

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2279 SCOMM 94: SENATE SPECIAL COMMITTEE ON OIL & GAS, 1993-94

III. Capital credits could undermine the fiscal security of the state.

Currently, royalty revenues (including RIK payments) constitute 45% of the state's income. RIK payments range from 25% to 50% of that total. It is possible, under this legislation, that the state could be deprived of 10 to 25% of its entire income for any given year. In essence, it would be giving away a substantial portion of its natural resources.

IV. RIK purchasers are not in the business of benefitting Alaskans.

The primary RIK purchasers who would potentially benefit from the proposed legislation, i.e., Tesoro, MAPCO, and Chevron, are subsidiaries of out-of-state parent corporations. They have made substantial profits from their Alaskan operations to pay dividends to their shareholders or fund non-Alaskan operations. Their business is to benefit their shareholders, not Alaska. From 1987 to 1991, MAPCO paid its shareholders in excess of \$134 million in dividends, \$26 million more than the total amount of the state's claim, inclusive of interest. Note, it would have the state underwrite its further competitive advantage by forgiving its debts, and allowing it to shelter even greater profits for its shareholders.

RIK purchasers fail to produce data which support their contention that they priced their product based upon the supply price. In fact, MAPCO's SEC filings suggest that sales prices remained constant while supply costs decrease. Price was, and is, controlled only by competition. It must be remembered that MAPCO has monopoly power in Fairbanks and anti-trust violations were alleged against MAPCO in that

area. For example, MAPCO charges more for gas in Fairbanks (where it processes its oil) than in Anchorage (where competition exists). There is no independent evidence to suggest that MAPCO has passed on the benefits of lower supply prices to Alaskans.

Third, the refiners have not always used the oil they purchased from the state to make products for consumption in Alaska. For example, Chevron bought oil from Tesoro which Tesoro bought from the state. Chevron then shipped the oil out of state to its West Coast refineries.

V. Royalty Oil Purchasers should not be singled out for favorable treatment.

A. If the state is going to give capital credits for money the state alleges is due it under a contract with a third party, there is no reason to single out refiners for special treatment. North Slope producers provide greater economic benefits to the state and have many large disputes regarding amounts owed to the state for royalties. The producers also are planning substantial additional capital investments in the future. How can the state maintain equal treatment for all parts of the oil industry unless it allows capital credits to others?

B. The state has loan programs to assist students, fishermen, farmers, small business owners, and homeowners. Those people are expected to repay their obligations to the state. It is difficult to see the fairness of a doctrine that throws a farmer and his family off the farm or forecloses a poor student when

he won't or can't pay his obligation to the state, yet forgives (by capital credit) the debt of large, powerful corporations who negotiated their contracts with the state with the benefit of informed counsel, and who have been cognizant of their potential retroactive obligations since their original contracts were signed.

VI. The legislation encourages RIK purchasers not to pay amounts legitimately owed the state.

In essence, the bill provides for a capital credit any time an RIK purchaser disputes a debt owed to the state. In other words, any time a lawyer for an RIK purchaser dreams up a reason for not paying, they won't. The legislation would invite perpetuation of disputes so that debts could be avoided and new investments could be underwritten by the state's citizens.

Moreover, the bill allows the purchaser to try first to get a favorable result in court. Then, even if the purchaser loses (after the state incurs considerable litigation costs), the purchaser wins because he will be entitled to capital credits.

The bill sends a strong message to those who contract with the state that they will not be required to honor the agreement they made with the state.

VII. The legislation has many technical problems.

- A. Terms like "credit," "gross value of capital investment," and "substantially completed" are not defined. For example, does the credit apply to a total capital investment of \$100 MM when \$99 MM of the expenditure occurred out of state for construction of modular refining components which were subsequently shipped to Alaska and reassembled?
- B. It creates an administrative bureaucracy to determine whether a project's benefits are commensurate with the credit.
- C. It is impossible to determine how the credit would work.
- D. The bill appears to allow the Department of Commerce and Economic Development to approve material amendments to existing RIK contracts without the benefit of legislative oversight currently required by AS 38.05.183(f).

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

WALTER J. HICKEL, GOVERNOR

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March 12, 1993

Hon. Bill Hudson
Alaska House of Representatives
Room 108
State Capitol
Juneau, AK 98081-1182

Re: SB 134 and HB 185 (Capital
credits for royalty
oil purchasers)

Dear Representative Hudson:

Royce Weller of your staff requested our analysis of materials prepared by certain royalty oil purchasers concerning HB 185 and SB 134 (capital credits for royalty oil purchasers). The materials we reviewed include:

1) "A Response to Two questions Regarding Capital Credit Legislation for Royalty Oil Purchasers" - author unknown;

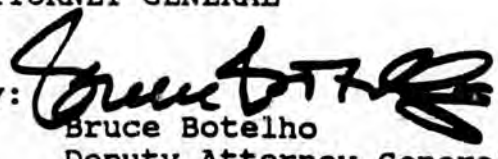
2) "SB 134 and HB 185 - A Sound Investment in Alaska's Economic Future" - by Tesoro Petroleum Company; and

3) "The fiscal and Economic Impact of New Vacuum and Asphalt Units at the Kenai Refinery of Tesoro Alaska Petroleum Company" - by ECO Northwest.

The foregoing documents provide a rationale for the passage of SB 134 and HB 185. Our analysis of the points raised in these documents by proponents of the bills is attached. If you desire more detail concerning any of the points raised in the analysis, do not hesitate to ask. Also enclosed is a copy of the Tesoro royalty oil settlement agreement you requested.

Sincerely yours,

CHARLES E. COLE
ATTORNEY GENERAL

By: 
Bruce Botelho
Deputy Attorney General

BMB:JLB:tg
Attachments

RESPONSE TO CERTAIN MATERIALS SUPPORTING
THE ENACTMENT OF SB 134 AND HB 185 (CAPITAL CREDITS)

Material is being circulated purporting to analyze the relationship between the Amerada Hess settlements and the amounts owed by the royalty oil purchasers. These materials lead the reader to the incorrect conclusion that SB 134 and HB 185 (capital credits for royalty oil purchasers) will create jobs and tax revenues. The following analysis serves as a rebuttal to

1) "A Response to Two Questions Regarding Capital Credit Legislation for Royalty Oil Purchasers" - author unknown;

2) "SB 134 and HB 185 - A Sound Investment in Alaska's Economic Future", by Tesoro Petroleum Company; and

3) "The Fiscal and Economic Impact of New Vacuum and Asphalt Units at the Kenai Refinery of Tesoro Alaska Petroleum Company," by ECO Northwest:

1. Paying full value for the Oil Does Not Threaten the In-State Refining Industry--MAPCO and Tesoro Have the Right to Pay the Claim in Modest Installments Over Ten Years

The state's claim against the royalty oil purchasers arose out of certain provisions in present and past contracts that required the purchasers to pay the state additional retro-active amounts if the state prevailed in the Amerada Hess case against the producers of North Slope crude oil. As a result of settlements between the state and the producers, the state

claimed that the royalty oil it sold to purchasers was undervalued to the extent that the producer's undervalued the oil.

Those who would benefit from the enactment of the bill imply that the payment of the state's claim would threaten the fiscal health of major in-state refiners. However, existing contracts and settlement agreements contain provisions that fairly provide for the payment of the debt owed to the state. MAPCO and Tesoro have the right to pay over approximately ten years. MAPCO has that right in its major contract which accounts for most of the state's claim against that company. Tesoro was given that right in its recently negotiated settlement agreement with the state. Neither company has reported to its shareholders or to the Securities and Exchange Commission that payment of the settlement amount over ten years (Tesoro) or the claim (MAPCO) would threaten the future of the companies.

MAPCO has repeatedly said to the SEC and its stockholders that the claim "will not have a material adverse effect on MAPCO's consolidated financial position." MAPCO, Inc. 10-Q Report to the SEC. Tesoro praised the settlement in its January 19, 1993 press release saying:

Management is pleased that this dispute was concluded on mutually favorable terms This settlement represents a significant step forward and will allow Tesoro's management to focus on other operational and financial matters. Further it removes an enormous uncertainty regarding the Company's future operations.

News Release of Tesoro Petroleum Corporation, January 19, 1993.
State fiscal policy should not be driven by hollow threats.

2. Capital Credits Do Not Create Jobs or Tax Revenue.

The standing committees hearing these bills should carefully weigh the claim that the bills will create new jobs or unanticipated tax revenue. The ECO Northwest study claims that a \$46.5 million refinery expansion may work economic wonders. The questionable assumptions made in that study are discussed in paragraph 4A and B, but the study methodology merely diverts attention from the real issue. That being: are the benefits of capital construction available without the provision of capital credits? In Tesoro's case, capital credits will not create the promised economic bonanza - it is the refinery expansion itself that will produce whatever benefits may arise. The study did not take into consideration the state's role in the funding of Tesoro's refinery expansion. Nor did it consider Tesoro's motivation to expand.

The State's settlement with Tesoro was made so as not to interfere with expansion of Tesoro's refinery. The State agreed to take modest payments and to reduce its collateral so Tesoro could expand (page 11, paragraph 6 of the settlement agreement). In its news release, Tesoro acknowledged the key

provisions of the settlement that provide for future expansion by saying:

Tesoro's obligation owed the state under the agreement is subordinated to current and future senior debt of Tesoro of up to \$175 million plus indebtedness incurred in the future to improve the Company Alaska Refinery.

Id.

Whatever the benefits of the expansion may be, they are available without capital credits. The state gave Tesoro the ability to undertake the expansion without capital credits.

3. Royalty oil purchasers would be singled out for Special Treatment.

The legislature is prohibited by article II, section 19 of the Alaska Constitution from passing special legislation if a general act can be made applicable.

Under the bill, royalty oil purchasers would have a special benefit available only to them. In order to validly provide a valuable benefit to a limited group of firms doing business in the state, the legislature would need to establish that it is not denying equal protection of the law to other firms that are similarly situated. There must be a fair and substantial relationship to legitimate purposes. State v. Lewis, 559

P.2d 630 (Alaska 1977). The burden of proving the legitimacy of legislation under this standard has become significantly more complicated under the Alaska Supreme Court's enlightened approach to analyzing equal protection claims.

- A. The amount owed by royalty oil purchasers doesn't justify special treatment.

In an attempt to show that royalty oil purchasers are a class warranting special treatment, Tesoro notes that they owe approximately \$300 million, an amount equal to the total value of their capital assets, and that the approximately \$700 million paid by the producers represents only 6 percent of the value of their assets.

Among other things, this assessment indicates that the value of the investments by the producers is somewhere in the vicinity of 12 billion dollars. In the interest of equity, it is clear that the producers have made much greater direct investments which, in turn, have had even greater indirect multiplier effects on the Alaska economy.

It is suggested that the state's claim for reimbursement is huge in relation to the ability of royalty oil purchaser's to pay. The claim, for example, is compared to the value of the companies' Alaska assets. This comparison has no

meaning. It is characteristic of many industries that raw material or feed-stock costs exceed the value of the plants in which they are processed. For example, fish cost more than the plants in which they are processed. MAPCO and Tesoro have paid for oil many, many times the value of their Alaska assets. That is a characteristic of the refining business, not a distinguishing characteristic.

Proponents of the bill claim that royalty oil purchasers are entitled to special treatment because they are being asked to pay a disproportionate part of the total price adjustment resulting from the Amerada Hess settlement. They argue that the royalty oil purchasers have taken only 4 percent of total oil production yet owe \$300 million for the retroactive price adjustment. The implication is that the State is claiming \$300 million for 4 percent of the oil and \$700 million for the remaining 96 percent. However, this comparison is disingenuous and misleading. The proper comparison is to royalty oil taken, not to total oil production. The State's royalty share is 12.5 percent. Three-quarters of this amount, 9 percent, is subject to Amerada Hess price adjustments. Roughly 4 percent was sold to in-state refiners and 5 percent (not 96 percent) was taken "in value" by the producers. The royalty oil purchasers thus received about 44 percent of the State's oil subject to price adjustment (4 percent divided by 9 percent) and are being asked to pay only one-third

(\$300 million divided by \$1 billion) of the total amount owed. There is no disparity here that warrants special treatment.

B. The effect of the Amerada Hess settlement on royalty oil purchasers does not warrant special treatment.

The royalty oil purchasers imply that they deserve special treatment because they were unfairly made subject to the Amerada Hess oil values settlement. Tesoro and MAPCO negotiated contracts with the state to be bound to the results of the Amerada Hess litigation or settlement and to refrain from intervening in that litigation. It is disingenuous now for Tesoro or MAPCO to imply that they were unfairly excluded from settlement discussions with various producers. The refiners had little or no knowledge of the producers' pricing practices and would have added time and expense to the ultimate resolution of that dispute. The Superior Court decided that the refiners interests were well represented by the producers when it denied the refiners' motion to intervene. The State now asks for nothing more from Tesoro and MAPCO than they agreed to pay in their contracts. This would not provide a reasonable basis for special treatment.

4. The Royalty Oil Purchasers Owe a pre-existing debt for the Modest Price Adjustment which the State now Claims.

The state's claim for reimbursement represents a pre-existing debt of the royalty oil purchasers. They are asking for forgiveness of this debt. As a general matter, the public purpose provision of the Alaska Constitution forbids the bare forgiveness of preexisting debt. However, if it can be shown that the state receives adequate consideration for the forgiveness, the public purpose may be established.

As for the validity of the debt, the materials provided by the refiners in support of the bills imply that something is wrong with being asked to pay an addition to the original charge. The truth is that the royalty oil purchasers agreed by contract to make the additional payment now. It is suggested that prices of refined products would have been higher if only the royalty oil purchasers had known about the additional charge.

The price adjustment the state is seeking is about 3.0 percent (excluding interest) of the total amount which the refiners paid for royalty oil. This is a very modest adjustment accrued over roughly ten years. A tiny accounting reserve each year would have been prudent. The oil producers and Tesoro apparently had reserves, but MAPCO filed lawsuits asserting

surprise and disaster. Neither surprise nor disaster should be the result of a 3.0 percent price adjustment. MAPCO is hard pressed to claim surprise now, particularly when it was aware that its neighbor refinery, Petro Star, was required to escrow \$1.12 per barrel for its future Amerada Hess adjustments beginning in 1985. It comes as no surprise that Petrostar satisfied its obligations to the state without complaint.

A. The ECO Northwest Study use faulty assumptions.

The clear implication of ECO Northwest's study is that consideration for debt forgiveness will flow from the benefits of capital construction. The ECO Northwest study relies on a computer model that assumes capital spending will directly and indirectly stimulate economic activity. The desired result is programmed into the model. Furthermore, the model does not recognize public costs (e.g., schools, sewer, water, police, fire) which result from a project, it double counts revenue, and it ignores the beneficial effect of the field cost allowance discussed in subparagraph B below. The model also uses the wrong discount rate to determine the present value of alleged benefits which will occur, if they occur at all, over 20 or more years.

The model shows total Alaska spending benefits of \$87 million dollars per year (see Table 1 of the study). This amount serves as the basis for each result of the model and creates the

desired economic bonanza. Of the \$87 million, \$82 million (94 percent) is "expenditures on additional crude petroleum. . . ." This must mean royalty oil purchased from the state because there is no other long-term source of large quantities of oil. This amounts to double counting. The model assumes that additional oil will be produced because of the refinery expansion. In fact, the oil will be produced and purchased without the refinery expansion. The oil will either be taken in value (i.e., effectively "purchased" by the producers) or taken in kind, but the quantity produced will not be changed. On average, the likely real benefits are only about 6 percent of the benefits claimed in the ECO Northwest study (see Table A-3).

The model further overstates the adequacy of consideration by using an incorrect discount rate to determine the present value of future dollars. The model uses 4 percent and ignores inflation (see Table 4 of the study). A more realistic discount rate would be in the range of 8 to perhaps as high as 15 percent to recognize both inflation and the risk that the projected benefits will not occur. Using the correct discount rates would dramatically reduce the claimed benefits. For example, Table A-8, found on the next to last page of the ECO Northwest study, shows that at any discount rate greater than 4 percent, the additional tax revenues over 20 years are less than the cost of the project. Put another way, the project has a negative return to the state even with the double counting of crude oil

sales revenue. The selection of a 4 percent discount rate for the model was not a coincidence.

- B. The ECO Northwest study omits consideration of other benefits provided by the state.

In determining whether there is adequate consideration to support the forgiveness of debt, the legislature must consider the other valuable benefits provided by the state treasury to encourage in-state refining. In the first phase of the Amerada Hess litigation, the Superior Court found that the state had no obligation to reimburse its lessees for field costs so long as the state took its oil in value, but ruled that a field cost was due if the oil was sold to an in-state refiner. This ruling was a major impediment to the development of in-state refining.

Recognizing this impediment, and in a conscious decision to support in-state refining, the state gave up its right to avoid the payment of field costs for in-value royalty oil and negotiated a settlement agreement with the North Slope producers which obligated it to pay the same field costs regardless of whether it takes its oil in value or in kind. That amount is currently 79 cents per barrel at Prudhoe Bay and 42 cents per barrel at the Kuparuk River Unit. These are field costs which the state incurred only because it chose as a matter of policy to sell to Tesoro, MAPCO, GVEA, Chevron and Petro Star.

The total value of the field cost deduction is now more than \$700 million, and is subject to escalate under the settlement agreements. These field cost deductions are estimated to total a minimum of \$1.4 billion over the life of the fields.

Based on the foregoing analysis it is questionable whether there would be adequate consideration to support the forgiveness of the RIK purchaser's preexisting debt or offset the incentives previously provided.

5. There Are No Safeguards in the Bill

The bill takes from the legislature and gives to royalty oil purchasers the responsibility and authority to spend hundreds of millions of dollars. There are no safeguards, checks, or balances. The authority extends for ten years. There is no oversight of the company's decisions, decisions that amount to material amendments of the royalty contracts.

Proponents of the legislation claim that the state is protected because the commissioner of the Department of Commerce and Economic Development must approve capital credits. However, the protection afforded by the bill is illusory. The commissioner is compelled to approve the credits unless there is proof by "clear and convincing evidence," that the credit will not

adequately benefit the state. Furthermore, the commissioner is compelled by the statute to act in sixty days. Who will analyze the proposed credit and represent the state's interest? How can the commissioner in sixty days determine the statewide effect of a multimillion dollar capital expenditure? There is no conceivable justification for shifting the burden to the state to prove that the expenditures are not in the state's interest. Any attempts to support a determination to that effect likely would spawn additional litigation.

The legislature understandably has required legislative approval of royalty oil contracts and modifications to those contracts. One reason is to be sure that a disposal of state resources is in the best interest of the state. Reducing the contract price and taking a capital credit are economically the same, yet the legislature will have no opportunity to review capital credits. There may be bizarre results. For example, MAPCO is the major customer of Golden Valley Electric Association. However, with the benefit of capital credits to make the necessary investment, MAPCO could generate its own electricity at its North Pole refinery (Tesoro generates electricity at Nikiski). Electrical generation paid for with capital credits could be very cost effective and, using the ECO Northwest model, would show benefits to the state. Unfortunately, it would be a disaster for GVEA's other customers. Their rates would rise

significantly because fixed costs now paid by MAPCO would be shifted to the remaining customers.

The legislature should not shift control of major expenditures to the RIK oil purchasers.

DRAFT

8-LS0691VE.2 -
Chenoweth
3/20/93

AMENDMENT

OFFERED IN THE SENATE

TO: SB 134

Page 4, line 8, after "agreement":

Insert "entered into after December 31, 1979, and before January 1, 1993,"

DRAFT

8-LS0691E.5
Chenoweth
3/20/93

AMENDMENT

OFFERED IN THE SENATE

TO: SB 134

Page 3, lines 9 - 17:

Delete all material and insert:

"(C) must claim the credit within 3 years of the effective date
of this subsection;"

Page 3, line 26:

Delete "any"

Insert "the"

DRAFT

8-LS0691NE.6
Chenoweth
3/20/93

AMENDMENT

OFFERED IN THE SENATE

TO: SB 134

Page 3, lines 9 - 17:

Delete all material and insert:

"(C) must claim the credit within the later of

(i) five years of the effective date of this subsection; or

(ii) the second anniversary date of the contract,
settlement, or final judgment that is the basis of the liquidated purchase
arrearage under which the credit is claimed;"

DRAFT

8-LS0691\E.9
Chenoweth
3/22/93

AMENDMENT

OFFERED IN THE SENATE

TO: SB 134

Page 3, lines 9 - 17:

Delete all material and insert:

"(C) must claim the credit within five years of the effective
date of this subsection;"

Page 3, line 26:

Delete "any"

Insert "the"

DRAFT

8-LS0691NE.7
Chenoweth
3/22/93

AMENDMENT

OFFERED IN THE SENATE

TO: SB 134

Page 2, line 15, after "credit;":

Insert "in determining whether the investment for which the credit is claimed will yield benefits to the economy of the state, the commissioner shall

(i) determine the location or locations in which the purchaser proposes to add substantial value to the capital project for which the credit is sought; and

(ii) reject the credit if any substantial portion of the material, labor, and other factors that are claimed as part of the projected gross value of the purchaser's investment in the capital project will be paid to employees, vendors, or contractors in a location or locations outside the state;"

DRAFT

8-LS0691E.8
Chenoweth
3/22/93

AMENDMENT

OFFERED IN THE SENATE

TO: SB 134

Page 2, lines 12 - 15:

Delete all material and insert:

"(B) if the purchaser demonstrates to the commissioner of commerce and economic development, by clear and convincing evidence, that the investment for which the credit is claimed will yield benefits to the economy of the state that are greater than the amount of the credit allowed on that investment;"

SENATE COMMITTEE REPORT

(POST COMMITTEE OF REFERRAL)

DATE: 2/24/93

FURTHER: L&C
JUDICIARY
FINANCE

Date of 5-Day Notice: 3-11-93
(in accordance with Uniform Rule 23)

DATE TURNED 4-2-93
INT() OFFICE:

Senate Special Committee on Oil and Gas considered SB 134

"An Act establishing credits for purchasers of state royalty oil for expenditures made by those purchasers on qualifying capital investments to be applied against liquidated purchase arrearages established in contracts, settlements, or final judgments; and providing for an effective date."

and recommends:

☒ replace with CS SB 134 (O+G)

☐ attaches amendment(s)

☐ same title
☒ new title
☐ technical
title change
(HB only)

☐ adopts _____ Letter of Intent

☐ further referral to the _____

☐ do pass

☐ do not pass

☐ no recommendation

☒ individual recommendations

FISCAL NOTE INFORMATION

Department	Date	Zero	Fiscal

Department	Date	Zero	Fiscal
DNR-SB	3/16/93	Indet (333,300)?	
DNR-CS	4/1/93	Indet (249,750)?	

☐ Appropriation No Fiscal Note

☐ Governor's Bill with Previous Fiscal Notes (enter information above)

DO PASS.

OTHER RECOMMENDATIONS:

Boyd Thayer No-Rec
Rich Halford No Rec
J. E. Ballo No Rec
Al Adams - DO NOT PASS - cut Budget
give away our
dollars - bad pol/c

Robert A. Brown No Rec
Chair: Signature and Recommendation

FISCAL NOTE

Bill Version: SB 134(S) Publish Date: 4-2-93STATE OF ALASKA
1993 LEGISLATIVE SESSIONBILL NO. SB134

Revision Date Original Department Affected: Natural Resources
 Title: "An Act establishing credits for purchasers
of state royalty oil..." BRU: Resource Development
 Sponsor: Senators Miller and Pearce Components: Oil & Gas Development
 Requestor: O&G, JUD, FIN Component Serial No. 439

EXPENDITURES/REVENUES: (Thousands of Dollars)

OPERATING	FY 94	FY 95	FY 96	FY 97	FY 98	FY 99
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	*****See attached fiscal note analysis*****					

CAPITAL	0.0	0.0	0.0	0.0	0.0	0.0
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REVENUE fund source:	0.0	0.0	0.0	0.0	0.0	0.0
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FUNDING: (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	*****See attached fiscal note analysis*****					

POSITIONS:

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

Estimate of current year (FY93) Impact: \$ (333,300.0)

ANALYSIS: (Attach a separate page if necessary)

See Attached

Prepared by: Jim Eason, Director Phone: 762-2547
 Division: Oil & Gas Development Date: 16-Mar-93
 Approved by Commissioner: Glenn A. Olds Date: 16-Mar-93
 Agency: Department of Natural Resources

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE

For further distribution information call the Governor's Legislative Office

Fiscal Note Analysis
SB134
March 16, 1993

The full financial impact of this bill is difficult to quantify because, in addition to allowing "credits" for past liabilities, it would essentially present each of the in-state refiners with blank checks for "new" credits against any future royalty disputes that might arise. However, it is possible to estimate the minimum fiscal impacts based upon the current value of the principal and interest attributable to each debt related to past liabilities. As of March 31, 1993, that amount would equal slightly more than \$333.3 million, including the liquidated debt of Petro Star and the settled debt of Tesoro, which each would presumably prefer to avoid through reallocating those amounts to investments in their respective in-state operations under the provisions of the legislation.

In addition to these past liabilities, the purchasers would be able to "create" new credits at any time simply by withholding payment for their royalty in kind crude oil purchases, having the court certify their liability and then simply making new investments in their facilities to "repay" their obligations to the state. As royalty oil volumes decline over time, the volume of in-kind oil from which the state could conceivably receive no revenues under such circumstances would grow in relative terms.

FISCAL NOTE

No. 2Bill Version: CSSB 1340FG(S) Publish Date: 4-2-93STATE OF ALASKA
1993 LEGISLATIVE SESSIONRevision Date April 1, 1993Department Affected: Natural ResourcesTitle: "An Act establishing credits for purchasers
of state royalty oil..."BRU: Resource DevelopmentComponents: Oil & Gas DevelopmentSponsor: Senators Miller and PearceRequestor: O&G, JUD, FINComponent Serial No. 439

EXPENDITURES/REVENUES:

(Thousands of Dollars)

OPERATING	FY 94	FY 95	FY 96	FY 97	FY 98	FY 99
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND&STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	*****See attached fiscal note analysis*****					

CAPITAL	0.0	0.0	0.0	0.0	0.0	0.0
---------	-----	-----	-----	-----	-----	-----

REVENUE fund source:	0.0	0.0	0.0	0.0	0.0	0.0
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FUNDING:

(Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1006 GF/MHTIA						
Other						
TOTAL	*****See attached fiscal note analysis*****					

POSITIONS:

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

Estimate of current year (FY93) Impact: \$ (249,750.0)

ANALYSIS:

(Attach a separate page if necessary)

See Attached

Prepared by: Jim Eason, DirectorPhone: 762-2547Division: Oil & Gas DevelopmentDate: 16-Mar-93Approved by Commissioner: Glenn A. OldsDate: 1-Apr-93Agency: Department of Natural Resources

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Fiscal Note Analysis
CSSB134 (O&G)
April 2, 1993

The full financial impact of this bill is difficult to quantify because, in addition to allowing "credits" for past liabilities, it would essentially present each of the in-state refiners with blank checks for "new" credits against any future royalty disputes that might arise. However, it is possible to estimate the minimum fiscal impacts based upon the current value of the principal and interest attributable to each debt related to past liabilities. As of March 31, 1993, that amount would equal slightly more than \$333.3 million, including the liquidated debt of Petro Star and the settled debt of Tesoro, which each would presumably prefer to avoid through reallocating those amounts to investments in their respective in-state operations under the provisions of the legislation.

The Committee Substitute for SB 134 appears to place a maximum exposure for potential credits at 75% of the amount determined to be due the state. As drafted, the CS for SB 134 would appear to assure that 25% of all debts would go to the Permanent Fund, with any credits being taken only against amounts owed to the general and school funds. As a result, the amount of the original fiscal note, \$333.3 million is reduced to \$249.75 million.

In addition to these past liabilities, the purchasers would be able to "create" new credits at any time simply by withholding payment for their royalty in kind crude oil purchases, having the court certify their liability and then simply making new investments in their facilities to "repay" their obligations to the state. As royalty oil volumes decline over time, the volume of in-kind oil from which the state could conceivably receive no revenues under such circumstances would grow in relative terms.

SUPPORT

Introduced by: Brown, Glick,
Reilly, Scalzi, Torgerson
Date: 3/16/93
Action: Adopted
Vote: Unanimous

KENAI PENINSULA BOROUGH
RESOLUTION 93-24

A RESOLUTION SUPPORTING A REQUEST BY TESORO ALASKA AND MAPCO
FOR CAPITAL CREDIT

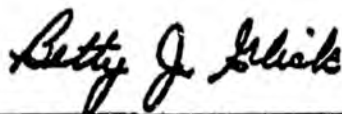
- WHEREAS, the Kenai Peninsula Borough supports Tesoro Alaska and Mapco's request to credit the value of future capital investments (in-state) against their royalty settlement; and
- WHEREAS, the value-added refiners have incurred claims from the state of over \$300 million in retroactive price increases following the settlement of the Amerada Hess case for Alaska North Slope Crude Oil they purchased over a 10+ year period in the 1980's which such claims exceeding the continued assets of the companies in Alaska; and
- WHEREAS, the value-added refiners in Alaska represent one of the most successful and efficient utilizations of Alaska's natural resources resulting in in-state manufactured fuel availability to 90% plus Alaskans; and
- WHEREAS, there are ample precedents of state and federal policy and law providing investment credits from some or all such obligations; and
- WHEREAS, the availability of investment tax credits can provide exceptional return on the investments in terms of long term employment, tax revenue, and business stimulation; and
- WHEREAS, such investments will further assure the continued viability of the value-added refinery industry and provide immediate benefits to the state; and
- WHEREAS, one of Tesoro's proposed capital investments will be a pipeline that will eliminate Tesoro's need to transport crude by tanker; and
- WHEREAS, this proposed pipeline will greatly reduce the potential environmental disasters in the Cook Inlet;

NOW, THEREFORE, BE IT RESOLVED BY THE ASSEMBLY OF THE KENAI
PENINSULA BOROUGH:

SECTION 1. That the Kenai Peninsula Borough supports passage of Senate Bill 134 and House Bill 185 and urge the legislature to pass bills that stimulate investment to the maximum extent allowed by State law.

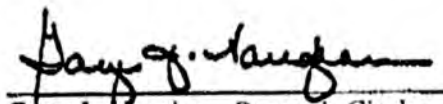
SECTION 2. That copies of this resolution be sent to Governor Walter J. Hickel, Senators Suzanne Little, Judith Salo, Georgianna Lincoln, Fred Zharoff, and Jay Kerttula, and Representatives Mike Navarre, Gail Phillips, Gary Davis, Irene Nicholia, Cliff Davidson and Curt Menard.

ADOPTED BY THE KENAI PENINSULA BOROUGH ASSEMBLY THIS 16th DAY OF MARCH, 1993.



Betty J. Glick, Assembly President

ATTEST:


Gaye J. Vaughan, Borough Clerk



News Release

FOR IMMEDIATE RELEASE

Contact:

**William M. Sims
Tesoro Petroleum Corporation
(210) 828-8484**

or

**Bryan Oakley
Edelman Public Relations
(713) 623-2666**

San Antonio, Texas -- January 19, 1993 -- Tesoro Petroleum Corporation (NYSE) announced today that its wholly-owned subsidiary, Tesoro Alaska Petroleum Company (Tesoro Alaska), has successfully settled its contractual dispute with the State of Alaska.

"Management is pleased that this dispute was concluded on mutually favorable terms," stated Mike Burke, President and Chief Executive Officer of Tesoro. "This settlement represents a significant step forward and will allow Tesoro's management to focus on other operational and financial matters. Further, it removes an enormous uncertainty regarding the Company's future operations." With the agreement, Tesoro will immediately pay the State \$10 million and make variable monthly payments to the State over the next nine years based on the volume of feedstock processed at the Company's Alaska refinery. At the end of the nine-year period, Tesoro will have the option to continue the variable monthly payments to the State or to conclude the agreement by paying the State \$60 million. Variable monthly payments made after the nine-year period will not reduce the \$60 million obligation to the State. Tesoro's obligation owed the State under the agreement is subordinated to current and future senior debt of Tesoro of up to \$175 million plus indebtedness incurred in the future to improve the Company's Alaska refinery. This obligation is collateralized by a second mortgage on the assets of the Company's Alaska refinery.

As a result of the final terms of the agreement and based on projections of future operating volumes, Tesoro will accrue an additional non-cash charge during the fourth quarter of 1992 in the amount approximately equal to the \$10 million cash payment. With this additional charge, Tesoro will have accrued a total of \$72.5 million for this agreement.

The State's claim against Tesoro Alaska arose out of certain provisions in present and past contracts with the State that required Tesoro Alaska to pay the State additional

- more -

retroactive amounts if the State prevailed in its ANS Royalty Litigation against the producers of North Slope crude oil. As a result of settlements between the State and the producers, the State claimed that the royalty oil it sold Tesoro Alaska and others was undervalued to the extent that the producers undervalued their oil.

Tesoro announced that it reached agreement with its existing consortium of banks to amend and extend the Company's letter of credit facility through September 30, 1993, and to reduce the credit commitment from \$110 million to \$80 million. Bruce Smith, Vice President and Chief Financial Officer of Tesoro, stated, "This amendment and the restructuring of the State of Alaska claim are important steps in the Company's efforts to address its financial issues. In addition, the Company recently restructured the payment terms of a \$15.6 million obligation on terms that will defer almost \$9 million of payments over the next two years and repaid the loan for the development of its South Texas field."

Additionally, Tesoro announced that it will adopt Statement of Financial Accounting Standards No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," during the year ended December 31, 1992. This statement requires Tesoro to accrue costs associated with future payments for post-retirement benefits during the years that employees render the service necessary to receive the benefits, rather than accounting for such benefit payments on a pay-as-you-go basis. The implementation of SFAS No. 106 will result in an initial non-cash charge of about \$23 million in 1992. Tesoro announced that it will also adopt Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," during the year ended December 31, 1992, which will not have a material impact on 1992 results. The Company also anticipates an estimated \$9 million to \$13 million of other non-cash year-end charges.

Tesoro Petroleum Corporation is a natural resource company engaged in refining and marketing; development and production of natural gas; environmental product sales; and oil field supply and distribution.

SB134



Structural

Mechanical

Electrical

Civil

Project and

Construction

Management

March 18, 1993

Oil & Gas Committee
State Capitol
Room 113
Juneau, Alaska 99801-1182

Attention: Ms. Annette Kreitzer

Reference: SENATE BILL 134

Dear Ms. Kreitzer:

Coffman Engineers would like to express our support for passage of proposed Senate Bill SB 134.

We believe passage of this bill will promote capital projects by refiners in Alaska. These projects would result in potential jobs for people in the Alaska engineering and construction community, as well as an increase in support services and operations jobs in the local communities.

Promoting development and job growth in Alaska is very important, especially with the current uncertainty of funding for federal and military development. Therefore, we encourage you to also support passage of this bill.

Thank you for your time and consideration.

Sincerely,

COFFMAN ENGINEERS, INC.

A handwritten signature in cursive script, appearing to read "Will Veelman".

Will Veelman, P.E.
Principal

30319/06217/SB134

S. Darby Howell,
President - Treasurer



Dorothy R. Howell
Vice President

D. Mark Howell
Corp. Secretary

KENAI INDUSTRIAL MECHANICAL CO.
P.O. BOX 1810 KENAI, ALASKA 99611
PHONE (907) 283-3858

March 18, 1993

Dear Senator Loren Leman,

We would like to show our support for S.B. 134. We think it would be good for the state and the local economy.

Thank You,

A handwritten signature in cursive script that reads "D. Mark Howell".

D. Mark Howell.

A handwritten signature in cursive script that reads "S. Darby Howell".

S. Darby Howell.



Official Business

COMMITTEE:

SENATE OIL & GAS

DATE: 3/17/93

Subject of meeting:

SB 134 CREDITS AGAINST PURCHASE OF ROYALTY ON

SIGN-IN

PLEASE PRINT!

[illegible][illegible]

ALASKA PETROLEUM CONTRACTORS INC.
General Contractors

March 18, 1993

Senator Loren Leman
State Capital
Room 113
Juneau, Alaska 99801-1182

MAR 22 1993

Dear Senator:

Please support Senate Bill 134 since we feel it would be a very sound investment in Alaska's economic future.

Sincerely,
ALASKA PETROLEUM CONTRACTORS



William H. Cheek
General Manager



SB134

SOUTHWOOD MANOR

6499 BRAYTON DR. #68

ANCHORAGE, ALASKA 99507

Telephone 907-349-5529

Facsimile 907-349-2541

March 24, 1993

MAR 25 1993

The Honorable Sonters Pearce and Miller and the Honorable
Representatives Green, Barnes, Sanders and OlbergBr:

RE: SB 134 and HB 185

Dear Sirs:

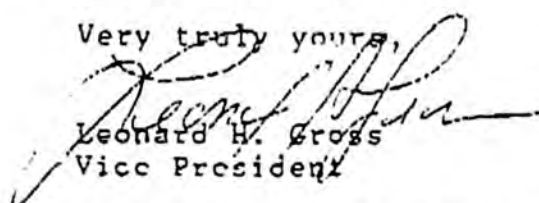
It appears to the undersigned that the above two bills constitute nothing more than raiding the State Permanent Fund and or the State Treasury for private gain.

It does not matter how a tax becomes payable to the state and if the above bills are passed then any other tax that would be payable to the state for any reason could be offset in the same manner.

We pay our taxes to all level of government and would expect that all employers and citizens be treated the same as respects the payment of taxes. Without same how are we to pay for the services we need or desire.

The above self-serving bills are to me only a method to take from me and others.

Very truly yours,


Leonard H. Gross
Vice President

Copies to House: Labor, Commerce and Finance Committees.
Senate: Oil and Gas, Judiciary and Financial Committees.
Charles Cole, Attorney General, Department of Law
The Honorable Walter J. Hickel, Governor

STATE OF ALASKA

DEPT. OF NATURAL RESOURCES**DIVISION OF OIL AND GAS**

WALTER J. HICKEL, GOVERNOR

P.O. BOX 107034
ANCHORAGE, ALASKA 99510-7034
PHONE: (907) 762-2553

(907)762-2547

March 31, 1993

The Honorable Loren Leman, Chairman
Senate Special Committee on Oil and Gas
Alaska State Legislature
State Capitol, Room 113
Juneau, Alaska 99801

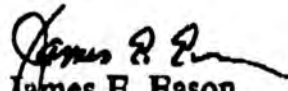
Dear Senator Leman:

As requested at last night's hearing on SB-134, I am responding to a question asked by Senator Halford regarding RIK contractual agreements which may exceed a 25% distribution to the Permanent Fund.

For your, and the committee's, information I have attached a sheet that summarizes the volumes and Permanent Fund obligations of the several current RIK contracts, and explains the prospective obligations of potential future contracts.

Please call if you need more information.

Sincerely,


James E. Eason
Director

Attachment

00310001.je

Permanent Fund Share of ANS RIK Oil Contracts

Contracts In Force Today

Tesoro--Prudhoe Bay

Mapco--Prudhoe Bay plus contingency for other fields

PetroStar--Kuparuk; no oil taken as of yet under this contract

RIK Volumes Taken Through 1991

Prudhoe Bay--404 million barrels

Kuparuk River--14 million barrels

(see attached table for volume details)

Mapco and Tesoro Contracts

Tesoro and Mapco oil taken to date was from Prudhoe Bay Unit--Permanent Fund (PF) gets 25% share of the royalty.

Tesoro remaining oil to be taken will be from Prudhoe Bay at 25% to PF.

Mapco remaining oil to be taken most likely will be from Prudhoe Bay at 25% share to the PF. If sufficient oil is not available at Prudhoe Bay then Mapco can nominate oil from other fields. This should not be necessary.

PetroStar Contract

If any oil is taken under the existing contract, it will be from the Kuparuk Unit. Only 1.084 % of it will be subject to the 50% PF sharing rule. The remaining 98.916 % of the volume is subject to the 25% PF sharing rule.

Oil taken under PetroStar's old contract also was from Kuparuk, so 1.084 % was subject to the 50% PF sharing rule.

Chevron

Some of Chevron's oil taken in the past was from the Kuparuk Unit, so 1.084% of the Kuparuk volume was subject to the 50% PF sharing rule.

Any New Contracts

The PF sharing rate (25% or 50%) will depend on the field and the leases in that field. For example, 32% of the Endicott oil is subject to the 50% PF sharing rule and approximately 30% of the Point McIntyre oil will be subject to the 50% PF sharing rule. None of the Milne Point oil is subject to the 50% sharing rule at this time although this would change if production is commenced from some of the northern Milne Point leases in the next few years.

Volumes by Field/Purchaser for Potential Capital Credits

	Kuparuk	Prudhoe	Total Bbls
Chevron	10,959,317.08	56,331,133.31	67,290,450.39
GVEA		17,138,882.90	17,138,882.90
MapCo		135,685,354.22	135,685,354.22
Petro Star	3,030,010.57		3,030,010.57
Tesoro		194,620,097.84	194,620,097.84
	13,989,327.65	403,775,468.27	417,764,795.92

NOTE1: Volumes are for RIK purchases through 12/31/91.

MEMORANDUM

State of Alaska

Department of Law

TO: Annette Kreitzer
Committee Staff
Senate Oil and Gas Committee

DATE: March 23, 1993

FILE NO:

TEL NO: 465-3600

SUBJECT: SB 134 (capital credits
for RIK purchasers)


FROM: James L. Baldwin
Assistant Attorney General
Oil, Gas and Mining - Juneau

This will transmit our response to questions raised by members of the oil and gas committee and other points raised by proponents of SB 134. Please find attached:

1) A February 1986 report to Governor Sheffield concerning the retail price of gasoline in Fairbanks. Please pay particular attention to the conclusions set out a page 17 of the report. The report concludes that for 1985:

Despite the decrease in Tesoro's price for the bulk of its 1985 feedstock, the wholesale prices for all four brands of gasoline in Anchorage and Fairbanks increased by an average of about 6.5 cents per gallon over the last year.

The inverse relationship between decreasing 1985 royalty oil prices and increasing 1985 selling prices is a strong indication that Tesoro and the oil companies which sell Tesoro gasoline under their brand names have been pursuing a "what the market will bear" pricing strategy for selling motor gasoline in Alaska. Over the last year, increases established by oil companies in their Alaska selling prices have been passed on throughout the petroleum distribution chain to retailers, and ultimately to Alaskan consumers.

(Emphasis in original).

2) A letter sent to Senator Leman. This letter provides the details of the contracts under which a retroactive price adjustment is claimed by the state. The letter describes the pricing methodology and sets out the amount claimed under each contract. The letter also details the interest accrual

Annette Kreitzer, Committee Staff
Senate Oil & Gas Committee

March 23, 1993
Page 2

under each contract and the present value of the stream of payments that MAPCO owes under its "North Pole - 1" contract.

Let me know if you require clarification of the attached documents or further information on this issue.

JLB:tg

STATE OF ALASKA

DEPT. OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

WALTER J. HICKEL, GOVERNOR

P.O. BOX 107034
ANCHORAGE, ALASKA 99510-7034
PHONE: (907) 762-3553

(907)762-2547

March 19, 1993

The Honorable Loren Leman, Chairman
Senate Special Committee on Oil and Gas
Alaska State Legislature
State Capitol, Room 113
Juneau, Alaska 99801-1182

Dear Senator Leman:

I wanted to thank you again for the opportunity to testify before your committee last evening on SB 134. As I mentioned last night, I think it is important that the legislature have a good historical perspective of the state's support for the development and continuation of in-state refining. I believe this is particularly so given the relatively large number of new senators and representatives in the legislature this session. In deliberating the merits of subsidizing in-state refineries through the use of credits for capital projects, it is important to understand the magnitude of the state's past and continuing financial support of those refiners.

The Amerada Hess litigation which gave rise to the contract liabilities which the purchasers now face continued over 15 years. That litigation consisted of three separate phases. The first dealt with whether the state should bear any share of field costs, the second with how to calculate an appropriate tariff for the TAPS pipeline, and the last phase concerned the value of the crude oil in the multiple markets in which it was sold, as well as certain transportation deductions and other matters. In the first phase of the Amerada Hess litigation, the Superior Court found that the state had no obligation to reimburse its lessees for field costs so long as the state took its oil in value, but ruled that a field cost was due if the oil was taken in kind and sold to an in-state refiner. This ruling obviously was a major impediment to the development of an in-state refining industry. In that decision, the Court found that the state could not take less for its oil sold in kind than it received if it left the oil in value with the North Slope producers to be sold by them on the state's behalf.

Recognizing this impediment, and in a conscious decision to support in-state refining, the state gave up its right to avoid the payment of field costs for in-value royalty oil and negotiated a settlement agreement with the North Slope producers which obligated it to pay the same field costs regardless of whether it takes its oil in value or in kind. That amount is currently 79 cents per barrel at Prudhoe Bay and 42 cents per barrel at the Kuparuk River Unit. These are field costs which the state incurred only because it chose as a matter of policy to sell to Tesoro, MAPCO, GVEA, Chevron and Petro Star. The total value of the field cost deduction is now more than \$700 million, and is subject to escalate under the settlement agreements. These field cost deductions are estimated to total a minimum of \$1.4 billion over the life of the fields. This represents money which the state willingly agreed to forego so as to make in-kind sales to the in-state refiners.

The Honorable Loren Leman

March 19, 1993

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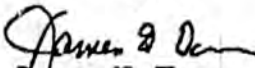
In addition, when the ERCA (Mapco) and Tesoro contracts were negotiated and approved by the legislature, the record reflects that the North Slope producers were unwilling to enter into long-term crude oil supply contracts with those refiners. The state's commitment to do so made it possible for those refiners to secure the financing necessary to construct their facilities and to begin their operations in Alaska. Without this commitment from the state, the refiners would not have been here today, and there would be no dispute over what they owe under their respective contracts.

The state's support has continued through the recent settlement agreement between the state and Tesoro. In recognition of Tesoro's financial position, the state crafted a settlement agreement that had Tesoro acknowledge its liability for the entire Amerada Hess adjustment to which it was liable, but it provided for repayment of that liability over an extended period of time. In addition, the state agreed to remain in a subordinated position to other lenders regarding Tesoro's Alaska refinery assets and to be subordinated to an additional \$175 million for any future expansion of those facilities. The specific intent of the state in accepting both the extended payment schedule and this subordinated position was to enable Tesoro to borrow additional funds necessary for future expansions, while at the same time assuring that Tesoro was not unnecessarily burdened in repaying its past debt.

In testimony before your committee on Wednesday evening, March 17, Tesoro representative Mr. Gene Burden said that the administration should not be surprised by Tesoro's support for SB 134. Mr. Burden was correct in pointing out that Tesoro was persistent in its advocacy for capital credits provisions in its negotiations with the state settlement team. However, as the settlement agreement itself confirms, the state rejected a capital credit solution to Tesoro's Amerada Hess obligations. Our reasons were fourfold: We wanted to maintain the competitive balance between in-state refiners; we wanted to avoid skewing competition in the marketplace toward those in-state refiners at the expense of independent petroleum retailers; we wanted to avoid the precedent of rewarding non-compliance with valid contractual obligations; and, finally, we wanted to maximize the state's income from its most important non-renewable resource.

If you or other members of the committee have any additional questions regarding the history of the state's royalty policies or the recently concluded settlement with Tesoro, please feel free to call.

Sincerely,


James E. Eason
Director

cc: Committee Members
Commissioner Olds
Attorney General Cole

State of Alaska
DEPARTMENT OF NATURAL RESOURCES
DIVISION OF OIL AND GAS

DIRECTOR'S OFFICE
3601 C Street, Suite 1380
Anchorage, Alaska 99503

(907)762-2547 phone
(907)562-3852 fax

FAX TRANSMITTAL

DELIVER TO/HOLD FOR PICKUP:

Annette Kreitzer

FAX NUMBER:

465-3810

DATE:

3/19/93

TIME:

5:15

TOTAL PAGES (including transmittal sheet):

3

FROM:

Jim Eason

COMMENTS:

If you experience any problems receiving fax, please call (907)762-2549 immediately.

FROM: JIM EASON
3/19/93

For Current EICs Under Title 38

EICs

Discretionary as to use.

Timing and period of use controllable.

For past uses under AS 38, always tied to a NPS so state shares in both royalties and net profits from discoveries.

Encourages competition - available to all potential lessees, in sales where EICs are offered.

Always returns some measurable benefit, i.e., well data, third party jobs, etc.

Represents no forgiveness of contract debt. It is prospective only.

SB 134

Non-discretionary absent a "clear and convincing" determination.

No control because disputes can be generated at will by purchasers.

No sharing of profits generated from state's 100% underwriting of refinery expansions and other capital projects.

Anti-competitive; results in "tilts" of the playing field.

May or may not produce predicted benefit.

Obviates contract debt; encourages non-compliance with valid contracts.

EICs

Totally discretionary.

Applies only to projects which are in state's best interest.

Limits on maximum amount available, and limited to \$5 mm per project with "caps" of 25% or 50% of "eligible" costs.

SB 134

Very limited discretion to deny.

All projects not "determined" by clear and convincing evidence to produce "commensurate" value.

Unlimited -- "gross" value of qualifying projects.

private
land

state

EICs/031893

000514

Doc # 3769

HC 130

AGREEMENT FOR THE SALE AND PURCHASE

OF

STATE ROYALTY OIL

EARTH RESOURCES COMPANY OF ALASKA
an Alaskan corporation

THE STATE OF ALASKA
Department of Natural Resources

March 27, 1978

EXHIBIT 5

000515

Doc # 3769

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000518

Reel # 3769

AGREEMENT FOR THE SALE AND
PURCHASE OF ROYALTY OIL

THIS AGREEMENT entered into as of the 22 day of
May, 1978, by and between the STATE OF ALASKA, here-
inafter called the "Seller", acting by and through its Commissioner
of Natural Resources pursuant to AS 38.05.183 and EARTH RESOURCES
COMPANY OF ALASKA, an Alaskan corporation, hereinafter called the
"Purchaser",

W I T N E S S E T H

Whereas, Seller has the right under each of the leases identified
in Exhibit "A" to this Agreement to take a royalty of twelve and one-
half percent (12 1/2%) in kind (amount) of the crude oil production
removed or sold from the lands covered by each such lease; and

Whereas, Seller is authorized by AS 38.05.183 to sell such royalty
oil; and

Whereas, Seller desires to sell royalty oil to Purchaser and
Purchaser desires to purchase royalty oil from Seller under the terms
and upon the conditions hereinafter set forth:

NOW, THEREFORE, in consideration of the representations, covenants
and conditions hereinafter contained, Seller and Purchaser agree as
follows:

ARTICLE I

DEFINITIONS

As used herein, the following terms shall have the following
meanings:

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- 1.1 "Commissioner" means the Commissioner of the Alaska Department of Natural Resources, except as used in Article XIX "Commissioner" as used in Article XIX shall mean the Commissioner of the Alaska Department of Revenue.
- 1.2 "Date of First Delivery" means the first date the oil sold hereunder passes the Point of Delivery.
- 1.3 "Day" means a period of twenty-four (24) consecutive hours beginning at 12:01 a.m., Alaska Standard Time.
- 1.4 "Lessee" means any Person owning a working interest in any of the Leases.
- 1.5 "Leases" means the oil and gas leases which are described in Exhibit "A" attached hereto and made part hereof.
- 1.6 "Month" means the period beginning at 12:01 a.m. Alaska Standard Time, on the first day of the calendar month and ending at the same time on the first day of the next succeeding calendar month.
- 1.7 "Nomination" means notice by Purchaser of the quantity of royalty oil to be purchased by it from Seller during a specific period of time under this Agreement.
- 1.8 "Oil" or "crude oil" shall have the same meaning as the word "oil" under the Prudhoe Bay Unit Agreement effective April 1, 1977, by and between the Seller and the Lessees.
- 1.9 "Return Oil" means that portion of the crude oil in-take which after processing in Purchaser's facility is not normally distributable to the local market, and which would still be acceptable for reinjection into the TAPS pipeline for mingling with the common stream if tendered to the pipeline for transportation.
- 1.10 "Royalty oil" means the oil which the Seller may take in kind (amount) as its royalty under the Leases.

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ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity From Leases In Exhibit "A". Seller agrees to sell to Purchaser and Purchaser agrees to buy from Seller during any calendar month, on an average daily basis, the quantity nominated by Purchaser. Provided, however, that such daily quantity shall not exceed fifteen (15) percent of the total amount of Seller's royalty oil out of the crude oil production received or sold from the Leases which the Seller has the right to take, and is available to the Seller for taking in-kind, minus the amount of oil Seller is obligated to deliver under its present contract with Golden Valley Electric Association, Inc., and minus that minimum quantity of oil which the Seller, during the term of this Agreement, must continue taking and receiving in-value rather than in-kind as a requirement to Seller's obtaining a report of the in-value price from each Lease.

2.1.1 Additional Quantity From Leases In Exhibit "A". Subject to all other terms and conditions hereunder provided, Purchaser may nominate to purchase additional quantities of oil in excess of the quantities specified above, when additional oil is available to Seller from the Leases, for such period of time as such oil is unobligated and available.

2.1.2 Quantity From Other leases. Subject to all other terms and conditions hereunder provided, if purchaser presents to Seller sufficient evidence of contracts between Purchaser and third parties requiring Purchaser to supply products for consumption in Alaska (excluding return oil) in excess of the quantity of products which Purchaser is able to produce from the oil from the Leases in Exhibit "A" and Purchaser is unable to purchase crude oil from other producers in

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Alaska, then purchaser may nominate to purchase additional quantities of oil from other leases from which Seller has the right to take royalty oil in kind. Provided however, that the additional quantity nominated by Purchaser from other leases shall be that additional quantity of oil required to produce sufficient products for Purchaser to fulfill its contract obligations.

2.1.3 Maximum Quantity. Purchaser agrees that in no event shall the total quantity of oil supplied by Seller under Article 2.1 and 2.1.1 and Article 2.1.2 exceed an average daily quantity of 35,000 barrels.

2.1.4 Minimum Quantity. Purchaser agrees to nominate and purchase a minimum average daily quantity of 3,000 barrels of oil per calendar day, after initiation of first delivery hereunder.

2.1.5 Termination For Failure to Take Minimum Quantity. If Purchaser fails to take the minimum quantity specified in Article 2.1.4 for a period of three (3) consecutive months, the Seller, at its option may terminate this Agreement unless failure to take oil is due to force majeure and Seller has been able to cancel delivery of nominated quantities under the provision of Article 12.2.

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2.1.6 Oil Not Nominated. Purchaser recognizes and agrees that if Purchaser has not nominated the full quantity of oil to which Purchaser is entitled under Article II, then Seller may sell or otherwise dispose of such oil as Seller deems provided such action of Seller does not impede Seller's ability to deliver oil to Purchaser upon proper notice (nomination) by Purchaser to receive some or all of the oil to which Seller is entitled to receive Under Article II.

2.2.1 Initiation of First Delivery. Seller, within the thirty (30) days after (i) fulfillment of the condition precedent stated in Article 2.3, (ii) receipt of a written notice from the Purchaser stating the quantity of oil desired to be purchased, and (iii) receipt of an opinion from the Department of Energy that the Advance Termination provisions in this Agreement are valid and enforceable, shall deliver notice to all its Lessees that it is exercising its right to take its royalty oil in-kind and stating the quantity to be delivered. Purchaser nomination shall not exceed the amount specified in Article II. Initiation of First Delivery thereafter shall occur as soon as Seller is able to receive royalty oil in-kind from its Lessees.

In the event Seller shall obtain a modification of the Prudhoe Bay Unit Agreement to reduce the time period required under the (six) 6 month's notice provision, the Date of First Delivery under this Agreement shall be reduced accordingly.

2.2.2 Nominations, Increases, and Decreases of Crude Oil. After the Date of First Delivery and from time to time thereafter, Purchaser shall have the right upon notice to Seller to require Seller to exercise its right under the Prudhoe Bay Unit Agreement to increase or decrease, by the terms of said Unit Agreement the quantity of royalty oil to be delivered to Seller, and the quantity of royalty oil to be delivered to and purchased by Purchaser under this Agreement shall be so adjusted, subject to the quantity limitations of Article II.

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In addition to the time for notice in the Prudhoe Bay Unit Agreement, Purchaser agrees to give Seller an additional thirty (30) days notice of its nomination under this paragraph. Nominations shall be made not more than once every thirty (30) days. After the Date of First Delivery, if no nomination is given to the Seller by the Purchaser for any particular month, the nomination shall be considered as being the same as the preceding month.

2.3 Advance Approval of Termination of "Supplier/Purchaser Relationship"

Prior to the Purchaser requesting initiation of first delivery under Article 2.2.1, Purchaser agrees to obtain and deliver to Seller a letter that Interpretation No. 1978-1, issued January 25, 1978 by the Division of Interpretations, United States Department of Energy, attached hereto as Exhibit "C", is applicable to this Agreement between Seller and Purchaser hereunder.

2.4 Return Oil. To assist the state in other sales of royalty oil, Purchaser hereby offers for sale to any other third party purchaser of royalty oil any return oil attributable to the royalty oil sold hereunder, on fair and reasonable terms to be negotiated between Purchaser and said third party purchaser. Provided however, that said third party purchaser offers to take Purchaser's return oil within sixty (60) days following the effective date of this Agreement, or the Agreement between the State and such third party purchasers, whichever is later, but prior to September 1, 1978.

Purchaser hereby offers for sale to any other purchaser of royalty oil other available return oil attributable to oil produced from Prudhoe Bay that Purchaser is selling (or could sell) to other buyers, on the same terms described in the paragraph immediately above.

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2.5 Quality. The royalty oil sold hereunder shall be the same quality as the oil delivered by the working interest owners from the Leases and the leases to the Seller at the Point of Delivery. Except for the foregoing, there is no guarantee, representation, or warranty by Seller, either express or implied, of the merchantability, fitness for use, or suitability for any particular use or purpose, or otherwise, of any of the oil delivered hereunder. There are no warranties, representations or agreements which extend beyond the description of the oil set forth in this Article.

2.6. Prices of Oil Delivered Out of the Leases. As to oil sold and delivered hereunder, the prices to be paid by Purchaser to Seller shall be equal to the actual sum the Seller would have received had Seller received its royalty in value instead of taking the quantity of royalty oil delivered hereunder as its royalty in-kind (amount). Seller and Purchaser recognize that the method and basis of computing the royalty due Seller from Lessees under the Leases is currently a matter of dispute and litigation among the Seller and its Lessees, said litigation being entitled State of Alaska, et al vs. Amerada Hess Corp. et al., (CA No. 77-847, Superior Court of the State of Alaska, First Judicial District at Juneau). Pending resolution of said dispute among Seller and Lessees, by judicial decision or settlement in the above-referenced case, the in value royalty under the Leases shall be computed in accordance with Exhibit "B", attached hereto and by reference made a part hereof. After such time as said dispute shall be resolved among Seller and its Lessees, the parties hereto will be bound by terms of such resolution, judicial or

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otherwise. Seller and Purchaser expressly recognize that adjustment in prices previously paid may be necessary following said resolution and adjustment shall be duly made, with interest, pursuant to the applicable provisions of Article VI. Any settlement agreement which agrees to the imposition of costs which are reimbursable by Purchaser to Seller under Article 2.6.1, however, shall not be final and binding upon Purchaser, unless Purchaser has consented in advance to such settlement.

2.6.1 Reimbursement of Certain Costs of Seller. In addition to the price stated in Article 2.6, Purchaser shall also reimburse Seller for Seller's pro rata share of (i) any basic sediment and water removal costs if Seller is required to pay such costs as a result of Seller's election to take its royalty oil in kind; and (ii) any other direct cost legally incurred and paid by Seller which would not have been incurred by Seller had the Seller taken its royalty in value rather than in kind and if such costs under Article 2.6.1 (i) and (ii) were not previously reflected in applicable computations of value for payments of royalty in value. Seller shall use its best efforts to minimize any such costs incurred by Seller by reason of Seller's taking royalty oil in kind; such best efforts shall include but not be limited to litigation in cooperation with and at the request of Purchaser, at Purchaser's cost, to the extent necessary to contest the imposition of unwarranted or improper charges; provided, however, that Seller shall in no event be required to advocate legal positions or adopt legal strategies which it, in its discretion, deems contrary to its own interests, in any such litigation. Seller at this date does not know of any potential costs legally to be incurred by it as a result of its taking in kind rather than in value other than the costs stipulated in this Article 2.6.1 (i) above.

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2.7 Passage of Title. Title to the royalty oil to be sold hereunder shall pass from Seller to Purchaser at the same point that Seller receives title to the oil from the Lessees, or the lessees.

2.7.1 Purchaser's Responsibility. Purchaser shall be responsible for the oil to be sold hereunder after passage of title hereunder. Purchaser will indemnify and hold Seller harmless from and against any and all claims, costs, damages, expenses or causes of action as a result of any loss, injury, or damage incurred by any party as a result of any transaction or event which relates to the crude oil after title thereto has passed to Purchaser. Purchaser shall make all necessary arrangements for transporting the oil sold hereunder from the Point of Delivery to its refinery.

2.8 Point of Delivery. Seller shall deliver the oil to Purchaser at the point at which Seller receives delivery of its royalty oil from its Lessees, or lessees.

2.9 Delivery of TAPS Fill by Seller. Upon initiation of deliveries pursuant to Article 2.2.1, Seller in addition to all other quantities of crude oil deliverable hereunder shall deliver to Purchaser on or prior to the Date of First Delivery a sufficient quantity of crude oil for Purchaser to fulfill its tariff obligations to supply Trans-Alaska Pipeline System pipeline fill except line fill required for Purchaser's return oil. Purchaser shall pay for such quantity of oil on the date of termination pursuant to any of the provisions of this Agreement, at the price stipulated in Article II and VI, as if such oil

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had been delivered to Purchaser at the Point of Delivery forty-five (45) days prior to the said date of termination. In the event that Purchaser suspends its purchase of oil from the Leases after having initiated deliveries and after Seller has delivered the pipeline fill as provided by this Article 2.9, Purchaser shall pay for such quantity of oil as if it had been delivered at the Point of Delivery on the date Purchaser suspended its purchases. Thereafter Seller shall be obligated to provide pipeline fill upon Purchaser's reinitiation of deliveries of oil out of the Leases as provided by other provisions of this Article II.

ARTICLE III

REPRESENTATIONS AND OBLIGATIONS OF PURCHASER

Purchaser warrants, represents, and agrees:

3.1 Good Standing. Purchaser is, and at all times hereafter shall remain, a corporation qualified to do business in, and in good standing with, the State of Alaska.

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3.2 Purchase. Purchaser will buy and receive such royalty oil as it has nominated, and has been delivered according to the terms set forth in this Agreement.

3.3 In-State Processing. Purchaser agrees that any and all royalty oil purchased under this Agreement shall be processed at Purchaser's refinery which is located near North Pole, Alaska; except that, as provided in Article IX, and XII. Purchaser may dispose of the royalty oil in accordance with those Articles.

3.3.1 Export. From time to time Purchaser will consult with the Commissioner of Natural Resources to ensure that any products (exclusive of return oil) produced from the royalty oil sold hereunder are surplus to the State of Alaska's needs, prior to export thereof.

ARTICLE IV

REPRESENTATIONS AND OBLIGATIONS OF SELLER

Seller warrants, represents and agrees:

4.1 Seller's Royalty Oil. Under the Leases, Seller has the right to take its royalty in-kind (amount), which royalty oil is twelve and one-half percent (12 1/2%) of the crude oil production removed or sold from the Leases, unless otherwise specified in Exhibit A.

4.2 Title. Seller has good and marketable title to the royalty oil sold by it hereunder and its right to sell the same. All such oil is owned by Seller free from all third party liens, encumbrances and valid adverse claims.

4.3 Sale. Seller will sell and deliver to Purchaser hereunder royalty oil under the terms set forth in this Agreement.

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ARTICLE V
MEASUREMENTS AND TESTS

3.1 Testing Standards and Procedures. The quantity and quality of the crude oil sold and purchased from the Lessees shall be determined at Lessees' A.C.T. meters at Pump Station No. 1, Prudhoe Bay, Alaska. The quantity and quality of the crude oil sold and purchased from the other leases shall be determined at the lessee's point of delivery. All measurements hereunder shall represent one hundred percent (100%) volume, consisting of United States barrels of forty-two (42) gallons, the quantity and gravity of which shall be adjusted to a temperature of sixty degrees (60°) Fahrenheit. Full deduction shall be made for all basic sediment and water content according to the ASTM Standard Method then in effect. Unless agreed otherwise between Purchaser and Seller or set forth herein, procedures for measuring and testing and for metering the crude oil shall be completed in accordance with standard oil field practices. Procedures for metering deliveries under the Leases shall be in accordance with accepted oil field practices in effect at Prudhoe Bay, Alaska. At the direction of Purchaser, Seller shall direct the Lessees or lessees to test the accuracy of their measuring equipment if and to the extent that the provisions of the Prudhoe Bay Unit Agreement or any other agreement between Seller and Lessees or lessees permit Seller to make such request. Notice of the time and nature of each test of Lessees' or lessees' measuring equipment shall be given by Seller to Purchaser sufficiently in advance to permit convenient arrangement for Purchaser's representative to be present. Tests and adjustments shall be made in the presence of representatives of Purchaser if present at the time scheduled for such test and adjustment. At Purchaser's election and subject to obtaining the permission of any necessary third parties, Purchaser may also install equipment to measure or gauge all oil received by Purchaser hereunder at the Point of Delivery, and Purchaser shall bear the entire acquisition, calibration, maintenance and operating cost of any such loading, measuring or testing equipment required by Purchaser.

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ARTICLE VI
PAYMENTS AND ACCOUNTING

6.1 Billing. Seller will furnish Purchaser monthly, on or before the tenth (10th) business day of each month after the first full month of delivery of crude oil, a statement of account of all crude oil estimated to have been delivered through and measured at the Point of Delivery during the immediately preceding month according to the best information available to Seller, the price or prices estimated as applicable thereto according to the best information available to Seller, the basis for computation of the applicable estimated price or prices in full detail and the total net amount due. Seller shall render its billings to Purchaser based upon the values, receipts, costs and computations reported by the Lessees and the lessees to Seller. Seller shall thereafter adjust its initial billing pursuant to Article 6.4. To the extent not contrary to law Purchaser and its authorized agents shall be permitted access during reasonable business hours to Seller's books and records pertinent to this Agreement to determine the correctness of the billings of Seller.

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6.2 Payment. Purchaser will make payment on or before the twenty-fifth day of the calendar month in which such statement is rendered or fifteen (15) days after rendition of the invoice called for in Article 6.1, whichever is later, by direct wire transfer of federal reserve funds through the Federal Reserve Bank wire transfer system to the following address or such other address as Seller may designate upon seven (7) days prior written notice:

Bank of America, NT & SA
San Francisco, California
Securities Department 3255

Credit to: State of Alaska Investment Account

All other payments to be made under this Agreement shall be paid in the same manner. If payment is to be made on a Saturday, Sunday, or legal holiday, under the preceding provisions hereof, payment shall be made on the next following business day.

6.3 Late Payment Charge. Should Purchaser fail to make timely payment to Seller of any amount due hereunder, including any payment delayed by a bona fide dispute which is later determined to be validly owing, or should Purchaser be required to pay any amount which is later determined not to be validly payable to Seller, interest shall accrue and be payable on said sum from the date when such payment was due or was paid, as the case may be, until the same is paid, at a rate per annum equal to the prime rate then being charged by Chemical Bank of New York, New York, plus one and one-quarter percent (1 1/4%) per annum.

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6.4 Adjustments to Billings. Each month Seller shall adjust its statement of accounts to reflect the actual amounts delivered and the price or prices applicable thereon. Seller shall from time to time adjust its prior billings to reflect adjustments necessitated as a result of (i) a final judgment or settlement entered in certain pending litigation between Seller and the Lessees styled State of Alaska, et. al. vs. Amerada Hess Corporation, et. al., CA No. 77-847, in the Superior Court of the State of Alaska, First Judicial District at Juneau; (ii) adjustments necessitated as a result of the filing with the Seller by the Lessees or lessees of more current reports applicable to the billing period in question; (iii) actual adjustments necessitated as a result of changes to values, receipts, costs and computations previously reported by the Lessees or lessees and utilized by Seller as a basis for billing under Article 6.1, if such adjustments are based upon actual later severance tax or royalty oil payments by or refunds to the Lessees or lessees; or (iv) adjustments required as a result of clerical or arithmetical errors in the billings of Lessees or lessees, or of Seller; provided, however, that no adjustments, whether credits or debits, under Articles 6.4 (ii) through 6.4 (iv) shall be made by Seller or demanded by Purchaser more than twelve (12) months after billing except as to matters which are the subject of (x) pending litigation by either party, (y) pending regulatory proceedings (or appeals thereof) whether or not Seller or Purchaser is a party thereto, or (z) bona fide audits by Seller which audits have been terminated or completed by Seller within twelve (12) months after initiation of same.

Due to the potentially large sums of money involved, any adjustments to any billing under the provisions of this Article VI by Seller made more than sixty (60) days after such billing was initially rendered shall be paid to or refunded by Purchaser or Seller over the same period over which such adjustments accrued or thirty-six (36) months, whichever is longer, beginning with the first payment next following

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the date such adjustment has been determined; provided, however, no such payment extension permitted hereunder shall extend beyond the term stipulated in Article 7.1, and accordingly the full balance of any unpaid adjustments shall become due and payable on the termination date hereof.

6.5 Cancellation in Event of Non-Payment. Except for amounts disputed in good faith, should Purchaser fail to make any payment due to Seller hereunder, Seller shall have the right to cancel this Agreement by giving written notice of cancellation to Purchaser prior to receipt of such payment. Cancellation shall be effective thirty (30) days from the date of the notice unless full payment is made.

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ARTICLE VII
TERM

7.1 Term. Subject to the other conditions, covenants and terms contained in this Agreement, this Agreement shall become effective on the Effective Date, defined in Article 8.1 hereof and shall continue and remain in full force and effect until December 31, 2003.

ARTICLE VIII
APPROVAL OF CONTRACT BY STATE OF ALASKA
AND EFFECTIVE DATE

8.1 Condition Precedent. This Agreement shall take effect on the date on which this Agreement is approved by a concurrent resolution of a majority of each house of the Tenth Alaska Legislature ("Effective Date").

ARTICLE IX
TRADE OR EXCHANGE OF CRUDE

9.1 Conditions. Purchaser may enter into agreements to trade or exchange any or all of the royalty crude oil for other Alaskan crude oil or products. Purchaser agrees that such trade or exchange shall not reduce the price to be paid to Seller under Article II hereof, and such trade or exchange shall be at no cost or expense to Seller. Purchaser further agrees that oil or oil products received in trade or exchange will be substituted for the royalty oil with respect to its obligations under Article 3.3 and 3.3.1.

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ARTICLE X
SUPPLIER-PURCHASER RELATIONSHIP

10.1 Advance Termination. In the event that this Agreement is cancelled or terminated by any party, Purchaser hereby agrees to waive any rights which it may have to a continuation of any supplier-purchaser relationship that may have been established with respect to the royalty oil for purposes of any federal mandatory crude oil allocation program. Specifically, the Purchaser expressly states that the consent given in the immediately preceding sentence is such a consent to the termination of any supplier-purchaser relationship between the Seller and the Purchaser which may be deemed to exist under the Federal Mandatory Petroleum Allocation Regulations (10 C.F.R., Part 211) as is provided in 10 C.F.R. 211.63 (d)(1)(i) of such Regulations.

Purchaser agrees that any subsequent contracts for the sale, trade, exchange or other disposition of the State of Alaska royalty crude oil or products refined therefrom that may be entered into by the Purchaser herein will include the advance written consent of the Purchaser, exchange or trade partner, or other recipient of the crude oil or said products to the termination of any supplier-purchaser relationship which may be deemed to exist with respect to royalty oil or products therefrom for purposes of any mandatory crude oil allocation program upon the expiration, termination or cancellation of the underlying contractual agreement for the sale, trade, exchange or other disposition of the oil or products, or in the event that this Agreement between the Seller and the Purchaser for the sale and purchase of the royalty oil is terminated for any reason, including termination for default as stated in Articles VI and XI. Purchaser also agrees to include in any contracts for the sale, trade, exchange or other disposition of the royalty oil or products therefrom an agreement by the purchaser, exchange or trade partner or other recipient of the royalty oil or products to include identical waiver provisions in all subsequent sales, trades, exchanges, or other disposition of the royalty oil or products by that purchaser, exchange or trade partner or other recipient and by any subsequent purchaser, exchange or trade partner or other recipients.

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ARTICLE XI
DEFAULT OR TERMINATION

11.1 Default. If

(i) either party shall fail to perform any of the covenants or obligations imposed upon it by this Agreement, except where such failure shall be excused under the force majeure provisions of Article XV, or

(ii) Purchaser becomes insolvent or commits any act constituting an act of bankruptcy, or

(iii) Purchaser involuntarily files an action under the United States Bankruptcy Act, or

(iv) Purchaser fails to obtain the dismissal of any involuntary bankruptcy proceeding filed against it under the provisions of the United States Bankruptcy Act within sixty (60) days of the filing thereof,

then and in any such event, the other party may, at its option and without waiving any other remedy for breach hereof, indicate such party's election to cancel this Agreement by notice in writing specifying in detail wherein the default has occurred. Except for the instances stipulated in Articles 11.1 (ii) through (iv) above, and except for payment by Purchaser to Seller, which shall be governed by Article 6.5, the party in default shall have thirty (30) days from the receipt of such notice to remedy such default and to pay the other party for all loss or damage incurred as a result of such default and indemnify such party against future claims or loss arising out of such default. Upon failure of the defaulting party to remedy its breach within the time stipulated above, this Agreement may be cancelled by the non-defaulting party by service of written notice thereof upon the defaulting party. Any cancellation under Article 6.5 or this Article 11.1 shall not prejudice the right of the party not in default to collect any amounts due it hereunder for any damage or loss suffered by it and shall not waive any other remedy to which the party not in default may be entitled for breach of this Agreement.

11.2 Termination by Purchaser. Purchaser shall have the right to terminate this Agreement, at its discretion, upon giving Seller eight (8) months notice.

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ARTICLE XII
DISPOSITION OF OIL

12.1 Disposition of Oil Upon Default or Termination. Notwithstanding termination of this Agreement for default or under any other termination provision contained herein, unless Seller is released from the six (6) month notice provision of the Prudhoe Bay Unit Agreement, Purchaser shall have an obligation to continue to take and purchase Seller's royalty oil for up to seven months following termination of the Agreement, in such quantities as Purchaser has elected pursuant to the nomination procedure set forth in this Agreement during the six (6) months preceding termination or cancellation of this Agreement, if Seller, in its discretion, so requires. Seller shall use its best efforts to secure a waiver from the six (6) month notice provision of the Unit Agreement.

12.2 Inability to Receive Oil. If for reason of force majeure or otherwise Purchaser is unable to receive into Purchaser's facility the oil hereunder as made available to Purchaser pursuant to Purchaser's nomination at the Point of Delivery, Purchaser shall be responsible for the disposal of said oil in accordance with Article 3.3, and for paying the Seller for the oil nominated as though it had been received into Purchaser's facility, unless Seller through an understanding with Lessees or lessees is able to cancel delivery of quantities called for in said nominations of Purchaser. Seller agrees that it will use its best efforts to negotiate with Lessees or other parties to accept delivery of the Seller's royalty oil if Purchaser is unable to receive the royalty oil.

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ARTICLE VIII
WAIVER

13.1 Waiver. The failure of Seller or Purchaser to insist upon strict performance of any provision hereof shall not constitute a waiver of, or estoppel against asserting, the right to require such 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; and a course of performance established by a party shall likewise not estop the other party from complaining of a later breach similar in nature.

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ARTICLE XIV

VALIDITY

14.1 Validity. If any provision or clause of this Agreement or application thereof to any person or circumstance is held invalid, such invalidity shall not affect other provisions or applications of the Agreement which can be given effect without the invalid provision or application.

ARTICLE XV

FORCE MAJEURE

15.1 Effect of Force Majeure. Except for Purchaser's obligations to make payment of money for royalty oil delivered hereunder and except for Purchaser's obligation to take oil nominated by it, neither party shall be liable for any failure to perform the terms of this Agreement when such failure is due in whole or in substantial part to "force majeure" as hereinafter defined, except that if said force majeure continues for a period of four (4) years, so as to prevent substantial performance of a party's obligations under this Agreement, the party not claiming "force majeure" shall have the right to terminate this Agreement, provided such right is exercised before the force majeure ceases to exist. Other remedies otherwise available for default or breach in the event of termination after such four year period shall not thereby be affected. The term "force majeure" as employed in this Agreement shall mean acts of God, strikes, lockouts or industrial disputes or disturbances, civil disturbances, arrests and restraint 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 reason of allocations promulgated by authorized governmental agencies, epidemics, landslides, lightning, earthquakes, fires, storm, floods, washouts, explosions, breakage or accident to machinery or lines of pipe, freezing of wells or pipelines, destruction or significant malfunction of Purchaser's

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refinery, the making of repair or alterations to pipelines or plants, including Purchaser's refinery, or any other event or condition, whether of the kind herein enumerated or otherwise, not within the reasonable control of the party claiming "force majeure".

15.2 Responsibility. Upon the occurrence and discovery of an event constituting force majeure, the party claiming that the event is force majeure shall notify the other party hereto of its claim of force majeure. Upon the occurrence of an event constituting "force majeure" the same shall, so far as possible, be remedied with all reasonable dispatch, and the obligations of the disabled party to perform under this Agreement, insofar as they are affected by such force majeure shall be suspended from the time such force majeure occurs and for so long as the disability so caused should have continued had the party claiming the existence of the force majeure met its remedial obligations under this Article 15.2, and for no longer. The settlement of strikes or lock-outs or industrial disputes or disturbances shall be entirely within the discretion of the party having the difficulty, and the above requirement that any force majeure shall be remedied with due diligence 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 XVI

NOTICES

16.1 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 by registered or certified United States mail, postage prepaid, with a return receipt requested to such party. Notice deposited in the mail in the manner hereinabove described 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 purposes of notice the addresses of the parties hereto shall be as follows:

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If to Seller: State of Alaska
 Commissioner of Natural Resources
 Pouch "H"
 Juneau, Alaska 99811

and
Commissioner of Revenue
Pouch "S"
Juneau, Alaska 99811

and
Director, Division of Minerals
and Energy Management
323 East Fourth Avenue
Anchorage, Alaska 99501

If to Purchaser: President, North Pole Refining
 P. O. Box 5028
 North Pole, Alaska 99705

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

ARTICLE XVII

RULES AND REGULATIONS

17.1 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, or any duly constituted agency thereof.

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ARTICLE XVIII

SOVEREIGN POWER OF STATE

18.1 Sovereign Power Of State. This Agreement and the covenants contained herein 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.

ARTICLE XIX

SECURITY

19.1 Creation of Security Interest. To secure payment of all amounts due Seller for oil sold hereunder, Seller retains and Purchaser hereby grants a purchase money security interest in all of the oil delivered and to be delivered to Purchaser hereunder and in all oil obtained by Purchaser in exchange for oil purchased hereunder; the products made or processed from any such oil, including all substances, if any, coningled therewith, or added thereto, and in the proceeds of the sale of any such oil or products, including the accounts receivable of Purchaser arising from its sales of oil or products manufactured therefrom. The security interest shall attach to the oil at the time and Point of Delivery but shall terminate as to oil or products therefrom sold to a bona fide purchaser of Purchaser in the ordinary course of Purchaser's business, provided however, that the said security interest shall attach to the accounts receivable arising therefrom. Notwithstanding the provisions of this Article 19.1, Seller agrees that (1) the security interest in the oil shall not attach at the same time and Point of Delivery but instead at the time the oil arrives and is delivered to Purchaser at the outlet flange measuring device of

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TAPS at North Pole, Alaska as to any oil shipped under any tariff pertaining to the TAPS which contains a prohibition against carriage of oil on which a lien of a party other than the carrier thereof exists or which grants to any carrier the right to reject carriage of oil on which such a lien exists if Purchaser has provided Seller a bond, letter of credit, marketable securities or other security as described in Article 19.2 in an amount or of a value equivalent to the value of oil of Purchaser in the TAPS on which no lien of Seller exists, unless Seller or Purchaser has obtained and furnished for Purchaser evidence that such prohibition or right of rejection has been effectively terminated or waived and is unenforceable; and (ii) no lien shall attach to any oil or products produced therefrom or accounts receivable created from the resale thereof as to which payments to Seller have been made for the account of Purchaser if (a) such payments are not derived from the sale of property otherwise subject to the security interest of the Seller and (b) such payments are secured or are to be secured by such oil, such products or such accounts receivable. Seller agrees that any document filed to perfect Seller's purchase money security interest described in this Article 19.1 shall contain an exclusion to the effect set forth in the next preceding sentence.

Purchaser agrees that it shall not agree, or consent to, or permit the filing of, any lien or security interest in the oil other than the liens of a TAPS carrier nor shall it transfer title thereto prior to its arrival and delivery to Purchaser at the outlet flange measuring device of the TAPS at North Pole, Alaska, or prior to the attachment of Seller's security interest thereto upon such delivery. Purchaser further agrees that it will not grant or consent to any security interest in the oil or other security in favor of any third party unless such third party agrees in writing prior thereto that such security interest is subordinate to the security interest of the Seller, except for the lien of a TAPS carrier or as provided otherwise in Article 19.1 (ii). Purchaser

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agrees to execute and file all documents necessary to perfect Seller's said security interest in the oil, proceeds from the oil and accounts receivable referred to above. "Proceeds of the sale" shall include proceeds derived from insurance or other payments resulting from damage to or destruction of the oil or other property covered by the security interest. To secure such payment Purchaser shall cause all policies of insurance on the oil or other property to which the security interest attaches to name the Seller as coinsured as its interests may appear.

19.2 Alternative Security. In lieu of the security interest provided in Article 19.1, Purchaser may provide alternative security in the form of a bond attached hereto and made part hereof as Exhibit "D", executed by the Purchaser, as principal, and a corporate surety agreed to by the Commissioner and authorized to write such bonds in the State of Alaska, as surety for a sum which shall substantially reflect the amounts owed by Purchaser to Seller plus an amount equal to the value of any oil delivered by Seller to Purchaser and not yet billed pursuant to Article VI; provided that whenever Seller has reasonable grounds for asserting and does assert any claims against Purchaser in excess of the sum of the bond of Purchaser then in effect hereunder, Purchaser after being so requested by Seller shall either increase the sum of such bond to an amount reasonably sufficient to cover the claim of Seller and all expenses which may be incurred by it in connection therewith or shall furnish other security satisfactory to Seller, such as a renewed security interest in the oil or a portion thereof sold hereunder, regardless of whether the Purchaser does or does not recognize the validity of the Seller's claim (so long as reasonable grounds for asserting such claim exist). Purchaser may at any time and from time to time deposit and maintain with the Commissioner at Purchaser's expense in lieu of any such bond, either (1)

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an irrevocable letter or letters of credit addressed to the Commissioner issued by the state or national banking institution of the United States which is a member of the Federal Deposit Insurance Corporation and has an aggregate capital and surplus of not less than \$10,000,000 or (ii) marketable securities which are approved by the Commissioner, and which shall be transferable by the Commissioner or by delivery by stock power attached or other means, such letter or letters of credit to be of an aggregate amount, or such marketable securities to be of an aggregate then fair market value, of not less than the amount then required for Purchaser's bond hereunder any such letter or letters of credit and marketable securities, together with any proceeds thereof, to be held by the Commissioner for the security and benefit of the Seller; and such letter or letters of credit and marketable securities, along with instrument of transfer to be in form and substance approved by the Seller. The amount of said letter or letters of credit or marketable securities shall be subject to increase in the same manner that the face amount of the bond is subject to increase. If marketable securities are so furnished, other marketable securities which meet the requirements of the Subparagraph (a) may be substituted at any time and from time to time for any previously furnished marketable securities, and the marketable securities so furnished shall be increased if at any time the fair market value of the securities then held by the Commissioner is less than, or may be reduced if the fair market value thereof exceeds, the amount of the bond then required of Purchaser herein. Purchaser may, in lieu of any other security provide other security which in the opinion of the Commissioner is of equal value to the security above described.

ARTICLE XX

EQUAL EMPLOYMENT OPPORTUNITY

20.1 Discrimination. In the operation of its refinery at which it processes royalty oil, Purchaser will not discriminate against any employee or applicant for employment because of race, color, religion,

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national origin, ancestry, age or sex. The Purchaser will take affirmative action to insure that applicants are considered for employment, and that employees are treated during employment, without regard to their race, color, religion, national origin, ancestry, age or sex. Such action shall include, but not be limited to, the following: employment, upgrading, demotion, or transfer; recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training, including apprenticeship. The Buyer agrees to post in conspicuous places, available to employees and applicants for employment, notices setting forth the provisions of this nondiscrimination clause.

20.2 Advertisement of Equal Employment Opportunity. The Purchaser shall state, in all solicitations or advertisements for employees to work at said refinery that all qualified applicants will receive consideration for employment without regard to race, color, religion, national origin, ancestry, age or sex.

20.3 Notices to Unions. The Purchaser will send to each labor union or representative of workers with which the Buyer has a collective bargaining agreement or other contract or understanding a notice advising the labor union or workers' representative of the Buyer's commitments under this Article and shall post copies of the notice in conspicuous places available to all employees and applicants for employment.

20.4 Inclusion of Equal Employment Opportunity Provisions in Contracts and Sub-Contracts. The Purchaser will include the provisions of Article 20.1 through 20.3 in its contracts pertaining to the construction and operation of said refinery and will require the inclusion of these provisions in every sub-contract entered into by any of its contractors, so that such provisions will be binding upon each sub-contractor of Purchaser.

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20.5 Cooperation with Agencies of Seller. The Purchaser agrees that it will fully cooperate with the office or agency of the State of Alaska which seeks to deal with the problem of unlawful or invidious discrimination, and with all other State efforts to guarantee fair employment practices under this Agreement, and Purchaser will comply promptly with all reasonable requests and directions from the State Commission for Human Rights or any of its officers or agents relating to prevention of discriminatory employment practice. Full cooperation as expressed above shall include, but not be limited to, being a witness in any proceeding involving questions of unlawful or invidious discrimination if such is deemed necessary by any official or agency of the State of Alaska; permitting employees of Purchaser to be witnesses or complainants in any proceeding involving questions of unlawful or invidious discrimination, if such is deemed necessary by any official or agency of the State of Alaska; participating in meetings; submitting periodic reports on the equal employment aspects of present and future employment; assisting in inspection of the said refinery site during and after the construction; and promptly complying with directives deemed essential by any office or agency of the State of Alaska to insure compliance with all federal and state laws, regulations and policies pertaining to the prevention of discriminatory employment practices.

ARTICLE XXI

LOCAL HIRE

21.1 Local Hire. (1) Purchaser will comply with all applicable Alaska statutes and regulations in effect at the time this Agreement becomes effective as well as all amendments thereto and subsequent enactments, providing for local or resident hire.

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(2) In addition, and subject to compliance with other requirements of state or federal law or regulation, Purchaser will give preference to hiring qualified and available residents over nonresidents for all work to be performed in the operation and maintenance of said refinery. Purchaser shall not discriminate against Alaska residents by differentiating between residents and nonresidents in payment of wages, salaries, fringe benefits and working conditions. Nothing shall prohibit the Purchaser from hiring Alaska residents through private sources. However, if private sources are unable to supply qualified Alaska residents, Purchaser shall then attempt to seek qualified Alaska residents through the Alaska Department of Labor prior to the employment of nonresidents. The Purchaser shall allow said Department of Labor two days, excluding Saturday, Sunday and state holidays, to produce qualified resident workers prior to the employment of nonresidents. If suitable resident workers are not provided within the specified time period, the Purchaser may hire nonresidents possessing the qualifications necessary to perform the work, on an emergency basis for the duration of the emergency, as casual or intermittent employees if their employment will not exceed thirty (30) working days, or as specially skilled employees when the Department of Labor agrees in advance that such specially skilled persons are unavailable within the State.

(3) Purchaser will use its best efforts to incorporate in any and all collective bargaining agreements into which it enters with Labor unions covering work to be performed in the operation and maintenance of said refinery and associated facilities and operations, a provision requiring the union's dispatch procedures to be established and operated in a manner which will assure that qualified Alaska residents will be employed to perform said work.

(4) Purchaser will incorporate in and all agreements it enters with contractors and sub-contractors provisions requiring the employment of qualified Alaska residents, as set forth in Article 21.1 and utilization of the contractors' or sub-contractors' best efforts to obtain agreements with labor unions, as specified in Article 21.1 (3).

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(5) Noncompliance with the preceding provisions of this Article 21.1 or of Article XX shall be grounds for a complaint which an aggrieved resident of the State of Alaska, on its own motion, may file with the Department of Labor, Wage and Hour Division, against the Purchaser, but shall not be considered a default under Article XI. Purchaser hereby agrees to submit to the jurisdiction of the Department of Labor for purposes of determining whether noncompliance in fact occurred. Said evidence and cross-examine witnesses prior to such determination. Adequate notice thereof shall be given to all parties concerned. Upon a determination that noncompliance occurred, the Purchaser shall pay the aggrieved resident a sum equal to the amount the resident would have received had he been employed by the Purchaser, up to a maximum of one (1) year's salary. If such noncompliance is determined to have been wilful the Department may award an additional sum up to the amount of the original sum awarded.

(6) For purposes of this Article, "qualified" means capable, through education, training or experience, of performing the duties and satisfying the usual terms and conditions of the employment; if those duties, terms and conditions meet the reasonable standards of the industry as required of other employees performing the same type of work in the industry.

(7) For purposes of this Article, "resident" shall have the meaning determined by the Commissioner of the Department of Labor.

ARTICLE XXII

APPLICABLE LAW

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