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# STATE OF ALASKA

**DEPARTMENT OF NATURAL RESOURCES**

**OFFICE OF THE COMMISSIONER**

**JAY S. HARRIMON, GOVERNOR**

**11TH FLOOR, STATE OFFICE BLDG.  
POUCH M - JUNEAU 99811**

September 28, 1977

The Honorable Clark Gruening  
House of Representatives  
State of Alaska  
940 Tyonek  
Anchorage, Alaska 99501

Dear Mr. Gruening:

The statute creating the Royalty Board and other laws relating to state owned royalty oil and gas create a preference in favor of taking royalties "in-kind", and making sales for use in Alaska. These directions were reinforced during the past legislative session by an amendment which directs in-kind taking of royalty unless the Commissioner of Natural Resources makes an express finding that taking royalty "in-value", through cash payments, is in the State's best interest. That amendment also provided for legislative override of a decision to take in-value.

During the final days of the last legislative session, several legislators expressed both publicly and privately their strong desire that we sell our Prudhoe Bay royalty oil for use in Alaska. Following discussion with the Governor I informed them that I would make every effort to conclude such a sale for consideration by the Royalty Board and the Legislature.

The Department of Natural Resources had earlier made two nationwide public solicitations for proposals to purchase our North Slope oil. The response to these solicitations had been very disappointing, producing only one serious applicant; and that applicant was willing only to study the idea, without committing to in-state use. Therefore, I undertook a third nationwide solicitation for proposals at the end of May. That solicitation set a deadline of August 1 for preliminary proposals and October 15 for final offers. Following negotiations with serious bidders, I hope to present a contract to the Royalty Board before the end of December. If approved by the Board, the contract would be presented to the Legislature for its approval early next session.

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In response to this final solicitation, ten preliminary proposals were submitted. Of these, five were rather detailed offers to process in-state all, or most of, the royalty oil from Prudhoe Bay. A summary of these proposals is enclosed. Other proposals from existing Alaskan refineries and utilities generally were aimed at securing options to purchase small volumes of royalty at a later date.

Although the royalty statute provides general guidance for negotiating a sale of royalty oil, these guidelines do not provide a specific enough framework for conducting a large-volume sale. To gain clear direction, I proposed to the Royalty Board in May a set of policies and invited the Legislature and other interested parties to discuss them with the Board. These were more specific than the general language of the statute, but still broad enough to encompass many competing objectives. Several legislators and industry representatives voiced their views on these policies at a public meeting. Following discussion and modification, the Board adopted eight policies. (Enclosed)

As the time for final sale negotiation draws near, it becomes necessary to translate these policies into detailed state positions. I have attempted to do this by defining for my own use in negotiations a set of proposed state objectives specific to the sale. I am enclosing a copy of these proposed objectives for your review, and would be very grateful if you would, in turn, send me your thoughts and reactions. Unlike other issues brought before the Legislature, contract approval is a yes or no question; a contract cannot be amended. For this reason, it is especially crucial that potential problems in our intended negotiation direction be brought to my attention early. I will, of course, be pleased to consider comments at any time, but would find it most useful if I could receive them prior to or shortly after October 15.

I also am anxious to receive any ideas or comments you might wish to offer on any other aspect of the proposed royalty sale. This letter has been sent to all legislators, and interested communities and organizations. Should you wish more information on proposals submitted to date, or if you would like to discuss policy options in more detail, please do not hesitate to contact me or my Deputy, Fred Boness.

Sincerely yours,



Robert E. LeResche  
Commissioner

Enclosures

PRELIMINARY PROPOSALS FOR A LARGE VOLUME (100,000+ B/D)  
SALE OF NORTH SLOPE ROYALTY OIL

SUMMARY

September 22, 1977

PRELIMINARY PROPOSALS FOR A LARGE VOLUME (100,000+ B/D)  
 SALE OF NORTH SLOPE ROYALTY OIL

PURCHASER	CONSORTIUM MEMBERS	FACILITY CAPACITY	PRODUCT SLATE	DOCUMENTS
Alaska Petroleum Company	a subsidiary of Coastal States Gas Corporation	150,000 B/D	Fuels	Prelim Proposal: 7/22; 12 pp. Supplement: 8/18; 5 pp.
Alaska Petrochemical Company (ALPETCO)	60% Alaska Interstate Company 20% Barbour Oil Co. 20% Alaska Consolidated Shipping; Seatrain Lines, Aleut, Bristol Bay Calista, Chugach Natives, Cook Inlet Region, Koniag	150,000 B/D	Primarily Petrochemicals; * possibly more advanced processing; Fuels	Prelim Proposal: 8/1; 70 pp.
Alaska Petrofining Corporation	Sealaska Kaiser Aluminum Southern California Edison Dow Chemical Co. Pacific Gas & Elect.	250,000 B/D	Primarily Petrochemicals; * Coke; Fuels	Prelim Proposal: 7/27; 5 pp. Press release: 9/7; 5 pp.
Energy Resources Inc.	unidentified	150,000 B/D	Primarily Petrochemicals; * Fuels	Prelim Proposal: 8/1; 50 pp. Supplement: 8/19; 25 pp
Alaska Oil & Chemical Company	Guam Oil & Refining American Petrofina --	100,000 B/D	Primarily Petrochemicals; * Fuels	Prelim Proposal: 7/28; 3 pp + 40 pp report.
Pacific Resources Inc.	WITHDRAWN			

\* aromatics: benzene, toluene, xylenes  
 olefins: ethylene, propylene, butylene

POLICY STATEMENT MADE BY

The Alaska Royalty Oil and Gas  
Development Advisory Board

May 5 & 6, 1977

1. The Royalty Oil and Gas Board shall recommend disposition of royalty oil and gas (through in-value taking, in-kind taking, sales, and sales conditions) in such a manner to maximize net benefits to the State. These net benefits include not only price, but also the various economic, social, and environmental ramifications, including employment, local training, Alaskan ownership, secondary effects, tax base, and many other factors.
2. The baseline price for any royalty oil or gas sale shall not be less than the price that would be received for that oil or gas if taken "in-value".
3. Preference will be given first to existing in-state facilities with no alternate sources of oil or gas, and second to those who will construct new in-state facilities or expand existing in-state facilities.
4. A portion of royalty oil will be withheld from long-term commitment in order to anticipate future small local demands.
5. With the exception of small sales to public utilities, sales will be for specified volumes or proportions of production, constant throughout the year, rather than for flexible volume "options" to be called by the purchaser.
6. Sales of royalty oil and gas for in-state processing will attempt to insure that products for in-state use are priced at the lowest possible price, within the limits of the general net benefit policy and the pricing policy.
7. Products produced from royalty oil and exported from the State must be surplus to the State's domestic and industrial product needs.
8. In general royalty oil and gas will be disposed of in long-term contracts, rather than in "piece lots" as may be done by a private-sector trader or dealer.

Proposed State Objectives for  
Negotiating a Large-Volume Sale of  
Prudhoe Bay Royalty Oil

\* \* \*

Volume of Crude to be Sold  
Interim Sale of Crude  
Product Slate  
Facility Size  
Facility Siting  
Price of Crude  
Environmental Controls  
Termination Provisions and Penalties  
State Advocacy  
Resident and Minority Hire  
In-state Product Sales and Prices

Note: The list of proposed objectives do not include all topics which will form the basis for negotiations. It includes only those objectives for which State interests may not be clearcut.

Robert E. LeResche  
Commissioner  
Department of Natural Resources

## VOLUME OF CRUDE TO BE SOLD

### Background

All companies proposing to build a world-scale facility speak in terms of 20-25 year contracts, as financing of such a project necessitates the long-term assurance of crude supply. Prospective purchasers view state royalty as the core for their 100 to 250 thousand barrel/day operations, with other crude sources (such as producer crude) filling the remaining capacity. Several companies have proposed to buy all of the State's North Slope oil royalties, which are estimated at 150,000 barrels/day at a field production rate of 1.2 million barrels/day. However, the Royalty Board established a policy in May designed to keep our options open:

"A portion of royalty oil will be withheld from long-term commitment in order to anticipate future small local demands."

The question now arises as to the percentage of our royalty oil which should be reserved for future sales. Several parties have shown interest in obtaining small volumes (generally from 3,000 to 5,000 barrels a day) for varying lengths of time. Last spring Golden Valley Electric Company of Fairbanks was awarded approximately 5,000 b/d of royalty for a 6 year term. Municipal Utilities System (Fairbanks), North Pole Refining, and Tesoro-Alaskan have also expressed interest in small-volume sales.

### Proposed State Action

I intend to design contract terms which will grant the large-volume producer long-term certainty of a substantial supply (90%) of Prudhoe crude; and yet reserve a small portion (10%) for future local sales.

## INTERIM SALE OF CRUDE

### Background

Early this year, concern arose over whether the State would lose control of its royalty oil if it was taken "in-value" when pipeline flow began. Arguments were made that with in-value taking marketing arrangements would be "frozen" by the Emergency Petroleum Allocation Act of 1973. On March 23 the State asked the Federal Energy Administration for an interpretation of the Act as it affects in-value taking of royalty oil. On April 27 a ruling was issued, which proved favorable to the State's interests: As long as Alaska receives its royalties in-value we retain the option at a future time to take in-kind and sell to a purchaser of our choice. However, once we do begin taking royalty in-kind for sale, and establish a "supplier-purchaser relationship", the State's control is less certain.

If Alaska sells its oil for immediate delivery to a purchaser who agrees to construct a facility in-state, a supplier-purchaser relationship will be established. If that purchaser then defaults on contract terms and does not follow-through on facility construction, there is a possibility that the State might not be able to terminate sales, regardless of how carefully the contract was written. For this reason, I am hesitant to develop a contract which includes purchase of crude prior to refinery construction. This is especially true now that several companies have offered to enter into a contract in which royalty is purchased only after a refinery becomes operational.

### Proposed State Action

I intend to favor proposed contract terms which commit State royalty oil only after a facility is constructed. Any prospective purchaser who desires to purchase oil prior to facility operation will carry the burden of proof. He must demonstrate a need for such an arrangement, propose contract language to protect the State in the event of default, and otherwise suggest how this might benefit Alaska's interest.

## PRODUCT SLATE

### Background

Preliminary proposals offered a range of product slates from 100 percent fuels to a mixture of fuels and petrochemicals. One company also anticipates producing petroleum coke.

Prospective purchasers are constrained by a variety of factors in deciding upon the type and quantity of products to produce. For example, one consortium has designed a product slate based on the distinct product needs of its member companies. In general, processing capabilities, interests, and marketing outlets for products differ among the applicants. And of course, all have their own separate perceptions as to what product slate will ensure an economically viable project in Alaska.

The State's interest in product slates is not a simple question. One argument is that the State should remain "indifferent", selecting a purchaser and negotiating a contract based on criteria other than the product slate. The other side of the coin is that the State should take an active interest in influencing the companies selection of products to be produced.

All companies are aware of the State's interest in assuring petroleum products to meet Alaskan energy needs. For this reason they all offer to produce enough fuels to meet in-state needs, although I believe some would have concluded this aspect of the project will not be economically attractive for them. Beyond that threshold, proposals diverge as to how the remaining crude should be processed. Some argue that petrochemicals provide more benefit to the State than do fuels. The concept of "value-added" as it relates to jobs and property taxes is advanced. The potential for satellite growth is another factor: The production of petrochemical intermediates may stimulate more advanced petrochemical processing; and coke has been suggested as a product which could lead to in-state processing of metals. In addition to economic concerns, the State must also consider how environmental impacts relate to various product slates.

### Proposed State Action

My Department recently published a report which portrays the current and expected in-state needs for petroleum fuels. I have requested that this analysis be supplemented by a discussion of the capabilities of the three existing Alaska refineries to satisfy these needs. Based on this information I intend to determine a minimum threshold of fuels production to meet in-state needs. Once that need is met I believe the State should adopt a position favoring the "value-added" concept of petrochemicals and the potential for satellite growth of a diverse product slate.

In addition, I plan to be sensitive to the need to temper state desires with the realities of marketing economics, which are of prime concern to prospective purchasers, and will consider not requiring a company to produce fuels for in-state use if that company can clearly demonstrate that the State's best interests are served by not doing so.

## FACILITY SIZE

### Background

Preliminary proposals have offered to construct a world-scale facility ranging from a crude intake of 100 to 250 thousand barrels per day. The amount of royalty crude requested by the applicants differ very little among these proposals. Any facility at or above a threshold of 120,000 barrels/day will be capable of processing virtually all of the North Slope royalty oil. All companies recognize that they likely will have to contract with one or more of the North Slope producers to fill out their needed supply requirements, especially in light of uncertainties of exact field production characteristics.

Several companies indicate that their choice of facility size is based on economics. Some argue that economies of scale translate into "bigger is better". Others argue that market or financing considerations constrain the size. The State, of course, has an interest in the economic viability of a project; and therefore, the State must be sensitive to the concerns of each prospective purchaser.

Socioeconomic and environmental considerations likely will differ with facility size. Economic benefits may very well increase with the size. Environmental and infrastructure problems of a particular site may increase with size, although these costs may or may not outweigh the additional benefits.

### Proposed State Action

At present, I will encourage prospective purchasers to develop proposals which optimize the economies of their projects. Within this framework, I will also suggest that bidders maximize in-state processing of Alaskan oil -- using other crude sources as well as our North Slope royalties.

## FACILITY SITING

### Background

State interests in siting involve a variety of environmental, social, and economic considerations. Industry interests in choosing a site are governed principally by some of these same considerations; physical characteristics, overall economic viability, and favorable local opinions and environmental conditions. As several contract elements may be linked to a choice of site, it will be necessary to select a site before a final contract is developed.

I have asked industry to consider sites anywhere in Alaska in conducting their site analyses. Basic economics have caused industry to focus on sites from the western side of Cook Inlet, through the Kenai Peninsula, Prince William Sound, Gulf of Alaska, and down the northern half of Southeast Alaska. I have asked that in addition to identifying and prioritizing preferred sites, reasons be given for not selecting considered sites.

Agency analyses will center on the information and criteria submitted by the companies, and on the factors of principle concern to Alaska.

### Proposed State Action

I will not finalize a contract for Royalty Board and legislative approval until a site is identified and can be included as a contract term. The siting term may possibly include an alternative site, in the event that the selected location cannot be used.

Hearings will be conducted before a site is determined; and a site will not be selected in any area where local or public opinion is strongly adverse.

Proposed sites will be viewed favorably which would result in minimal social and environmental impacts, access of fuel products to Alaska markets, positive synergistic effects with other resources and industry potential for satellite development, and optimal economies for the refinery complex.

## PRICE OF CRUDE

### Background

In May the Royalty Board adopted a pricing policy:

"The baseline price for any royalty oil or gas sale shall not be less than the price that would be received for that oil or gas if taken "in-value".

This policy is premised on the notion that the revenue received for our royalty oil benefits the State as a whole; whereas spinoff effects of refinery development benefit distinct localities (jobs, property taxes) and users of petroleum products. Therefore, the State as a whole should not "subsidize" industrial development in a particular location.

### Proposed State Action

I intend to negotiate a contract with the "in-value" price serving as the minimum acceptable bid.

## ENVIRONMENTAL CONTROLS

### Background

Prospective purchasers have been asked to address in their final proposals the subject of environmental controls. It is conceivable that a company may find it can reasonably offer to build and operate a facility which surpasses minimum environmental standards. In this event it may be in the State's interest to include as a contract provision a standard higher than a state or federal regulatory agency can impose through their permit processes. If a prospective purchaser receives a favorable review of his offer and is selected on the basis of promises made, then it is in the State's interest to ensure that these promises are incorporated into a contract as commitments.

### Proposed State Action

I intend to consult with the Departments of Fish and Game and Environmental Conservation to determine contract elements which might protect the environment in a way or to an extent which is currently beyond their regulatory powers. In so doing, I intend to be sensitive to industry considerations and to ensure that minor environmental gains are not dependent upon monumental economic losses.

## TERMINATION PROVISIONS AND PENALTIES

### Background

The State has an obvious interest in selecting a purchaser who will carry through with facility construction. Further it has been brought to my attention that time is an important factor in securing favorable financing: Each day of Prudhoe production taken in-value reduces the total volume of royalty the State can provide over the length of a contract. Hence, a false start resulting in contract default carries substantial burdens.

The State must examine the experience and financial status of prospective purchasers in order to ascertain capabilities to carry through with facility construction and operation. It is also important to ensure that the successful bidder fully intends to execute the contract, rather than viewing a contract as an option to be executed or terminated following the outcome of a feasibility study. There are several elements of the project which, inherently, will demonstrate the level of industry commitment. These include the status of securing crude from other sources to assure full volume beyond the royalty core, the extent to which take-or-pay product sale contracts have been executed, and the success in obtaining committed project financing before the time of contract finalization.

In addition the State might also assess the sincerity of the prospective purchasers by their willingness to limit purchaser termination clauses and to include penalties for non-performance or default in the contract.

### Proposed State Action

I intend to evaluate each company's capabilities and commitment to build a facility in-state before selecting a successful bidder. In addition, I intend to negotiate for a contract which will limit purchaser termination rights and which includes penalties or liquidated damages provisions in the event of non-performance or default.

## STATE ADVOCACY

### Background

Several companies have indicated a desire for the State to contractually (or otherwise) commit to assuming an advocacy role in government regulatory processes. These suggestions include the following:

- \* The State will supply supportive testimony during local, state, and federal permit processes.
- \* The State will commit itself to ensuring that state permit applications are reviewed in a timely fashion.
- \* The State will grant the issuance of all state (and local) permits required by law.

### Proposed State Action

I intend to keep the State's proprietary powers entirely separate from its sovereign powers.

While we may properly commit to taking an active role as an interested party in a regulatory process, we will not use our sovereign powers to interfere in any manner with the normal decision-making processes of those regulatory bodies. I further will not grant the purchaser any special termination rights, nor allow the State to be liable for any actions or inactions which may occur because of a state agency carrying out its duly authorized responsibilities.

## RESIDENT AND MINORITY HIRE

### Background

As evidenced by recent court decisions, the State, as a sovereign, has limitations imposed on its powers to influence resident hire. However, conditions the State may wish to impose through a contract are not so constrained.

### Proposed State Action

I intend to include strong provisions requiring resident and minority training and hire in the contract.

## IN-STATE PRODUCT SALES AND PRICES

### Background

The royalty statute addresses in-state use in the following manner:

"Oil or gas taken in-kind by the state as its royalty share may not be sold or otherwise disposed of for export from the state until the Commissioner with the approval of the Alaska Royalty Oil and Gas Development Advisory Board determines that the royalty in-kind oil or gas is surplus to the present and projected intrastate domestic and industrial needs." AS 38.05.183(d)

While it may be argued that the statute refers only to crude oil and not to the refined products, the Royalty Board has set as policy:

"Products produced from royalty oil and exported from the State must be surplus to the State's domestic and industrial product needs."

In addition the Royalty Board adopted a policy that:

"Sales of royalty oil and gas for in-state processing will attempt to insure that products for in-state use are priced at the lowest possible price, within the limits of the general net benefit policy and the pricing policy."

### Proposed State Action

I will endeavor to include a provision ensuring a preference of product sales to in-state markets. The extent of this preference will be tempered by the recognition that prospective purchasers must secure long-term sales contracts for a substantial portion of their products, in order to obtain financing.

STATE ENERGY POLICY COMMITTEE

October 19, 1977

Minutes (draft)

On Wednesday, October 19, 1977, the fourth meeting of the State Energy Policy Committee was called to order by Chairman Miles at approximately 2:00 p.m. In attendance were: Members Joan Ray, Bob Huffman, Clarissa Quinlan, Kay Poland and Bill Miles.

Chairman Miles stated that the meeting was called at the request of Commissioner Gallagher to discuss the solicitation, for proposals regarding the use and disposition of Alaska's royalty gas. The Committee itself would not be taking any formal action but the Commissioner wanted the Committee's comments, suggestions and questions.

Commissioner Gallagher said that following consultation with the Departments of Commerce and Natural Resources, the Department of Revenue sent out letters soliciting bids for studies that would analyze relevant state options for the use and disposition of Alaska's royalty gas. One study will deal with technical and engineering aspects associated with royalty gas, while the other concerns the economics or marketing of the royalty gas, inside and outside the state, including foreign markets. The budget for these studies is \$150,000. The money was allocated pursuant to HCR 27, passed by the Legislature last session. These solicitations were sent to approximately ten firms. Any interested firm that did not receive either solicitation letter should contact Jim Edenso in Juneau.

A separate study (HCR 27 \$60,000 budget) will deal with the feasibility of state financing of separate royalty gas spur lines, etc.

Commissioner Gallagher introduced Jim Edenso who gave a detailed overview of both solicitations. Phase I included eight subjects, summarized as follows: I. Injecting the NGL into the TAPS crude-oil stream at Prudhoe Bay and subsequently extracting the NGL from the crude-oil stream at Fairbanks or tidewater; II. Constructing a pipeline to carry "wet gas" from Prudhoe Bay to Fairbanks or tidewater and producing NGL and NG at Fairbanks or at tidewater; III. Feasibility of constructing a gas conditioning plant at Prudhoe Bay and a separate pipeline to carry NGL to Fairbanks for royalty and producers gas liquids; IV. Feasibility of a NG pipeline from Fairbanks to Haines; V. Feasibility of thermally polymerizing excess propane and butane into gasolines at Prudhoe Bay and transporting gasolines in crude oil to market; VI. Feasibility of hydrocracking excess propane and butane to methane and ethane at Prudhoe Bay and transporting

methane and ethane in NG to market; VII. Feasibility of using excess NGL in combined cycle, gas turbine power generation at Prudhoe Bay and sending power south via high-voltage DC transmission to Fairbanks, Anchorage, and to run pipeline pumps and compressors; VIII. Feasibility of doing nothing and simply taking the state's royalty share in dollars.

Phase II should answer questions of production and marketing. It will give the State answers to the questions of how much natural gas is being produced at Prudhoe Bay and Cook Inlet and what is the disposition of that production. It also delves into current plans for construction of a gas conditioning plant at Prudhoe Bay and the maximum amount of natural gas liquids that can technically be included in a crude oil pipeline. Phase II will also look into market for natural gas and natural gas liquids in the Fairbanks/Anchorage railbelt area; the market for natural gas, liquid propane and natural gas liquids in rural and southeast Alaska, including specific product delivery modes, and the market for natural gas liquids in the Lower 48.

Questions asked by the Committee included the following: The firms are only being given approximately two weeks to formulate a bid and the study itself must be completed in two or three months. Is that an adequate length of time? Where and/or how would a bidder obtain the answers to these questions? Does the State have any personnel qualified to answer them? Commissioner Gallagher replied it would take a technical engineering firm to obtain the answers. He plans to interview the potential bidders. Time requirements would be a part of that discussion.

Ms. Quinlan asked if the producers had developed plans for their seven-eighths share of natural gas liquids? No word has been received. Commissioner Gallagher felt the producers are presently undecided.

Speaker Malone questioned Commissioner Gallagher as to what will be done with what is left over after the liquids are extracted? The Commissioner said it is not yet clear what will be done. The study will address that issue. As to the methane, it is presently being reinjected into the field. Speaker Malone also asked what is Alecon going to do about the gas liquids? Discussion by Senator Poland, Commissioner Gallagher, Rep. Chatterton and Bob Huffman followed as to the probable, highest and best use of the natural gas liquids.

Speaker Malone asked whether the study would consider the present and projected energy demands of the Southcentral area? Also, in this regard, Committee Staff Assistant David Rogers asked whether Alaska's needs for natural gas would be addressed in this study. Commissioner Gallagher answered affirmatively that all the State's natural gas needs would be considered.

In discussing sites for possible conditioning plants, Speaker Malone requested that they consider sites in the Kenai Peninsula Borough. He also expressed concern that the feelings and planning efforts of local governments be taken into account as well as the possibility of pricing reductions for areas in the processing areas. Chairman Miles questioned whether the solicitations to the contractor took into consideration royalty oil options as they relate to decisions regarding royalty gas? The study will definitely address this problem, according to Commissioner Gallagher.

Executive Director of OMAR Paula Easley raised the issue of whether Canada would extract certain natural gas liquids as the pipeline enters Canada and replace those extracted natural gas liquids with others as the pipeline reenters the U.S. Discussion by Bob Huffman, Commissioner Gallagher and George Silides ended with Commissioner Gallagher stating he would obtain a legal analysis of the Treaty and Agreements related to this problem.

Chairman Miles requested that the Phase II marketing study not limit itself to looking only at domestic markets for the State's natural gas and natural gas liquids but include the potential foreign markets, i.e. Japan. Commissioner Gallagher assured the Committee this would be done.

Representative Rhode inquired if the producers were helping finance these studies, couldn't they furnish most, if not all, the information requested? He felt that since they own seven-eighths share, it seems they would have a greater interest in these studies than the State would owning only one-eighth share.

Chairman Miles closed the meeting by stating that it was his understanding the solicitation for proposals would not be sent out until the Energy Policy Committee had a chance to make comments and recommendations. He added that it appeared to be the consensus of the Committee that the final contract include: all options for the use of royalty gas, consideration of the relationship between a royalty oil decision and the royalty gas options and the question of local pricing exceptions.

The meeting adjourned at approximately 3:30 p.m.

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STATE ENERGY POLICY COMMITTEE

Memo: To All Legislators  
From: Bill Miles, Chairman  
State Energy Policy Committee  
Re: Royalty Oil Proposals, Report I  
Date: October 20, 1977

In order that the entire Legislature may have access to available information on the Royalty Oil Proposals prior to the commencement of the next legislative session, the attached report is being sent to you. It represents the first in a series of reports designed to keep members abreast of pertinent information as it develops regarding royalty oil.

This report includes an overview of various activities relating to the royalty-oil disposition question. It further includes a summary analysis of the preliminary proposals submitted to the Royalty Oil and Gas Advisory Board.

REPRESENTATIVE BILL MILES, CHAIRMAN

SENATOR KAY POLAND, VICE CHAIRMAN  
SENATOR W. E. "BEAD" BRADLEY  
SENATOR GLENN HACKBELY  
REPRESENTATIVE AL NAKAK  
REPRESENTATIVE LEO RHODE

COMMISSIONER H. PHILLIP HUBBARD  
COMMISSIONER ROBERT LERESCHE  
ROBERT HUFMAN  
WILSON A. RICE  
JOAN A. RAY

# I. THE USE AND DEVELOPMENT OF ALASKA'S ROYALTY SHARE OF PRUDHOE CRUDE-- OVERVIEW

In June of this year, Commissioner Robert LeResche, on behalf of the Department of Natural Resources and the Alaska Royalty Oil and Gas Development Board, mailed detailed nation-wide solicitations for a negotiated sale of Alaska's Royalty share of Prudhoe Bay crude oil--approximately 150,000 barrels per day (b/d) on a field production rate of about 1.2 million b/d. To date, the Royalty Board has received eleven proposals offered pursuant to the June, 1977, solicitation (Phase I). Final proposals were due to the Royalty Board on October 15, 1977 (Phase II). The State will select one or more proposals which will provide the basis for final action by the Administration. During the first part of February, 1, 1978, contract(s) will be concluded and submitted to the Legislature for its approval.

The Alaska Royalty Oil and Gas Development Advisory Board is charged with primary substantive review of these proposals. Under AS 38.06.050 (a), no sale, exchange, encumbrance or other disposition of oil or gas or the rights or waiver of the right to receive a future production of royalty oil or gas may be offered by the Commissioner of Natural Resources to the Legislature without the prior written approval of the Board. The Board's decision must promote private economic growth consistent with applicable environmental standards

and public fiscal stability (AS 38.06.010) taking into consideration State revenue needs, present and projected local and regional need for oil and gas products and by-products as balanced against state and federal requirements, desirability of the various local economic effects of the bargain, social and environmental impacts, benefits to local and regional labor and consumption markets, state and local costs as a result of related development, and effects on private enterprise. (AS 38.06.070(a) 1--8) The Board may recommend to the Commissioner that royalty oil may be taken in kind rather than in value if it is determined that such an acquisition would be in the best interests of the State. (AS 38.05.182) The Board may also require, as a condition for disposition, that oil or gas be refined or processed in the State. (AS 38.06.070(b)) No royalty oil taken in kind may be sold or otherwise disposed of for export from the State until the Commissioner, with the approval of the Royalty Board, determines that the in kind oil is surplus to present and projected intrastate domestic and industrial needs. (AS 38.05.183 (d))

Commissioner LeResche has publicly enumerated certain "bottom line" conditions and objectives for the sale. The price for crude oil must be equal to or greater than that received if royalty oil taken "in value." In-state processing facilities must provide net positive effect on Alaska's social and economic welfare. It must also be environmentally acceptable. Finally, the state should seek to ensure a relative decrease in the price of fuel and, perhaps, petrochemical products in

Alaska, all without government subsidies in the form of tax relief, risk assumption "under sold" crude, or other mechanisms. According to Commissioner LeResche, the ideal offer would provide as follows: purchase of up to 150,000 b/d of Alaska's royalty crude for a term of twenty to twenty-five years; pay "in-value" price or more; construct in four to five years an integrated refinery and petrochemical complex in Alaska for 150,000 through 250,000 b/d; commit \$400 million to \$1.5 billion in private capital to the project; train and employ three hundred to four hundred Alaskans in permanent refinery and shipping jobs and about two thousand in construction; insure availability of products in Alaska at a price below imported product; pay state and local taxes of up to \$100 million per year; provide the "world's most sophisticated" design and pollution control capabilities. The Commissioner has also indicated that 90% of the royalty oil will be offered for sale. The remaining 10% will be reserved for use by in-state refineries.

In an effort to facilitate timely development of proposals which adequately reflect the requirements of law and administration policy in this matter, the state has prepared a "Developers' Guide for Alaska's Royalty Oil and Gas." The stated intent of this Guide is to "assist potential developers in providing responses necessary to satisfy the state's evaluation procedure" and to "describe specific areas of concern, preliminary siting criteria and an inventory of

state permitting requirements" This comprehensive manual systematically categorizes, lists and illustrates the various information requirements that must be met by serious proposals. The guide requests such things as general project descriptions, site development data, power needs, state and local revenue projections, financing and ownership schemes, labor demands including local hire provisions, subsidy requirements, in-state product pricing and availability potentials, views and suggestions on methods to share certain development costs, environmental implications, and ways to accommodate public participation in the decision making process. This information is required in some detail in Phase I and in greater detail and scope in Phase II. In addition, the Developers' Guide provides readers with a list of preliminary siting criteria "to assist a developer in preparing a description of the proposed facility and locating potential acceptable sites." This section asks the developer to consider a wide range of factors including project compatibility with projected land and water uses, transportation needs and impacts, safety controls, environmental effects and safeguards and local preferences for development. The Guide also includes a draft inventory of state permit requirements to "assist prospective developers in understanding the scope of required actions necessary prior to development activities."

The Developers' Guide comes complete with a detailed listing of sample evaluation factors to help developers understand

"how their input will be utilized by the state and the key factors of concern to the state." A working committee of state personnel has been assigned to assist in the information exchange/evaluation process.

(FOOTNOTE\*: The "Developers' Guide for Alaska's Royalty Oil and Gas" from which much of the above information was taken, is available from the State Energy Policy Committee library.)

## II. ROYALTY OIL PROPOSALS

Eleven proposals were submitted for Phase I scrutiny. Eight primarily involve the construction of new fuel and petrochemical refineries; three involve requests from local users of petroleum seeking to supplement their present supply with Alaska Royalty Oil. The information contained in this report has been taken directly from the preliminary proposals submitted to the State.

### New Facility Proposals

#### Alaska Petroleum Company

##### A. General Information

The Alaska Petroleum Company is a wholly-owned subsidiary of Coastal States Gas Corporation with its principal offices in Houston, Texas. To date, the Coastal States Gas Corporation has refineries in Corpus Christi, Texas, Hercules, California and Wichita, Kansas which produce "a full line of petroleum products." It operates refined products terminals in Boston, Los Angeles and southeast United States. Coastal owns four tankers, operates nine others under time charter, and utilizes up to twenty additional vessels from "time to time." Subsidiaries of the company also own two crude carriers presently under construction and scheduled for completion in late 1977 and mid-1978. In 1976, Forbes, which publishes a ranking of the five hundred largest U.S. corporations, ranked Coastal 131st

in total sales, 230th in total assets and 312th in net income. According to the proposal, Alaska Petroleum Company, incorporated in Alaska, "looks to the parent organization for financial support and management advice in conducting its business in the State."

B. Proposal

Alaska Petroleum Company seeks to contract with the State for the purpose of building and operating 150,000 b/d refinery to be located at a site "mutually acceptable to both parties." More specifically, APC is bargaining for a State guarantee of 150,000 barrels per day capacity for twenty years commencing on the first day of refinery operations for the purpose of producing a variety of fuels and, perhaps, certain petrochemical products such as Benzene, Toluene and Paraxylene. Alaskan markets for these products would be preferred. APC requests expeditious permit processing, no "new burdensome government regulations," and preferential rights to purchase royalty crude oil from "time to time" until refinery operations are established. The company agrees to employ "best available technology" in complying with applicable federal and state environmental control standards.

The company has identified several possible plant sites including Port McKenzie, Tyonck, North Kenai to Homer, Seward, Gravana Orca Bay and "in the vicinity of Juneau." The facilities will cost approximately \$400 million excluding

marine facilities and community development expenditures, will take three to four years to construct and will employ up to fifteen hundred trade people in the process. The refinery operation itself will employ approximately three hundred people. When necessary, community service personnel are added to the work force. Alaska Petroleum Company claims seventeen hundred new jobs would be created by the refinery operation with a payroll contribution of thirty-five to forty million dollars annually. The company endorses preferential employment of qualified Alaskans and agrees to provide training programs to enable Alaskan applicants to qualify for employment in the proposed refinery.

The Alaska Petroleum Company is proposing a solely private venture and contends that "contractual assurance of a long term raw material supply with the state would be required to obtain favorable loan consideration." Sales contracts for the principal products may also be necessary "depending on the magnitude of the loan obligation." Some of these commitments may be obtained from affiliates on the West Coast and "elsewhere in the U.S." The project will be completed "under normal circumstances" by 1983 to 1985. Alaska Petroleum will pay "its fair share" of the development costs for the project.

#### Alaska Petrochemical Company

##### A. General Information

The Alaska Petrochemical Company (ALPETCO), is an Alaskan

corporation formed and owned by Alaska Interstate Company (AKI) (60%), Barbour Oil Company (20%) and Alaska Consolidated Shipping Inc. (20%): Aleut Corp. Bristol Bay Native Corp., Calista Corp., Chugach Natives, Inc., Cook Inlet Region, Inc., Koniag, Inc. and Seatrain Lines, Inc. Ford, Balon & Davis Inc. will provide engineering management. It is interesting to note that Barbour Oil Company currently owns and operates about seventeen thousand acres of oil and gas leases in Kansas, Louisiana, Oklahoma, and Texas. Seatrain Lines, Inc. which owns 49% of the ACS stock operates ocean terminals, a refinery in Abilene, Texas through its wholly owned Pride Refinery, Inc., has six U.S. vessels available for use and is able to acquire other vessels on an "as needed" basis. In addition, a subsidiary, Seatrain Ship Building Corp., operates a ship yard and has recently completed construction of three petroleum tankers with one scheduled for delivery in early 1978. Alaska Interstate Company which owns Anchorage Natural Gas Company and the Alaska Pipeline Company, holds interests in 285,000 gross acres of federal oil and gas lease applications in Alaska and has a working interest in a Susitna exploration drilling venture. AKI employs approximately 200 persons in Alaska.

#### B. Proposal

ALPETCO proposes to purchase all available royalty crude for twenty-five years at a price "which is not less than the price the State of Alaska would have received in value" for the purpose of building a 150,000 b/d petrochemical refinery

complex in Alaska. The proposal contemplates production of aromatics, olefins and their intermediates. This facility would also produce gasoline, arctic diesel and jet fuels at approximately 30,000 b/d for in-state use through existing channels of distribution. The proposal also encourages the possibility of more advanced processing facilities by the private sector. Petrochemicals would be marketed preferentially in Alaska, in the U.S. and to customers outside the U.S. ALPETCO estimates a three to four year design and construction period and proposes to buy, transport and market, as a condition to any agreement with the State of Alaska, the state's royalty crude to contractually bound purchasers in Alaska and the lower 48 during the interim. ALPETCO pledges the "latest technology available" to meet all federal, state and local regulations.

ALPETCO has indicated a preliminary preference for Valdez, the terminus for the North Slope Pipeline, but, "has reached no conclusion." The cost of siting is "disproportionately important to the project. The complex will cost approximately \$1.5 billion and will permanently employ fifteen hundred people with an estimated average annual payroll of \$34 million. Three-hundred fifty of these jobs will be associated with marine transportation of the products. Up to two thousand people will be employed in the three to four year construction phase with a gross payroll of \$38 million. ALPETCO commits to some form of Alaska hire as a "fundamental building block

of its corporate responsibility in which the company will reside." It will also "plan for and realize" the development of the comprehensive training program associated with petrochemical and marine employment. The new facility will generate up to \$100 million per year in local and state taxes.

According to Kuhn Loeb & Co. Incorporated and E. F. Hutton & Company Inc., financial advisors and investment bankers for Alaska Petrochemical Company, a twenty-five year crude supply commitment and assurances that preliminary details (e.g. permits) will be expeditiously processed by the State of Alaska are deemed essential to successful financial arrangements.

#### Alaska Petrofining Corporation

##### A. General Information

Alaska Petrofining Company is a sponsoring group consisting of the Sealaska Regional Native Corporation, Henry J. Kaiser Co. (Kaiser Aluminum), Southern California Edison, Dow Chemical Company and Pacific Gas and Electric Company. Project financing will be handled by Stone and Youngburg, investment bankers. CH<sub>2</sub>M Hill, a west coast environmental assessment firm, will be involved in the environmental conservation plans. UOP Process Division of UOP, Inc. is responsible for refinery process design. It is interesting to note that this group has provided complete process designs for sixty-five basic refineries. Henry J. Kaiser Co. will perform detailed engineering and construction management.

UOP Management Systems will provide operational management.

#### B. Proposal

The Alaska Petrofining Corporation seeks to install a world scale size 250,000 b/d capacity completely integrated fuel, petrochemical refinery which will utilize as a basic feedstock, royalty oil "purchased from the state at a competitive price." These facilities would produce such things as low sulphur fuel oil for power generation to west coast utilities, distillate fuels (jet fuels, diesel and home heating oils) to local and west coast industrial and utility markets, petrochemicals to "one of the five largest U.S. chemical companies," gasoline (aviation and motor) to the local markets and petroleum coke (used in metallurgical refining). The proposal indicates that sponsoring companies which make up the Alaska Petrofining Corporation have a "current internal demand for the full output of the proposed facilities" which includes energy products and speciality products. They assure competitive pricing and the "latest environmental safeguards" so that the benefits of the refinery can be realized without significant penalty to the environment."

#### Energy Resources, Inc.

##### A. General Information

The consortium members are unidentified. Financial backing has been raised from an international consortium. Information will be released "to the proper authorities upon request."

The Ralph M. Parsons Company has prepared a proposal for

Energy Resources, Inc.

B. Proposal

Energy Resources, Inc. contemplates construction of a fully integrated petroleum and petrochemical complex processing 150,000 barrels per day of Alaska royalty crude to be completed in 1981. Fuels and petrochemicals will be produced for in-state and presumably out-state markets. The plant will be built to "more than satisfy all current federal, state and local environmental standards."

The proposal forecasted a permanent workforce of three hundred twenty-five refinery personnel plus an additional forty administration personnel with an estimated annual payroll of \$34 million. During peak construction periods twenty-five hundred to twenty-eight hundred persons will be employed with an estimated annual payroll of \$47 million. The state will received \$655 million for the sale of royalty crude and \$27 million annually in taxes. No estimates have been provided with respect to employment and taxes generated by supporting industries. Energy Resources, Inc. intends to "hire and train the majority of all personnel required" from Alaska. No subsidies are requested. Moreover, the proposal contemplates a six to seven cent cost reduction from existing prices to in-state wholesalers who "hopefully will pass the savings to the consumer."

## Alaska Oil And Chemical Company

### A. General Information

The Alaska Oil and Chemical Company is a wholly owned subsidiary of the Guam Oil and Refinery Co, Inc. (GORCO). GORCO was formed for the purpose of building an oil refinery on the island of Guam. The refinery has been operating in Guam since 1970 and has a capacity of 45,000 barrels per day. The company is privately owned and currently has a sales volume in excess of \$150 million annually. GORCO proposes that the project should ultimately take the form of a "consortium effort, consisting of chemical companies, oil refiners and marketers, native Alaska investors and others." Their preliminary proposal incorporates the conclusions contained in a feasibility analysis completed by Purvin & Gertz, Inc.

### B. Proposal

The Alaska Oil and Chemical Company wants to build a 100,000 barrel per day petrochemical refinery which will use North Slope Royalty Oil and produce primary petrochemicals and low sulfur fuels. The proposal appears to assume the tandem development of derivative plants which produce intermediate petrochemicals from primary petrochemicals produced in the facility proposed by Alaska Oil and Chemical Company. It is not clear whether these intermediate facilities form part of the Alaska Oil and Chemical Company proposal or whether a primary facility would be constructed without these adjacent derivative industries. The project is estimated to be

completed by 1982 at a total cost of \$950 million for the basic petrochemical refinery. Additional investments in excess of \$1 billion would be necessary for derivative plants. The refinery and all derivative plants would be designed to meet "the strictest environmental regulations."

The Purvin & Gertz proposal favors Valdez and Kenai Peninsula sites but does not exclude consideration of other sites. It should be noted that Valdez is viewed as logistically superior but there is some question as to the availability of a suitable site location. Kenai is also preferred because it is already the home of a major concentration of Alaskan carbon based industries including two petroleum refineries, an LNG plant and a nitrogen fertilizer plant. Four hundred thousand to five hundred thousand gallons per day of fresh water will be required "and this must be considered in selecting the site." Purvin & Gertz estimate that two to four thousand workers will be involved in the three year construction phase (Four to five years if derivative plants are included.) with plant operations beginning in 1982. The petrochemical refinery itself will employ seven hundred employees with an annual payroll of \$14 million. Derivative plants would employ two or three times more in total. Ultimate employment projections thus range over three thousand persons with little seasonal variation. Three additional support jobs would be generated for every petrochemical refinery job.

### Commercial Realty Company

Commerical Realty Company is a Los Angeles realty company which claims to be affiliated with several companies which "taken together, have significant experience" in oil production, refining, terminaling, and marketing. Commerical Realty proposes the construction of "one or more" petroleum processing plants probably located in the Valdez area. Products would be marketed in Alaska and "elsewhere." Initial plans contemplate a 50,000 b/d processing plant for bunker fuel, asphalt, diesel, jet fuel, naptha and possibly gasoline. Later phases could involve more sophisticated products. Retail marketing facilities are also mentioned in the proposal. "First phase" possibly could begin "relatively soon after governmental permits have been granted." All facets of the environment will be protected. It should be noted that Commerical Realty requires moderate oil pricing to offset the high cost of construction and operation in Alaska.

### Tesoro-Alaskan Petroleum Corporation

In addition to proposals for use of royalty oil in existing refineries, Tesoro has proposed to contract for up to 74,000 barrels per day for possible use in an expanded and/or new refinery facilities at the "highest posted price by a substantial purchaser in Prudhoe Bay." The proposed contract terms would include a three year feasibility analysis period with an option to purchase royalty oil for any purpose during this time, a three year construction period with an option

to purchase royalty oil for any purpose during this time, and a twenty year primary operations period commencing with start up operations of expanded or new refinery facilities. Tesoro may, at its option, cancel the contract after the initial three year feasibility period.

Pacific Resources Inc.

This proposal has been withdrawn.

EXISTING FACILITY PROPOSALS

There are three proposals which solicit the use of royalty oil as a supplement to existing refinery operations:

The Municipal Utility System (MUS) in Fairbanks would use substantial quantities of oil to fire their existing power plants. Although the city of Fairbanks is attempting to enter into a joint venture agreement with Golden Valley Electric Association for the construction of a large scale coal fired electric generating plant by 1983 at the earliest, the MUS, during the interim period, "will be relying heavily on oil fired electric generation equipment and is in need of a committed source of oil to use in the turbines."

Tesoro-Alaska Petroleum Company is interested in purchasing Prodhoe Bay crude for use at its Kenai Alaska Refinery.

North Pole Refinery at North Pole, Alaska wants royalty oil for its refinery operations to "meet the demand of future petroleum growth in the interior of the state." NPR envisions royalty oil as a supplement to a non-royalty base supply adjusted to future demands in amounts ranging from three thousand to five thousand barrels per day.