery throughput. Purchaser Petro Star's daily Maximum Quantity approximates its maximum retained product and Purchaser Chevron's daily Maximum Quantity approximates what would otherwise be Purchaser Petro Star's return oil. Thus, under the arrangements contemplated under this Agreement, no return oil would exist upon which the state could retain an option. Should the arrangements contemplated under this Agreement cease to exist, Purchaser and Seller agree to negotiate in good faith towards agreement upon a market price option for Seller on whatever return oil or residual oil may exist under the new arrangements.

2.14 Arrangements between Purchasers. Purchaser Chevron and Purchaser Petro Star have entered into an arrangement under which Purchaser Petro Star will use as refinery charge Purchaser Chevron's volume of Royalty Oil under this Agreement. The arrangement includes the purchase of Royalty Oil taken by Purchaser Chevron under this Agreement by Purchaser Petro Star at TAPS Pump Station No. 1, and resale of the Royalty Oil to Purchaser Chevron at Valdez. A copy of the document which specifies the terms of the arrangement is attached as Exhibit A. Should the terms of the arrangement change materially so that Purchaser Petro Star is precluded from economically using Purchaser Chevron's volume as refinery charge, Seller shall have the right at the Commissioner's discretion to terminate this Agreement on nine (9) months notice.

Should Purchaser materially reduce its Maximum Quantity under Section 2.1 or terminate its portion of this Agreement under Section 2.4, or should termination occur due to an Event of Default under Article VII, either Seller or the other Purchaser may terminate the remaining portion of this Agreement by giving nine (9) months written notice, except as provided below. In this section a material reduction means a reduction of 50% or more from the original Maximum Quantity.

Upon termination of Purchaser Petro Star's portion of this Agreement for any reason or material reduction of Purchaser Petro Star's Maximum Quantity under Section 2.1, Seller shall exercise its right to terminate Purchaser Chevron's portion of this Agreement. However, if Purchaser Chevron agrees to process in its refinery at Nikiski, Alaska the Royalty Oil to be sold under this Agreement after that time, and if Purchaser Chevron successfully completes negotiations with the commissioner for an amendment to this Agreement which grants Seller a market price option on Purchaser Chevron's residual oil resulting from the processing of that oil, the Commissioner shall have the discretion to not terminate Purchaser Chevron's portion of this Agreement.

Upon termination of Purchaser Chevron's portion of this Agreement for any reason or material reduction of Purchaser Chevron's Maximum Quantity under Section 2.1, Purchaser Petro Star shall have the option to continue purchasing up to its Maximum Quantity, or to increase its Maximum Quantity to include all or part of the volume formerly purchased by Purchaser Chevron under this Agreement. Purchaser Petro Star shall exercise this option in writing within one month of the termination of Purchaser Chevron's portion of this Agreement. Purchaser Petro Star's option shall be conditioned on Purchaser Petro Star (1) agreeing for any increased quantity to pay the Purchase Price that Purchaser Chevron would pay under this Agreement, (2) agreeing to increase its Section 15.2 letter of credit to ninety (90) days for all volumes it would purchase under this Agreement, (3) agreeing to pay its Section 15.3 Amerada Hess escrow amount for all volumes it would purchase under this Agreement, (4) agreeing to increase its Section 2.11 and Section 2.12 in-state processing and best efforts obligations to include all volumes it would purchase under this Agreement, and (5) successfully completing negotiations with the Commissioner for an amendment to this Agreement which grants Seller a market price option on Purchaser Petro Star's return oil from all volumes it would purchase under this Agreement. The Commissioner shall have the discretion to accept other or additional security arrangements as part of Purchaser Petro Star's option as she, in her sole discretion, considers adequate to protect Seller. In accordance with Article XIX of this Agreement, the exercise of any option described in this section that would appreciably reduce the consideration received by Seller requires prior approval of the Alaska Legislature.

2.15. Performance Guaranty and Reservation Fee. If Purchaser does not take the Maximum Quantity on the Date of First Delivery, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to 1.25% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the actual quantity tendered to and accepted by Purchaser ("Actual Quantity") for each day Purchaser does not take the Maximum Quantity on and after the Date of First Delivery. The payment of this fee shall end on the day that Purchaser accepts delivery of the Maximum Quantity. When

Purchaser accepts the Maximum Quantity, all of the amounts paid under this Section 2.15 will be allowed to be credited against future payments for oil tendered under this Agreement except for an amount to be retained by Seller equal to .75% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the Actual Quantity for each day Purchaser did not take the Maximum Quantity on and after the Date of First Delivery. If Purchaser should thereafter decrease the amount of Royalty Oil to be tendered under this Agreement, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to .75% of the Purchase Price per barrel per day after the date that the decrease in the amount of Royalty Oil to be tendered by Seller takes effect on the difference between the Maximum Quantity and the Actual Quantity.

ARTICLE III
REPRESENTATIONS AND OBLIGATIONS OF PURCHASER

Purchaser warrants, represents, and agrees:

3.1 Good Standing and Due Authorization. Purchaser is, and at all times during the operation of this Agreement shall remain, (a) a natural person who has reached the age of majority and who is a citizen of the United States; or (b) a corporation organized and existing under and by virtue of the laws of the United States or of any state, territory or the District of Columbia and qualified to do business in Alaska; or (c) any association of the foregoing. If a corporation, Purchaser has all necessary corporate power to enter into this Agreement and to perform its covenants and obligations under this Agreement, and all necessary corporate action has been taken to authorize Purchaser's entering into this Agreement and performing its covenants and obligations under this Agreement.

3.2 Financial Condition. The financial information submitted to Seller is complete and correct and fairly presents Purchaser's financial condition at the time the information was submitted to Seller. The financial information was prepared in accordance with generally accepted accounting principles consistently applied. Since the date the information was submitted, the condition, business and properties of Purchaser have not been materially adversely affected in any way. Purchaser agrees to inform Seller immediately if during the term of this Agreement there is any material adverse change in the condition, business, or properties of Purchaser which would have an appreciable adverse effect on Purchaser's ability to perform under this Agreement. Purchaser, in addition, will immediately inform Seller of any significant change in ownership of either Purchaser or any of its affiliates or parent company, and of any change in Purchaser's operations or agreements, which would appreciably affect Purchaser's performance under this Agreement.

3.3 Financial Statements. As soon as possible after the end of each fiscal year of Purchaser, and in any event within one hundred twenty (120) days thereafter, Purchaser will furnish to Seller, at Purchaser's sole cost and expense, a report or a complete copy of a report in a form to be prescribed from time to time by Seller which will include Purchaser's balance sheet as of the close of the fiscal year and the income statement for that year prepared in each case in accordance with generally accepted accounting principles consistently applied by certified public accountants of recognized standing. For purposes of complying with this section, Purchaser Chevron may submit, and Seller will accept, the annual report and supplement of Chevron Corporation.

ARTICLE IV MEASUREMENTS AND TESTS

The quantity and quality of the oil sold under this Agreement shall be determined at the Point of Delivery. Procedures and methods for measuring and metering the oil sold under this Agreement shall be in accordance with the practices then in effect at the Point of Delivery specified under Section 2.5.

ARTICLE V
PAYMENTS AND ACCOUNTING

5.1 Billing. Seller will send to Purchaser, on or before the 10th (tenth) business day of each Month after the month of delivery of Oil, an invoice statement of account of all Oil estimated to have been measured at the Central Production Facility Meter into the Kuparuk Pipeline and tendered to Purchaser under this Agreement during the immediately preceding Month according to the best information available to Seller, the estimated Purchase Price(s) applicable to those deliveries, and the total amount due ("initial billing"). The estimates will be made by Seller according to the best information reasonably available to Seller. Seller shall thereafter adjust its initial billing under this section as soon as more accurate information concerning the quantity and Purchase Price(s) of Oil delivered each Month is available. Seller, however, shall not be required to adjust the initial billing prior to the sending of the next Month's invoice statement of account.

5.2 Initial Adjustment. After the first monthly invoice under Section 5.1, each subsequent monthly invoice will also state Seller's initial adjustments to be made, if any, to the invoice rendered in the immediately preceding Month, in accordance with any additional or more accurate information which may have become available to Seller. Whether or not initial adjustments are made, however, subsequent adjustments may be made under Section 5.5.

5.3 Payment. Purchaser will make payment of each amount billed under this section within ten (10) Days after receipt of the invoice statement of account. Payment shall be made without any deduction, set off, or withholding by wire transfer of immediately available funds to Seller's account at the following address:

First Pennsylvania Bank Philadelphia
ABA No. 031000024
For Credit to State of Alaska
Account No. 07/089250/00
Attn: Catherine Hess

Payment may be made in such other manner or to such other address as Seller may specify in the invoice statement of account or by other written notice. All other payments to be made under this Agreement shall be paid in the same manner. If payment is due on a Saturday, Sunday, or legal holiday of the place where payment is to be received, payment shall be made on the next following business day. It is recognized that Seller may bill, and that Purchaser will pay, amounts that are based upon confidential information held or received by Seller. If confidential information is used as the basis for a billing, then upon request Seller will furnish Purchaser with the certified statement of the Commissioner that the amounts billed are correct based upon the best information available to Seller. Buyer will only be permitted to review material or information that is not confidential. If a dispute concerning a bill arises, Purchaser agrees to pay the full amount billed by Seller, except for obvious clerical mistakes, pending final resolution of the dispute.

5.4 Payment to Lessee(s). Purchaser, at the request of Seller in the invoice statement of account or otherwise in writing, shall pay all or any portion designated by Seller of the amount due to Seller to one or more of the Lessees at an address or addresses and in the manner designated by Seller. The payment will be made within the time limit specified in Section 5.3. Seller may authorize and designate a third party to make the request and designate the amount, manner and place of payment under this provision. Unless otherwise specified, the balance of the payment due, if any, and payments for subsequent months, shall be made in accordance with Section 5.3.

5.5 Subsequent Adjustments. Purchaser acknowledges that more accurate information concerning the quantity of or Purchase Price for Oil tendered may subsequently become available to Seller. In the event that any such information should subsequently become available to Seller, Seller shall promptly furnish a corrected invoice statement of account to Purchaser and the parties will adjust the amount billed and pay or refund the amount of those adjustments.

In the event that Seller should render a corrected invoice to Purchaser, any amount to be refunded from Seller to Purchaser or paid from Purchaser to Seller will be paid within fifteen (15) Days after the date of the corrected invoice, unless the adjustment concerns an amount last invoiced more than sixty (60) Days before the corrected invoice. In that case, the amount will be paid by Purchaser or refunded by Seller, as the case may be, in equal monthly installments over the same period of time as that over which the adjustment accrued or six (6) Months, whichever is the shorter period. No adjustment will be made more than twelve (12) Months after the date of the last original invoice to which the adjustment relates, except for adjustments resulting from regulatory or court proceedings (including appeals) commenced or pending during that twelve (12) month period, whether or not Seller or Purchaser is a party to the proceeding. Adjustments due to regulatory or court proceedings may be made at any time and shall bear interest at the rate stated in Section 5.6 from the date of payment of the invoice upon which an adjustment is subsequently made pursuant to this section. The provisions of this Section 5.5 will survive any termination of this Agreement.

5.6 Interest. Except for adjustments made upon resolution of Amerada Hess under Section 2.3, all sums which are not paid when due under this Agreement or which are subsequently determined to be due under an adjustment under Section 5.5, shall bear interest from the date accrued until paid in full at a variable rate per annum equal to the prime rate as announced from time to time by the Bank of America, San Francisco, California, plus one and one-quarter percent (1.25%) per annum.

5.7 Late Payment Penalty. Except for unintentional failures to pay, including clerical mistakes or occurrences not within the reasonable control of Purchaser, or insignificant underpayments, if Purchaser fails to make payment within one (1) Day of the date that payment is due, then in addition to the amount due plus interest from the date that payment was due until the date of payment, Purchaser will pay an amount equal to one percent (1%) of the amount owed.

5.8 Payment to Third Parties. Seller may direct that Purchaser pay any amount due to Seller or which may become due directly to a third party in the manner and time as may be directed by Seller in written notice to Purchaser if, in Seller's sole discretion, the payment to the third party will assist Seller in monitoring or enforcing this Agreement.

ARTICLE VI

TERM

This Agreement shall become effective upon execution by the parties and enactment of legislation by the State of Alaska (including approval by the Governor) approving this Agreement. This Agreement shall be null and void if it is not so approved by September 30, 1986. Subject to the other provisions contained in this Agreement, Seller's obligation to sell and Purchaser's obligation to buy Royalty Oil shall begin as specified in Section 2.10, and shall end September 30, 1996. As used in this section, "enactment of legislation" is as defined in AS 01.10.070(f)(4).

ARTICLE VII

DEFAULT OR TERMINATION

7.1 Default. If any one or more of the following events ("Events of Default") occur, then at Seller's option, Seller may terminate or suspend its obligation to tender and sell Oil and proceed to exercise any one or more of the rights and remedies provided in this Agreement:

- (i) Except for obvious clerical errors, Purchaser does not pay in full any sum invoiced under this Agreement at the time when payment is due; or
- (ii) Purchaser fails to observe or perform any of its other covenants and obligations under Article VI or

- (iii) Purchaser does not perform any act required or contemplated under this Agreement and either: (a) the nonperformance continues for more than thirty (30) days after Seller has notified Purchaser of Purchaser's nonperformance; or (b) Purchaser had failed to perform the same or any other act required or contemplated under this Agreement during the immediately preceding twelve (12) month period; or
- (iv) There is a material adverse change in Purchaser's condition, business or property which appreciably affects the ability of Purchaser to perform any of its obligations under this Agreement, and Purchaser is unable to give Seller adequate assurance of continued performance either within fourteen (14) days of a request for such an assurance or within such other shorter time period as Seller may reasonably request under the circumstances; or
- (v) Any representation or warranty made by Purchaser in this Agreement proves to have been false or incorrect in any material respect at the time that the representation or warranty was made.

7.2 Failure to Pay Debts. If at any time Purchaser becomes unable to pay any of its debts when those debts are due, or should otherwise become insolvent (without regard to how that insolvency may be evidenced), Purchaser will immediately give notice of that fact to Seller. Whether or not that notice is given, if Purchaser becomes unable to pay any of its debts when those debts are due or should otherwise become insolvent, Seller's obligation to tender and sell Oil under this Agreement will automatically and immediately terminate without any requirement of notice or other action by Seller; however, Purchaser will nevertheless be and remain liable for payment and performance of all of its obligations and covenants under this Agreement with respect to Oil actually tendered by Seller to and after any such termination. Within thirty (30) days after receipt of Purchaser's notice or, if no notice

is given, after Seller otherwise becomes aware (as determined in Seller's sole discretion) of Purchaser's insolvency, Seller will have the right, upon written notice to Purchaser, to reinstate all of Seller's and Purchaser's obligations under this Agreement retroactively to the date of termination.

7.3 Seller's Remedies. Upon the occurrence of any Event of Default or if Seller's obligation to tender and sell Oil under this Agreement is terminated or suspended under Sections 7.1 and 7.2, all obligations of Purchaser accrued but not otherwise due and payable under this Agreement will immediately be due and payable in full. In addition, Purchaser will indemnify and hold Seller harmless from and against all other liability, damages (including reasonably foreseeable consequential damages), costs, losses and expenses (including reasonable attorneys' fees and disbursements) incurred by Seller and arising out of the Event of Default, termination, or suspension. Seller shall have the right cumulatively to exercise any and all other rights and remedies and to obtain all other relief available under applicable law or at equity, including mandatory injunction and specific performance. Seller, upon occurrence of any Event of Default, in its sole discretion, may arrange for any disposition to third parties of Oil to be tendered and sold under this Agreement. Upon the occurrence of any Event of Default, Purchaser is released from the obligations set forth in Sections 2.11 (In-State Processing) and 2.12 (Best Efforts) until the Event of Default no longer exists or the obligation of Purchaser to take Royalty Oil under this Agreement expires. If upon occurrence of any Event of Default Seller makes arrangement for disposition to third parties of Oil whether or not this Agreement is terminated, Purchaser will nevertheless be and remain liable to Seller for the full amount of the Purchase Price for that Oil in excess over any amount or amounts received by Seller on account of that disposition, net of the expenses of that disposition and for all other costs, losses and expenses (including reasonable attorneys fees and disbursements) incurred by Seller and arising out of the Event of Default or disposition.

7.4 Purchaser's Exclusive Remedies. Upon any breach of, or default in, the due and timely observance or performance of any of Seller's covenants or obligations under this Agreement, Purchaser acknowledges and agrees that Purchaser's remedies will not include a temporary restraining order or preliminary injunction preventing Seller from taking any action with regard to the Oil which is the subject of this Agreement.

ARTICLE VIII DISPOSITION OF OIL

8.1 Inability to Receive Oil. Purchaser acknowledges and agrees that under the Unit Agreement and Leases, Seller's election to take Royalty Oil in kind can be revoked or reversed only upon the satisfaction of various conditions, including the giving of thirty (30) days advance written notice to return up to 2500 barrels of Seller's then current nominations. Purchaser acknowledges and agrees that Seller's election to invoke its rights to return to taking its Royalty Oil in value on less than six (6) months' prior notice, or to attempt to secure a waiver of any condition or requirement, is at Seller's sole and complete discretion. If for any reason Purchaser is unable or refuses to accept or receive any Oil tendered under this Agreement, Purchaser shall nevertheless be and remain responsible for the disposal of that Oil and for paying Seller for the Oil as though it had been received and accepted by Purchaser unless Seller, in its sole discretion elects to waive this requirement. In order to secure the obligations of Purchaser under this Section 8.1 and under Section 2.8, Purchaser shall, if and as Seller may request from time to time, assign to Seller all right, title and interest of Purchaser under any nominations, leases, agreements, contracts, charter parties and other arrangements for the transportation of the Oil sold under this Agreement through and away from the Kuparuk Pipeline and the Trans Alaska Pipeline System; provided, that Seller shall not have any liability or obligations under any such nominations, leases, agreements, contracts, charter parties or other arrangements unless, and to the extent that, Seller shall actually exercise its rights to succeed to Purchaser's interest thereunder and shall obtain the benefits thereof.

8.2 No Right to Storage or Underlift. Purchaser waives and disclaims any interest or right that it may assert to storage of Royalty Oil, including by underlift or other means; to which Seller is or may come to be entitled under the Leases, Storage Agreement, or any other agreement. However, Purchaser shall use due diligence and make its best efforts to act in a manner that enables Seller to adhere to the notice requirements and other obligations provided in the Storage Agreement. Purchaser agrees that when it executes this Agreement, it will also immediately execute the release attached as Exhibit B to this Agreement.

ARTICLE IX

WAIVER

The failure of either party to insist upon strict performance of any provision of this Agreement shall not constitute a waiver of, or estoppel against, asserting the right to require that performance in the future. A waiver or estoppel in any one instance shall not constitute a waiver or estoppel with respect to a later breach of a similar nature or otherwise. A course of performance established by a party shall also not stop the other party from complaining of a later breach similar in nature.

ARTICLE X

SEVERABILITY

If any provision or clause of this Agreement or application of this Agreement to any person or circumstance is held invalid, that invalidity shall not affect other provisions or applications of this Agreement which can be given effect without the invalid provision or application. If, however, an invalidity should operate to impair any material right or remedy of a party to this Agreement, that party may terminate this Agreement by notice to the other.

ARTICLE XI
FORCE MAJEURE AND CHANGE IN CONDITION

11.1 Effect of Force Majeure. Except for Purchaser's obligations to make payment of money for Oil tendered under this Agreement and except for Purchaser's obligations to accept and dispose of Royalty Oil, neither party shall be liable for any failure to perform the terms of this Agreement when the failure is due in whole or in substantial part to force majeure. The term "force majeure" as applied to this Agreement shall mean Acts of God, strikes, lockouts and industrial disputes or disturbances, civil disturbances, arrests and restraints from rulers or people, interruptions by government or court orders or by present or future orders of any regulatory body having or asserting jurisdiction, acts of the public enemy, wars, riots, blockades, insurrections, inability to secure materials by reasons of allocations promulgated by authorized governmental agencies, epidemics, landslides, lightning, earthquakes, fires, storms, floods, washouts, explosions, breakage or accident to machinery or lines of pipe, freezing of wells or pipelines, or any other event or condition, whether of the kind herein enumerated or otherwise, not within the reasonable control of the party claiming the benefit of this excuse. If however, any material obligation of Purchaser is excused or suspended because of a claim of force majeure for a period of three hundred sixty five (365) successive days or more, Seller will have the right to terminate this Agreement. Prior to Seller exercising its right to terminate this Agreement Seller and Purchaser shall enter into good faith negotiations to restore, to the fullest extent possible, Seller and Purchaser to the benefits and obligations that existed under this Agreement before the occurrence of the force majeure condition.

11.2 Responsibility. Upon the occurrence and discovery of an event providing the basis for a claim of force majeure, the party making a claim shall notify the other party to this Agreement of its claim of force majeure. Upon the occurrence of an event constituting force majeure that event shall, so far as possible, be remedied with all reasonable diligence and dispatch. Except for Purchaser's obligations to make payment of money for Oil tendered

under this Agreement and except for Purchaser's obligation to dispose of Oil, the obligations of the disabled party to perform under this Agreement, insofar as they are affected by that force majeure, shall be suspended from the time that force majeure occurs and for so long as the disability caused should have continued had the party claiming the existence of the force majeure remedied the event providing the basis of the claim of force majeure with reasonable diligence and dispatch, and for no longer. The settlement of strikes or lockouts or industrial disputes or disturbances will be entirely within the discretion of the party having the difficulty, and the above requirement that any force majeure shall be remedied with diligence and dispatch shall not require the settlement of strikes, lockouts, or industrial disturbances by acceding to the demands of any opposing party therein when such course is inadvisable in the sole discretion of the disabled party.

ARTICLE XII

NOTICES

12.1 Method. All notices, requests, demands or statements shall be in writing, and may be delivered personally to the party to be notified or may be sent to the party by registered or certified United States mail, postage prepaid, with a return receipt requested of the party. Notice deposited in the mail in this manner shall be effective upon the expiration of seven (7) days after it is so deposited. Notice given in any other manner shall be effective only if and when received by the addressee. For the purposes of notice, the addresses of the parties to this Agreement shall be as follows:

If to Seller:

State of Alaska
Commissioner of Natural Resources
Pouch "M"
Juneau, Alaska 99811

and

Commissioner of Revenue
Pouch "S"
Juneau, Alaska 99811

and

Director, Division of Oil and Gas
Pouch 7-034
Anchorage, Alaska 99510

Telephone:

Telex:

If to Purchaser Petro Star:

Telephone:

Telex:

If to Purchaser Chevron:

Telephone:

Telex:

12.2 Change of Address. Each party may change its address for notice by giving notice of the change.

ARTICLE XIII
RULES AND REGULATIONS

This Agreement is subject to all present and future valid laws, orders, rules and regulations of the United States, the State of Alaska, and any duly constituted agency thereof.

ARTICLE XIV
SOVEREIGN POWER OF THE STATE

This Agreement and its covenants shall not be interpreted as a limit on the exercise by the State of Alaska of any of its sovereign or regulatory powers, whether conferred on the State by constitution, statute or regulation, including but not limited to, its regulatory power over the Leases. The exercise by the State of Alaska of any sovereign or regulatory power will not operate or be deemed to enlarge any rights of Purchaser or to limit or impair any obligations or liability of Purchaser under this Agreement, except for state statutes enacted after the effective date of this Agreement which have a direct and significant adverse effect on the ability of Purchaser to perform an obligation under this Agreement other than the obligations to accept, dispose of, and pay for Oil tendered under this Agreement.

ARTICLE XV
SECURITY

15.1 Purchaser Chevron Letter of Credit. Sixty (60) days prior to Date of First Delivery, Purchaser Chevron shall cause to be issued and delivered to Seller an irrevocable stand-by letter of credit, with an effective date no later than the Date of First Delivery, issued for the benefit of Seller by a state or national banking institution of the United States ("Issuer"), which is insured by the Federal Deposit Insurance Corporation and has an aggregate capital and surplus of not less than One Hundred Million Dollars (\$100,000,000), or other banking institution acceptable to Seller in its sole discretion. The principal face amount of such letter of credit shall be a sum estimated by the Commissioner to be equal to the aggregate Purchase Price for the approximate total amount of Oil to be tendered by Seller to Purchaser Chevron during the first ninety (90) days following the Date of First Delivery, calculated at the Purchase Price. The letter of credit shall be substantially in a form satisfactory to the Commissioner, but in any event shall not require any documents to be submitted

in support of drafts drawn against this letter of credit other than the certified statement of the Commissioner or her designee and the Attorney General of the State of Alaska or his designee that Purchaser Chevron is liable to Seller for a sum equal to the amount of such draft, and that that sum is due and payable in full and has not been timely paid.

In the event that Seller should have reasonable grounds for asserting any claims against Purchaser Chevron under this Agreement and does assert those claims in an aggregate amount in excess of the aggregate principal face amount of the letter of credit then in effect, Purchaser Chevron shall upon Seller's request (whether or not Purchaser Chevron may deny, reject or otherwise resist such claims) cause the principal face amount of the letter of credit to be increased by an amount equal to the excess. The principal face amount of the letter of credit shall also be automatically increased by Purchaser Chevron without request from Seller whenever the face amount is less than the expected Purchase Price of ninety (90) days of Oil tenders to Purchaser Chevron under this Agreement, to an amount equal to the expected Purchase Price of ninety (90) days of Oil tenders to Purchaser Chevron. The principal face amount of the letter of credit may be decreased by Purchaser Chevron upon approval of Seller if the face amount is more than the expected Purchase Price of ninety (90) days of Oil tenders to Purchaser Chevron under this Agreement, to an amount equal to the expected Purchase Price of ninety (90) days of Oil tenders to Purchaser Chevron.

The letter of credit must allow drafts to be drawn and presented to the Issuer up to and including the 90th day after the last delivery of Royalty Oil to Purchaser Chevron under this contract. The Commissioner may accept such other or additional security as she, in her sole discretion, considers adequate to protect Seller.

15.2 Purchaser Petro Star Letter of Credit. Sixty (60) days prior to the Date of First Delivery, Purchaser Petro Star shall cause to be issued and delivered to Seller an irrevocable stand-by letter of credit, with an effective date no later than the Date of First Delivery, issued for the benefit of Seller by a state or national banking institution of the United States ("Issuer"), which is insured by the Federal Deposit Insurance Corporation and has an aggregate capital and surplus of not less than One Hundred Million Dollars (\$100,000,000), or other banking institution acceptable to Seller in its sole discretion. The principal face amount of such letter of credit shall be a sum estimated by the Commissioner to be equal to the aggregate Purchase Price for the approximate total amount of Oil to be tendered by Seller to Purchaser Petro Star during the first sixty (60) days following the Date of First Delivery, calculated at the Purchase Price. The letter of credit shall be substantially in a form satisfactory to the Commissioner, but in any event shall not require any documents to be submitted in support of drafts drawn against this letter of credit other than the certified statement of the Commissioner or her designee and the Attorney General of the State of Alaska or his designee that Purchaser Petro Star is liable to Seller for a sum equal to the amount of such draft, and that that sum is due and payable in full and has not been timely paid.

In the event that Seller should have reasonable grounds for asserting any claims against Purchaser Petro Star under this Agreement and does assert those claims in an aggregate amount in excess of the aggregate principal face amount of the letter of credit then in effect, Purchaser Petro Star shall upon Seller's request (whether or not Purchaser Petro Star may deny, reject or otherwise resist such claims) cause the principal face amount of the letter of credit to be increased by an amount equal to the excess. The principal face amount of the letter of credit shall also be automatically increased by Purchaser Petro Star without request from Seller whenever the face amount is less than the expected Purchase Price of sixty (60) days of Oil tenders to Purchaser Petro Star under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Oil tenders to Purchaser Petro Star. The principal face amount of the letter of credit may be decreased by Purchaser

Petro Star upon approval of Seller if the face amount is more than the expected Purchase Price of sixty (60) days of Oil tenders to Purchaser Petro Star under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Oil tenders to Purchaser Petro Star.

The letter of credit must allow drafts to be drawn and presented to the Issuer up to and including the 60th day after the last delivery of Royalty Oil to Purchaser Petro Star under this contract. The Commissioner may accept such other or additional security as she, in her sole discretion, considers adequate to protect Seller;

15.3 Purchaser Petro Star Amerada Hess Escrow. Sixty (60) days prior to the Date of First Delivery, Purchaser Petro Star shall cause to be executed and delivered to Seller an executed escrow agreement with a state or national banking institution of the United States ("Escrow Bank"), which is insured by the Federal Deposit Insurance Corporation, and which has a aggregate capital and surplus of not less than One Hundred Million Dollars (\$100,000,000), or other banking institution acceptable to the Seller in its sole discretion. The escrow agreement shall be in a form satisfactory to the Commissioner. The escrow agreement shall provide for payment of escrowed amounts only after final resolution of the Amerada Hess litigation, including any appeals, and upon tender of a certified statement, signed by the Commissioner of Natural Resources and the Attorney General of the State of Alaska. The certified statement shall specify the disposition of the principal and accrued interest of the escrow as calculated under the provisions of Articles II and V of this Agreement, with the full adjusted Purchase Price and interest payable to Seller, and any escrow balance payable to Purchaser Petro Star. Before requesting escrow payment, Seller will give Purchaser Petro Star at least twenty (20) days written notice of its calculations for the escrow disposition.

Purchaser Petro Star agrees to make monthly deposits into the escrow of the sum equal to \$1.12 per barrel of Royalty Oil purchased by Purchaser Petro Star from Seller under this Agreement during the previous month. This sum represents a negotiated escrow amount, and is not any party's estimate of litigation results. The amount of this escrow shall be an element of the "Purchase Price" under this Agreement, and shall be subject to periodic renegotiation as specified in the purchase price reopener provision of Section 2.4.

Purchaser Petro Star shall make payments to the escrow at the same time as it pays Seller under Article V of this Agreement, including increased payments necessitated by quantity adjustments under that Article. Purchaser Petro Star shall bear all expenses of the escrow, and shall arrange for the Escrow Bank to send to Seller monthly statements showing the escrow balance.

15.4 Chevron Backup. Purchaser Chevron agrees that, after receiving at least five (5) days notice from Seller, it will accept delivery of any volumes of Royalty Oil upon which Purchaser Petro Star has defaulted under this Agreement. The notice referenced above shall be given by telephone and by telex to the telephone number and address provided in Section 12.1. Purchaser Chevron agrees to take those volumes subject to all the terms of this Agreement, except that the price for those volumes shall be the Petro Star Purchase Price. Purchaser Chevron will promptly increase its letter of credit to include the increased volume. The Commissioner will return the defaulted volumes to in value as soon as possible, and will promptly notify Purchaser Chevron of the date on which deliveries to it under this section will cease.

ARTICLE XVI
PREFERENTIAL HIRING

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. As used in this Agreement "Alaska resident" means an individual who has resided in the State for one year at the time of hiring or employment and "Alaska companies" means those companies who are incorporated in the State of Alaska or whose principal place of business is in Alaska. Seller acknowledges that under the arrangements initially contemplated under this Agreement, Purchaser Chevron will not be performing work in Alaska under or in connection with this Agreement.

If this provision is determined to be unconstitutional by a court of competent jurisdiction, then Purchaser agrees to hire and employ Alaska residents and Alaska companies to the extent such preferential hiring is determined to be constitutional.

ARTICLE XVII
APPLICABLE LAW

17.1 Alaska Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Alaska, excluding any conflict-of-law rule or principle which might refer such construction to the laws of another state or country.

17.2 Submission to Jurisdiction. Any legal action or proceeding arising out of or relating to this Agreement or for the enforcement of the covenants or obligation of either party must be instituted in a State court of general jurisdiction sitting in the State of Alaska, and Purchaser hereby irrevocably submits to the jurisdiction of that court in any such action or proceeding.

ARTICLE XVIII
NO WARRANTIES

The purchase and sale of Royalty Oil under this Agreement is subject only to the warranties of Seller expressly set forth in this Agreement and Seller disclaims and Purchaser waives all other warranties, express or implied in law, whatsoever.

ARTICLE XIX
AMENDMENT

This Agreement may be supplemented, amended or modified at any time, but only by written instrument duly executed by the parties to this Agreement. Any material amendment to this contract that appreciably reduces the consideration received by the state requires prior approval of the legislature.

ARTICLE XX
SUCCESSORS AND ASSIGNS

No assignment, pledge or encumbrance of this Agreement shall be made by either Purchaser without first obtaining the written consent of Seller, or by Seller without obtaining the written consent of both Purchasers. The Commissioner may grant such consent on behalf of Seller. The Commissioner shall have sole and complete discretion in granting or denying a proposed assignment, pledge or encumbrance. Subject to the above requirements in this Article, this Agreement will be binding upon and inure to the benefit of each of the parties and its successors and permitted assigns. In addition, if Purchaser gains or acquires a controlling interest in an entity which has an agreement with Seller for the sale of Oil ("Other Agreement"), then Seller, at its option and on thirty Days' prior notice, may require Purchaser to terminate either this Agreement or the Other Agreement. The choice of which

Agreement to terminate will be Seller's. Purchaser may request that Seller waive this provision in advance of Purchaser gaining a controlling interest in an entity which has an agreement with Seller for the sale of Oil. The Commissioner has sole and complete discretion in granting or denying the requested waiver.

ARTICLE XXI

HEADINGS

Headings used in this Agreement are for convenience only and shall not affect the construction of this Agreement.

ARTICLE XXII

RECORDS

22.1 Preservation of Records. Purchaser will preserve and maintain all books, accounts, and records directly relating to the performance of this Agreement, including but not limited to the purchase or sale of Oil and its refined products, for a period of six (6) years. Purchaser will also maintain and preserve all similar books, accounts, and records of which it has possession belonging to those third parties with whom it contracts for the performance of various parts of this Agreement. Neither Purchaser nor Seller shall be required to retain any records for more than six (6) years unless retention of such records is specifically required by applicable law or regulation. Purchaser shall either maintain its records within the State of Alaska or make such records available to Seller at Purchaser's principal office in the State of Alaska within thirty (30) days after written request by Seller.

22.2 Inspection of Records of Parties. Purchaser and Seller will accord to each other and to their authorized agents, attorneys, and auditors during reasonable business hours access to any and all property, records, books, documents, and indexes directly relating to Purchaser's or Seller's performance of this Agreement and which are under the control of the party from which access is desired, so that the other party may inspect, photograph and make copies of that property, records, books, documents and indexes. In no event, however, shall Seller be required to disclose any information, data, or records which are required to be held confidential by state law or regulation. If the information obtained by Seller may be held confidential under state or federal law or regulation, Purchaser may request that that information be held confidential by Seller.

ARTICLE XXIII
INTERPRETATION OF TERMS AND CONDITIONS

In the event that there is a disagreement about the meaning or application of a word, term, or condition in this Agreement, Purchaser will present the arguments supporting its view in writing to the Commissioner for her consideration. The Commissioner will subsequently, within a reasonable time, issue a finding on the meaning or application of the disputed word, term, or condition, setting forth the basis for her conclusions. Purchaser agrees to accept findings by the Commissioner under this Article as long as there is substantial evidence supporting the Commissioner's findings.

DATED this 9th day of December, 1985

SELLER:

THE STATE OF ALASKA

by Tay Brown, Director
Commissioner
Department of Natural Resources

PURCHASER PETRO STAR, INC.:

PETRO STAR, INC.

By

Stephen J. Luns
President

PURCHASER CHEVRON:

CHEVRON U.S.A. INC.

By

Al W. Caccamo

3928s

EXHIBIT B

RELEASE

For a valuable consideration, the receipt and adequacy of which are acknowledged, the undersigned does hereby release and forever discharge ARCO Alaska, Inc., BP Alaska Exploration Inc., Chevron U.S.A. Inc., Exxon Corporation, Mobil Oil Corporation, Phillips Petroleum Company, Sohio Alaska Petroleum Company, Union Oil Company of California, Amoco Production Company, individually and collectively, and each of their predecessors, successors, assigns, and all persons acting by, through, under or in concert with them, or any of them (the "Releasees"), of and from any and all claims, demands or causes of action of any nature whatsoever, known or unknown, fixed or contingent, hereinafter made against the Releasees, or any of them arising out of, based upon, or relating to the purported storage rights of the State of Alaska with respect to royalty oil produced from the land as to which the Kuparuk River Unit Agreement is now effective on to which it may be extended.

The undersigned represents and warrants that there has been no assignment or other transfer of any interest in any claim which agrees to indemnify and hold Releasees, and each of them, harmless from any liability, claims, demands, damages, costs, expenses and attorney's fees incurred by Releasees, or any of them, as a result of any person asserting assignment or transfer or any rights or claims under that assignment or transfer. It is the intention of the parties that this indemnity does not require payment as a condition precedent to recovery by the Releasees against the undersigned under this indemnity.

The undersigned agrees that if after execution of this Release the undersigned commences, joins in, or in any manner seeks relief through any suit arising out of, based upon, or relating to any of the claims released under this Release or in any manner asserts against Releasees, or any of them, any of the claims released under this Release, then the undersigned will pay to Releasees, and each of them, in addition to any other damages caused to Releasees by that action or claim all attorney's fees incurred by Releasees in defending or otherwise responding to the action or claim.

The undersigned further understands and agrees that the execution of this Release shall neither constitute nor be construed as an admission by the Releasees, or any of them, that they have any storage obligation with respect to the State's royalty oil.



PETRO STAR, INC.

5 December 1985

DATE



CHEVRON U.S.A.

6 December 1985

DATE

STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL AND GAS

ESTIMATED PRODUCTION AND SALES FOR NORTH SLOPE ROYALTY OIL (1)

YEAR	ESTIMATED TOTAL PRODUCTION (BARRELS PER DAY)					TOTAL	ESTIMATED ROYALTY (BARRELS PER DAY)					TOTAL ROYALTY	ESTIMATED SALES OF ROYALTY OIL (BARRELS PER DAY)								
	(1) TOTAL PRUDHUE	(2) TOTAL KUPARUK	(3) TOTAL LISBURN	(4) TOTAL ENBICOTT	(5) TOTAL HILHE PT.		PRUDHUE ROYALTY	KUPARUK ROYALTY	LISBURN ROYALTY	ENBICOTT ROYALTY	HILHE PT. ROYALTY		NAPCO	(12) OVER	(13) TESORO (OLD)	(14) TESORO (NEW)	(15) CHEVRON	(16) COMPETITIVE SALE 12-11-84	(17) PETRO/CHEVRON (PROPOSED)	(18) COMPETITIVE SALE 2-4-86 (PROPOSED)	ROYALTY IN VALUE
1985	1,350,000	180,000			3,000	1,733,000	193,750	22,500			375	216,625	35,000	5,167	47,533	26,867	18,600	65,000			10,000
1986	1,350,000	220,000			30,000	1,800,000	193,750	27,500			3,400	226,650	35,000	5,167	47,533	26,867	18,600	65,000	6,000		27,000
1987	1,350,000	220,000	30,000		30,000	1,850,000	193,750	27,500	6,750		3,400	232,400	35,000	5,167	47,533	26,867	18,600	65,000	6,000		27,000
1988	1,350,000	220,000	60,000		30,000	1,736,000	177,000	27,500	7,500	7,000	3,400	219,400	35,000	4,507	42,197	23,851	16,312	6,500			27,000
1989	1,183,000	220,000	70,000	30,000	23,000	1,598,000	147,875	27,500	8,750	14,000	4,500	202,625	35,000	3,943	34,278	20,506	14,196	6,500			27,000
1990	1,015,000	187,000	80,000	100,000	20,000	1,402,000	127,250	23,375	10,000	14,000	3,600	178,725	35,000	3,393	31,218	17,644	12,216	3,325			27,000
1991	920,000	139,000	90,000	100,000	13,000	1,292,000	111,000	19,875	11,250	14,000	2,700	165,825	35,000	3,093	28,458	16,086	11,136	4,690			27,000
1992	846,000	125,000	100,000	100,000	13,000	1,196,000	105,750	16,875	12,500	14,000	2,700	151,825	35,000	2,820	25,944	14,664	10,152	3,905			27,000
1993	772,000	122,000	100,000	85,000	10,000	1,089,000	96,500	15,250	12,500	11,000	1,800	137,950	35,000	2,573	25,674	13,582	9,264	3,605			27,000
1994	706,000	109,000	100,000	75,000	10,000	1,000,000	88,750	13,625	12,500	10,500	1,800	126,675	35,000	2,353	21,650	12,738	8,472	3,220			27,000
1995	646,000	90,000	90,000	70,000	10,000	916,000	81,750	12,250	11,250	9,800	1,800	115,850	35,000					2,875			27,000
1996	591,000	80,000	80,000	65,000	0	825,000	73,875	11,125	10,000	9,100	0	104,100	35,000					2,630			27,000
1997	541,000	80,000	72,000	60,000	0	753,000	67,625	10,000	9,000	8,400	0	95,025	35,000								27,000
1998	490,000	72,000	65,000	55,000	0	690,000	62,250	9,000	8,125	7,700	0	87,075	35,000								27,000
1999	450,000	65,000	50,000	50,000	0	631,000	57,250	8,125	7,250	7,000	0	79,625	35,000								27,000
2000	421,000	50,000	52,000	45,000	0	576,000	52,625	7,250	6,500	6,300	0	72,675	35,000								27,000
2001	387,000	52,000	47,000	40,000	0	526,000	48,375	6,500	5,875	5,600	0	66,350	35,000								27,000
2002	357,000	47,000	42,000	30,000	0	466,000	44,625	5,875	5,250	5,000	0	58,550	35,000								27,000
2003	320,000	42,000	38,000	20,000	0	418,000	41,000	5,250	4,750	4,500	0	52,400	35,000								27,000
2004	302,000	30,000	34,000	0	0	374,000	37,750	4,750	4,250	4,000	0	46,750	35,000								27,000
2005	278,000	34,000	31,000	0	0	343,000	34,750	4,250	3,875	3,600	0	42,875	35,000								27,000
2006	255,000	31,000	29,000	0	0	314,000	31,875	3,875	3,500	3,300	0	39,250	35,000								27,000
2007	235,000	20,000	25,000	0	0	280,000	29,375	3,500	3,125	3,000	0	36,000	35,000								27,000
2008	216,000	25,000	20,000	0	0	261,000	27,000	3,125	2,500	2,400	0	32,625	35,000								27,000
2009	199,000	20,000	15,000	0	0	234,000	24,875	2,500	1,875	1,800	0	29,250	35,000								27,000
2010	183,000	15,000	10,000	0	0	208,000	22,875	1,875	1,250	1,200	0	26,000	35,000								27,000
2011	168,000	10,000	0	0	0	178,000	21,000	1,750	0	0	0	22,250	35,000								27,000
2012	155,000	0	0	0	0	155,000	19,375	0	0	0	0	19,375	35,000								27,000

(1) OUR ESTIMATE OF FIELD PERFORMANCE, DECEMBER 1985.

(2) OVER'S TEN-YEAR CONTRACT COMMENCED JULY 1, 1985. QUANTITY IS 2.667% OF DAILY PRUDHUE ROYALTY OIL.

(3) TESORO'S CONTRACT IS CURRENTLY AT ITS MAXIMUM QUANTITY OF 24,533% OF DAILY PRUDHUE ROYALTY OIL. THE CONTRACT EXPIRES JANUARY 1995.

(4) ON OCTOBER 1, 1985 TESORO COMMENCED DELIVERIES UNDER 12/9/85 PRUDHUE CONTRACT WHICH WAS A MAXIMUM QUANTITY OF 15.84% OF DAILY PRUDHUE ROYALTY OIL AND EXPIRES JAN. 1, 1995.

(5) CHEV ON'S CONTRACT CALLS FOR A MAXIMUM QUANTITY OF 9.6% OF DAILY PRUDHUE ROYALTY OIL. THE CONTRACT EXPIRES JANUARY 1, 1995.

(6)

(6) DELIVERIES COMMENCED APRIL, 1985 FOR 30,000 BPD OF PRUDHUE RAY UNIT ROYALTY OIL AND 15,000 BPD OF KUPARUK RIVER UNIT ROYALTY OIL, AND WILL CONTINUE FOR ONE YEAR AS A RESULT OF THE DEC. 11, 1984 COMPETITIVE SALE AND THE SUBSEQUENT KUPARUK SOLICITATION. PRIOR TO THAT TIME THIS OIL REMAINED "IN VALUE."

(7) A PROPOSED PETRO STAR/CHEVRON CONTRACT WILL BE SUBMITTED TO THE LEGISLATURE FOR APPROVAL OF A SALE OF 8,500 BPD ROYALTY OIL FROM THE KUPARUK RIVER UNIT. PETRO STAR/CHEVRON INITIALLY WOULD PURCHASE 4,000 BPD. THE CONTRACT IS EXPECTED TO COMMENCE IN LATE 1986 AND EXPIRE SEPTEMBER 30, 1996.

(8) ON FEBRUARY 4, 1986 THE STATE WILL SELL BY COMPETITIVE BID APPROXIMATELY 10,000 BPD FOR A SIX-MONTH TERM COMMENCING JUNE 1, 1986.

(9) Includes only fields in, or planned for production in the near future.

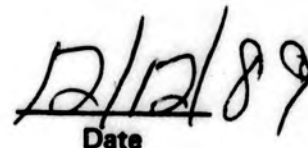


RECORDS CERTIFICATION



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

#46:26

STATE OF ALASKA 1986 LEGISLATIVE SESSION

FISCAL NOTE

REQUEST

HB 572

Bill/Resolution No.: Law File #377-023-86

Title: Dealing with the State's
underground injection well
program.

Sponsor: Governor

Requestor: Governor

Date of Request: 1-21-86

FISCAL DETAIL

Revision Date: _____

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						
---------	--	--	--	--	--	--

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

Prepared by: Rod Mourant

Division: Management

Phone: 465-2424

Date: 1-22-86

Approved by Commissioner: Ned Fongshen

Agency: Natural Resources

Date: 1-23

Distribution (by Agency preparing fiscal note):

Legislative Finance

Legislative Sponsor

Requestor

Office of Management and Budget

Impacted Agency(ies)



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

February 12, 1986

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 relating to the Alaska Oil and Gas Conservation Commission (commission). This bill offers revisions to improve the state's proposed underground injection control (UIC) program for injection wells related to the recovery and production of oil and natural gas (Class II wells). It also reinstates statutory authority for affiliation with the Interstate Oil Compact Commission, and conforms certain sections of AS 31.05 to the revised criminal code.

In 1984, CSHB 680 (L&C) was enacted (ch. 91, SLA 1984), which authorized the commission to "take all actions necessary to allow the state to acquire primary enforcement responsibility under 42 U.S.C. 300h-4 (Safe Drinking Water Act of 1974, as amended, 42 U.S.C. 300f-300j), for the control of underground injection related to the recovery and production of oil and natural gas." AS 31.05.030(h). Under this authority, the commission prepared an application for a state UIC program for Class II wells, which has been submitted to the U.S. Environmental Protection Agency (EPA) for approval.

In the context of their review, EPA staff identified certain provisions in AS 31.05 which could be amended to improve the state's proposed program. The amendments were proposed under the terms of a memorandum of agreement between the commission and EPA, Region 10.

Amendment of the criminal provisions of AS 31.05 is recommended by the criminal division of the Department of Law. When the comprehensive rewrite of AS 11 and AS 12 was undertaken in 1981-82, it was determined to be too great a task to attempt amendment of the state's other criminal provisions, scattered throughout the Alaska statutes, at the same time. As this bill amends AS 31.05 for other reasons, I believe it appropriate to take advantage of this opportunity to "clean up" the criminal provisions of AS 31.05 as well, in order to make them consistent with AS 11 and AS 12, as revised.

The amendments to AS 31.05 in the bill are as follows:

Section 1. AS 31.05.027 is amended to eliminate state statutory limitations on the commission's jurisdiction over land of the United States.

Federal law requires that state UIC programs apply to underground injection occurring on property leased or owned by the United States. 42 U.S.C. 300h(b)(1)(D) and 300j-6. However, AS 31.05.027 presently provides in part:

The authority of the commission. . . applies to land of the United States or to land subject to the jurisdiction of the United States only to the extent that control and supervision of conservation of oil and gas and prevention of waste by the United States on its land fails to carry out the intent and purposes of AS 31.05.005 -- 31.05.170, and otherwise applies to federal land so far as an officer of the United States having jurisdiction, or an authorized representative, shall approve any of the provisions of AS 31.05.005 -- 31.05.170 or orders of the commission which affect land.

The jurisdictional limitations of AS 31.05.027 first appeared as territorial legislation enacted in 1955, when Alaska's relationship to the federal government was far more subservient than after Alaska's acceptance into the Union. As a state, Alaska's potential jurisdiction over oil and gas activities on federal land is limited only by constitutional restrictions on the exercise of state police powers. See Myers, The Law of Pooling and Unitization, sec. 11.04 (2d Ed. 1984). AS 31.05.027 asserts less jurisdiction than is now constitutionally permissible, and would be amended by the bill to remove this potential impediment to the commission's regulation of oil and gas activities on federal land.

Section 2. AS 31.05.070(a) is amended to eliminate the transactional immunity provided as a result of a person

being compelled to testify or produce documents before the commission or a court, and to make its provisions consistent with the revised criminal code.

As it now reads, AS 31.05.070(a) affords a person transactional immunity if compelled to appear as a witness under that statute. This provision could preclude effective enforcement of the state's UIC requirements if it were to be applied to compel testimony of a witness, and consequently foreclosed subsequent prosecution of that witness for violating a requirement of the state's UIC program. The provision is also inconsistent with the immunity provision of AS 12.50.101. The amendments eliminate the immunity provision. Under new language added to AS 31.05.070(a), a witness who asserts his or her privilege against self-incrimination may be granted immunity under AS 12.50.101 -- that is, immunity from the use of his or her testimony and any evidence derived from it. Language that disallows self-incrimination as a ground for excusing attendance, testimony, or production of books and records, is also deleted. That language is potentially unconstitutional, and is unnecessary.

AS 31.05.070(a) also provides that a compelled witness is not exempt from prosecution and punishment for perjury committed while testifying. This provision would also be repealed because it duplicates provisions of the criminal code.

Section 3. New AS 31.05.141 would be placed in a "miscellaneous provisions" article in AS 31.05, to reinstate express authority to affiliate with the Interstate Oil Compact Commission (IOCC). The new statute is patterned after Vt. Stat. Ann., tit. 29, sec. 565 (1983). Section 15, ch. 40, SLA 1955, which created the Oil and Gas Conservation Commission, authorized affiliation with the IOCC. After statehood, sec. 15 became AS 31.05.130 and 31.05.140. Section 2, ch. 247, SLA 1970, repealed AS 31.05.130 and 31.05.140, purging AS 31.05 of that authorization. Of note is the fact that the state is still a dues-paying member of the IOCC.

Sections 4 and 5. AS 31.05.150(a) and (b) are amended to eliminate the "wilful" standard from consideration in the imposition and recovery of civil penalties; to increase imposable civil penalties; to make its provisions consistent with the provisions of the revised criminal code; and to institute criminal liability for violations of the commission's regulations and orders.

AS 31.05.150(a) imposes civil penalties for wilful violations of AS 31.05 or regulations or orders of the commission. However, there is no indication of the type of wilfulness required.

Use of the term "wilfully" in criminal statutes has traditionally required a showing of bad intent. Although evidence of bad intent is generally not required to impose civil penalties, amendment of the statute to eliminate the term would remove any doubt as to the ability of the state to impose civil penalties in the absence of evidence of bad intent.

The amendments would increase the amount of civil penalties imposable under AS 31.05.150(a) from "not more than \$1,000" to "no more than \$5,000 per day for each day of violation." The \$1,000 amount, which was first established in 1955, is now inadequate to deter violations. The increased penalty would more effectively accomplish that.

The bill would amend AS 31.05.150(b), which imposes criminal liability for falsifying records and committing similar offenses, to make the description of those offenses consistent with AS 11.46.630(a)(1)--(4). The class A misdemeanor penalty classification raises the possible maximum term of imprisonment to one year but the amount of the fine is unaffected.

Section 6. AS 31.05.150 is amended by adding a new subsection (f), imposing criminal liability on a person who knowingly violates a regulation or order of the commission. I urge your prompt action on this measure to strengthen the state's UIC program, to reinstate authority to affiliate with the IOCC, and to update AS 31.05.

Sincerely,


Bill Sheffield
Governor



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

#46:27

Introduced: 2/17/86
Referred: House Special Committee on
Oil & Gas and Resources

1 IN THE HOUSE

BY HERRMANN AND ADAMS

2

HOUSE BILL NO. 628

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FOURTEENTH LEGISLATURE - SECOND SESSION

5

A BILL

6 For an Act entitled: "An Act relating to certain oil terminal operators."

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

8 * Section 1. AS 46.04.050 is amended by adding a new subsection to
9 read:

10 (b) AS 46.04.040 does not apply to an electric cooperative
11 incorporated under AS 10.25 that operates an oil terminal facility
12 under this chapter.

Oil Spill Financial Responsibility Requirements

1. Who must prove financial responsibility for potential oil spills.

AS 46.04.040(a) - Everyone who operates an oil terminal facility.

AS 46.04.120(11) defines oil terminal facility as anyone who transfers, processes, refines or stores oil on or near water.

AS 46.04.050 exempts facilities with less than 10,000 barrels of storage capacity.

2. Liabilities for which financial responsibility must be proved.

18 AAC 20.035 requires proof of financial ability to respond to damage for each pollution incident covered by AS 46.04.040(i)

AS 46.04.040(i) simply refers to the following:

AS 46.03.760(e) - Liability to the state for full amount of direct and indirect cleanup costs.

AS 46.03.822 - Strict liability (without regard to fault) for damages to persons or property (public or private) resulting from an oil spill unless the operator can prove the spill resulted from an act of war, intentional or negligent act of an unrelated third party, negligence by the U.S. Government or State of Alaska, or an Act of God.

AS 46.03.258 - Liability to the state for penalties of:

\$10.00 per gallon of oil in fresh water;

\$2.50 per gallon of oil in an estuary;

\$1.00 per gallon of oil in unconfined saltwater.

Penalties can be multiplied by 5 as punitive damages.

AS 46.03.760(a) - Liability to the state for civil penalties of \$500 to \$100,000 for a violation and \$5,000 per day for each day the violation continues.

3. Amount of financial responsibility which must be proved.

AS 46.04.040(a) requires \$10 per barrel of storage capacity or \$1 million, whichever is greater.

4. How an operator can prove financial responsibility.

18 AAC 20.045 - Possession of Federal Maritime Commission certificate. Not applicable to utilities.

18 AAC 20.055 - Self-insurance. To qualify, an operator must maintain "working capital and net worth" in the amount required in AS 46.04.040(a)-(c)--(\$1 million). In the Statute, AS 46.04.040(a), the term "working capital and net worth" are not used. The Statute speaks of "ability to respond."

18 AAC 20.065 - Insurance. Underwriter must be an admitted carrier or approved by the Division of Insurance. The policy must be written on an occurrence policy form.

18 AAC 20.075 - Surety Bond. The surety must be registered to do business in Alaska, possess a current U.S. certificate and have sufficient underwriting capacity.

18 AAC 20.085 - Guaranty. This permits some other entity to qualify as a self-insurer and then guarantee the operator's financial responsibility.

5. Criminal penalties for violations.

AS 46.03.790

(a) Violation is a Class B misdemeanor.

(b) Wilfull violation is a Class A misdemeanor.

(c) Each day of violation is a separate violation.



ALASKA RURAL ELECTRIC COOPERATIVE ASSOCIATION, INC.

237 E. FIREWEED LANE • SUITE 301
ANCHORAGE, ALASKA 99503 • (907) 276-3235

February 21, 1986

Representative Mike Davis, Chairman
House Special Committee on Oil & Gas
Alaska State Legislature
Pouch V (MS 3100)
Juneau, Alaska 99811

Dear Mike:

As I indicated in our brief conversation yesterday afternoon, we would really like to get HB 628 moving and hope you will schedule it at the earliest opportunity. This letter is in response to a request from Jonathan for additional information.

Enclosed is a copy of my letter to Representative Herrmann asking that this kind of legislation be introduced. It gives the background to the problem, specifically for Naknek Electric and Nushagak Electric. Both are cooperatives and members of our organization.

Also enclosed is a copy of correspondence from Glen Adams, of the Department of Environmental Conservation, suggesting some other places to look for means of complying with the statute. When I received the letter from Glen, I gave a copy to our insurance consultant and broker, Corroon & Black, Dawson and Company. After they checked out each suggestion, Joe Piccione wrote me a letter detailing their findings. A copy of this letter is enclosed. It indicates conclusively that in today's insurance market, compliance is simply impossible.

Jonathan also asked which utilities have this problem, what are their tank capacities, and how often do they fill their tanks.

At present, Nushagak Electric and Naknek Electric are the only utilities which have had dealings with DEC on this issue. Kotzebue Electric also has new tank capacity sufficient to bring them into the same problem, but DEC has not yet made an issue of it with them. Nome Joint Utilities, a municipal utility, is negotiating to lease tank space to use in 1986. If their negotiations are successful, they will have sufficient capacity to face the same problem. (I hope that my responding fully to Jonathan's questions will not cause problems for Kotzebue or Nome.)

DEMOCRACY IN ACTION

Representative Mike Davis
February 21, 1986
Page 2 of 2

The tank capacities for these four utilities will vary from approximately 20,000 to 35,000 barrels. They typically fill their tanks only once a year. That is why they need so much tank capacity in these ice-bound communities.

We understand that DEC has offered to "look the other way," but even a non-willful violation of this statute is a Class B Misdemeanor. Each day of non-compliance is a separate violation. This is a serious business that simply must be resolved legislatively.

Thank you for your interest. If you have additional information, please let me know.

Sincerely,



Dave Hutchens
Executive Director

Enclosures

DH:ph



ALASKA RURAL ELECTRIC COOPERATIVE ASSOCIATION, INC.

237 E. FIREWEED LANE • SUITE 301
ANCHORAGE, ALASKA 99503 • (907) 276-3235

January 15, 1986

Representative Adelheid Herrmann
Alaska State Legislature
Pouch V (MS 3100)
Juneau, Alaska 99811

Dear Representative Herrmann:

Last November, Claude Franke and Dave Bouker wrote you about a problem they were having -- and expecting to get worse -- caused by a statutory requirement that they buy strict liability insurance for oil spills. Both NEC and NEA have increased their fuel storage capacity in recent years in order to buy competitively priced oil and store it themselves. It was increasing their tank capacity above 10,000 barrels that makes this statute apply to them.

For 1985 we went through great difficulty to find a way to help these two small coops comply with the law. Their regular policy for general liability insurance issued by the ARECA Insurance Exchange provided \$500,000 of oil spill insurance. There was no other oil spill liability insurance available for them to buy at any price.

To get the additional \$500,000 in coverage for them, what we had to do was to get them to indemnify the Exchange and post an irrevocable letter of credit payable to the Exchange to cover costs of oil spills between \$500,000 and \$1 million, and the Exchange then issued the insurance policy. This insurance policy met the DEC requirements, but the coops were fully responsible for any losses exceeding \$500,000 which might have occurred. This arrangement cost them the fee for the letter of credit and the expenses incurred by the Exchange for setting it up. Much more importantly, this approach tied up a major part of their credit capacity which then could not be used for normal business requirements.

For 1986, even the ARECA Insurance Exchange is completely unable to provide oil spill insurance because it is not possible for us to buy reinsurance covering oil spills. This means that the only way for NEC and NEA to comply with the law is go through the cumbersome and expensive process of retaining the

entire risk of the \$1 million policy limit, and have the Exchange issue the \$1 million policy. But this would use nearly their entire line of credit! They might not even be able to borrow the money to buy the fuel which they would have sole responsibility to clean up if they spilled some of it.

This is an absurd situation which requires a legislative solution this session. Claude and Dave sent you a draft providing an easy way of resolving the problem. Our idea is that a certificate of public convenience and necessity for a utility should be proof in itself of financial responsibility. A utility isn't going anywhere. If a spill occurs, they will still be there and have the financial ability to pay for the clean up.

After consulting with the attorney who drafted it, I have slightly reorganized the proposed statutory amendment. We hope you will introduce a bill to resolve the problem being experienced by NEC and NEA and push it through to passage.

Sincerely,



David Hutchens
Executive Director

DH/CF

cc: Claude Franke, NEA
Dave Bouker, NEC

cc: KEN Johnson

STATE OF ALASKA

DEPT. OF ENVIRONMENTAL CONSERVATION

BILL SHEFFIELD, GOVERNOR

Telephone: (907) 465-2653

Address: Box 0

Juneau, Alaska 99811

January 27, 1986

JAN 29 1986

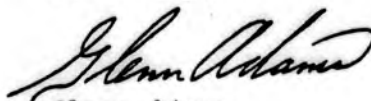
Mr. Dave Hutchens
ARECA Insurance Exchange
237 East Fireweed Lane, Suite 301
Anchorage, AK 99503

Dear Dave:

During your phone call last week to myself and Paul O'Brien, Manager of the Oil Pollution Program, problems of obtaining adequate insurance coverage for oil pollution damages were discussed. Paul agreed that I would review our files and send you the names of insurance underwriters that have current policies in force. I reviewed the files and came up with four underwriters and information on what other fuel handling companies are doing (enclosed). I am also sending a copy of the report from the Task Force on Insurance Availability and Pricing.

The Department of Commerce and Economic Development, Division of Insurance said they can provide "special market assistance" to the broker, their address is on the Task Force report. We will continue to work with the industry in every way that we can.

Sincerely,



Glenn Adams
Oil Pollution Control
Division of Environmental Quality

cc: Keith Kelton, Director
Bill Ross, Commissioner
Representative Adelheid Herrmann
Representative Rich Yehling
Senator Fred F. Zharoff

January 23, 1986

INSURANCE INFORMATION FOR FUEL STORAGE FACILITIES

The following information is taken from current files that require proof of financial responsibility for oil pollution for "fuel storage facilities." This information is not an endorsement or recommendation but is provided in an attempt to help locate insurance coverage that will comply with Sec. 46.04.040(e) and 18 AAC 20.065.

Insurance underwriters and brokers that have currently active policies:

1. Lloyd's London and various companies
Broker - Pacific International Brokers, Ltd.
2. Employers Mutual Casualty Company
Broker - Mutual Marine Office, Inc.
3. National Union Fire Insurance Company of Pittsburgh, Pa.
Broker - Alaska 100 Insurance
4. Midlands Insurance Company, Inc.
by West Coast Marine Managers, Inc.
Broker - Nasman and Associates, Inc.

The 34 files (representing 67 facilities) are broken down to show how many are using other means of providing proof of financial responsibility.

Surety Bonds	4
Guaranty	3
*Self-Insurance	12
Government	3
Insurance	8
Other	7

* Some use this means to cover deductible or financial records requirements for guaranty.

Of the eight showing insurance as their preference, five have policies that expired this December and January and are trying to renew their policies. There are seven new owners/operators that have not returned their application forms or shown what means of proof they intend to use.

Glenn Adams
Oil Pollution Control



CORROON & BLACK, INC.

4220 "B" Street
Anchorage, Alaska 99503
907-562-2266 Telex: 25-109

February 6, 1986

David Hutchens
Chairman
ARECA Insurance Exchange
237 East Fireweed Lane, Suite 301
Anchorage, AK 99503

RE: Pollution Liability

Dear Dave,

Pursuant to your request for current information on the availability of Pollution Liability coverage for Alaska risks required to provide proof of financial responsibility for oil pollution for "Fuel Storage Facilities", in compliance with Alaska Statute Sec. 46.04.040(e) and 18AAC 20.065, here are my findings after contacting various carriers and brokers, including those insurance underwriters and brokers who have current active policies.

- (1) Lloyds of London & various companies - This market does not offer on-shore Pollution coverage and has not done so since 1983.
- (2) Employers Mutual Casualty Co. - This market does not write monoline Pollution Liability coverage. They are a member of the Pollution Liability Insurance Association (PLIA) and only offer Pollution Liability coverage in conjunction with other lines of coverage (Property, General Liability, and Business Auto.) Further information revealed that they do not write this coverage in Alaska although they are an admitted carrier in the state of Alaska.
- (3) National Union Fire Insurance Company of Pittsburgh, Pa. - This is the only insurance carrier that I was able to confirm is still affording monoline Pollution Liability coverage for on-shore storage facilities. Their form does not comply with Alaska Statute unless endorsed to provide Defense Costs for plaintiff's attorneys as a supplemental limit. Basic form includes Defense Costs within the Aggregate Limits of Liability. Further, their form does not

CORROON & BLACK/DAWSON & CO., INC.

comply with Alaska Statute unless amended to remove the exclusions pertaining to resultant Property Damage to: (a) Property owned or occupied or rented to the Insured, (b) Property used by Insured, or (c) Property in the Care Custody or Control of the Insured or as to which the Insured is for any purpose exercising physical control.

It is extremely unlikely that this carrier would remove these standard exclusions pertaining to damage occurring to and on the Insured's premises, including the cost of clean-up.

- (4) Midlands Insurance Company, Inc. - This particular insurer has an A. M. Best's "Omitted" rating. The financial security of this market is questionable. In contacting this carrier, I was advised that they are no longer a Pollution Liability coverage market.

In summary, 97% of the capacity previously available has disappeared during the last 12 months. The premiums for Pollution Liability coverage have sky rocketed up to 1000%. There is only one available monoline Pollution Liability market writing in Alaska. This carrier is National Union Fire Insurance Company of Pittsburgh, Pa. with an A. M. Best rating of A+ XV. They have recently announced that as of December 1985 they do not want to write risks that are primarily tank oriented. Therefore, availability is questionable since their recent announcement. If even available, the terms offered are subject to \$250,000 minimum deductible at a cost indication of between \$40,000 - \$250,000. Limits available, if offered, are up to \$10,000,000.

Further checking found that there is a Pollution Liability Insurance Association, referred to as PLIA, with approximately 18 member insurers, including but not limited to, Employers Mutual Casualty Company, Chubb Insurance Group, U. S. Fire, Crum & Forester, Ranger, Century, and Industrial Indemnity. Unfortunately, a lot of these insurers do not write in Alaska and all member companies require the supporting lines of coverage (Property, General Liability, and Business Auto) be written with them to consider entertaining Pollution placement.

We have also explored the possibility of purchasing a Surety Bond or Financial Guaranty as another means of providing proof of financial responsibility. Neither of these two means are true insurance, but rather an immediate remedy to a demand for payment should a loss occur. The ultimate responsibility for

David Hutchens
February 6, 1986
Page 3

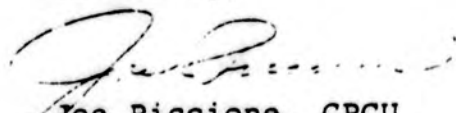
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the loss is still born by the individual utility, since this is really a pass-through coverage via the indemnity requirement of the Bond or Guaranty.

The premium for such coverage is very expensive and at times equal to the Bond limit or Guaranty required, plus the cost of the Bond. With the deteriorating experience on this type of bonding, the number of carriers willing to write are limited, and those who write the coverage are very expensive.

I hope that my findings will be helpful to you in presenting the Pollution Liability coverage options available, or the lack thereof, for your member utilities.

Sincerely,



Joe Piccione, CPCU
Marketing Manager

JP:sd

Attachment

cc: Wayne Brown
Nancy Jo Brown

Sec. 46.04.040. Proof of financial responsibility. (a) A person may not cause or permit the operation of an oil terminal facility in the state unless he has furnished proof of financial ability to respond in damages which has been accepted by the department. Ability to respond in damages need not exceed \$50,000,000 but must be in an amount (1) not less than \$10, per incident, for each barrel of storage capacity at the oil terminal facility; or (2) \$1,000,000, whichever is greater.

(b) After July 1, 1981, a person may not cause or permit the operation of an offshore exploration or production facility in the state unless proof of financial ability to respond in damages has been accepted by the department. Proof of financial responsibility may not be less than \$35,000,000 per incident.

(c) A person may not cause or permit the transfer of oil to or from a tank vessel, or, after January 1, 1981, to or from an oil barge, unless proof of financial responsibility for the tank vessel or barge has been accepted by the department. Financial responsibility under this subsection shall be in the following amounts:

(1) for a tank vessel or oil barge involved in the transportation of trans-Alaska pipeline oil, the amount required by the Federal Maritime Commission under sec. 204(c)(3) of the Trans-Alaska Pipeline Authorization Act (43 U.S.C. sec. 1653(c)(3));

(2) for any other oil barge, the amount required by sec. 311(p)(1) of the Clean Water Act, or \$1,000,000, whichever is greater;

(3) for any other tank vessels, the amount required by sec. 311(p)(1) of the Clean Water Act, or \$20,000,000, whichever is greater.

(d) Except for prosecutions under AS 46.03.790(b), it is not a defense to an action brought for violation of (c) of this section that the person charged believed in good faith that the vessel operator possessed proof of financial responsibility accepted by the department.

(e) Financial responsibility may be demonstrated by self-insurance, insurance, surety, or guarantee, under terms the department may prescribe. An action brought under AS 46.03.758, 46.03.760(a) or (e), or 46.03.822 may be brought in a state court directly against the insurer or another person providing evidence of financial responsibility. The applicant, and an insurer, surety, or guarantor shall appoint an agent for service of process in the state. An insurer must either be authorized by the Department of Commerce and Economic Development to sell insurance in the state or be an unauthorized insurer listed by the Department of Commerce and Economic Development as not disapproved for use in the state.

(f) Acceptance of proof of financial responsibility expires

(1) one year from its issuance for self-insurance;

(2) on the effective date of a change in the surety bond, guarantee, or insurance agreement; or

(3) on the expiration or cancellation of the surety bond, guarantee, or insurance agreement.

(g) The person whose proof of financial responsibility is accepted by the department under this section shall notify the department at least 30 days before the effective date of a change, expiration or cancellation in the surety bond, guarantee, or insurance agreement. Application for renewal of acceptance of proof of financial responsibility under this section must be filed at least 30 days before the date of expiration

(h) The department, after notice and hearing, may revoke acceptance of proof of financial responsibility if it determines that

(1) acceptance was procured by fraud or misrepresentation; or

(2) a change of circumstance has occurred other than a change specified in (f)(1) — (3) of this section, which would have warranted denial of the application.

(i) Financial responsibility under this section extends to a loss compensable under AS 46.03.760(e) or 46.03.822 and an assessment under AS 46.03.758 or 46.03.760(a). (§ 2 ch 116 SLA 1980; §§ 117, 118 ch 59 SLA 1982)

Sec. 46.04.050. Exemptions. Because of the restricted nature of the operations and the minimal danger to the environment posed by the activities, AS 46.04.030, 46.04.040 and 46.04.060 do not apply to an oil terminal facility that has an effective storage capacity of less than 10,000 barrels of oil. (§ 2 ch 116 SLA 1980)

Sec. 46.04.060. Inspections. Oil terminal facilities, offshore exploration and production facilities, tank vessels, and oil barges are subject to inspection by the department to ensure compliance with the provisions of this chapter. (§ 2 ch 116 SLA 1980)

Sec. 46.04.070. Scope of regulations. The department shall adopt regulations which are necessary to carry out the purposes of this chapter and which do not conflict with and are not preempted by federal law or regulations. (§ 2 ch 116 SLA 1980)



RECORDS CERTIFICATION



I, the undersigned, an employee of the State of Alaska, do hereby certify that the microfilm images on this microfilm 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.

98/12/15
Date


Signature of Camera Operator

SCOMM

#46:28

Proposed CS for HR 9

Title Change: Relating to energy resources.

WHEREAS effective April 15, 1985, the Department of Natural Resources assessed royalties on Cook Inlet Basin natural gas at current market rates instead of contracted rates, thereby raising the price of royalty gas the state sells to producers; and

WHEREAS the increase in the price of royalty gas has increased electric rates by no more than 4 percent to Southcentral energy consumers; and

WHEREAS Southcentral energy consumers enjoy the lowest electric rates in Alaska and some of the lowest electric rates in the United States; and

WHEREAS Southcentral energy consumers will continue to enjoy the lowest electric rates in Alaska and some of the lowest electric rates in the United States, notwithstanding this rate increase; and

WHEREAS the state is presently experiencing a \$436,000,000 decline in FY 86 revenues due to a decrease in the value of crude oil; and

WHEREAS selling the royalty share of Cook Inlet Basin natural gas to producers at below-market contracted rates will decrease general fund revenues by an additional \$7,000,000 per year; and

WHEREAS conflicting policies exist regarding the value and best use of the state's royalty share of energy resources;

WHEREAS these policy conflicts have led to regional disputes regarding energy costs;

BE IT RESOLVED that the House of Representatives urges the Governor to direct the administration to develop a comprehensive and equitable statewide energy policy that encourages the efficient use of energy; and

BE IT FURTHER RESOLVED that existing and proposed state energy subsidy programs be reviewed and that, where possible, these programs be made consistent with this policy.

MEMORANDUM

State of Alaska

TO: Esther C. Wunnicke, Commissioner DATE: April 26, 1985
Department of Natural Resources
and Kay Brown, Director FILE NO:
Division of Oil and Gas
Department of Natural Resources TELEPHONE NO:

FROM: NORMAN C. GORSUCH
ATTORNEY GENERAL

SUBJECT: Dale Teel "Letter to
the Editor" in the
Anchorage Daily
News.

By: Mark P. Worcester
Assistant Attorney General
Oil, Gas and Mining-Anchorage

On April 24, 1985 the Anchorage Daily News published a "Letter to the Editor" from Dale Teel, President of Enstar Natural Gas Company. A copy of that letter is attached. If any response is made, the following comments would appear to be appropriate.

1. Mr. Teel states that the royalty enforcement action would be "with no established legal basis -- with no public hearings, no regulations, and no Alaska court decisions to support that decision" Of course, the "legal basis" for the action is found in the terms of the leases issued many years ago to the oil companies. Apparently, Mr. Teel will justify his position that there is no "established" legal basis for the state's action upon the proposition that no regulation and no Alaska court decision has interpreted the oil and gas leases to require current market valuation of the state's royalty shares. If this is Mr. Teel's argument, it is fatally flawed, because there is also no Alaskan court decision and no regulation which supports the position he would advocate. Alaskan case law is silent on the issue. In the absence of court decision and regulations, the only basis for construing the obligations of the gas producers must be found in the lease forms themselves. The lease forms are precisely what the state's enforcement action is based upon.

2. Mr. Teel asserts that the long-term contracts were the result of "tough arm's-length negotiations in 1971 and in 1974" However, Mr. Teel does not explain to the readers that those "tough" negotiations resulted in Enstar's commitment to purchase the one-eighth royalty share of gas at the values required by the leases between the state and the oil companies. This contract term demonstrates that the oil companies and Enstar both fully recognized that the one-eighth royalty share could be valued at a level higher than the contract price. Accordingly, the action by the state does not frustrate any of the purposes of

Esther Wunnicke, Commissioner
Department of Natural Resources
and
Kay Brown, Director
Division of Oil and Gas
Department of Natural Resources

April 26, 1985
Page 2

the "tough" long-term contracts negotiated by Enstar in 1971 and 1974. Instead the contracts specifically anticipated and provided for the eventuality of this royalty enforcement action.

3. Mr. Teel states that the state's action means the royalty share of gas which Enstar buys under its 1974 contract with the oil companies "will be priced" according the new 1982 contracts rather than the 1974 contract. This is incorrect. The state is not party to the Enstar-oil company contract and hence has not set a "price" for it. Rather, the state is merely enforcing its lease (contract) with the oil companies that the one-eighth royalty share be value and paid according to its current market price or value. As stated above, Enstar's own 1974 contract sets Enstar's "price." In that contract Enstar agreed to be responsible for any additional royalty amounts.

4. Lastly, Mr. Teel claims that the state's action constitutes a departure from a "25 year standard." There is no "25 year standard." Historically, long-term contract prices fairly reflected the then-current market value. It was not until December 1982, when Enstar negotiated new contracts at rates between three and ten times higher than the long-term contracts that objective evidence of a disparity between old long-term contract prices and current market prices and values was available. Thus, if anything, there is a "two year standard." However, there really was no "standard" at all, even between December 1982 and the recent notices. In that period the state never agreed to the propriety of the oil company royalty payments, and the six year statute of limitations for challenging the adequacy of the payments had not run for any of the additional royalties due after December 1982.

I have also enclosed a "synopsis" of Peter Ginder's testimony before the Legislature on April 11, 1985. Mr. Ginder is counsel for Enstar. The synopsis appears to be a rewrite, rather than a true synopsis. I have not prepared any rebuttal to this statement (which Enstar is apparently planning on circulating widely). If a rebuttal is desired, please let me know.

MPW/ma

enclosure

cc: Norman C. Gorsuch
Attorney General



Official Business

Alaska State Legislature House

Pouch V
State Capitol
Juneau, Alaska 99811

MEMORANDUM

3/28/85

TO: ALL REPRESENTATIVES

FROM: REPRESENTATIVE VIRGINIA COLLINS *WVC*

RE: HOUSE RESOLUTION 9

On March 19, 1985, Esther Wannicke, Commissioner of the Alaska Department of Natural Resources announced a far-reaching policy decision which will affect the rates consumers pay for gas-fired power for, literally, hundreds of thousands of citizens residing throughout South Central, Fairbanks and interior regions of our State. The policy decision assesses royalties on national gas at current market rates instead of contracted rates, thereby raising the price of royalty gas that the State sells to producers, which in turn is passed on to consumers.

This policy, which is scheduled to take effect April 1, 1985, will increase electric rates for South Central consumers by as much as 20%. Further, this policy will increase the cost of natural gas-fired electrical energy to be transmitted to the Fairbanks/Interior Region over the Anchorage-Fairbanks transmission intertie.

It is for these reasons that I ask you to join me in supporting a House Resolution which calls upon the Governor to direct the Department of Natural Resources to suspend its decision pending legislative review of its impact upon the utility consumers of our State.

Thank-you for your assistance and valued support.

Chugach Electric Association
1984 Annual Report

How our rates compare

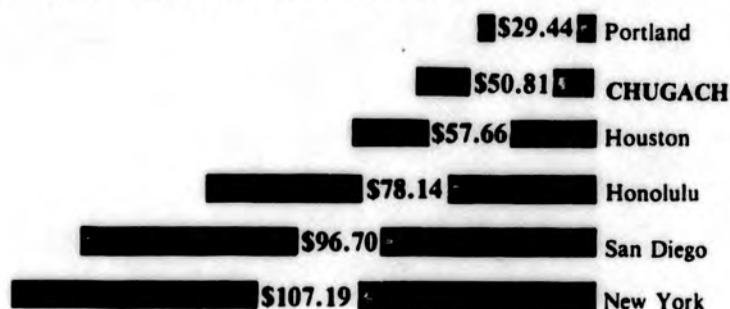
Chugach consumers enjoy some of the lowest electric rates in the nation, thanks in part to a long-term supply of inexpensive natural gas used to generate power.

Statistics compiled by the National Association of Regulatory Utility Commissioners show that consumers in New York City pay \$107.19 for 750 kilowatt hours (kWh) of electricity, more than double the \$50.81 charged by Chugach.

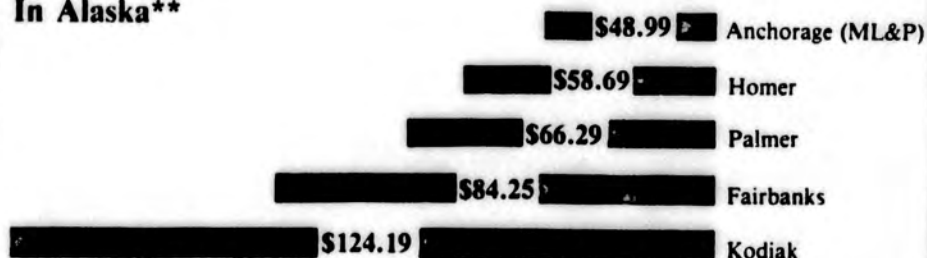
Residents of Tampa Fla., pay \$60.74 for 750 kilowatt hours while those who live in Philadelphia pay \$73.08.

Chugach's rates have remained surprisingly constant over the past 30 years, although electrical usage has soared. The average residential usage in 1984 was 805.4 kWh per month.

Outside: Residential electric bills at 750 KWH*



In Alaska**



*As of Feb. 1, 1984 Source: National Association of Regulatory Utility Commissioners

**As of March 1, 1985 Source: Alaska Public Utilities Commission

Electricity's Surging Cost

Average residential electric bills climbed 7.9 percent in 1984, nearly twice as fast as the 4.0 percent inflation rate.

A national survey by utility regulators found power costs varied widely, with consumers in the Northeast paying the most and those in the Northwest the least. New York City's rate was the highest in the nation.

The 25 most expensive and 25 least expensive cities by kilowatt hour in 1984:

25 Most Expensive

	Average KWH Cost	1-Year Change
New York City	16.17¢	+ 4.1%
Kahului, Hawaii	14.33¢	+ 8.3%
Nantucket, Mass.	14.31¢	+ 7.6%
Hilo, Hawaii	13.92¢	+10.7%
Middletown, N.Y.	13.78¢	+ 0.3%
Long Beach, N.Y.	13.05¢	+10.5%
Boston, Mass.	12.77¢	+30.8%
Poughkeepsie, N.Y.	12.14¢	+11.5%
Dover Township, N.J.	12.01¢	- 5.8%
San Diego, Calif.	11.79¢	- 6.1%
Fitchburg, Mass.	11.55¢	+20.1%
Bergen County, N.J.	11.43¢	-14.6%
Newark, N.J.	11.31¢	- 1.1%
Honolulu	11.30¢	+ 9.4%
Exmore, Va.	11.23¢	+ 1.5%
Gary, Ind.	11.20¢	+22.3%
Bridgeport, Conn.	11.14¢	+11.6%
Bridgeton, N.J.	11.07¢	- 2.0%
Chicago, Ill.	10.80¢	+ 4.6%
Philadelphia, Pa.	10.80¢	+20.9%
Pawtucket, R.I.	10.78¢	+21.8%
Wilmington, Del.	10.75¢	- 2.8%
Elkton, Md.	10.65¢	+21.0%
Fall River, Mass.	10.60¢	+12.2%
Davenport, Iowa	10.57¢	-

25 Least Expensive

Billings, Mont.	3.55¢	-15.5%
Spokane, Wash.	3.61¢	+23.0%
Boise, Idaho	3.85¢	+ 8.5%
Ontario, Oreg.	3.85¢	+11.0%
Portland, Oreg.	3.91¢	+10.8%
La Grande, Oreg.	4.37¢	+21.1%
Casper, Wyo.	4.92¢	+ 7.4%
Bellevue, Wash.	4.96¢	+35.2%
Ashland, Ky.	5.20¢	+ 1.6%
Duluth, Minn.	5.45¢	+ 1.5%
Franklin, N.C.	5.46¢	+35.5%
Marietta, Ohio	5.48¢	- 0.1%
Cheyenne, Wyo.	5.55¢	+21.7%
Washington, Pa.	5.56¢	+ 3.3%
Las Vegas, Nev.	5.67¢	-27.4%
Rutland, Vt.	5.74¢	+ 5.7%
Kingsport, Tenn.	5.75¢	+ 2.2%
Flint, Mich.	5.82¢	+ 2.4%
Juneau, Alaska	5.85¢	+ 3.2%
Lexington, Ky.	5.85¢	0%
La Crosse, Wis.	5.89¢	+ 7.9%
South Beloit, Ill.	5.91¢	- 1.1%
Fargo, N.D.	5.95¢	- 3.8%
Burlington, Vt.	5.98¢	- 4.6%
Parkersburg, W.Va.	6.08¢	- 1.8%

Resource policies not always popular

By ESTHER WUNNICKE

No decision is more difficult for a public official than one that may hit people in their pocket-books. Such is the case with the Cook Inlet royalty gas decision you've been reading about recently.

There's more than money at stake here. There's also a fundamental question of fairness for Alaskans everywhere, including the people of Anchorage and the Southcentral area.

Alaskans living on the shores of Cook Inlet enjoy plentiful, inexpensive natural gas for home heating and power generation. A good share of that gas is produced from fields owned by all of the people of Alaska and leased to private industry for development, just as the giant Prudhoe Bay field is.

For years, the price local public and private utilities paid for this gas has remained very low, under long-term contracts between the utilities and the gas producers. And except for the share due the state as landowner, those prices will continue to stay low until the contracts expire in 1986, 1992 and 1994. We're all thankful for that.

While industry is producing Cook Inlet gas used by thousands of Alaskans in the Southcentral area, a portion of that gas is owned by all Alaskans. That smaller ownership share, called a royalty, equals 12.5 percent of the gas from these fields. The state reserved this 12.5 percent as the public's share when the leases were awarded.

It's this royalty gas — less than 5 percent of all gas used for home heating or power in the Anchorage area — that is at issue in a pricing decision I announced in mid-March. That decision which took effect April 1, seeks to capture the prevailing market value for this publicly owned gas, a value established by sales contracts for other gas produced in Cook Inlet.

That prevailing market value is \$2.05 per thousand cubic feet, compared to the 21 to 61 cents the public has been earning on its gas under the long-term contracts. The result of the March pricing decision could bring an extra \$7

million a year to the public treasury.

On the other hand, what does this decision mean to your utility bill?

The increase in monthly rates would be between 3 percent and 4 percent, according to estimates from Enstar and Chugach Electric. For the average home serviced by Chugach using approximately 800 kilowatt-hours a month — a total monthly bill of about \$37 that translates into an increase of about \$2.30 per month. For an Enstar customer who consumes a monthly average of 16,000 cubic feet of gas, the average monthly bill of \$44 would increase by about 90 cents.

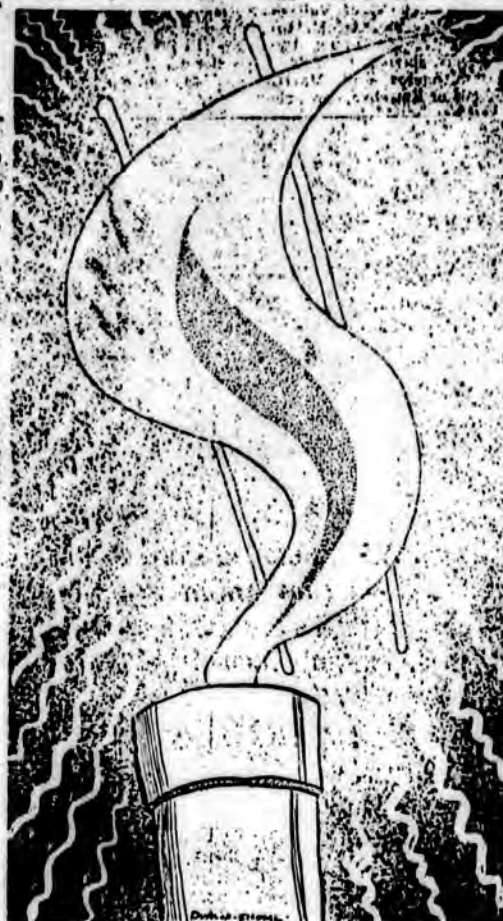
No public official, elected or appointed, wants to take money out of people's pockets unless a greater public good is served. That's the case here.

The principle underlying the Cook Inlet gas decision is the same being pursued on the public's behalf on a wide variety of fronts, both in court and out. Last year, for example, the Phillips Petroleum Co. paid the state \$38 million in additional royalties for publicly owned gas from five Cook Inlet leases, following an agreement between the company and the state on how to value royalty gas. That agreement did not result in higher Anchorage area utility bills because the gas is not used by local consumers, but the principle is the same.

Likewise, the state is involved in several lawsuits seeking to establish accurate values for oil and gas on the North Slope. Billions of dollars are at stake in this ongoing effort to obtain for the people what is their due — a maximum benefit for their resources.

I fully appreciate the desire to keep consumer gas and electricity prices as low as possible. This cannot be done, however, by hidden subsidies to Southcentral consumers through a disregard of the state's oil and gas leasing laws and contracts.

The state currently is investing hundreds of millions of dollars to ensure the energy needs of all Alaskans are met, including those in the Railbelt. Some of that investment has been directed first to the rural areas of Alaska,



where residents often pay a quarter of their annual incomes for home heating and electricity. The state also is nearing completion of the \$150 million electrical intertie between Anchorage and Fairbanks, plans to begin construction next year to the Bradley Lake hydro project near Homer, and is continuing to pursue the Susitna hydro project. Toward those ends and more, Gov. Sheffield has worked with the legislature to appropriate \$250 million during this session to a power development fund.

As the governor told a statewide conference on alternative energy last month, Alaska may or may not build Susitna, depending on the future price of oil, agreement on power sales contracts, and the securing of financing.

"But I believe we're going to have to build something that will fulfill

the growing demand for affordable, dependable power in Anchorage, the Kenai Peninsula and the Railbelt," the governor said. "It may be a series of coal-fired plants, the Susitna and Bradley Lake dams, or alternative energy facilities. More likely, it will be some combination of methods, including better conservation."

To help finance that affordable, dependable energy future for Alaska, as well as take care of all our other needs, the department of Natural Resources is required by law to maximize the people's return on natural resource development. That requirement may not always be popular, but it is a wise one for our state and our future.

□ Esther Wunnicke is Alaska Commissioner of Natural Resources.

Energy decisions hurting Anchorage

By VIRGINIA COLLINS

If there is equity in our statewide energy program, you won't find it in Anchorage.

From 1977 through 1985 the Anchorage area received only one-fifth of the \$1.65 billion appropriated for state energy projects and subsidy programs, including Susitna, yet Anchorage metropolitan area residents make up over one-half of the state's population. In other words, for every energy dollar appropriated over the last nine years, 20 cents was earmarked for Anchorage and 80 cents for the remainder of the state.

Now the state has implemented a new policy which will have the effect of a hidden state tax on Anchorage and Southcentral area utility customers. The cumulative impact of this policy will increase electric utility and gas bills by more than \$3 million annually or more than \$30 million over the next 10 years.

On April 15, 1985, the Department of Natural Resources began assessing higher royalty values on Cook Inlet natural gas it sells to producers. The royalty price increase will be passed on to Chugach Electric and Enstar customers comprising approximately 250,000 residents throughout the Mat-Su Valley, Anchorage and Kenai Peninsula.

In defense of its decision, the department of Natural Resources would have us believe that it is statutorily obligated to implement this new policy on the grounds that this action would "assure full and proper royalty collection for the benefit of all the citizens of Alaska."

In a nutshell, this new state policy implies that the citizens of Anchorage and Southcentral Alaska do not qualify to participate fully in the benefits accorded to other citizens of the state — namely, lower utility rates than would be possible without state assistance.

The state has clearly established its commitment to energy subsidies throughout most other areas of the state in an effort to reduce the escalating costs of power; examples include the \$500 mil-

lion Four-Dam Pool for Southeast, Kodiak, Valdez and Glennallen; a much-needed \$21 million annual appropriation for power cost assistance in rural Alaska and a \$150 million Railbelt transmission line intertie that will enable the Fairbanks/Interior area to avail itself of low cost, natural gas-generated power from Anchorage.

It is true that Anchorage area residents currently enjoy reasonable power rates relative to rural communities; nonetheless these rates are due to increase dramatically within a few short years. The state's decision to assess higher royalty taxes which will be passed on to Anchorage area utility consumers raises fundamental questions about the fairness of subsidizing energy costs for one-half of the state's population while simultaneously taxing the other half; in effect creating two classes of citizens, the subsidized and the de-subsidized.

This issue is greater in scope than the question of whether or not the state should assess higher royalties on Cook Inlet natural gas.

The Alaska Constitution requires that "The legislature shall provide for the utilization, development and conservation of all natural resources belong to the state . . . for the maximum benefit of its people." It is, therefore, the legislature's constitutional responsibility to determine if the state's policy to assess higher royalties for Cook Inlet gas meets the test of providing for the "maximum benefit" of all Alaskan citizens, rural and urban alike.

Clearly, that is not the case for the 250,000 people who live in our state's largest urban area — Anchorage.

The issue of "fairness" in the implementation of our state's energy policy will not fade away. If we fail to address it now, it will come back to haunt us another day and will galvanize public opinion of every utility ratepayer in Alaska.

□ Virginia Collins, a Republican, represents Midtown Anchorage in the Alaska House of Representatives.

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

BILL SHEFFIELD, GOVERNOR

POUCH M
JUNEAU, ALASKA 99811
PHONE:

March 11, 1985

The Honorable Ben Grussendorf, Speaker
Alaska State House of Representatives
Pouch V
Juneau, Alaska 99811

Dear Speaker Grussendorf:

Attached for your information is a recently completed update of Cook Inlet Oil and Gas data prepared by the Division of Oil and Gas. This information updates figures in the Historical and Projected Oil and Gas Consumption report, which was submitted to you in January, 1985.

Total remaining Cook Inlet gas reserves were previously estimated to be 3.26 trillion cubic feet (Tcf) as of January 1, 1984. The revised estimate of Cook Inlet reserves is 4.46 Tcf as of January 1, 1985.

Inclusion of additional gas reserves from the Grayling gas sands (Trading Bay Unit) and incorporation of gas reserves from the Stump Lake Units, Cannery Loop Unit, and Pretty Creek Unit were primarily responsible for the increase in gas reserves.

Assuming current use patterns are maintained, we estimate that cumulative use of natural gas from Cook Inlet fields will be 3.3 Tcf between 1985 and 1999. Thus, it appears that there are sufficient gas reserves to meet projected needs in the railbelt for more than 15 years.

An estimate of state royalty oil available from Cook Inlet fields is also attached.

If you have questions about this information please do not hesitate to contact me.

Sincerely,


Esther C. Wunnicke
Commissioner

Attachments as stated

cc: Members of the House of Representatives

AVAILABILITY OF
COOK INLET ROYALTY OIL

<u>Year (1)</u>	<u>Barrels Per Day</u>
1985	5935
1986	5032
1987	4290
1988	3645
1989	3097
1990	2645
1991	2226
1992	1903
1993	1613
1994	1387
1995	1181

(1) As of January 1 of each year

Department of Natural Resources
Division of Oil and Gas
March, 1985

COOK INLET GAS RESERVES *
(Billions of Cubic Feet)

<u>FIELD</u>	<u>REMAINING RECOVERABLE GAS</u> (as of Jan. 1, 1985)	<u>STATE ROYALTY SHARE</u> (as of Jan. 1, 1985)
Kenai	850	17
North Cook Inlet	650	81
Beluga River	800	60
Swanson River	260	0
Cannery Loop	300	9
McArthur River & Trading Bay	650	81
Beaver Creek	230	0
Cook Inlet Associated Gas	60	7
Ivan River - Lewis River - Pretty Creek - Stump Lake	600	75
Other	63	8
Totals	<u>4463</u>	<u>338</u>

* Department of Natural Resources
Division of Oil and Gas
Updated March 1985

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

BILL SHEFFIELD, GOVERNOR

POUCH M
JUNEAU, ALASKA 99811
PHONE: 907-485-2400

April 2, 1985

The Honorable Mike Davis
Alaska State House
Pouch V
Juneau, AK 99811

Dear *Mike* Representative Davis:

On March 18, 1985, the Department of Natural Resources (DNR) notified certain Cook Inlet gas producers that effective April 1, 1985, the state would no longer accept long-term contract prices as determinative of value of the state's royalty share of gas from the Kenai, Sterling, Beluga River, Trading Bay, and McArthur River Fields. The effective date of this notice has since been modified to April 15, 1985.

The mandate of DNR is to administer the state's leases in accordance with their terms and applicable law, and thereby to collect full and proper royalties for the extraction and use of the state's natural resources. DNR determined that royalties should be based on the current value of the gas which may or may not be reflected by long-term contract prices. The Department of Law has advised DNR that its action is supported by decisions in courts outside Alaska which have addressed this issue. It is also consistent with the position that the federal government and Cook Inlet Region, Inc. (CIRI) have expressed in current litigation with Union Oil Company under federal and CIRI leases in Cook Inlet.

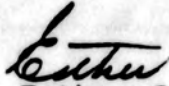
As you can see from the enclosed exhibits, this decision affects only 4.4 percent of the gas stream allocated to consumer use. Chugach, the utility likely to be most affected by the Notice, testified before the Anchorage Caucus today that rates to their customers would increase approximately 4 percent as a result of the decision. The department estimates that the increase to Enstar consumers would be approximately 1/2 of 1 percent. The exhibits also explain the location of the fields, contract prices, current prices, producers, and how state royalty gas is allocated. I also believe my testimony before the Anchorage Caucus today will enable you to better understand both the Administration's efforts to enforce the provisions of the state leases and the fundamental issues of contract enforcement which are at stake. A copy of that testimony is enclosed.

Page 2

April 2, 1985

We understand the concerns raised by our decision. My staff and I stand prepared to work with the Legislature to address these concerns.

Sincerely,



Esther C. Wunnicke
Commissioner

Enclosures:

Testimony
Charts (2)
Pie Charts (2)
Map

STATEMENT
BY
ESTHER C. WUNNICKE, COMMISSIONER
DEPARTMENT OF NATURAL RESOURCES
TO
ANCHORAGE CAUCUS
April 2, 1985

Thank you. You've asked that I provide the Anchorage Caucus with information about our recent decision regarding the valuation of state royalty gas.

It has been the consistent policy of the Department of Natural Resources in managing resources to obtain maximum benefit - in this case revenues - for the people of Alaska.

The department recently notified Cook Inlet lessees that the state will no longer accept royalty valuation based on long-term contract prices that are significantly below market value. This action will increase income to the state treasury by more than \$8 million dollars a year.

Although this is not a popular decision since it may increase the price of electricity and gas in the southcentral area, I nonetheless determined that the best interests of the state required us to take this action. But because of the impact this may have on consumers, Governor Sheffield has asked me

to postpone the effective date of the decision, which was to be April 1, for two weeks to April 15 in order to give the Legislature, the public and the producers more time to consider their responses to the decision.

I'm going to explain the legal basis for the decision and briefly address some of the issues we considered.

The Cook Inlet gas situation is complex, involving multiple owners and uses. Cook Inlet gas goes to Japan as LNG, and is used locally to make ammonia and urea, pressurize an oil field, heat greenhouses, make electricity and heat homes and businesses. Staff from the Division of Oil and Gas will be covering this background material in more detail in a few minutes.

This action results from our obligation to enforce the provisions of the state's oil and gas leases, which are contracts between the producers and the state, and which entitle the state to receive current market value for royalty gas taken in-value. *at the time of production.*

Our position is grounded upon the principle of the sanctity of contracts. The state's leases explicitly obligate the producers to pay the state royalty payments based upon the price or value of the gas, whichever is higher. In this case, we are merely invoking the state's rights to royalty

payments based on the value of the gas, which is higher than the price under the long-term sales contracts. Our policy is totally consistent with the producer utility sales contracts. Those contracts explicitly anticipated that the royalty payment rate to the state might exceed the contract price, and provide that the burden of the higher royalties is to be passed through and borne by gas purchasers.

We advised the gas producers that effective April 1 - now April 15 - they should pay royalties based on a price of \$2.05 per mcf. We did not arbitrarily pick the minimum \$2.05 per mcf value. Rather, Enstar established this value in its recent negotiated contracts.

I decided not to seek retroactive royalty payments based on current market values. For both the retroactive and prospective periods, the gas sales contracts between the producers and the utilities provide that royalty adjustments will be passed through to Enstar and Chugach Electric. Prospective collection can be implemented in an orderly fashion.

However, retroactive collection would create significant legal and financial risks for the state's utility companies, including Chugach - a consumer cooperative. In particular, it is uncertain how, and to what extent, retroactive royalty collections could be passed through to consumers. Since the main benefits of the royalty collection are prospective (the basis for the \$2.05/mcf price was not established until

December 1982), I believe that the financial risks to the utilities and legal uncertainty far outweigh the desirability of seeking retroactive collection.

- ✓ This is a lease enforcement action and it is not optional. The Department of Natural Resources is the agency designated by statute to enforce the provisions of oil and gas leases. (AS 38.05.036)

The Legislature has required the department to obtain as royalty a minimum of 12 1/2 percent of the amount or value of oil and gas production from state leases. (AS 38.05.180(f)). The only exception is when the net profit share is used as the bid variable. Any lease form which is inconsistent with this directive would be void. Thus, "value" is the guiding standard. The "price" of the gas is acceptable for royalty valuation purposes only if that price fairly represents its value at the time of production.

Several statutes mandate or infer our obligation to obtain full value for oil and gas resources:

- AS 38.05.180(a) states that the people of Alaska have an interest in maximizing the economic and physical recovery of oil and gas resources;

- AS 38.05.180(f) requires that leases be awarded to the highest bidder and established bidding methods with a minimum royalty requirement of 12 1/2 percent of the amount or value of production;
- AS 38.05.183(a) provides that as a general rule, royalty gas or oil must be sold to the highest bidder.

There is thus a statutory mandate to obtain a minimum of 12 1/2 percent of the value or amount of production. There are some statutes which allow some discretion to relax a standard or to forgive strict compliance with a term of the lease. However, each of these exceptions to the general rule is specifically limited, and none of the exceptions would allow DNR to relax its lease enforcement practices solely for the purpose of benefitting southcentral consumers. Absent such statutory direction and authority, the department perceives its obligation as being to enforce the terms of the leases equally for all lessees.

Some of the statutes which allow relaxation include the following:

- AS 38.05.020(b)(5), states that the commissioner may extend the time for rental or royalty payments due whenever acts of God, war or riots prevent timely payment.

- ° AS 38.05.035(b)(8) states that the director may extend the rental payment deadline for up to 90 days upon a showing of good cause.
- ° AS 38.05.135(a) says that royalty may be reduced to a minimum of 5 percent, and other incentives provided, in unproven areas in order to encourage exploration. (This section does not appear to apply to existing leases, only to the lease issuance stage).
- ° AS 38.05.180(j) allows reduction of royalty to compensate for increasing costs of production after two years of initial production.
- ° AS 38.05.180(h) allows the commissioner to forgive work commitment stipulations upon certain showings.
- ✓ ° AS 38.05.180(i) allows the commissioner to give exploration incentive credits in certain circumstances.
- ° AS 38.05.180(p) allows the commissioner to change, establish or revoke drilling, producing and royalty obligations of the lease at the time of unitization with the consent of the holders of the leases.

• AS 38.05.810 authorizes disposal of state resources at below market value under certain circumstances. Specifically, it allows disposals at below market value to a state or federal agency or political subdivision, or disposal of coal to non-profit utility cooperatives for electrical generation. It does not mention disposal of state gas to utilities at below market value.

Many other statutes expressly grant limited discretion for DNR to treat some group of citizens in a preferential manner. However, none apply in this context.

I'd like now to briefly discuss the applicable provisions of the oil and gas lease form DL-1.

Paragraph 11 provides that the producers owe to the state 12 1/2 percent of the amount or value of production.

Paragraph 15 provides that royalty may be taken in-value, or in money, in lieu of royalty in-kind. Royalty owed is based upon the "field market price or value at the well."

Paragraph 16 establishes three alternative, independent floors for in-value royalty valuation. It says that the field market price or value "shall not be less than the highest of": 1) the actual price paid; 2) the posted price; and 3) the prevailing price.

The state is thus entitled to royalties based upon the "value" of the gas. The actual price at which the royalty share is sold by the producer is an acceptable basis for royalty valuation under Paragraph 16(1) only if it fairly represents "value" when compared against the other methods of valuation.

✓ In this case, it is clear that the present value of gas being produced is not reflected in the 21¢ and 61¢ long-term contracts. Objective evidence of current value is provided by the December 1982 contracts between Enstar-Marathon, and Enstar and Beluga producers (Shell, Chevron, Arco). In both instances the contract price is currently about \$2.05 per mcf.

Madam Chairman, the department cannot be arbitrary in the administration of oil and gas leases. All leases must be treated the same, and must be administered in accordance with their terms, the regulations and statutes.

Accepting less than current value for in-value royalty gas is not an appropriate mechanism for providing energy subsidies to southcentral Alaska. This would require the department - whose obligation is to all Alaskans - to relax our lease enforcement practices solely in order to benefit some Alaskans at the expense of the general treasury.

If we hope to prevail in the North Slope royalty litigation, it is our view that we must act across the board to collect full value for the state's resources. It would be improper to have one standard of enforcement where oil companies bear the burden and a different more lenient standard where some of that burden is passed on to Alaska consumers.

I'd like to talk for a moment about the specific impacts on consumers. I believe those impacts have been somewhat overstated in the press accounts of our decision. About two-thirds of the \$8 million dollars we expect to collect annually from the producers as a result of the decision could be passed through to Chugach and Enstar. The royalty enforcement policy affects only the royalty share (one-eighth) of the volume of gas sold from state leases to the utilities. The policy has no effect upon the other seven-eighths of the gas sold under these contracts. South-central consumers will continue to enjoy seven-eighths of the bargain prices contained in the long-term contracts.

Gas purchase costs are only a part - about 30 percent - of a utility's expenses, which also include operating and maintenance costs and debt service. By far, the greatest impact falls on the customers of Chugach Electric Association, which is a non-profit cooperative utility. We estimate that Chugach's gas purchase costs will increase by 47 1/2 percent above current rates as a result of our action. However,

residential electric bills are expected to increase by no more than 10 percent for Chugach customers.

As a 60.44 percent owner of the Beluga River gas field, the state's royalty share equals 7.5 percent of total Beluga River gas production. That is the share of production affected by the decision. The decision translates into an overall Beluga gas stream price increase of about 13.3¢ per mcf for Chugach.

Chugach will still be paying a weighted average price of only about 41.3¢ per mcf overall for Beluga gas, compared to their 21¢ and 28¢ contract prices. Forty-one cent gas is still a real bargain.

In the Kenai field, the state owns 16.68 percent of the land and that results in a state royalty share of about 2 percent of total field production. Consequently, the result for Enstar is a price increase of about 2.5¢ per mcf on its overall gas stream out of the Kenai field. With this increase, Enstar still pays a weighted average price of only about 96¢ per mcf for Kenai gas.

We estimate that Enstar's system-wide gas purchase costs will increase by only 1 percent as a result of our action, since that company consumes much less state royalty gas compared to Chugach. According to our calculations,