

SCOMM

94:7

Alaska State Legislature

Legislative Research Agency



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February 7, 1990

MEMORANDUM

TO: Senator Mike Szymanski

FROM: Gordon S. Harrison, Director 

RE: Policy Options for Legislation Dealing With Claims Against Royalty Oil Purchasers
Research Request 90.201

You asked for a discussion of policy options for legislation dealing with claims by the state of Alaska against purchasers of the state's royalty oil arising out of the *Amerada Hess et. al.* litigation. In particular, you were interested in possible approaches to legislation that would mitigate the financial burden of these claims on the royalty oil purchasers.

I described in general terms the pricing dispute in the *Amerada Hess* case in my memorandum to you on royalty oil of November 9, 1989, so I will not do so here.

The point of departure for considering legislative involvement in this matter is a series of background facts and observations about the *Amerada Hess* case and its implications for purchasers of royalty oil.

Background Observations

1. The *Amerada Hess* case is years away from a judicial settlement.

While the state's attorneys hope that the case will get to court in 1990, there is a possibility of delay into 1991. When it does get to court, the jury trial will doubtless be a long and tedious affair, given the technical complexity of the issues and the money at stake. Whoever loses at trial will have the opportunity to appeal, thereby prolonging further a final judgment.

2. The state's claim against the royalty oil purchasers (also referred to as in-kind purchasers) for \$379 million is only a claim.

The actual debt, which may not exceed \$379 million, will depend on the outcome of the *Amerada Hess* case. A final figure has not been set by a court or by negotiated settlement. Indeed, the state's calculation of its claim is the heart of the dispute in the *Amerada Hess* litigation. Although the state

believes its case is very strong, a final determination of money actually owed the state by the in-kind purchasers has yet to be made.

3. The state's claim against the producers is for something over \$900 million.

This amount, too, is only a claim at this point. However, the state's case against the producers is clearly of more financial importance to the treasury than that against the in-kind purchasers. It should be noted that the claims of \$379 million and \$900 million cover the period July 1977 through the end of 1986. The state will assert additional claims from 1987 to the current period. These amounts include interest on the back payments. The state is also seeking damages from Chevron, British Petroleum and Arco for breach of the fiduciary responsibility these companies have with the state. Damages are not included in the \$900 million figure.

4. Settlements negotiated out of court with the producers may obviate the need for a jury trial.

Attorneys for the state of Alaska and the major producers are discussing possible terms of settlement. A settlement has already been reached with Amerada Hess, a comparatively minor company in the litigation.

5. ~~Claims against the producers and the in-kind purchasers are interwoven, and the disposition of one set of claims may affect the disposition of the other.~~

Indeed, the claims against the royalty purchasers are derived from the claims against the producers (the in-kind purchasers are obligated to pay the true in-value price, which is set by the producers; under-reporting by the producers caused under-payment by the in-kind purchasers). Thus, the logical sequence of events is to settle the claims against the producers, either by negotiation or litigation, and then deal with the claims against the royalty purchasers. If this sequence is reversed because of legislative intervention, it is possible that the legislative settlement with the in-kind purchasers would undercut the legal case against the producers.

6. ~~Negotiated settlements with the producers may recognize the plight of the in-kind purchasers.~~

~~Attorneys for the state of Alaska are mindful of the situation created for the purchasers of royalty oil by the inaccurate reporting of the producers. It is conceivable that they will seek to include some measure of redress for the in-kind purchasers in settlements they negotiate.~~

7. Although the in-state purchasers may now complain that they face unknown and potentially substantial liabilities, they knowingly and voluntarily (indeed, eagerly) entered into contractual agreements with the state that created these liabilities.

The potential consequences of the *Amerada Hess* litigation were well-known to the purchasers of the state's royalty oil. Sales contracts explicitly commit the purchasers to make good on the full in-value price as it may be determined by the outcome of the case.

8. The unwavering policy of the state has been to obtain the full in-value price for oil taken in-kind and sold to local refiners.

The state's policy of obtaining the full in-value price has been supported by several administrations and affirmed by several legislatures. A policy of subsidizing in-state refiners and other purchasers of the state's royalty oil through sales at less than the full in-value price has been repeatedly rejected.

Implications for Legislative Policy

The foregoing information raises three key questions about legislative intervention in the administration's pursuit of claims against the in-kind purchasers of royalty oil.

1. Is legislation that diminishes the financial return to the state's general fund from its royalty oil sales good and justifiable public policy?

Should the state reverse its long-standing policy in this matter, particularly for the benefit of businesses that freely entered into contracts with the state? A related question, of course, concerns the political feasibility of legislation that proposes to reverse the state's policy.

2. Is legislative intervention at this point timely?

Is it premature for the legislature to address the issue of financial burden to the in-kind purchasers when this burden is unknown, and may be substantially less than feared by the companies? Judicial or negotiated out-of-court settlements may reject or reduce the state's claims; negotiated settlements may contain some element of relief for the royalty oil purchasers. Therefore it may be more appropriate to deal with the problem after its true dimensions are known.

3. Does the legislation impose a settlement, directly or indirectly, on the state's claims against in-kind purchasers, or does it merely establish terms or conditions for repayment of a settlement arrived at by litigation or negotiation.

This distinction is a critical one that the bill should address in burnished language.

Draft Legislation

The contents of a bill, should you decide to introduce one, will depend on whether its purpose is to settle the claims or merely authorize specific terms of repayment when the size of the debt is established in the normal course of events.

If the bill amounts to a settlement, it should be carefully crafted to avoid undermining the state's continuing case against the producers. Even a blanket waiver of all back-payments from the in-kind purchasers might give the producers a new line of argument in court. I strongly urge you to discuss the language of any such bill with the Department of Law to avoid inadvertently putting the state's \$900 million claim at risk.

A bill that authorizes terms of repayment would presumably be less difficult to draft. It might forgive a certain percentage of the final settlement, or a certain portion of it (the accrued interest, for example). It might authorize amortization of the debt over a substantial period of time at a specific interest rate. Repayment might take the form of a surcharge on each future barrel of royalty oil purchased. Noncash goods might be acceptable for part of the repayment, such as preferred stock or refined products, if one or more of the companies claimed financial hardship.

I hope this discussion has been informative for you. If you would like me to pursue the matter further, please contact this agency.

FISCAL NOTE

STATE OF ALASKA 1993 LEGISLATIVE SESSION

Revision Date <u>Original</u>	BILL NO. <u>SB134</u>	Department Affected: <u>Natural Resources</u>
Title: <u>"An Act establishing credits for purchasers of state royalty oil..."</u>	BRU: <u>Resource Development</u>	
Sponsor: <u>Senators Miller and Pearce</u>	Components: <u>Oil & Gas Development</u>	
Requestor: <u>O&G, JUD, FIN</u>	Component Serial No. <u>439</u>	

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

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

For full XXXXXXXXXX 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.

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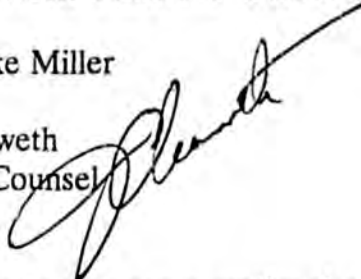
130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

MEMORANDUM

March 9, 1993

SUBJECT: Senate Bill 134, establishing a credit for purchasers of state royalty oil for certain capital investment expenditures which they may make (Work Order No. 8-LS0691E)

TO: Senator Mike Miller

FROM: Jack Chenoweth
Legislative Counsel 

Through staff, you have asked me to prepare a sectional analysis of this measure.

Senate Bill 134 would put into place a credit against certain payments due the state on purchased state royalty oil. The credit would be claimable by certain purchasers of state royalty oil who, as a result of collateral negotiations that culminated in adjustment of the price or value of the royalty oil paid by producers, now find themselves indebted to the state. The royalty oil purchasers would be allowed to take as a credit against the payment due the state on that indebtedness the expenditures that the purchasers make on qualifying capital investments in the state.

Bill section 1: This bill section adds a new subsection, subsection (i), to AS 38.05.-183. AS 38.05.183 is the section that sets out the procedures applicable to sale of state royalty oil. Specifically,

Paragraph (i)(1) authorizes a claim of a credit by a purchaser of state royalty oil. The credit is claimable against "any liquidated purchase arrearage"--the term is later defined--of the purchaser, and is based on the "gross value" of the purchaser's investment in a capital project. The commissioner of commerce and economic development is to establish procedures under which a purchaser may claim the credit, and the purchaser may file with the commissioner for the credit using those procedures. Under this paragraph, a credit that qualifies "shall be allowed" unless, on application of a clear and convincing evidence standard, the commissioner disallows or denies the credit because the purchaser's investment for which the credit is claimed "will not yield benefits to the economy of the state that are commensurate with the amount of the credit."

Paragraph (i)(2) explains the manner in which the credit may be taken and sets a limit on the amount of credit that may be claimed. If investment exceeds liquidated purchase arrearage, the purchaser may claim the overage or surplus as a credit "against any other obligation that the purchaser may owe the state."

Paragraph (i)(3) authorizes the purchaser seeking to claim the credit based on anticipated or expected investment in a capital project to obtain from the commissioner an advance determination as to whether or not the investment qualifies, and directs the commissioner to respond to that request for determination within 60 days. The paragraph also sets out circumstances that must be met before the credit is claimed and sets limits on the duration in which the credit may be claimed.

If a purchaser claims a credit and the commissioner does not disallow it, paragraph (i)(4) directs that any payment on the revised royalty that is due the state by the purchaser is suspended for the duration of the period under the preceding paragraph during which the credit may be claimed. The balance payable, less any credit allowed, plus interest becomes due and payable to the state 60 days after the last day on which the credit may be claimed.

Paragraph (i)(5) supplies definitions for the terms "commissioner" and "liquidated purchase arrearage."

Bill section 2: This section gives the bill an immediate effective date.

JBC:pl
93-172.plm

B.J. Moon - Heese M010

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To: Buki Wright	From: Greg Burden
Co: Tesoro	Co: Tesoro
Dept:	Phone: 561-3521
Fax: 563-4749	Fax: 561-8218

**A Response to Two Questions Regarding Capital Credit Legislation for
Royalty Oil Purchasers**

Legislation has been discussed that would allow purchasers of royalty oil who find themselves faced with delinquency assessments from the state (as a result of pricing or valuation controversies) to credit against those retroactive assessments the value of qualifying capital investments that the purchaser may make in Alaska in the future. The legislation, which would include a number of safeguards to ensure that the public receives benefits commensurate with the credit, is intended to further these public policy goals:

1.

Encourage job creation, increased tax revenues and economic stimulus by inducing Alaska's in-state refiners to expand their Alaska operations. The legislation proceeds on the premise that the stimulation of specific, long-term capital growth is a prudent investment for the one-time, extraordinary claims that the state has asserted against its in-state royalty oil purchasers. Indeed, a recent study prepared for Tesoro Alaska Petroleum by ECO Northwest indicates that a particular \$46.5 million refinery expansion would return to the state, in 1993 dollars, \$51.3 million in new tax revenues; \$126 million in new employee compensation; \$1.2 billion in increased industrial output; and \$632 million in property income increases. In addition, that investment would create 2,787 new person/years of employment. The report thus suggests that Alaska's return on investment from this legislation would be extraordinary;

2.

Assure the continued provision of reasonably priced refined products to the majority of Alaskans now served by those refiners. For nearly 20 years, the state has successfully pursued a policy of using royalty oil sales to generate

new in-state refining capacity, recognizing that stable and reasonably priced crude supplies were critical to providing Alaskans with reasonably priced refined products. To underscore that linkage between crude supplies and refined product prices, a recent Mapco study found a high correlation (approximately 80%) between crude prices and fluctuations in costs of gasoline and other fuels.

3.

Bring balance to the state's settlement of the Amerada Hess controversy. That litigation involved a dispute over the "value" of North Slope oil. That litigation was settled as a result of negotiations between the state and North Slope producers. The amount of that settlement was financially acceptable to those producers, and represented only 6 percent of the assessed value of their North Slope property. On the other hand, the state is now attempting to apply that settlement to its royalty oil purchasers, even though: (1) the State consistently maintained that these purchasers were precluded from participating in *Amerada Hess* negotiations; and therefore could not protect their interests through that process; and (2) the state's demands represent up to 100% of the assessed valuation of these purchasers' property in **the entire state**. Moreover, the amount the state would seek to claim from these purchasers--about \$300 million--is nearly half the \$700 million that the state accepted from North Slope producers. This despite the fact that in-state refineries have taken only about 4% of all crude oil from the North Slope since Prudhoe Bay came into production.

* * *

Particularly in light of the ECO Northwest report, it appears that the direct returns to the public from this proposal will substantially exceed any reduction in state revenues. And as an investment in the economy, it is consistent with a number of other state programs designed to stimulate the private economy through government activism. Two questions that have been asked about the

proposed legislation focus on private benefits that could accrue from the legislation; however, there are significant public benefits of the proposals.

1. Isn't this Legislation Just A Subsidy for In-State Refiners?

No. It is, in fact, a firmly engrained concept in both federal and state revenue policy. The federal government long ago enacted the investment tax credit, which foregoes tax revenues when taxpayers devote resources to new capital investment. Not only has Alaska followed suit with a general investment tax credit ^{1/}, it has also enacted a special, more generous tax credit for new gas processing facilities and new mineral exploration. AS 43.20.042. Over the past six years, Alaska has also granted a tax credit from the fisheries tax--for new fisheries investment. AS 43.75.032.

The capital credit legislation now being discussed has a number of safeguards not present in other private-sector investment initiatives: (1) the credit cannot be granted if the particular investment will not yield benefits justifying the credit; (2) the time period for taking these credits is limited; and (3) credits cannot be taken for investments that pre-date passage of the law, or which are already compelled by law (such as mandatory pollution control equipment).

Whenever government proposes to invest in its economy, the issue can't be "is it a subsidy," because every government entry into the private sector will yield direct benefits to some identifiable businesses. The issue, rather, must be "***is it a good investment in terms of public benefits that will result.***" The ECO Northwest report prepared for Tesoro strongly suggests that, more so than in many cases, the capital credit legislation is a very good investment indeed.

^{1/} AS 43.20.021(d).

II. Why Should Only Purchasers of Royalty Oil Have This Program, Rather than All Taxpayers?

No other "taxpayer" has purchased royalty oil, and then been asked to retroactively pay more than they were originally charged. The amount sought from the royalty purchasers covered over ten (10) years of purchases with the oil processed and sold many years ago with the benefits of the lower crude oil prices enjoyed by the Alaska Consumer.

- As we have seen, the royalty oil purchasers are being asked to bear a disproportionate share of the *Amerada Hess* controversy--with demands against them approaching 100% of the assessed value of their Alaska property. And, even though in-state refiners have received only 4% of the North Slope crude oil they are being asked to pay approximately 30% of the total that the state hopes to receive from its *Amerada Hess* claims. The legislation, in part, is therefore aimed not at creating disparity, but curing it.

The issue isn't whether one industrial sector might benefit from a particular legislation program, but whether the public benefits from that program outweigh the costs to the government. Every economic incentive program brought to the legislature must be judged under that yardstick, and we're confident that the capital recovery legislation will pass it.

SB134

WALTER J. HICKEL, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

February 26, 1993

REPLY TO:

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The Honorable Loren Leman
Alaska Senator
Room 113
State Capitol
Juneau, AK 99801-1182

FEB 26 1993

Re: SB 134 and HB 185

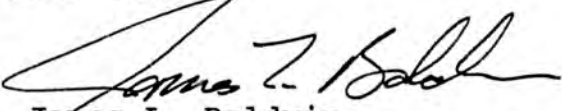
Dear Senator Leman:

Attached please find arguments and analysis of points in opposition to SB 134 and HB 185 (credits for capital investments of RIK purchasers). The arguments raised in the attachment form the basis for the attorney general's opposition to these bills.

Sincerely,

CHARLES E. COLE
ATTORNEY GENERAL

By:


James L. Baldwin
Assistant Attorney General

JLB:tg

Rationale for Opposing Capital Credits Legislation (SB 134)

I. Capital credits are anti-competitive and not necessary for the refiners' economic expansion.

- A. Capital credits are anti-competitive. Tesoro and MAPCO are expanding primarily into the super convenience store business (featuring the sale of alcohol), not the refining and distribution business. The state is being asked to finance competition with locally-owned grocery stores, fuel companies, fast food outlets, and other businesses. If the state pays for that expansion with capital credits, it makes all competing stores less competitive and dramatically discourages entry of new competitors. Moreover, MAPCO presently ships refined crude to Anchorage on the Alaska railroad, but is considering building a pipeline. If the state in effect pays for the pipeline with capital credits, it will be harming the railroad, as well as further exacerbating Tesoro's economic disadvantage vis a vis MAPCO.

The effect is worse on the oil side of the business. There is very limited competition now. If the state pays for expansion of the existing industry, no one will be able to afford to enter the market. Further, the greater the former underpayment (i.e., the bigger the RIK bill), the greater the subsidy. Capital credits use public funds to destroy private capital and tend to create monopolies.

- B. Capital credits would increase refining margins (profits). They would not decrease consumer costs and would probably increase consumer costs by limiting competition. If the legislature's goal is to reduce consumer energy costs, it could better ~~achieve~~ that goal by issuing checks to consumers when they purchase fuel. The consumers would then decide whether to keep the check for themselves, or return it to MAPCO or Tesoro.
- C. Payment of the purchasers' debts with public funds has nothing to do with their economic decisions to expand. Facilities that make economic sense will be built without this bill. This bill puts the state in the business of financing non-economic construction. At best, the bill will create low paying jobs that could not exist without a subsidy and those jobs will displace skilled jobs such as railway workers and truckers. Furthermore, payment of accrued obligations does not affect refining margins (profits); it simply increases the purchasers' stockholders' equity.
- D. Capital credits to the oil refiners would harm the development of other alternative fuels by making it possible to sell refined products cheaper. This, in turn, may depress economic development by limiting the competitiveness of alternative fuels.

II. Capital credits violate the spirit, if not the letter, of the constitution requiring the legislature to manage its resources to obtain the maximum benefit for all of the state's citizens.

The Alaska Constitution requires that the legislature must provide for the "maximum benefit" of all citizens of the state. An Alaska court has already ruled that this provision prohibits the state from selling its oil for less than it would receive if it allowed the producers to sell the oil for the state. This bill would result in that effect because the state would receive less than if it had let the producers sell the oil. Thus, the bill would violate the constitution.

Moreover, it would benefit some citizens of the state more than others. Capital credits are a form of appropriation. The debt is owed to the general fund (and Permanent Fund). Capital credits, however, only "benefit" a small portion of the state, presuming that any benefit from having had their valid debts forgiven through capital credits were in turn passed through to purchasers of Tesoro's and MAPCO's refined products.

Finally, the Permanent Fund is entitled to 25% of the debts currently owed. If this bill is enacted, the state treasury is exposed to a claim by the Permanent Fund for the value of any credits attributable to the Permanent Fund.

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

REPLY TO:

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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 Miller 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

Barbara A. Brown No Rec
Chair: Signature and Recommendation

FISCAL NOTE

Bill Version: SB 134(S) Publish Date: 4-2-93

STATE OF ALASKA

1993 LEGISLATIVE SESSION

BILL NO. SB134Revision Date OriginalDepartment Affected: Natural ResourcesTitle: "An Act establishing credits for purchasers of state royalty oil..."BRU: Resource DevelopmentSponsor: Senators Miller and PearceComponents: Oil & Gas DevelopmentRequestor: 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
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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, DirectorPhone: 762-2547Division: Oil & Gas DevelopmentDate: 16-Mar-93Approved by Commissioner: Glenn A. OldsDate: 16-Mar-93Agency: 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

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

For further distribution information call the Governor's Legislative Office

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

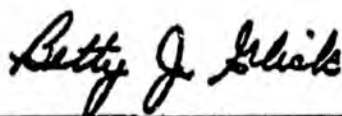
- WHEREAS, the Kenai Peninsula Borough supports Tesoro Alaska and Mapco's request to credit the value of future capital investments (in-state) against their royalty settlement; and
- WHEREAS, the value-added refiners have incurred claims from the state of over \$300 million in retroactive price increases 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.

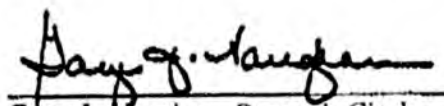
SECTION 2. That copies of this resolution be sent to Governor Walter J. Hickel, Senators Suzanne Little, Judith Salo, Georgianna Lincoln, Fred Zharoff, and Jay Kerttula, and Representatives Mike Navarre, Gail Phillips, Gary Davis, Irene Nicholia, Cliff Davidson and Curt Menard.

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 OIL

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:

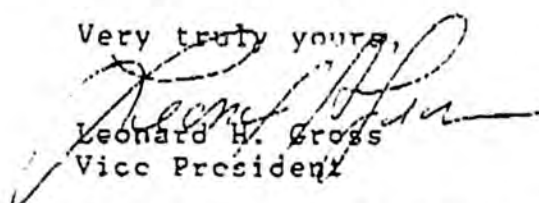
It appears to the undersigned that the above two bills constitute nothing more than raiding the State Permanent Fund and or the State Treasury for private gain.

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

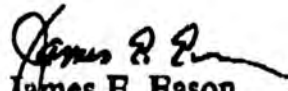
Dear Senator Leman:

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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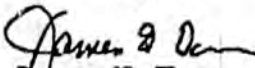
In addition, when the ERCA (Mapco) and Tesoro contracts were negotiated and approved by the legislature, the record reflects that the North Slope producers were unwilling to enter into long-term crude oil supply contracts with those refiners. The state's commitment to do so made it possible for those 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

Rec'd 3769

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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, hereinafter 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",

WITNESSETH:

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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Reel 8 3768

- 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

000520

Reel # 3769

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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Reel # 3769

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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Doc 1 of 3769

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, commingled 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.

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ARTICLE XXIII

AMENDMENT

23.1 Amendment. This Agreement may be supplemented, amended or modified at any time, but only by written instrument duly executed by the parties hereto, and approved by the Royalty Oil and Gas Development Advisory Board and by the Alaska State Legislature by Concurrent Resolution by majority vote of the members of each house.

ARTICLE XXIV

SUCCESSOR AND ASSIGNS

24.1 Successors and Assigns. This Agreement shall extend to, be binding upon, and inure to the benefit of the parties hereto and their respective heirs, devisees, legal representatives, successors, and assigns, and shall constitute a covenant of equitable servitude running with the interests covered hereby.

24.2 Transfer of Title. Any conveyance of all or any part of any interest owned by any party hereto shall be made expressly subject to this agreement. No change of title shall be binding on the other party hereto until the receipt by the other party of a photocopy or a certified copy of the recorded instrument evidencing such change in ownership.

24.3 General Prohibition. No assignment of this Agreement shall be made by either party without first obtaining the written consent of the other party. The Commissioner of Natural Resources may grant such consent on behalf of the Seller.

ARTICLE XXV

HEADINGS

25.1 Headings. Article headings used in this Agreement are for

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convenience only and shall not affect in the construction of this Agreement.

ARTICLE XXVI

OIL SPILL CLEANUP AND CONTINGENCY PLANS

26.1 Oil Spill and Cleanup Contingency Plans. Purchaser shall be responsible for the detection, location, confinement, and cleanup of oil discharges occurring at the Purchaser's refinery after the oil purchased hereunder has been delivered to Purchaser at the outlet flange measuring device of TAPS at North Pole, Alaska; and during the time such oil and the products therefrom remain in the physical possession of the Purchaser at its refinery or in pipelines or other carrier owned and operated by the Purchaser. At least 180 days prior to scheduled first delivery of royalty oil Purchaser shall submit its contingency plans to the Department of Environmental Conservation for review and approval. The plans shall provide for immediate corrective action in the event of oil discharges, including confinement and cleanup, and restoration of the affected resource. The plans shall include separate and specific techniques and schedules for cleanup of petroleum discharges on land, lakes, rivers and streams.

ARTICLE XXVII

RECORDS

27.1 Preservation of Records. Purchaser and Seller will preserve and maintain all books, accounts and records relating to or arising out of the performance of this Agreement, including but not limited to the purchase or resale of the royalty oil and its refined products for a period of four (4) years. Purchaser will also maintain and preserve all similar books, accounts and records of which it has possession belonging to those third parties with whom it contracts for the performance of various parts of this Agreement. Neither Purchaser nor Seller shall be required to retain any records for more than six (6) years unless retention of such records is specifically required by applicable

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law or regulation. Purchaser shall either maintain its records within the State of Alaska or make such records available to Seller and Purchaser's principal office in the State of Alaska within thirty (30) days after written request therefore by Seller.

27.2 Inspection of Records of Parties. Purchaser and Seller will accord to each other and to their authorized agents, attorneys, and auditors during reasonable business hours access to any and all property, records, books, documents and indexes thereto directly relating to the Purchaser's or Seller's performance of this Agreement and which are under the control of the party from which access is desired so that the other party may inspect, photograph and make copies of such property, records, books, documents and indexes thereto. Notwithstanding the foregoing, (i) Seller shall not be required to disclose any information, data or records which are required to be held confidential by applicable state law or regulation, and (ii) Purchaser shall not be required to disclose any information, data or records containing trade secrets which Purchaser or its Affiliates, contractors or subcontractors have agreed to hold confidential, or which Purchaser or its affiliates, contractors or sub-contractors by contract with unaffiliated third parties have agreed to hold confidential. Seller shall notify Purchaser of all information obtained, recorded or copied from Purchaser's records in order that Purchaser may evaluate the advisability of seeking that such information be held confidential by Seller under applicable law or regulation or under the provisions of this Article.

27.3 Financial Statements. Purchaser will provide Seller with year-end financial statements audited by an independent certified public accounting firm. Preparation of the financial statements shall be at Purchaser's cost. Said statements shall be communicated to Seller in the manner provided in Article XVI.

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IN WITNESS WHEREOF, the Seller has caused this Agreement to be executed by its Commissioner of Natural Resources and the Purchaser has caused this Agreement to be executed by its President, thereunto duly authorized by its Board of Directors in accordance with the certified seal, duly attested, to be affixed hereto, as of the day and year first above written.

ATTEST:

Ludwig H. Brown

THE STATE OF ALASKA

By: Walter E. Pascho

Commissioner, Department
of Natural Resources

"SELLER"

APPROVED AS TO FORM:

EARTH RESOURCES COMPANY OF ALASKA

ATTEST:

Angimio H. Shihus

By: Wm. F. Long

President

"PURCHASER"

I, Michael E. Craig, certify that I am the Secretary of the Corporation named as Purchaser in the above contract, that Louis Francis DeLong was then President of said corporation; that said Agreement was duly signed for and in behalf of said corporation by authority of its governing body, and is within the scope of its corporate powers.

Michael E. Craig
Secretary

(CORPORATE SEAL)

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EXHIBIT "A"

Attached to and Made a Part of the Agreement for the Sale and Purchase of State Royalty Oil dated May 2, 1927 between EARTH RESOURCES COMPANY OF ALASKA, an Alaska corporation "Purchaser", and the COMMISSIONER OF NATURAL RESOURCES OF THE STATE OF ALASKA, acting pursuant to Alaska Statute 38.05.183, "Seller", With Respect To Certain Royalty Oil Owned and Taken In-Kind by Seller Under the leases Described Herein Covering Lands in the State of Alaska.

Tract No.	Description (United Meridian, Alaska)	No. of Acres	ADL Bond No.	Rate Per Acre	Lease of Record	OPR Interest	Working Interest Ownership
1	TINN-RITE, Sec. 8, 10	1,250	47413	1/8	Mohd and Chavira		Mohd-77% Chavira-23%
2	TINN-RITE, Sec. 11, 12	1,250	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
3	TINN-RITE, Sec. 7	800	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
4	TINN-RITE, Sec. 21, 24	1,250	47413	1/8	So-Vo Petroleum Co.		So-Vo-100%
5	TINN-RITE, Sec. 21, 22	1,250	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
6	TINN-RITE, Sec. 19, 20	1,250	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
7	TINN-RITE, Sec. 23, 24	1,250	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
8	TINN-RITE, Sec. 24	640	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
9	TINN-RITE, Sec. 19	800	47413	1/8	Mohd and Phillips		Mohd-50% Phillips-50%
10	TINN-RITE, Sec. 23, 24	1,250	47413	1/8	Mohd and Phillips		Mohd-50% Phillips-50%
11	TINN-RITE, Sec. 21, 22	1,250	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
12	TINN-RITE, Sec. 17, 18, 19, 20	2,400	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
13	TINN-RITE, Sec. 12, 14, 15, 16	2,500	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
14	TINN-RITE, Sec. 15, 16, 17, 18	2,500	47413	1/8	Mohd and Chavira		Mohd-50% Chavira-50%
15	TINN-RITE, Sec. 17, 18, 19, 20	2,400	47413	1/8	Mohd and Chavira		Mohd-50% Chavira-50%
16	TINN-RITE, Sec. 12, 21	1,250	47413	1/8	A.R. Co., BP Alaska, So-Vo Petroleum Co.		A.R. Co.-50% BP Alaska-50% So-Vo-50%
17	TINN-RITE, Sec. 27, 28, 29	1,250	47413	1/8	Mohd and Chavira		Mohd-50% Chavira-50%
18	TINN-RITE, Sec. 27, 28, 29, 30	2,500	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
19	TINN-RITE, Sec. 25, 26, 27, 28	2,500	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
20	TINN-RITE, Sec. 29, 30, 31, 32	2,500	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
21	TINN-RITE, Sec. 27, 28, 29, 30	2,500	47413	1/8	A.R. Co. and Eason		A.R. Co.-50% Eason-50%
22	TINN-RITE, Sec. 25, 26, 27, 28	2,500	47413	1/8	Mohd and Phillips		Mohd-50% Phillips-50%

*See enclosure on page A-5

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Tract No.	Description (U.S. 21st 2nd Pa. Alaska)	Acres	AUL Foot No.	Lot No.	Owner of A-1	ORR Interest	Working Interest Owner
21A	T12N-R12E, SW 1/4 Sec. 22	40.0	21237	1/2	SLM, P. & S. Co. Chester		M&S-21237 P&S-21237 Chester-21237
22	T12N-R12E, Sec. 22, 23, 24, 25	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
23	T12N-R12E, Sec. 27, 28, 29, 30	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
24	T12N-R12E, Sec. 31, 32, 33, 34	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
25	T12N-R12E, Sec. 35, 36, 37, 38	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
26	T12N-R12E, Sec. 39, 40, 41, 42	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
27	T12N-R12E, Sec. 27, 28, 29, 30	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
28	T12N-R12E, Sec. 31, 32, 33, 34	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
29	T12N-R12E, Sec. 35, 36, 37, 38	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
30	T12N-R12E, Sec. 39, 40, 41, 42	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
31	T12N-R12E, Sec. 21, 22, 23, 24	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
32	T12N-R12E, Sec. 25, 26, 27, 28	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
33	T12N-R12E, Sec. 29, 30, 31, 32	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
34	T12N-R12E, Sec. 33, 34, 35, 36	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
35	T12N-R12E, Sec. 37, 38, 39, 40	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
36	T12N-R12E, Sec. 1, 2, 3, 4	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
37	T12N-R12E, Sec. 5, 6, 7, 8	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
38	T12N-R12E, Sec. 9, 10, 11, 12	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
39	T12N-R12E, Sec. 13, 14, 15, 16	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
40	T12N-R12E, Sec. 17, 18, 19, 20	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
41	T12N-R12E, Sec. 21, 22, 23, 24	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
42	T12N-R12E, Sec. 25, 26, 27, 28	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
43	T12N-R12E, Sec. 29, 30, 31, 32	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
44	T12N-R12E, Sec. 33, 34, 35, 36	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
45	T12N-R12E, Sec. 37, 38, 39, 40	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
46	T12N-R12E, Sec. 1, 2, 3, 4	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
47	T12N-R12E, Sec. 5, 6, 7, 8	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
48	T12N-R12E, Sec. 9, 10, 11, 12	2,475	21237	1/2	Solo Petroleum Co.		Solo-21237
49	T12N-R12E, Sec. 13, 14, 15, 16	2,475	21237	1/2	Mobil and Phillips		Mobil-21237 Phillips-21237
50	T12N-R12E, Sec. 17, 18, 19, 20	2,475	21237	1/2	Mobil, P. & S. Co. Chester		Mobil-21237 P&S-21237 Chester-21237
51	T12N-R12E, Sec. 21, 22, 23, 24	2,475	21237	1/2	A.R. Co. and Evers		A.R. Co.-21237 Evers-21237
52	T12N-R12E, Sec. 25, 26, 27, 28	2,475	21237	1/2	Mobil and Phillips		Mobil-21237 Phillips-21237
53A	T12N-R12E, SW 1/4 Sec. 3	40.0	21241	1/2	Mobil, P. & S. Co. Chester		Mobil-21241 P&S-21241 Chester-21241

*See continuation on page A-3

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Tract No.	Description	No. of Acres	ADJ. Serial No.	Survey	Owner of Record	Oil & Gas Interest	Working Interest
(Cont. From A-2)							
32	THIN-RICE, Sec. 13	6.75	21254	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
33	THIN-RICE, Secs. 13, 14, 21	1.725	21255	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
34	THIN-RICE, Secs. 17, 18, 19	1.945	21257	1/8	Chaves		Chaves—100%
34A	THIN-RICE, Sec. 27	6.65	21258	1/8	Chaves, Mohl, Phillips		Chaves—33 1/3% Mohl—33 1/3% Phillips—33 1/3%
35	THIN-RICE, Secs. 13, 18	1.255	21263	1/8	Mohl and Phillips		Mohl—50% Phillips—50%
35A	THIN-RICE, Secs. 21, 22	1.230	21263	1/8	Mohl, Phillips, Chaves		Mohl—33 1/3% Phillips—33 1/3% Chaves—33 1/3%
36	THIN-RICE, Secs. 13, 14, 21, 21A	2.375	21261	1/8	Mohl, Phillips, Chaves		Mohl—33 1/3% Phillips—33 1/3% Chaves—33 1/3%
37	THIN-RICE, Secs. 17, 18, 19, 20	2.440	21261	1/8	Sahia Petroleum Co.		Sahia—100%
38	THIN-RICE, Secs. 15, 16, 21, 22	2.990	21264	1/8	Sahia Petroleum Co.		Sahia—100%
39	THIN-RICE, Secs. 13, 14, 21, 21A	2.310	21263	1/8	Sahia Petroleum Co.		Sahia—100%
40	THIN-RICE, Secs. 17, 18, 19, 20	2.420	21263	1/8	Sahia Petroleum Co.		Sahia—100%
41	THIN-RICE, Secs. 15, 16, 21, 22	2.990	21266	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
42	THIN-RICE, Secs. 13, 14, 21, 21A	2.790	21267	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
43	THIN-RICE, Secs. 17, 18, 19, 20	2.430	21261	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
44	THIN-RICE, Secs. 15, 16, 21, 22	2.990	21262	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
45	THIN-RICE, Secs. 13, 14, 21, 21A	2.860	21262	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
46	THIN-RICE, Secs. 17, 18, 19	1.840	21273	1/8	Sahia Petroleum Co.		Sahia—100%
47	THIN-RICE, Secs. 15, 16	1.230	21270	1/8	Sahia Petroleum Co.		Sahia—100%
48	THIN-RICE, Secs. 13, 14	1.230	21271	1/8	Sahia Petroleum Co.		Sahia—100%
49	THIN-RICE, Secs. 21, 22, 23	1.571	21273	1/8	Sahia Petroleum Co.		Sahia—100%
50	THIN-RICE, Secs. 21, 22, 23, 24	1.560	21274	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
71	THIN-RICE, Secs. 27, 28, 31, 32	2.970	21275	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
72	THIN-RICE, Secs. 27, 28, 31, 32	2.971	21276	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
73	THIN-RICE, Secs. 21, 22, 23, 24	2.790	21277	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%
74	THIN-RICE, Secs. 27, 28, 31, 32	2.973	21279	1/8	Sahia Petroleum Co.		Sahia—100%
75	THIN-RICE, Secs. 21, 22, 31, 32	2.691	21279	1/8	Sahia Petroleum Co.		Sahia—100%
76	THIN-RICE, Secs. 21, 22, 31, 32	2.693	21280	1/8	Sahia Petroleum Co.		Sahia—100%
77	THIN-RICE, Secs. 27, 28, 31, 32	2.965	21281	1/8	Sahia Petroleum Co.		Sahia—100%
78	THIN-RICE, Secs. 27, 28, 31, 32	2.971	21285	1/8	Mohl and Phillips		Mohl—50% Phillips—50%
79	THIN-RICE, Secs. 27, 28, 31, 32	2.965	21284	1/8	A.R.Co. and Eason		A.R.Co.—50% Eason—50%

*See comment on page A-2

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Time No.	Company	No. of Aircraft	ADL Serial No.	Rate Per Hour	Power Plant	Other Remarks	Weight In Pounds
(United States, A-4s)							
80	TION-RITE, Ser. 27, 28, 29, 30	2,372	47412	1/8	Mohr, P. & Co. Cincinnati	Mohr, P. & Co. Cincinnati	10,000
81	TION-RITE, Ser. 29, 30, 31, 32	2,371	47413	1/8	Mohr, P. & Co. Cincinnati	Mohr, P. & Co. Cincinnati	10,000
82	TION-RITE, Ser. 33	640	47414	1/8	A.R. Co. and Evans	A.R. Co. and Evans	10,000
83	TION-RITE, Ser. 1, 4, 10	1,823	47414	1/8	Mohr, P. & Co. Cincinnati	Mohr, P. & Co. Cincinnati	10,000
84	TION-RITE, Ser. 1, 2, 11, 12	2,370	47415	1/8	A.R. Co. and Evans	A.R. Co. and Evans	10,000
85	TION-RITE, Ser. 6, 7, 8, 9 and NL/4 Ser. 1	2,371	47416	1/8	Mohr and Phillips	Mohr and Phillips	10,000
86A	TION-RITE, NW/4 Ser. 1	180	47416	1/8	Mohr, P. & Co. Cincinnati	Mohr, P. & Co. Cincinnati	10,000
86	TION-RITE, Ser. 1, 4, 9, 10	2,373	47417	1/8	American Home, et al.	American Home, et al.	10,000
87	TION-RITE, Ser. 1, 2, 11, 12	2,380	47418	1/8	American Home and Cory	American Home and Cory	10,000
88	TION-RITE, Ser. 1, 4, 7, 8	2,381	47419	1/8	A.R. Co. and Evans	A.R. Co. and Evans	10,000
89	TION-RITE, Ser. 1, 4, 9, 10	2,382	47420	1/8	St. Louis Petroleum Co.	St. Louis Petroleum Co.	10,000
90	TION-RITE, Ser. 1, 2, 11, 12	2,383	47421	1/8	St. Louis Petroleum Co.	St. Louis Petroleum Co.	10,000
91	TION-RITE, Ser. 1, 4, 7, 8	2,384	47422	1/8	A.R. Co. and Evans	A.R. Co. and Evans	10,000
92	TION-RITE, Ser. 1, 4, 9, 10	2,385	47423	1/8	A.R. Co. and Evans	A.R. Co. and Evans	10,000
93	TION-RITE, Ser. 1, 2, 11, 12	2,386	47424	1/8	A.R. Co. and Evans	A.R. Co. and Evans	10,000
94	TION-RITE, Ser. 1, 4, 7, 8	2,387	47425	1/8	A.R. Co. and Evans	A.R. Co. and Evans	10,000
95	TION-RITE, Ser. 1, 4, 9	2,388	47426	1/8	A.R. Co. and Evans	A.R. Co. and Evans	10,000
96	TION-RITE, Ser. 10	870	47427	1/8	A.R. Co. and Evans	A.R. Co. and Evans	10,000

*See also serial on page A-5

000558

Sheet # 3769

A-8

Trust No.	Description	No. of Acres	ADL Serial No.	Unit Size	Owner of Record	OPR. Interest	Working Interest C. 3769
(Unimproved, ALAs)							
97	TIGN-R152, Secs 17, 18, 19, 20	2,512	22306	1/8	ARCo and Exxon		ARCo-275 Exxon-275
98	TIGN-R152, Secs 12, 14, 22, 24	2,960	22321	1/8	ARCo and Exxon		ARCo-275 Exxon-275
99	TIGN-R152, Secs 12, 14, 22, 24	2,970	22321	1/8	ARCo and Exxon		ARCo-275 Exxon-275
100	TIGN-R152, Secs 17, 18, 19, 20	2,512	22322	1/8	ARCo and Exxon		ARCo-275 Exxon-275
101	TIGN-R152, Secs 12, 14, 22, 24	2,970	22323	1/8	ARCo and Exxon		ARCo-275 Exxon-275
102	TIGN-R152, Secs 12, 14, 22, 24	2,970	22324	1/8	ARCo and Exxon		ARCo-275 Exxon-275
103	TIGN-R152, Secs 17, 18, 19, 20	2,512	22325	1/8	ARCo and Exxon		ARCo-275 Exxon-275
104	TIGN-R152, Secs 12, 14, 24	2,512	22326	1/8	ARCo and Exxon		ARCo-275 Exxon-275
105	TIGN-R152, Secs 12, 14	2,512	22327	1/8	ARCo and Exxon		ARCo-275 Exxon-275
106	TIGN-R152, Secs 27, 28	2,512	22328	1/8	ARCo and Exxon		ARCo-275 Exxon-275
107	TIGN-R152, Secs 27, 28	2,512	22329	1/8	ARCo and Exxon		ARCo-275 Exxon-275
107A	TIGN-R152, Sec 28	640	22330	1/8	ARCo and Exxon		ARCo-275 Exxon-275
108	TIGN-R152, Secs 27, 28, 29, 30	2,512	22331	1/8	ARCo and Exxon		ARCo-275 Exxon-275
109	TIGN-R152, Secs 27, 28	2,512	22332	1/8	ARCo and Exxon		ARCo-275 Exxon-275
109A	TIGN-R152, Sec 28	640	22333	1/8	ARCo and Exxon		ARCo-275 Exxon-275
110	TIGN-R152, Secs 27, 28, 29, 30	2,512	22334	1/8	ARCo and Exxon		ARCo-275 Exxon-275
111	TIGN-R152, Secs 27, 28, 31	2,512	22335	1/8	ARCo and Exxon		ARCo-275 Exxon-275
			215,787				

*BP Alaska, Inc. owns an overriding royalty interest equal to 75% of all net profits from production in certain certain leasehold production.

**This Trust Number 104 was assigned to ARCo and Exxon. Upon approval of the margin set by the Board of Directors ADL Serial No. will be given to the Trust.

000559

Reel # 3769

EXHIBIT "B"

Calculation of monthly in value royalty under the Leases and leases (all calculations shall be rounded to the nearest \$0.001)

STEP 1: Calculate each producer's weighted average value per barrel at Point of Delivery for all oil sold by each producer during the month, as follows:

Example, Producer Y

(1) Destination	(2) Volume Sold	(3) Sales Price at Destination	(4) Shipping Costs	(5) Pipeline Tariff	(6) Point of Delivery Value	(7) Weighted Average Value
1	2,000,000	\$12.500	\$ -0-	\$4.770	\$7.730	-
2	4,000,000	13.370	1.110	4.750	7.510	-
3	5,000,000	13.440	3.830	4.750	4.860	-
						<u>\$6.345</u>

Columns 2, 3, 4 and 5 shall be computed from actual data as reported by each producer and filed with the State of Alaska for royalty purposes and severance tax purposes.

STEP 2: The "weighted average value" per barrel of each producer (column 7 above) at the Point of Delivery shall then be used in column (9) below in calculating the applicable in value price for each producer (column 11 below), the weighted average of which shall be the In Value Price to Buyer (column 12), as follows:

000560

Reel # 3769

-continued-

Example, all producers:

(8) Producer and Quantity	(9) Wtd. Avg. Value at Point of Delivery (Col. 7)	(10) Wtd. Avg. Price Received by all other Producers	(11) Applicable Price for In Value Calculation	(12) In Value Price to Buyer
X: 4,200,000	\$6.920	\$6.404	\$6.920	-
Y: 11,000,000	6.343	7.003	7.003	-
Z: 500,000	7.700	6.504	7.700	-
Weighted Avg.	\$6.542			\$7.083

Notes:

- 1) Values in column 10 are the weighted average of all producers other than the producer for which the calculation is being made.
- 2) Column 11 is the highest of the values in columns 9 or 10 for each producer.
- 3) Column 12 is the weighted average of values in column 11.
- 4) Buyer shall not pay any reimbursable costs under Article II until such costs are judicially determined as owing.
- 5) There is no posted price. "Market" or "field" value shall not be used in calculating the "In Value price to Buyer" unless and until the methodology of determining same is judicially decided.
- 6) Subject to later adjustment under Article VI.

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888 S.W. FIFTH AVENUE
PORTLAND, OREGON 97204-2028

ECO
NORTHWEST

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EUGENE OFFICE: (503) 687-0051

RANDALL J. POZDENA, PhD
Managing Director

Monday, March 22, 1993

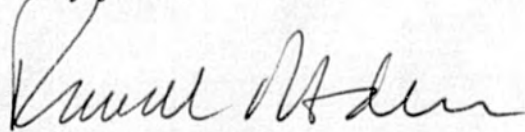
Ms. Annette Kreitzer
Staff Assistant
Office Of Senator Loren Leman
State Capitol
Juneau, AK 99801

Dear Annette:

Please find enclosed a copy of my slide presentation to Senator Leman's Committee last week, as per your request. Thank you for offering to distribute the attached to the committee members.

I appreciated the opportunity to present our work for Tesoro. Please let me know if I can be of further assistance.

Very truly yours,



Enclosure

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RANDALL J. POZDENA, PhD
Managing Director

Monday, March 22, 1993

Dear Committee Member:

The attached document is a copy of the slide presentation I made to your committee on Thursday, March 18, 1993. The presentation summarizes our analysis of the economic impact of an illustrative refinery capacity enhancement at the Kenai refinery of Tesoro Alaska Petroleum. As discussed in my presentation, such a refinery development and its on-going operation would generate over 2,700 jobs, and \$51.33 million in tax revenue.

I enjoyed the opportunity to share the results of our work for Tesoro. Please do not hesitate to contact us if we can be of further assistance.

Very truly yours,



Economic Impacts of Tesero's New Vacuum and Asphalt Units at Kenai, Alaska

Randall J. Pozdena
Managing Director
ECO Northwest
Portland, Oregon

ECO Northwest

ECO Northwest

Economics, finance and planning
consultants

- Founded by University of Oregon professors in 1974
- Offices in Eugene and Portland, Oregon
- Client base of public, private and litigation clients
- Specializing in quantitative valuation and analysis exercises

ECO Northwest

Selected Current Clients

- Pacific Gas Transmission Company
- Peavey Grain Company
- Plaintiffs in the Exxon Valdez litigation
- Tri-Met (Portland-area transit agency)
- California Air Resources Board
- Plaintiffs in the SeaTac airport noise litigation
- Defending oil refiner, gas station litigation

ECO Northwest

The Scale of the Project

Construction Phase:

- \$46.5 m. for capital equipment, labor and materials
- 18 month period beginning 1993 and ending 1994

Operational Phase:

- \$5 m. annual operating expenditures
- Refine 15,000 barrels/day = \$82 m.

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The Economic Impacts

- Direct impacts from spending on construction and operation
- Indirect impacts from the impact on other suppliers and vendors
- Induced impacts, as recipients of income spend their incomes on goods and services

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Modeling the Alaska Economy

ECO developed custom Input-Output models

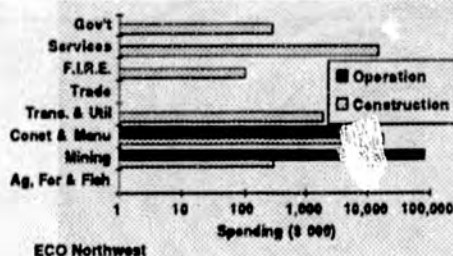
- Kenai Peninsula
- State of Alaska

ECO measured construction and operational spending

- by sector
- by year

ECO Northwest

Tesoro Spending by Sector



Multiplier Effects

Multiplier effects are limited by "leakage" from the Alaska economy

But significant multiplier effects occur nonetheless:

- Each dollar of Tesoro spending generates 20 to 30 cents of spending elsewhere
- For each first-round job, another one-half job is created elsewhere

ECO Northwest

Economic Impacts

The economic impacts are significant over the life of the Project:

	Alaska	Kenai
Business Output	\$1,284 m.	\$1,188 m.
Labor Income	\$126 m.	\$107 m.
Property Income	\$632 m.	\$591 m.
Jobs (person-yrs.)	2,787	2,357

ECO Northwest

Tax Revenue Impacts

Using the economic impacts, ECO calculated tax revenue over the life of the project

Historical ratios and relationships used for:

- Sales tax revenue
- Property tax revenue
- Corporate income tax revenue
- Fees and charges

ECO Northwest

Tax Rate Assumptions

Sales Tax:

- 3% Kenai, 2% Borough, 1.18% elsewhere

Property Tax:

- 1.261% of value in Kenai, 6.6% of income elsewhere

Corporate Income Tax:

- 3.4% of "property income"

Regulatory Cost Charges:

- 0.653% of gross pipeline revenue

Workers Comp and Unemployment Insur.:

- 2.4% of employee compensation

ECO Northwest

Tax Revenue Impacts

The tax revenue impacts over the life of the Project also are significant:

Tax	Statewide	Kenai
Sales	\$ 0.74 m.	\$ 0.67 m.
Property	\$ 22.76 m.	\$ 14.42 m.
Corp. Income	\$ 21.46 m.	NA
Misc.	\$ 6.35 m.	NA
TOTAL	\$ 51.33 m.	\$ 15.09 m.

ECO Northwest

Distribution of Tax Burden

Because Alaska relies on a corporate income tax:

- The tax revenues are collected from the sectors benefitting from the Project

Higher worker incomes:

- Lead to higher residential property spending and property tax revenues
- Effects will be confined to those areas benefitting from Project-stimulated jobs

ECO Northwest

Conclusions

Alaska economy would enjoy significant benefits from Tesoro Project

- Biggest effects come from on-going refining operations

Tax revenues also would increase significantly

- Corporate income tax and property tax revenues are the two biggest sources

ECO Northwest

ANS ROYALTY RIK RETROACTIVE AMERADA HESS ADJUSTMENTS

(Millions of Dollars)

(Includes Interest through Fall 1992 Billing Date)

Company	Billed	Resolved, Paid or Pending Settlement	Paid Under Protest	Unpaid or Disputed	Comments
Petrostar	\$ 2	\$ 2		\$ 0	
Tesoro To Chevron	142 (45) 97	97		0	\$45 M on bbls. sold to Chevron with an Amerada Hess Adjustment Clause. The rest would be covered under the Tesoro Settlement Agreement Payment Plan if consummated.
Chevron From Tesoro	64 45 109		\$47 — 47	\$17 45 62	\$47 M Payments under protest pending resolution of litigation. Scheduled for trial April 1995.
Mapco (GVEA) (Mapco)	18 101 119			18 101 119	Subject to two pending lawsuits -- one in Juneau and one in Anchorage.
TOTALS	\$327	\$99	\$47	\$181	

Mapco's 1991 10-K

Item 3. Legal Proceedings

.... Based on information supplied to MAPI by State representatives, it appears that the potential claims asserted by the State might total between \$120 million and \$160 million, including interest on the retroactive amounts claimed by the State. The State's ultimate claim against MAPI would be based upon the difference between the volume weighted average of the royalty values reported by the producers in the past and the volume weighted average of the revised values the State succeeds in proving in the

Amerada Hess litigation

After consideration of such legal, business and other factors it deems relevant, management believes that the outcome of such matters, including the matters specifically discussed above, will not have a material adverse effect on MAPCO's consolidated financial position.

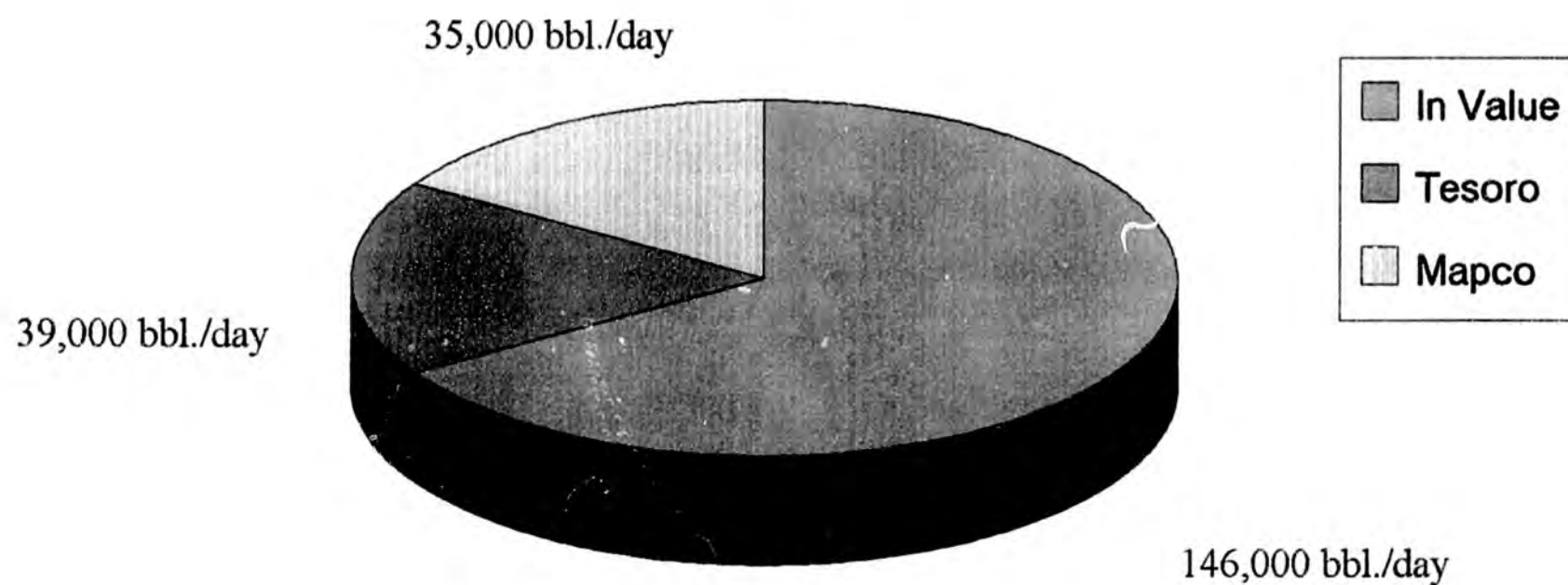
Section 6.4 Adjustments to Billings

Royalty Oil Sales Agreement between ERCA and the State

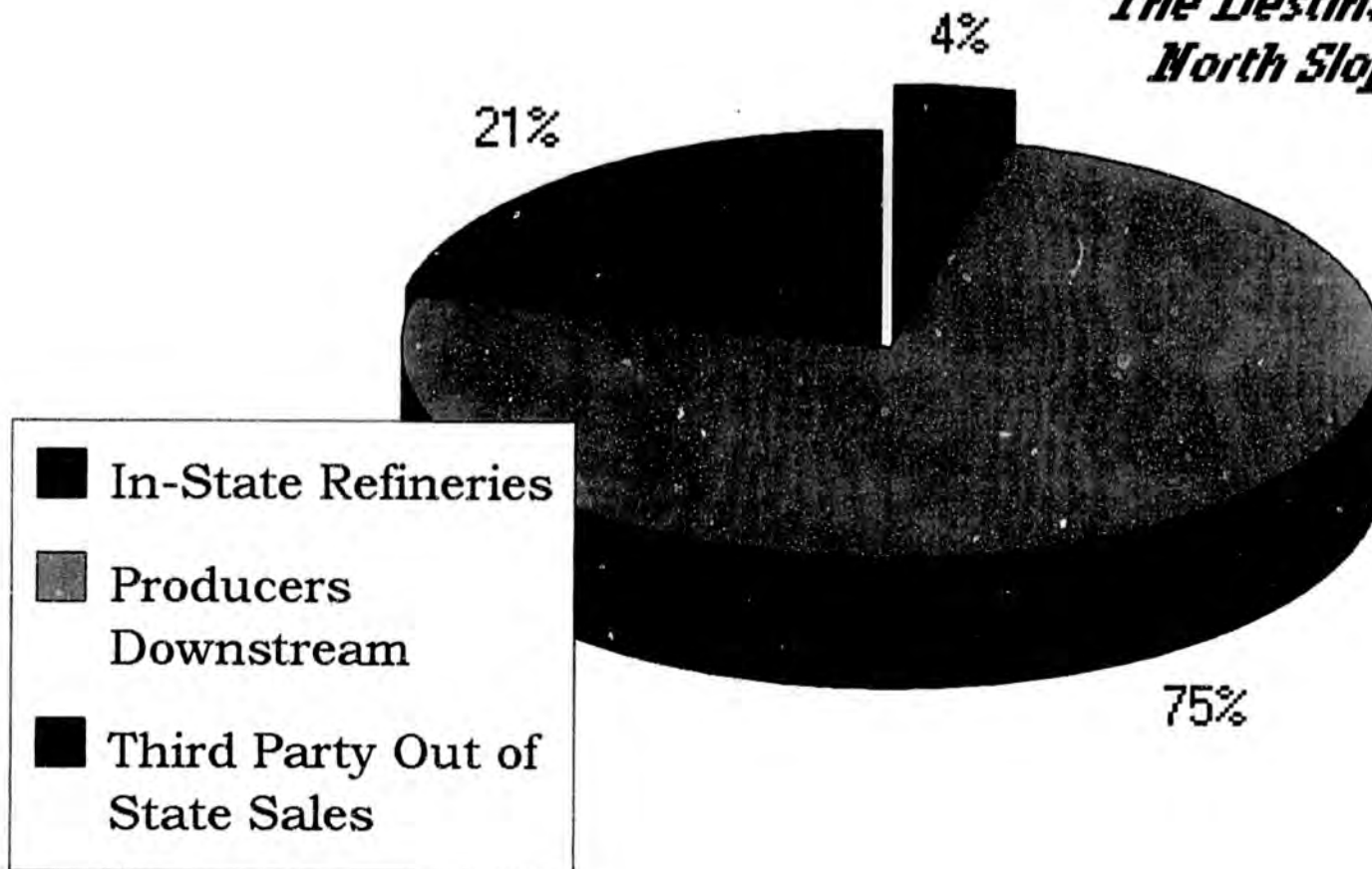
. . . . Seller shall from time to time adjust its prior billings to reflect adjustments necessitated as a result of (i) a final judgment or settlement entered in certain pending litigation between Seller and the Lessees styled State of Alaska, et. al. vs. Amerada Hess Corporation, et. al., Ca No. 77-847, in the Superior Court of the State of Alaska, First Judicial District at Juneau;

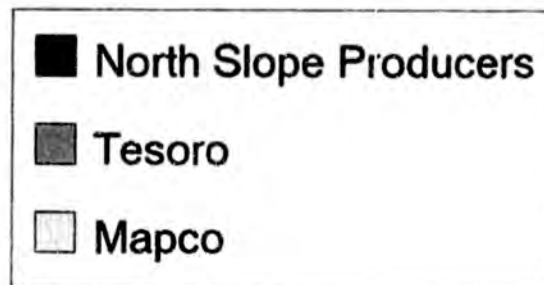
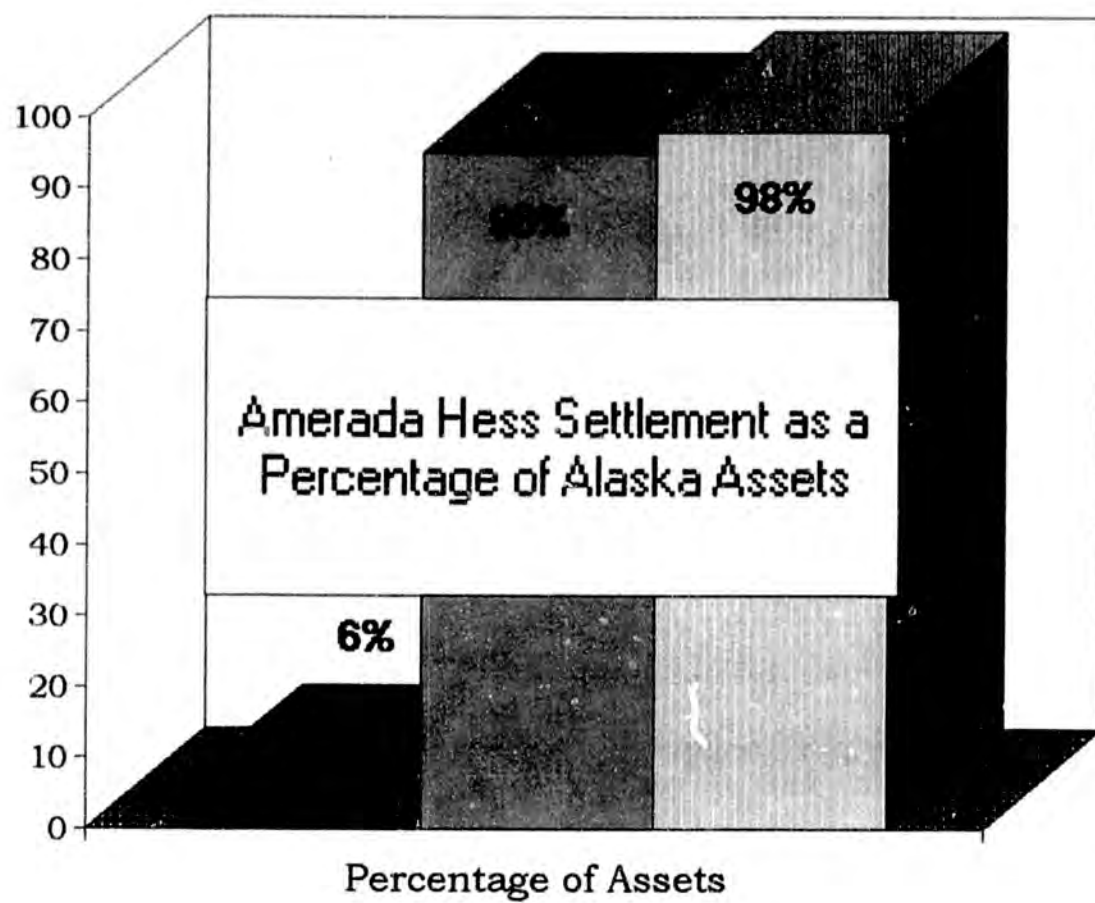
Due to the potentially large sums of money involved, any adjustments to any billing under the provisions of this Article VI by Seller made more than sixty (60) days after such billing was initially rendered shall be paid to or refunded by Purchaser or Seller over the same period over which such adjustments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

***Disposition of State's North Slope Royalty
Oil--1992***

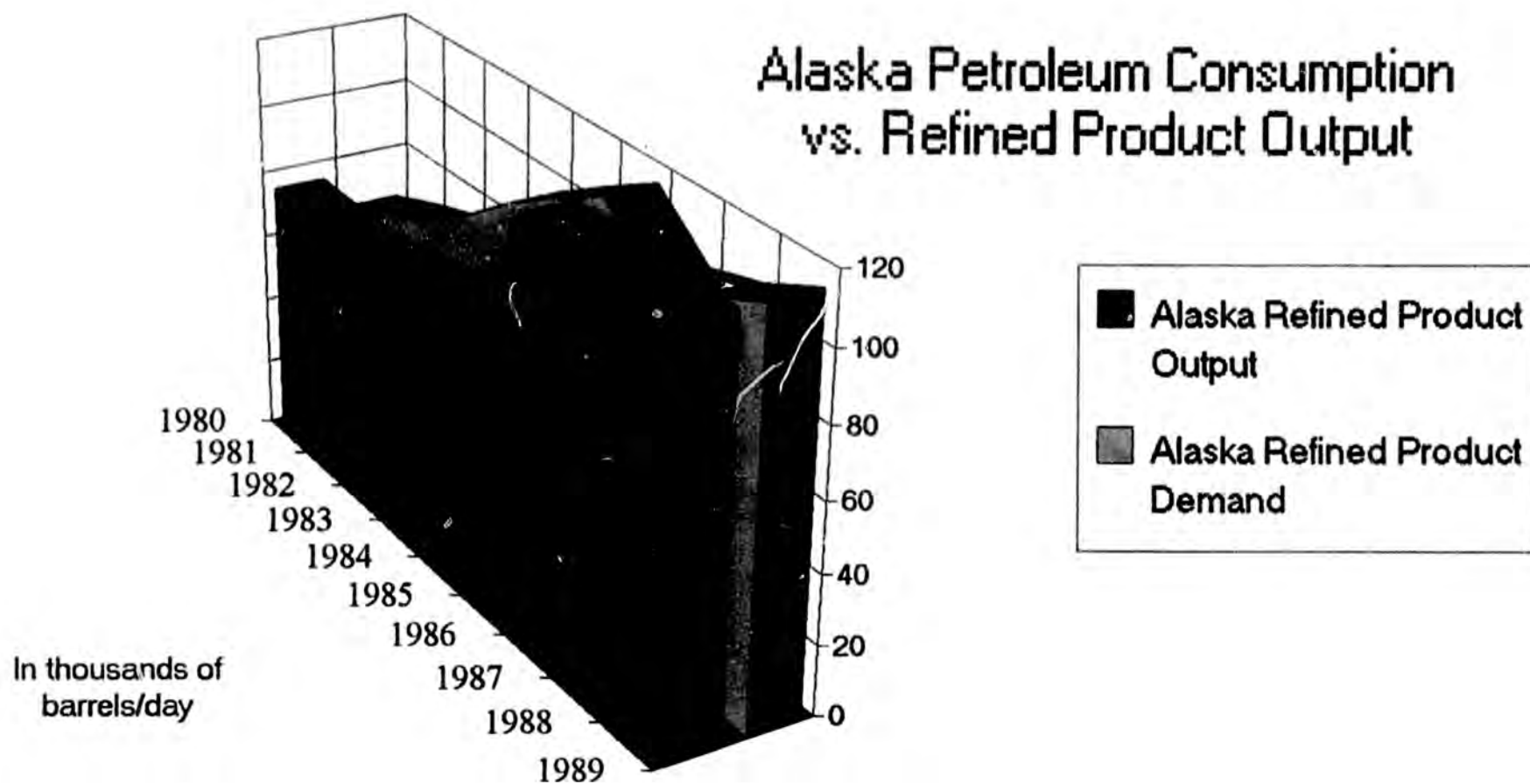


***The Destination of
North Slope Oil***

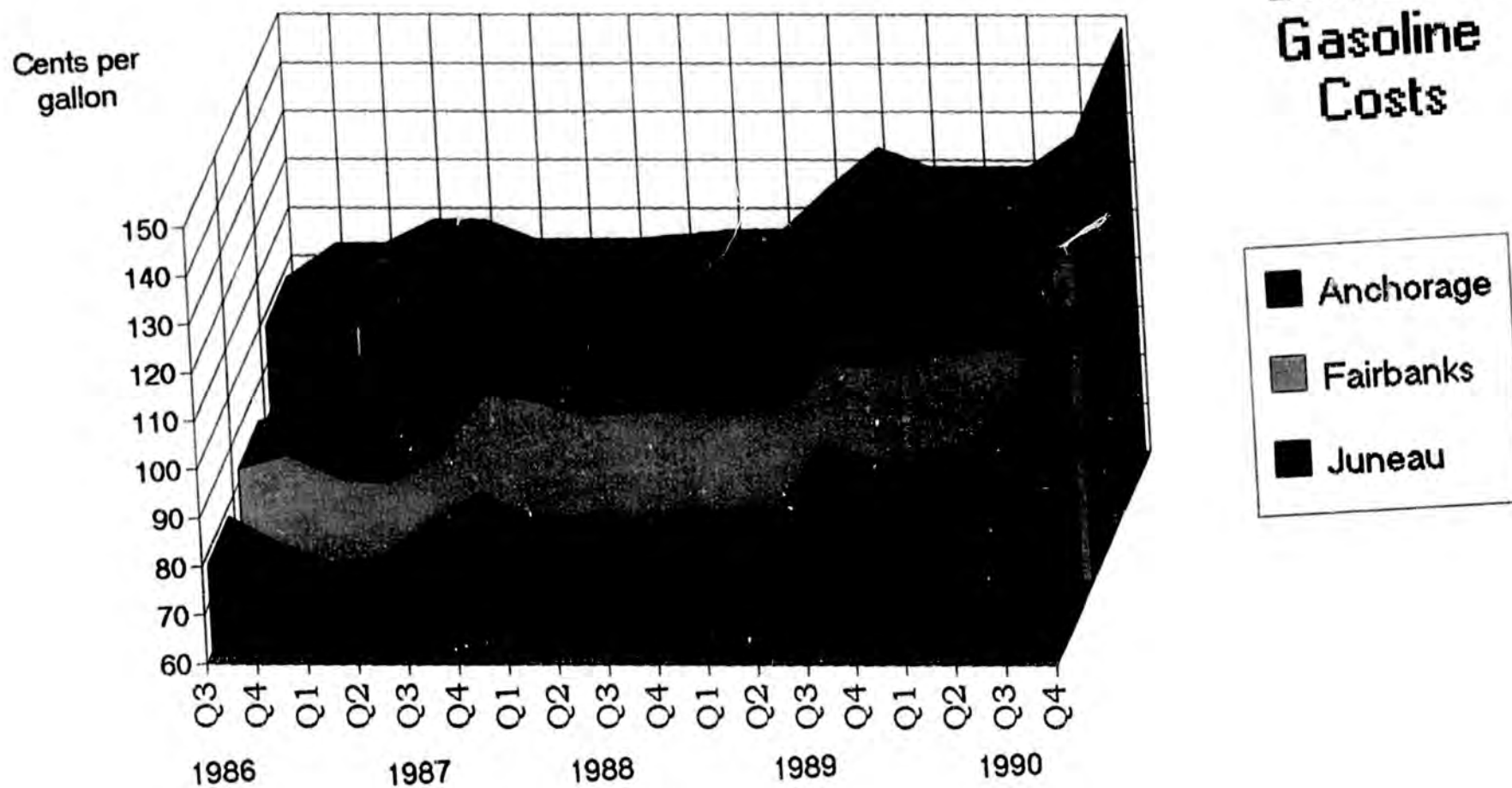




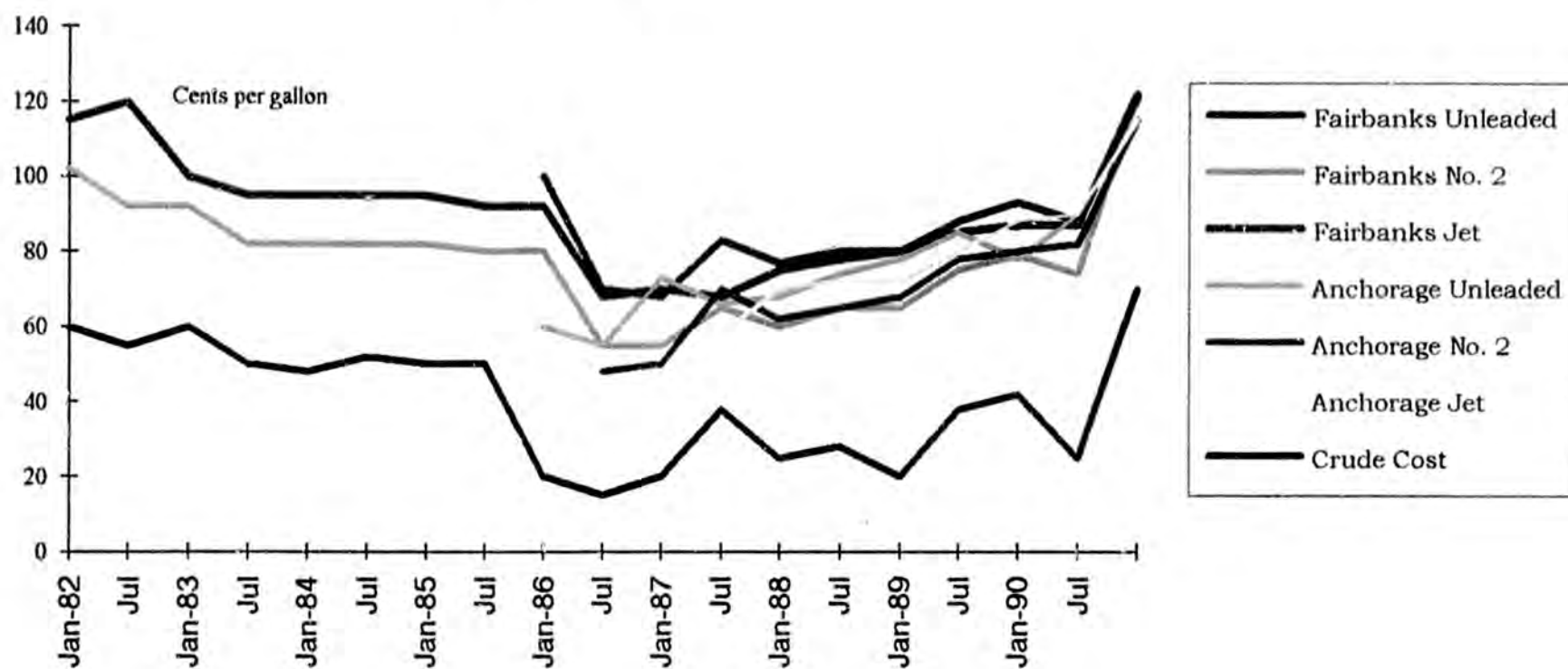
Alaska Petroleum Consumption vs. Refined Product Output



Unleaded Gasoline Costs



MAPCO WHOLESALE PRODUCT PRICES AND CRUDE COST



Other State Industrial Incentive/Credit Programs



- ♦ **Fisheries Business Tax Credit.** AS 43.75.032. For five years (1987-91), fisheries businesses could reduce tax liability by up to 50% by taking credits for new processing ventures. ***Total cost to state over 5 years: \$68 million.***



- ♦ **Industrial Incentive Investment Tax Credit.** AS 43.20.042. As a credit against the corporate income and/or mining license taxes, taxpayers could take 40-100 percent of the full federal investment tax credit (on up to \$250,000,000 in investment) for new gas processing facilities and mineral exploration and development (normally only 18% of the federal credit was creditable against Alaska taxes). The Department of Revenue has not calculated the fiscal impact of this credit.



- ♦ **Mining License Tax Incentive for New Mines.** AS 43.65.010(a). As an incentive to open new mines, any new mine is exempt from the mining license tax for the first 3 1/2 years of production.



- ♦ **Oil and Gas Exploration Incentive Credit.** AS 38.05.180(i). DNR may allow credits of up to 50% of the cost of exploratory drilling or geophysical work against up to 50% of the lessees' liability for royalties and severance taxes. ***Total credits taken in past 10 years: \$40.9 million.***

The "Public Purpose Clause"

"No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose."

- ♦ *"Whether private entities receive a benefit from an expenditure of public money is not, in our view, the dispositive factor."*

...The Attorney General's Office, April 10, 1992, in reviewing a \$1.2 million appropriation to assist an Arctic Slope Regional Corporation coal project.

- ♦ *"The test instead is whether the expenditure will directly enhance the general welfare of the community." This is true even though the appropriation will "extend a substantial benefit to...private entities."*

...From the same opinion.

- ♦ *Appropriations aiding a private development project pass the "public purpose" test as long as they are intended to "resolve energy problems...provid[e] an abundant, stable-priced energy source, as well as provid[e] long-term, stable employment opportunities...and potential tax revenues."*

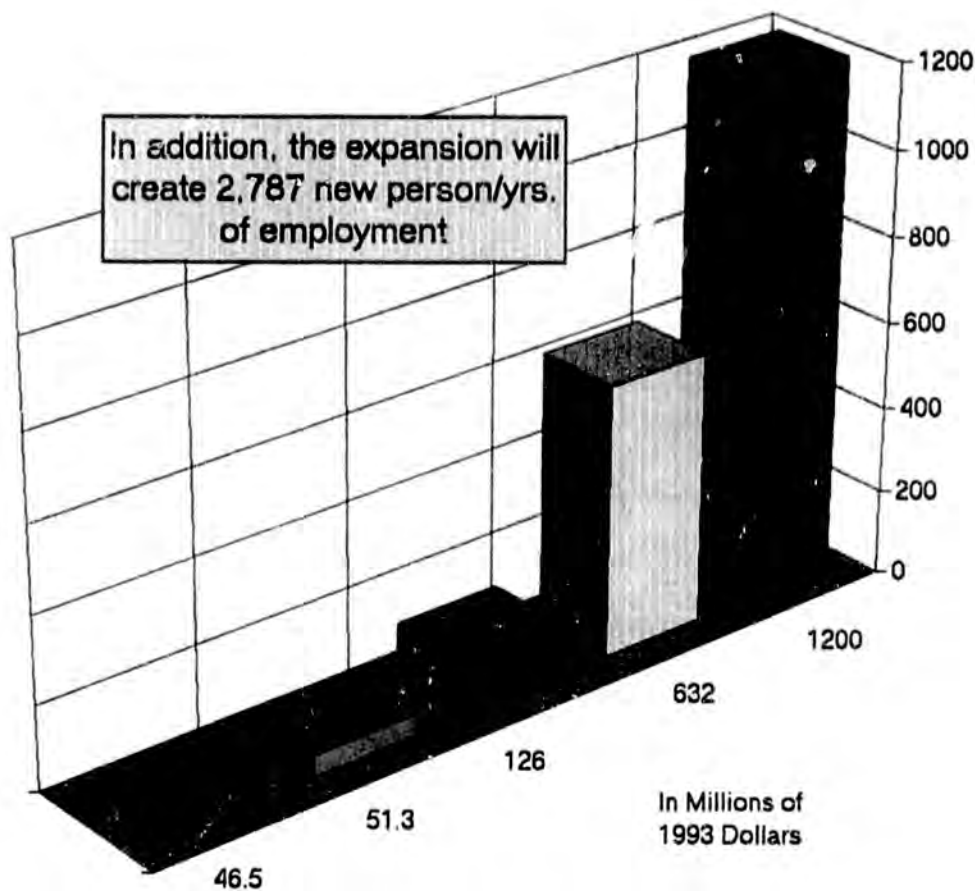
...From the same opinion.

- ♦ *"Substantial deference must be extended to the legislature's finding [that the program serves a public purpose]...[One] must therefore find that the legislative public purpose finding was arbitrary or without any reasonable basis in fact before concluding that the expenditure constitutes an impermissible expenditure of public funds."*

...The Attorney General's Office, Sept. 13, 1984, in reviewing an appropriation in aid of the Red Dog Mine.

- ♦ *For incentive programs, there need be no guarantee that the encouraged conduct would not occur anyway. It need only appear that the incentive is designed to "influence or affect private behavior."*

...The Attorney General, March 8, 1983, in reviewing proposed assistance to a private ski area.



The Costs and Benefits of Tesoro's Expansion Proposal

- Cost of Credit
- Increased State and Local Tax Revenues
- Increased Employee Compensation
- Increased Property Income
- Increased Industrial Output

The "Special Legislation" Clause

"The Legislature shall pass no local or special act if a general act can be made applicable. Whether a general act can be made applicable shall be subject to judicial determination."

The Test is Threefold:

♦ *Is the Act Special or Local?*

It is only "special or local" if, by its terms, it covers only an identified entity (e.g. the "Eagle River-Chugiak Borough"), geographic area (i.e. Prince William Sound or Delta) or event (i.e. Big Lake Ice Classic).

SB 134 is therefore not "special legislation--it applies statewide to any royalty oil purchaser.

♦ *If it is "special," what is unique about the topic that prevents it from being adequately taken care of by general law?*

For example, there was no justification for a special law dealing with formation of the Eagle River-Chugiak Borough, because formation could be dealt with under Title 29. Laws treating the unique issues of oil spill cleanup in Prince William Sound or Delta agriculture, however, had to be limited to those areas. Only a "rational basis" for separate treatment is required.

For reasons set out in Tesoro's White Paper, SB 134 treats issues unique to royalty oil purchasers. There are therefore several "rational reasons" for the legislation.

♦ *If the legislation is "special," is its overall goal a matter of "common concern" to Alaskans?*

This test relates to the law's goals, and not its reach or extent of impact.

SB 134's goals are to promote the state's economy, generate tax revenues, and assure energy self-sufficiency. These are all matters of "common concern."

The Permanent Fund Clause

*"At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds...and bonuses **received by the state** shall be placed in a permanent fund..."*

- ♦ *The key word is "received," since the state has not **RECEIVED** the funds from the royalty oil purchasers that would be subject to the credit*
- ♦ *On April 24, 1992, the Attorney General ruled that the phrase "administrative proceeding" in the budget reserve clause must be given a strict reading, because:*

*1. It is an "important right of the people..to have the constitution upheld as the people ratified it...Normally, such deference to the intent of the people requires 'adherence to the common understanding of words.' Applying this approach, the court **looked to a standard dictionary to determine the common understanding of the word at issue.**"*

2. There are other constitutional policies that must be reconciled with the permanent fund clause. In the budget reserve case, this other policy was the constitution's general preference for the unrestricted receipt of funds.

Applying the Attorney General's analysis to this issue:

- ♦ *The dictionary definition of "received" is "to come into possession of."*
...Webster's New Collegiate Dictionary (1981)
- ♦ *The term "received" has always been carefully chosen when implementing the permanent fund clause. See: AS 37.13.010.*
- ♦ *There are also other constitutional policies that must be accommodated here--specifically, the policy of allowing the legislature the power to legislate to promote the public welfare. The permanent fund clause should not be interpreted to impliedly limit the legislature powers beyond its explicit scope--i.e., with respect to the disposition of funds that "it has come into possession of."*

*SB 134 and HB 185--A Sound
Investment in Alaska's Economic Future*

Tesoro Alaska Petroleum Company

March 3, 1993

W. Gene Burden
Vice President
Administration & Government Relations

March 3, 1993

THE HONORABLE LOREN LEMAN
The State Senate, State of Alaska
Capitol Building, Room 113
Juneau, Alaska 99801-1182

Subject: SB 134 Background and Analysis Material

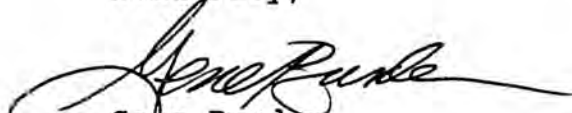
Dear Senator Leman:

Tesoro Alaska Petroleum Company supports the passage of SB 134 and looks forward to the opportunity for a full review of the benefits the legislation offers the state. Tesoro's support of the legislation is prompted by the obligations our company incurred as a result of the Amerada Hess settlements. In essence, Tesoro is now subject to payments over the next ten (10) years that are expected to be in excess of \$100 Million as a result of the state's retroactive price increases for crude oil we processed in the 1980's. We do not believe it likely that this obligation can be recouped from the 90% of the Alaska consumers who benefitted from fuel prices in effect during the years Tesoro paid the lower amount for royalty crude oil.

The legislation would offer a limited opportunity to obtain credit for qualifying capital investments made in the state which could be applied against our current obligations for the retroactive price increases. The benefits of such investments in terms of jobs, state and local tax income, and increased industrial output are substantial and are documented in the accompanying material. The concept presented is not unique and has been previously adopted by the Legislature for other industry and in related manners aimed at stimulating the economy. Examples of precedents are also presented in this package.

I look forward to meeting with you in the future and welcome any comments or suggestions you may have.

Sincerely,


Gene Burden

Enclosure

*SB 134 and HB 185--A Sound
Investment in Alaska's Economic Future*

Tesoro Alaska Petroleum Company

March 3, 1993

SB 134 and HB 185--a Sound Investment in Alaska's Economic Future

I. Introduction and Executive Summary

This paper discusses the background and rationale for SB 134 and HB 185-- legislation that would allow purchasers of state royalty oil to credit the value of future capital investment in the state against one-time retroactive claims made by the state under those purchasers' royalty oil sales contracts. That credit program would be: (1) a prudent investment of any benefits that the state might otherwise hope to receive from these claims, because ~~the capital investment resultantly encouraged would produce both tax revenues and private economic stimulus substantially in excess of the amount of the credit~~ (2) consistent with longstanding state royalty oil policy, which is to employ that oil to encourage Alaska energy self-sufficiency and provide refined products at a reasonable price; and (3) necessary to achieve equity in the sharing of burdens occasioned by the *Amerada Hess* litigation.

This paper is divided into six parts:

Sec. II The State of Alaska has long viewed its royalty oil as a critical tool in encouraging a competitive in-state refining industry, and that policy has enjoyed considerable success

As a result of that policy, the state has achieved virtual energy self-sufficiency. Its three refineries provide a variety of refined products to 90% of Alaskans, at a resultant savings during the 1980's of at least \$450 million from the costs Alaskans would have had to bear if their refined products were still imported. Gasoline prices in areas served by these refineries have averaged \$.30/gallon less than in areas of Alaska still needing imported fuels.

Sec. III *The success of state royalty oil policy is jeopardized by \$300 million in retroactive purchase assessments now claimed against in-state refiners as a result of the Amerada Hess litigation settlement*

The state is now demanding over \$300 million in retroactive price increases from its in-state refiners, based on a formula developed in negotiations between the state and producers to which the refiners weren't invited. The result is a grossly inequitable burden on those refiners. The state's settlement with the producers represents only 6% of those companies' assets in Alaska, but the demands against the in-state refiners ~~represents nearly 100% of their Alaska assets.~~ The state's retroactive claims will result either in: (1) future inability to finance critical improvements and expansions to meet growing demand; and/or (2) higher fuel costs to consumers (crude costs account for 80% of product price fluctuations).

Sec. IV *SB 134 and HB 185 would allow the state to earn full value on its Amerada Hess claims without risking the continued health of the state's refining industry*

The legislation would allow in-state refiners to credit the cost of refinery expansion against the state's retroactive price increase claims, but only under safeguards not found in similar credit legislation--such as a requirement that the each investment yield commensurate returns; that the investment isn't otherwise required; and that the investment must occur within a finite period.

Sec. V *Available evidence indicates that the state could expect an exceptional return from its investment through SB 134*

As an example of how the legislation would work, ECO Northwest has analyzed the public benefits of a \$46.5 million expansion of the Tesoro refinery--an expansion that likely could not occur in the absence of the legislation. A \$46.5 credit investment would return \$51.3 million in tax revenues, \$126 million in new employee compensation, \$632 million in increased property income, and \$1.2 billion in increased industrial output, and would generate 2,787 new person/years of employment.

Sec. VI *SB 134 backed by ample precedent, and is consistent with long-established public policy*

SB 134 is simply a variant--and a more secure and prudent variant at that--of the investment tax credit. The state has established such credits for a number of industries, including a ~~fisheries tax credit~~ *under which \$10 million were credited over a five-year period for new fisheries ventures.* The state also has a number of existing programs for crediting royalty obligations for new industrial activity.

Sec. VII *SB 134 is constitutional*

A detailed legal analysis, enclosed as Appendix B, concludes that SB 134 serves two valid public purposes and is not "special" in nature. There is also no violation of the Permanent Fund clause.

OK was this 111?

II. The State of Alaska has long viewed its royalty oil as a critical tool in encouraging a competitive in-state refining industry, and that policy has enjoyed considerable success

For nearly two decades, the State of Alaska has successfully pursued a policy of taking part of its royalty oil "in kind," and then selling that oil to encourage the creation and expansion of in-state oil refining capability. In furtherance of that policy, and after Prudhoe Bay oil began flowing in the late 1970's, the Alaska Legislature approved sales of royalty oil to Tesoro Alaska Petroleum and Earth Resources Company (the

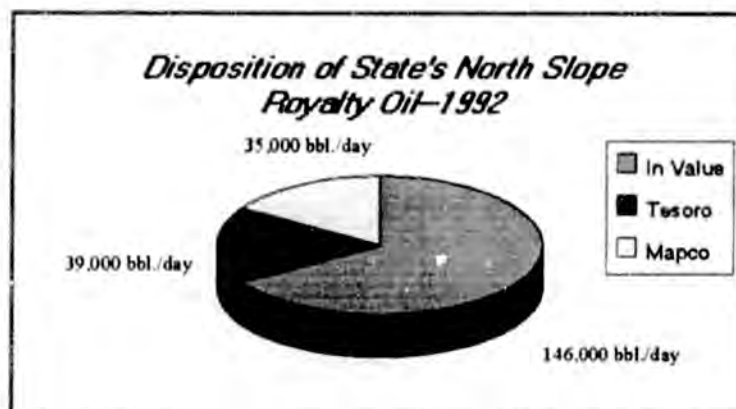


CHART 1. Source: Ak. Dept. of Natural Resources, *Historical and Projected Oil and Gas Consumption*, April 1992 at 6.

predecessor of Mapco Petroleum) of 39,000 bbl./day, and 35,000 bbl./day, respectively. See Chart 1. ^{1/} Both contracts required the oil to be processed at the companies' respective in-state refineries. ^{2/} At the time, the royalty oil sold by the state represented 100% of Earth Resources' throughput capacity, and enabled Tesoro to convert its refinery to operate with 100% ANS crude.

As a result of that policy, today three refineries--each fueled in part by state royalty oil--have made Alaska virtually self-sufficient in gasoline and other fuels.

^{3/} These refineries provide product to every area of Alaska except Southeast, and

^{1/} The Earth Resources contract was approved by HCR 130, Leg. Resolve 37 (1977), while Tesoro's contract was approved by §1, Ch. 105, SLA 1984. The Earth Resources contract (now assigned to Mapco) runs through 2003, while Tesoro's contract expires in 1995.

^{2/} Tesoro's Kenai refinery began operation in the 1960's, supplied in part by royalty oil from Cook Inlet, which Tesoro began receiving in 1969. Earth Resources' North Pole refinery began operations in 1977 in anticipation of receiving state royalty oil as feedstock.

^{3/} The three refineries are Tesoro's Kenai refinery (72,000 bbl./day capacity); Mapco's North Pole refinery (116,000 bbl./day); and Petro Star's North Pole refinery (7,000 bbl./day). A fourth refinery that once purchased royalty oil--Chevron's Nikiski refinery--closed for economic reasons in 1991.

have, throughout the 1980's, been able to expand their capacity to keep pace with rising consumer demand. Chart 2.

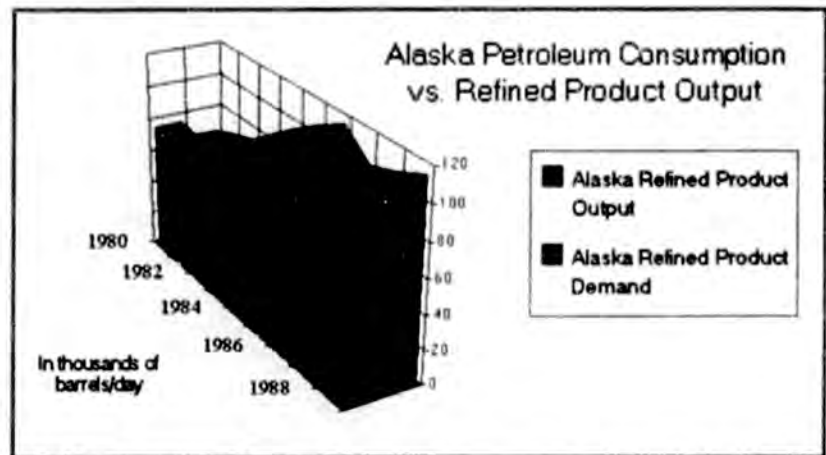


CHART 2.

Alaska's resultant energy self-sufficiency has brought with it considerable economic benefits. Aside

from the approximately 850 Alaskans directly employed by Tesoro, Mapco and Petro Star; the hundreds of Alaskans employed indirectly as a result of these refineries' operations; and the more than \$11 million in local and state tax revenues that these refineries generate annually, the state's royalty oil has fueled an intensively competitive product market, with considerable savings to the 90% of Alaskans within that market.

That fact can be seen clearly enough by comparing fuel prices in the markets served by these

refiners with the one Alaska market still dependent on lower-48 refined product--Southeast Alaska. As Chart 3 demonstrates, in recent years unleaded gasoline prices in Southeast

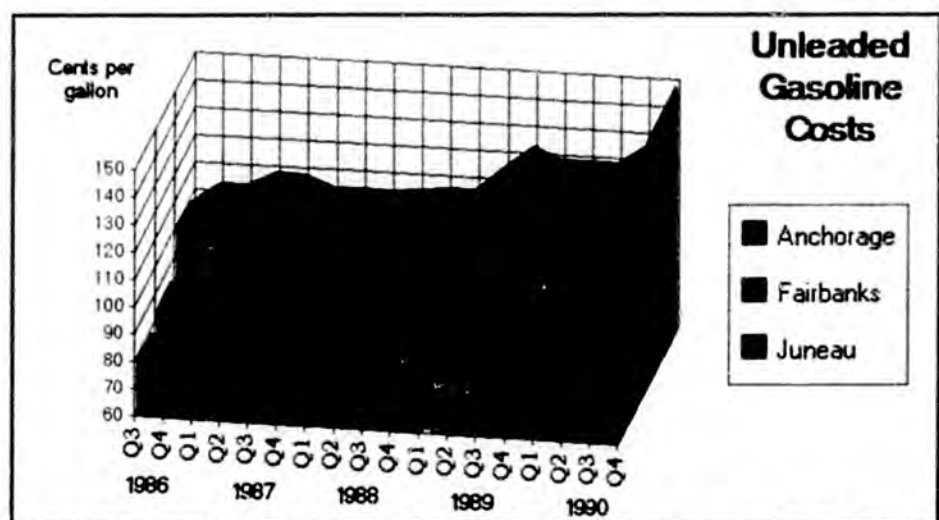


CHART 3. Source: Study by Purvin & Gertz, Inc. for Mapco Petroleum, 1992 at 4.

have averaged **30 cents per gallon** more than in Anchorage--a fact that experts

attribute in material part to the absence of refiner competition in the Panhandle.

^{4/} As Purvin & Gertz explain, even if only one third of the price differential between Anchorage and Juneau were attributable to the keen competition encouraged by state royalty oil policy, that policy would still be responsible for a **\$450 million savings** to Alaska consumers in the 1980's. ^{5/}

III. The success of state royalty oil policy is jeopardized by \$300 million in retroactive purchase assessments now claimed against in-state refiners as a result of the Amerada Hess litigation settlement

The state's North Slope royalty oil sales occurred during a period of considerable controversy between the state and the North Slope producers over the "value" of royalty oil taken *in value* by the state. In 1977, the state filed suit over that dispute--the so-called *Amerada Hess* litigation. The suit languished for 15 years in its preliminary stages and, on the eve of trial in 1992, finally settled. Under the settlement, all the North Slope producers agreed to pay both past and future royalties under a complex new pricing formula. The cost of the retroactive payments by the producers totalled about \$700 million.

The in-state royalty oil purchasers paid for oil under their contracts in a different manner. DNR maintains, however, that those purchasers are obligated to also pay the state any additional money due by application of any formula agreed to by the state and the producers in the *Amerada Hess* litigation. Using the formula negotiated in the *Amerada Hess* litigation, and applying that formula to all royalty oil purchased by Mapco, Tesoro, Chevron and Petro Star over their contract periods, would yield retroactive payments approaching **\$300 million**.

^{4/} Purvin & Gertz, Inc. report for Mapco Petroleum, 1992 at 1.

^{5/} "If the competition brought on by the instate refineries didn't exist and the rest of Alaska were still supplied from outside the state, [and] even if the premium [resulting from lower instate refinery prices] were only 10 cents per gallon, Alaskan consumers would have paid \$450 million more for gasoline, heating fuel and diesel over the decade of the 1980s." *Id.*

The harshness of the state's position begins with the process it used to settle *Amerada Hess*. Remember that the *Amerada Hess* formula was developed in closed-door negotiations between the state and the North Slope producers. The state, however, maintained that the in-state refiners were precluded from participating in those negotiations. As a result, the refiners were not able to add their concerns to the deliberations--the final formula was served upon them as a *fait accompli*, without a thought given to the refiners' very different situation.

This is not to say that the North Slope producers won some painless deal from the *Amerada Hess* negotiations--the \$700 million settlement they must pay is a weighty one. However, by failing to have the refiners' voices at the negotiating table, it was inevitable that the ultimate settlement would fail to recognize the material differences between the producers' position and the

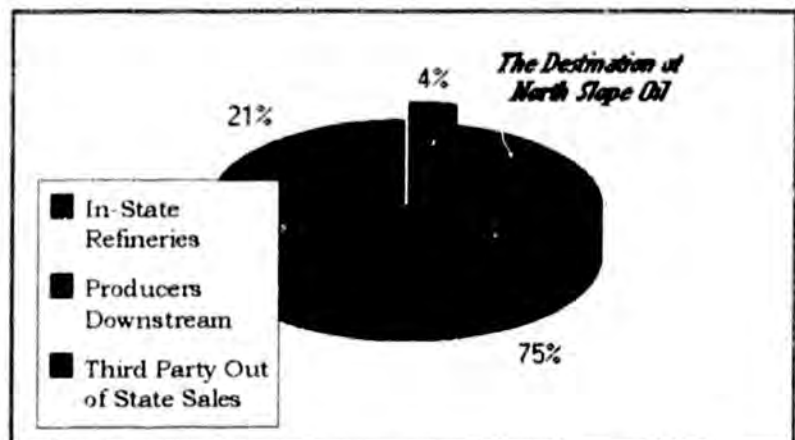


CHART 4

refiners'. For example, and as Chart 4 shows, three quarters of all North Slope oil is sent out of state to the producers' own refineries. Another 21% has been sold to out-of-state purchasers, including outside purchasers of royalty oil sold at auctions in the 1980's. Only 4% has been sold to in-state refiners, **but those refiners are being asked to shoulder 30%**--\$300 million out of a total \$1 billion--of all *Amerada Hess* payments.

And in this regard: of all the oil taken by North Slope producers, only 1/8th of that is royalty oil. What this means is that the producers are able to spread the *Amerada Hess* surcharge on one barrel of royalty oil over eight barrels of oil, while

the in-state refiners must bear that per-barrel surcharge undiluted. Thus, every \$1/bbl. *Amerada Hess* surcharge costs the in-state refiners \$1/bbl., while the same surcharge costs the producers 12.5 cents per barrel.

Moreover, the oil companies that purchased royalty oil at competitive bid in the 1980's, and shipped that crude outside for the benefit of lower-48 consumers (and conversely, without benefitting the Alaska economy at all), are not being asked to make *any* additional payments.

Additionally, the *Amerada Hess* settlement failed to account for the *relative* financial impact of the surcharge on the parties. As Chart 5 shows, while the producers' *Amerada Hess* settlements represent only six percent of the value of their Alaska holdings, the state's claim against Mapco virtually equals its entire Alaska asset base.

This kind of impact bodes ill for our in-state refiners' ability to continue to expand to meet growing market needs--a capability which, as we have seen, has heretofore been one of the principal dividends of state

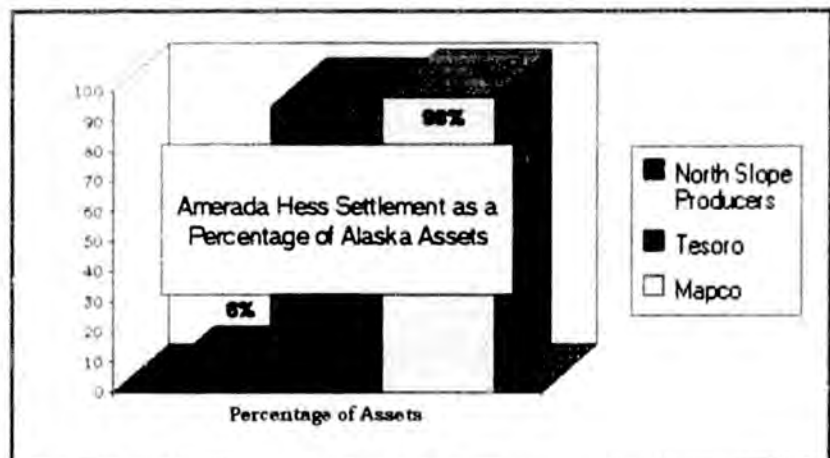
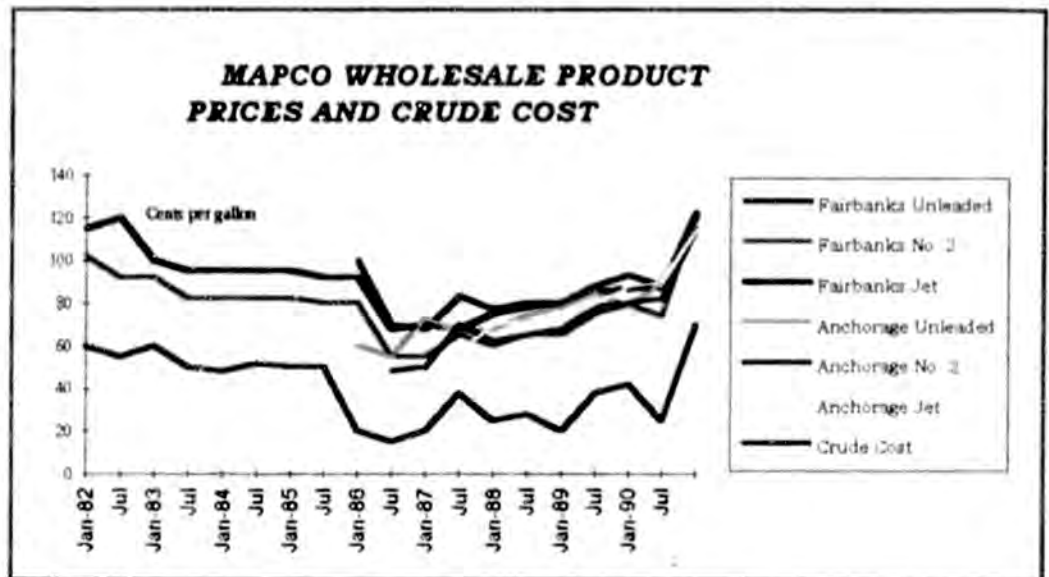


CHART 5 ^{6/}

royalty oil policy. Efforts to finance refinery expansion are impeded, or even barred, when a company faces extraordinary liability almost equal to its assets' value.

^{6/} Source: For Mapco: Mapco Petroleum, "State of Alaska Royalty Oil Contracts; Retroactive Price Changes; "A Challenge...With Practical and Fair Solutions" (1992); For Tesoro: comparison of state's reported value of settlement against current assessed valuation.

Another potential adverse impact of these claims may be increased fuel prices throughout most of Alaska. A recent Mapco study indicates that variations in crude prices account for about 80% of all variations in wholesale product prices. Chart 6.



The sums now demanded by the state will be a cost of crude to the refiners, and there is no realistic mechanism available to recoup any *Amerada Hess* surcharges against customers who purchased the products that the state now claims were sold too cheaply. The unknown here is the extent to which the market will allow the in-state refiners to recover the surcharge costs through higher future product prices. The irony is that the intense competitiveness that the state has fostered through its royalty oil policy now threatens to work against the very businesses the state once encouraged, by forcing them to absorb a material part of these surcharges.

And if that occurs, the state could face the ultimate adverse consequence of its position. When Chevron's Nikiski refinery closed in 1991 for economic reasons, 22 Alaskans were unemployed; the Kenai Peninsula Borough lost considerable property tax revenues; the state lost considerable revenues through lost corporate income taxes; and the spinoff effects of that closure continue to reverberate throughout Southcentral Alaska.

In short:

Whether the impacts of the state's claims manifest themselves in inability to expand refinery capacity; higher fuel prices or refiner insolvency, the result will be the same--state royalty oil policy will have undone itself.

IV. SB 134 and HB 185 would allow the state to earn full value on its Amerada Hess claims without risking the continued health of the state's refining industry

The achievement of energy self-sufficiency through the state's refining industry has been one of Alaska's most impressive triumphs resulting from the discovery of oil in our state. And as we have just seen, the state's proposed retroactive price increases threaten to imperil those gains. If that were to happen, we would not have left to future Alaskans the kind of legacy from our discovery of oil that we had hoped.

SB 134 rejects the extremes of either zealous prosecution of full cash payment, or forgiveness. ^{7/} Rather, it tries to continue the business relationship between the state and the industry that, to this juncture, has proven so mutually beneficial. It does so by allowing the claims against in-state refiners for retroactive royalty oil price increases to be invested in the Alaska economy in a carefully targeted manner--one calculated to ensure that the considerable public benefits of

^{7/} SB 134 and HB 185 are identical companion bills. For brevity's sake, the legislation is referred to here only as "SB 134."

energy self-sufficiency continue to be enjoyed by Alaskans well into the 21st century.

The legislation allows royalty oil purchasers to credit the cost of future capital investment in Alaska against "liquidated purchase arrearage claims." That phrase is defined to mean claims for retroactive royalty oil price increases, the amount of which has been fixed either by a court judgment, a settlement agreement between the state and the purchaser, or a contract that resolves the claim.

As we'll see in Section VI, granting tax or liability credits for new investment is an historically proven tool for encouraging economic growth. Unlike its prior precedents, however, SB 134 incorporates special safeguards to ensure that the program earns a sound return on the public's investment. For example:

- The Commissioner of Commerce and Economic Development will disapprove any proposed credit that will not yield economic benefits to the state commensurate with the amount of the credit. This case-by-case cost/benefit analysis is unprecedented in credit legislation, and is intended to ensure that the legislation is administered as an investment program, and not simply a special interest grant;
- The credits must be taken within a finite period--10 years, or the period of any settlement agreement--to ensure that Alaska's economy benefits from the program in the short run; and
- To ensure that credits are granted as an incentive for economic activity that might otherwise not occur, credits cannot be taken for investments already committed to, or investments (like pollution control equipment) that may be required by law.

In short, SB 134 seeks to put the state's claims for retroactive price increases against its royalty oil purchasers to immediate productive public use,

creating jobs, new tax revenues and economic stimulus exceeding the cost of the credit itself.

The next section of this paper describes the magnitude of the state's potential return on investment through SB 134.

V. Available evidence indicates that the state could expect an exceptional return from its investment through SB 134

Tesoro has explored the possibility of adding new vacuum and asphalt units to its Kenai refinery, increasing its throughput capacity by 15,000 bbl./day. It is precisely the kind of investment that the state has long encouraged its in-state refiners to make--one that would allow it to keep pace with increasing consumer demand.

It is a considerable undertaking--\$46.5 million in capital investment. And, burdened with an extraordinary settlement liability to the state payable over 10 years, the prospects of Tesoro's obtaining conventional financing for the project are poor.

On Tesoro's behalf, the economic firm of ECO Northwest performed a study of the return to Alaskans from that investment. The results demonstrate that, if SB 134 were enacted, and its credit provisions allowed Tesoro to undertake the expansion, the increased tax revenues alone (to the state and the Kenai Borough) would exceed the amount of the credit, and with the addition of direct economic benefits, would dwarf the amount of that credit. Chart 7 sets out the results of that study graphically:

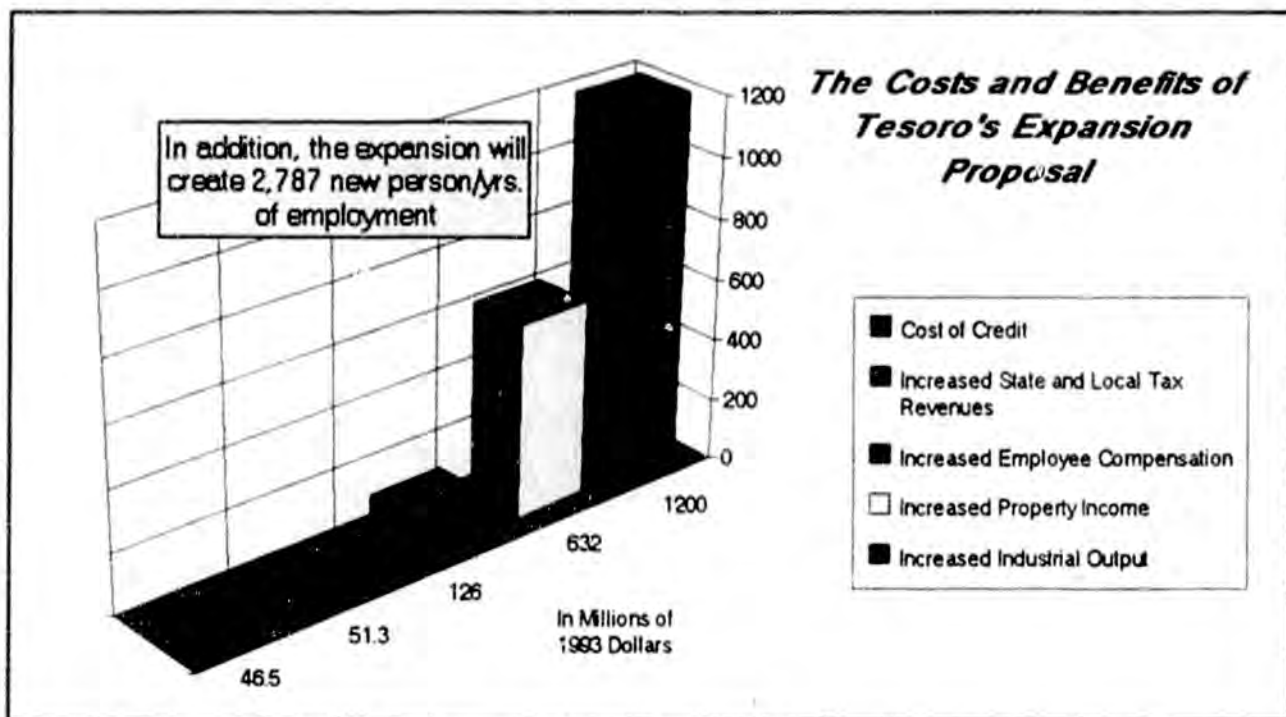


CHART 7. Source: ECO Northwest report, Appendix A.

The detailed executive summary of the ECO Northwest report is included as Appendix A to this paper. And there is nothing unique about the Tesoro proposal--investment in hard value-added assets can generally be expected to generate returns in healthy excess of the cost of investment.

Thus, viewed entirely from an economic perspective, SB 134 is an excellent investment and good public policy.

VI. SB 134 is backed by ample precedent, and is consistent with long-established public policy

The core purpose of government is to promote the well-being of the governed, and the ways in which government may act to achieve that purpose are virtually limitless, constrained only by organic restrictions ^{8/} on its powers, and by the creativity of the governing body.

^{8/} "Organic restrictions" meaning, in the context of state action, those limitations imposed by the U.S. Constitution or the Alaska Constitution. The principal restrictions relevant to the legislation presently under consideration are probably the "Public Purpose" and "Special Legislation" clauses of the Alaska Constitution. Those clauses are discussed in the next section of this paper.

It's not the intent of this paper to offer a comprehensive catalogue of the many ways in which Alaska has spent or foregone money in order to stimulate its economy. The point here is only to put SB 134 in perspective. From power cost equalization in rural Alaska to highway funds and business loans in Anchorage, state government is properly in the business of aiding its economy, and that aid will often be targeted at quite discrete commercial sectors. In every case, the rationale is the same--the investment will yield a proper return to the public.

That's true whether the program involves expending state funds in support of a particular industry, or offering to credit obligations if that industry will invest in the state. With respect to the former, our statute books are rich with loan, grant and incentive programs that often directly inure to the benefit of a single industry, or a single business. ^{9/} Individual appropriations are frequently made in direct aid of even specific private ventures, when the legislature concludes that the public benefits of the investment outweigh its cost, and the examples here are simply too numerous to list completely. See 1984 *Inf. Op. Atty Gen.* (Sept. 13; 366-127-85) (review of appropriation for studies related to the Red Dog mine); 1992 *Inf. Op. Atty. Gen.* (April 10; 663-92-0379) (reviewing a \$1.2 million appropriation in aid of an Arctic Slope Regional Corporation coal project); and see Section VII and Appendix B, *post*.

In other cases, the legislature has simply decided to forego receipt of certain obligations to the state that would otherwise be payable. The legislature, for example, has provided for the disposal of state land at less than market value

^{9/} The forms of this kind of government support given by the Alaska Legislature over the years are myriad. They include, but are certainly not limited to: direct loans; grants; loan guarantees; tax credits and other concessions; access to revenue bonding; creation of venture capital initiatives (e.g. the former Alaska Renewable Resources Corporation (ARRC), the Alaska Science and Technology Foundation; and AIDEA); and creation and support of specialized financial institutions (e.g., AIDEA, AHFC, and CFAB). Another form of assistance is the creation of entire divisions (such as the Division of Tourism, and ASMI) to assist developing industries.

in order to meet a number of economic and social needs. ^{10/} Most germane are legislative grants to various taxpayers of credits for the cost of new investments against their state taxes or royalty obligations. The following are examples, by activity, of tax credits allowed by the Alaska Legislature:

1. Fisheries.

- a. former Fisheries Business Tax Credit, AS 43.75.032. Under this credit, businesses could take a credit of up to 50% of their tax liability for new fisheries ventures. In its five years of operation (1987-91), the state allowed **\$68 million** in tax credits under this program. ^{11/}
- b. Fisheries Business Education Tax Credit, AS 43.75.032; and
- c. Tax Credit for Scholarship Contributions, AS 43.75.032 (effective January 1, 1992).

2. General Business.

- a. Income Tax Education Credit, AS 43.20.014;
- b. Incorporation of general Federal Investment Tax Credit, AS 43.20.021(d);
- c. Special Industrial Incentive Investment Tax Credits, AS 43.20.042. Under this law, taxpayers may take a more generous credit than the general federal credit for new gas processing plants and in-state mineral exploration and development activities.

3. Mining.

^{10/} See AS 38.05.057 (disposing of land at less than market value where land is scarce); AS 38.05.082 (shore fisheries lease rentals to be set at level only to compensate for administrative costs); AS 38.05.940 (25% discount for land acquisition by veterans); AS 38.08 (state homesite program).

^{11/} Ak. Dept. of Revenue, SB 27 Position Paper, 2/26/91.

- a. Mining License Tax, AS 43.65.010(a) (person subject to this tax is exempt from paying the tax for the first three and one-half years after starting production); ^{12/} and
 - b. Mining Business Education Credit, AS 43.65.018.
4. Oil and Gas.
- a. Exploration Incentive Credit, AS 38.05.180(i), allowing a credit for new exploratory wells drilled, based on the footage drilled; ^{13/}
 - b. Oil and Gas Producer Education Credit, AS 43.55.019;
 - c. Oil and Gas Property Education Credit, AS 43.56.018; and
 - d. Authorization to sell royalty gas at less than market value for utilities purposes, AS 38.05.133(h); and
 - e. Provisions to reduce lease royalties when necessary to prolong the life of the field. AS 38.05.180(j). ^{14/}

The preceding list is not intended to be exhaustive. Nonetheless, it does make it clear that credits against monetary obligations to the state are accepted mechanisms in Alaska for furthering various social or economic purposes. The credit against royalty oil price increases proposed by SB 134 is, by comparison, extremely appropriate.

^{12/} Although described as an exemption, this provision has the same effect and general purpose as a "credit" against taxes due during a start-up period.

^{13/} When authorized in an oil and gas lease, the statute permits the lessee to apply the credit against either taxes payable under AS 43.55 or against royalty and rental payments payable to the state. This credit, in particular, provides a very direct parallel to the credit against retroactive royalty oil price increases proposed by SB 134.

^{14/} In addition, throughout much of Alaska's history DNR inserted clauses in state oil and gas leases allowing a 10-year "discovery royalty"--one reducing the royalty from 12 1/2 to 5 percent--for the first production from a new geologic formation.

VII. SB 134 is constitutional

A. The "Public Purpose" and "Special Legislation" clauses of the Alaska Constitution

Appendix B to this paper analyzes SB 134 under Alaska Const., Art. IX, §6 (state funds must be expended for a public purpose) and Alaska Const., Art. II, §19 (prohibiting "local or special act[s] if a general act can be made applicable").

The appendix concludes that, under Alaska case law precedent and the consistent position of the Alaska Department of Law with respect to those provisions, SB 134 offends neither constitutional provision because:

- The legislation serves two "public purposes"--(1) encouraging new capital investment with its attendant direct and indirect economic benefits and tax revenues; and (2) helping ensure continued availability of refined petroleum products at reasonable prices throughout most of the state; and
- SB 134 isn't special or local in nature. It applies to any purchaser of royalty oil statewide, and it is motivated by a matter of common concern to all Alaskans--stimulating the Alaska economy.

B. The Permanent Fund and Budget Reserve Clauses

Alaska Const., Art. IX, §15 provides:

*At least twenty five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses **received** by the State shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments.*

Similarly, Alaska Const., Art. IX, §17 provides:

*There is established as a separate fund in the State treasury the budget reserve fund. Except for money deposited into the permanent fund under Section 15 of the article, all money **received** by the State after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production or property, shall be deposited in the budget reserve fund.*

The question has arisen whether, since at least 25% of any cash received by the state from its claims against the in-state refiners for retroactive royalty price increases would be deposited in the permanent fund, allowing in-state refiners to retire those claims through capital investment credits would violate either of those clauses.

The answer comes from the language of the clauses themselves. The key, and above-highlighted word is "**received**." By their terms, the two clauses impose obligations on the state to deposit funds **received** in a certain manner. They impose no obligation with regard to the stance that the state might take with respect to collection of those funds.

Were it otherwise--were the permanent fund and budget reserve clauses to obligate the state to collect the full amount from all its resource activities so that the fund and reserve might therefore be maximized--then much more than SB 134 would be at risk. For example, the state settled its *Amerada Hess* dispute with the North Slope producers for much less than it felt due through trial. The state forewent money that would have gone to the permanent fund. Did it violate the constitution?

Of course not. In fact, royalty and mineral tax disputes are often settled for less than the amount the state feels due. Other legitimate considerations always enter into the settlement equation, and there is nothing in either clause that

prohibits the state from continuing to factor all those considerations into any mineral settlement.^{15/}

VIII. Conclusion

The State of Alaska is an active player in the Alaska economy. And long ago it properly decided to use its North Slope wealth to become even more active--to help shape, through properly tailored investments and incentives, a self-sustaining economic infrastructure that would survive the boom. And nowhere was that policy more successful than in the encouragement of a healthy in-state refining industry.

Why, then, would Alaska want to reverse course, and use its considerable power as owner-state to imperil perhaps the most significant component of the value-added manufacturing base that it tried so hard to create? Surely there is a more creative use of the state's power here than simply to enter the bunkers, and bludgeon sums from this industry virtually equal to its entire Alaska worth. Higher fuel prices, insufficient future refining capacity, and lost jobs are not in anyone's interest. How the state chooses to use its considerable power here will help determine the kind of Alaska that enters the 21st century.

SB 134 is intended to give the state a prudent and creative path through this issue, by using its current claims against its refiners for sound investment, rather than mere submission.

^{15/} There are other, more technical reasons why these two clauses would not preclude the capital credit approach of SB 134. First, while Tesoro has entered into a settlement agreement with DNR, that agreement did not arise out of "an administrative proceeding or litigation," so the budget reserve clause of §17 would not be implicated. Second, most of the \$300 million allegedly due from these refiners is still very much in dispute.

The fundamental reason why these clauses aren't offended, however, lies in recognition of the common-sense fact that they impose **deposit** obligations, and not **collection** obligations.

Appendix A
ECO Northwest Report

The Fiscal and Economic Impact of New Vacuum and Asphalt Units at the Kenai Refinery of Tesoro Alaska Petroleum Company

Executive Summary

Dr. Randall J. Pozdena
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Portland, Oregon 97204

Introduction and Impact Summary

Tesoro Alaska Petroleum Company ("Tesoro") analyzed the addition of a new Vacuum Unit and a new Asphalt Unit at its refinery in Kenai, Alaska. The total cost for developing these new facilities (the "Project") is estimated to be \$46.5 million, assuming construction over the years 1993 and 1994. The subsequent, annual operating costs are estimated to be approximately \$5 million per year. In addition, the new units would permit Tesoro to refine approximately 15,000 additional barrels of oil per day, with a current value of \$82 million per year.

Tesoro has no present plan to go forward with this Project; however Tesoro retained ECO Northwest to analyze the economic and tax revenue impacts of the addition of a project of this magnitude to their Kenai, Alaska, refinery. A special input-output model was constructed for the borough of Kenai Peninsula and the state of Alaska to analyze these impacts. From this modeling exercise, ECO estimates that the Project will have the following effects, in present value terms, on the economy of the state of Alaska:

- Industrial output will increase by \$1.2 billion
- Employment will increase by 2,787 person-years, or the equivalent of approximately 200 permanent jobs
- Employee compensation will increase by \$126 million
- Property income will increase by \$632 million

This activity will, in turn, stimulate significant increases in the tax revenue enjoyed by various governmental jurisdictions. In present value terms, the Project will increase total revenues by \$51.3 million. The sources of these increases are as follows:

- Corporate income taxes will increase by \$21.5 million
- Property tax revenues will increase by \$22.8 million
- Sales tax revenues will increase by \$741 thousand
- Fees collected for regulatory costs, worker's compensation, and unemployment insurance will increase by \$6.3 million.

ECO believes that these impacts represent a conservative estimate of the economic and tax revenue effects of the Project.

The Modeling Process

ECO employed a special type of input-output modeling in the preparation of these impact estimates called IMPLAN modeling. IMPLAN is a set of computer programs and economic databases that permit estimation of the impacts of large scale projects such as Tesoro Project.

The use of input-output modeling is ideally suited to analysis of the Tesoro Project. The spending associated with the development and operation of the Project will *directly* stimulate output, employment, and personal and corporate income in the sectors affected by that spending. Those sectors, in turn, will *indirectly* stimulate other sectors with which they are linked in the Alaska economy. Finally, consumers and others that enjoy increases in income will *induce* additional economic activity through the spending of their incomes.

Input-output modeling permits tracing these direct, indirect, and induced effects. The IMPLAN modeling system, originally developed for the US Forest Service and other government agencies, is simply a cost-effective way of building an input-output model. ECO built separate models for the Kenai borough economy and the state of Alaska.

Modeling the Tesoro Project

The engineers at Tesoro and the economists at ECO Northwest first calculated the direct spending impacts of the Tesoro Project, and allocated them to the 528 industrial sectors accommodated by the IMPLAN model. Since the Project would be built over a two-year period, and would operate for approximately 20 years

thereafter, separate spending estimates were made for each of these phases. Spending that was unlikely to be channeled through the Alaska economy was eliminated from the impact analysis. Table 1 displays the spending assumptions, aggregated to eight major industrial sectors.

The Project would have major effects, during its development phase, on the construction, manufacturing, and services sectors. In its operational phase, its primary effect is on the mining sector, because of the expenditures on additional crude petroleum that will be utilized by the new refinery units.

TABLE 1: SPENDING IMPACTS OF THE TESORO PROJECT, BY SECTOR AND YEAR

Industry Sector	Year 1 (\$000)	Year 2 (\$000)	Annual (\$000)
Agriculture, forestry and fisheries	0	0	0
Mining	253	45	82,125
Construction and manufacturing	14,916	2,632	4,967
Transport, comm. and utilities	1,413	431	0
Wholesale and retail trade	0	0	0
FIRE	66	34	0
Services	10,895	4,033	0
Government enterprises	155	128	0
Total, Alaska spending	27,698	7,303	87,092
Total, all spending	37,711	8,791	87,092

Source: Tesoro Alaska Petroleum, ECO Northwest

Estimating Multiplier Effects of the Project

The spending impacts in Table 1 represent the first round, or direct effects of the Project. The size of any indirect, or induced effects depends upon the linkages in the economy. In an economy like Alaska, with relatively little indigenous equipment manufacturing and other heavy industry, some portion of the direct spending on refinery machinery and equipment "leak" out of the state, as purchases are made elsewhere. However, purchases of labor and other services are less likely to be fully dissipated, and generate indirect and induced activity in the Alaska economy.

In addition, the Project is particularly potent in the context of the Alaska economy because it does not come at the expense of

alternative expenditures within the state. Activities such as public infrastructure development or retail or wholesale trade, on the other hand, frequently divert spending from substitute activities or producers. On balance, such spending does not represent net new activity, and impact analysis will tend to overstate impacts. In contrast, in the Tesoro Project, both the development of the Project and the expenditures on operations represent spending that otherwise might not occur, rather than a diversion of spending from other activities.

The IMPLAN models built by ECO permit these effects to be traced throughout the Kenai and Alaska economies. On balance, the Tesoro Project has greater local effect on the Alaska economy than might otherwise be assumed. For each dollar of initial purchase of industrial output, the Project generates an additional 20 to 30 percent of output through indirect and induced effects. This "multiplier" of 1.2 to 1.3 is modest, but consistent with the special circumstances of the Alaska economy.

Job multipliers, which tend to be higher than spending multipliers, are as high as 1.5 —each job created directly by Project spending results in up to 0.5 jobs in other, independent sectors. The direct, indirect, and induced effects on jobs are summarized in Table 2.

TABLE 2: EFFECTS OF THE PROJECT ON KENAI AND ALASKA JOBS, IN PERSON-YEARS

Study Area (for all sectors)	Direct Jobs	Indirect Jobs	Induced Jobs	Total Jobs
Year 1 of Development Phase				
Alaska	358.78	50.00	80.49	489.33
Kenai	233.00	33.04	53.40	319.53
Year 2 of Development Phase				
Alaska	95.14	12.83	21.13	129.10
Kenai	55.02	8.04	12.63	75.84
Operating Phase, Annual				
Alaska	114.52	31.58	28.63	174.79
Kenai	106.50	24.59	26.30	157.44
Source: ECO Northwest. There may be errors due to rounding.				

Since the impacts of the Project are spread over a 22-year period (2 years of construction and 20 of operation), it is appropriate to calculate the present value, in 1993 dollars, of the impacts. As argued in the Technical Addendum, the use of a four percent real discount rate, coupled with no imputation of inflation to the annual impacts, represents a conservative means of estimating the present value of the Project impacts. These estimates, calculated separately for Kenai and the entire state of Alaska, are presented in Table 3.

TABLE 3: ECONOMIC IMPACT SUMMARY, ALASKA AND KENAI, IN PRESENT VALUE

Study Area	Total Output (\$m)	Labor Income (\$m)	Property Income (\$m)	Jobs (person-years)
Alaska	1,283.74	126.02	632.20	2,787.26
Kenai	1,188.18	106.57	591.12	2,356.56

Source: ECO Northwest. The various impacts are discounted at a 4 percent real rate, with no imputation of inflation. The construction phase lasts two years, and the operational life of the Project is 20 years. Dollar values are in 1993 dollars.

As summarized earlier, the Project has significant impacts in Kenai and in the State of Alaska.

Estimating the Effects on Tax Revenue

The economic impact estimates, such as those presented in aggregated form in Table 3, are the basis for estimating the tax revenue effects. ECO constructed a tax module that links the economic impact estimates to the sales, corporate income, property and other taxes and fees levied in Alaska. The outcome of this part of the modeling process, summarized earlier, is presented in somewhat greater detail in Table 4.

The impact of the Project on property and corporate income tax revenues contributes significantly to the \$51.3 million of revenue (in present value terms) generated by the Project. These follow, in turn, from the significant stimulus that the Project provides to personal and business income.

The use of conservative assumptions in constructing the IMPLAN model and the tax module suggest that the revenue calculations in Table 4 are conservative, but realistic estimates of the impact of the Tesoro Project.

**TABLE 4: TAX REVENUES GENERATED BY TESORO
PROJECT IMPACTS, IN PRESENT VALUE**

Tax Jurisdiction	Sales Tax (\$000)	Property Tax (\$000)	Corporate Income Tax (\$000)	Regulatory Cost Charge (\$000)	Workers Comp and Unemp. Insurance (\$000)	Total All Taxes (\$000)
Alaska	68.11	8,339.16	21,486.24	3,317.17	3,023.26	36,233.94
Kenai	673.15	14,419.52				15,092.68
All	741.26	22,758.68	21,486.24	3,317.17	3,023.26	51,326.61

Source: ECO Northwest. There may be errors due to rounding. "Alaska" refers to Alaska other than the Borough of Kenai Peninsula area. The various impacts are discounted at a 4 percent real rate, with no imputation of inflation. The construction phase lasts two years, and the operational life of the Project is 20 years. Dollar values are in 1993 dollars.

***An Analysis of Capital Credit Legislation
Under the "Public Purpose" and "Special
Legislation" Clauses of the Alaska
Constitution***

SB 134 and HB 185 would allow purchasers of state royalty oil to credit against certain retroactive payment assessments the value of new capital facilities constructed in the state. This paper analyzes that legislation under Alaska Const., Art. IX, §6 (state funds must be expended only for "a public purpose") and Alaska Const., Art. II, §19 (prohibiting "local or special act[s] if a general act can be made applicable").

This paper concludes that, under Alaska case law precedent and the consistent position of the Alaska Department of Law with respect to those provisions, the legislation offends neither constitutional constraint:

First, the legislation serves two "public purposes"--(1) encouraging new capital investment with its attendant direct and indirect economic benefits and tax revenues; and (2) helping to ensure continued availability of refined petroleum products at reasonable prices throughout much of the state. Legislative findings articulating those purposes should be prepared, and the courts will defer to those findings. The fact that private corporations will also benefit from the legislation does not diminish the significance of the public benefits that flow from it, and is legally irrelevant; and

Second, the legislation isn't special or local in nature. It applies to any purchaser of royalty oil statewide, and it is motivated by a matter of common interest to all Alaskans--stimulating the Alaska economy.

I. The Public Purpose Clause

Alaska Const., Art. IX, §6 provides:

No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose.

That clause has been applied by the Alaska Supreme Court to a number of statutes; however, in no instance was the law invalidated on this ground. ^{1/} A good statement of the judiciary's deferential attitude towards this clause appears in Wright v. City of Palmer, 468 P2nd 326, 331 (Alaska 1970):

The test...is whether the plan is so unreasonable as to transgress the limitations of our constitution. If the plan of action were plainly foolhardy, or if it amounted to the pledging of credit or the giving away of assets without any corresponding discernible benefit, we might be persuaded to strike down the plan.

Our supreme court has accordingly afforded great deference to the legislature's findings of public purpose, and has indicated that those findings won't be disturbed unless they lack any reasonable basis in fact. DeArmond v. Alaska State Dev. Corp., 376 P2nd 717 (Alaska 1962).

The program created by SB 134 and HB 185 would be available to any purchaser of state royalty oil, of which four have encountered disputes of the type covered by the legislation--Tesoro, Mapco Petroleum, Chevron and Petrostar. In each case, the Alaska Department of Natural Resources has demanded additional payments under their purchase contracts above the price originally paid. The legislation calls these "purchase arrearages," and once that arrearage is "liquidated" (that is, reduced to a sum certain through judgment or settlement), the

^{1/} A good summary of Alaska's public purpose cases can be found in Comtec, Inc. v. Municipality of Anchorage, 710 P2nd 1004, 1005-6 and n. 1 (Alaska 1986); See also Levy, Constitutional Limitations on Appropriations, 11 U.C.L.A.-Alaska L. Rev. 189, 204-5 (1982).

law allows the purchaser to take a credit against that arrearage for new capital investment in Alaska.

There are limits on the credits that may be taken: (1) pre-existing investments don't qualify, nor do investments that must be made in any event because of legal requirements; (2) the credit will be disallowed if it doesn't result in benefits to the public commensurate with the credit taken; and (3) in order to ensure that investment occurs soon, the credit period is limited to 10 years, or the term of the settlement agreement.

The arrearages against which these credits can be taken are, for the most part, one-time windfall claims arising as an indirect result of favorable (to the state) settlement of the *Amerada Hess* litigation (a case not involving these purchasers).

The concept of government-funded incentives aimed at stimulating new economic activity in the state is hardly a new concept--the Alaska Legislature having often recognized that the public benefits of encouraging new economic enterprise may outweigh the costs of providing the requisite inducement. With respect to the capital credit legislation, the firm of ECO Northwest has performed a study of a particular Tesoro investment that would be eligible for a credit--a possible \$46.5 million refinery addition--and estimated the following direct and indirect public benefits that would flow from such an investment:

Amount of Investment Credit

\$46.5 million

Resultant Public Benefit ^{2/}

*New direct tax revenue to state
and local governments...\$51.3 million*

Employment increase...2,787 person/yr.

New employee compensation...\$126 million

Industrial output increase...\$1.2 billion

Property income increase...\$632 million

In addition, the royalty oil purchasers affected by the legislation currently provide a majority of Alaskans with reasonably-priced refined products, using the royalty oil as feedstock. A retroactive assessment of arrearages against that royalty oil would adversely affect Railbelt energy prices, and resultantly impair the Railbelt economy. Indeed, in a recent Mapco study "Mapco's crude costs were found to explain over 80% of the variation in posted product prices." ^{3/}

Finally, receiving the revenue from the arrearage instead of allowing an investment credit would not be an unmixed blessing to the public. To the extent the market permitted, the costs of paying the arrearage may be passed on to Alaska consumers in the form of higher fuel prices. Conversely, to the extent that prices couldn't be passed through, Alaska refiners would be forced to absorb the cost--an event which, at a minimum, could impair their ability to expand operations and meet future market demand. Either way, the public would emerge the poorer. The capital credit legislation is intended to provide a third alternative--one allowing the public to benefit from the arrearages allegedly due while avoiding the damaging side-effects of demanding full direct payment.

^{2/} Expressed in 1993 dollars.

^{3/} Mapco, *Royalty Oil and Refined Products: Supply and Pricing Impacts*, Sept., 1991 at 7.

The public benefits of the credit legislation, then, are considerable. There are three arguments that might nonetheless be advanced against the legislation; however, as both the courts and the Attorney General have often decided, the legislature here would be within its prerogative to conclude that the public benefits of the proposal outweighed these other considerations.

The possible arguments against the bill are these:

(A) Private Businesses Will Also Benefit from the Legislation.

Certainly that's true--any purchaser who takes a credit will see its arrearage balance reduced commensurately. But according to the Attorney General, "whether private entities receive a benefit from an expenditure of public money is not, in our view, the dispositive factor."^{4/}

In a number of cases, the Attorney General has upheld appropriations clearly targeted at a specific private business, on the theory that the resultant spinoff benefits to the public gave the grant a "public purpose." In 1984 *Inf. Op. Atty. Gen* (Sept. 13; 366-127-85), the legislature had appropriated funds to the Alaska Industrial Development Authority (AIDA) for the purpose of certain port and road engineering studies. While the port and road would serve regional purposes, the particular transportation project was "inextricably linked to the development of the Red Dog mineral deposits"--a mining venture being undertaken by Cominco, Alaska and NANA Regional Corporation. The state was considering a role in the Red Dog project, through AIDA, which would include financial support for the transportation network.

Despite the private beneficiary of the legislation, the Attorney General found the expenditure was for a public purpose:

^{4/} 1992 *Inf. Op. Atty. Gen.* (April 10; 663-92-0379) at 3, citing *Wright v. City of Palmer*, 468 P2nd 326 and *Suber v. Alaska State Bond Commission*, 414 P2nd 546, 552 (Alaska 1966). The Alaska Supreme Court first reached this same conclusion in *Lien v. City of Ketchikan*, 383 P2nd 721, 722 (1963).

*The appropriation at issue is extended directly to AIDA, yet it is equally clear that expenditure of the funds will indirectly extend a substantial benefit to two private, for-profit corporations, Cominco, Alaska and NANA. Whether or not Cominco, Alaska receives a benefit is not the dispositive factor, however. **The test instead is whether the expenditure will directly enhance the general welfare of the community...**In undertaking this inquiry, substantial deference must be extended to the legislature's finding--as evidenced by the adoption of the appropriation--that the expenditure of public funds to assist in the development of preliminary site information for the DeLong Mountain Transportation Project serves a valid public purpose. AIDA, as would a court upon review of the appropriation, must therefore find that the legislative public purpose finding was arbitrary or without any reasonable basis in fact before concluding that the expenditure constitutes an impermissible expenditure of public funds.*

Id. at 2-3. Indeed, added the Attorney General, the intercession of AIDA in the funding process was not critical to the result. A public purpose would still exist, the Attorney General concluded, "[e]ven if the appropriation had been directly extended to Cominco, Alaska." *Id.* at 3.

The same result was reached in 1991 *Inf. Op. Atty. Gen.* (May 7; 661-91-0503), where the Attorney General upheld an appropriation to finance a drinking water filtration system for a privately-owned water utility. And most recently, in 1992 *Inf. Op. Atty. Gen.* (April 10; 663-92-0379), the Attorney General upheld an \$1.2 million appropriation to the North Slope Borough for use in funding a development study of a coal project owned by the Arctic Slope Regional Corporation.^{5/} Although acknowledging that the appropriation would "extend a substantial benefit to two private entities, namely, the corporation that owns the mine site and the consulting group performing the study," the Attorney General ruled that the legislature could properly conclude that the regional benefits of facilitating coal-generated electricity nonetheless justified the appropriation:

^{5/} This was, in fact, the third legislative grant for this project--the prior two being for \$2 million, and \$200,000, respectively.

According to documents accompanying the appropriation, the goal of the Project is to resolve energy problems that persist throughout rural Alaska by providing an abundant, stable-priced energy source, as well as providing long-term, permanent employment opportunities, development of an infrastructure in the region, and potential tax revenues...

Id. at 3. The parallel between this opinion, and the purposes of the capital credit legislation--to foster employment and aid the provision of reasonably-priced energy on a regional basis--should not be missed on the reader.

Occasionally, when there is no discernible public benefit from the appropriation at all, the Attorney General will intervene. That happened, for example, in 1987 *Inf. Op. Atty. Gen.* (March 19; 663-87-0372), where the Attorney General rejected a proposed appropriation to a regional aquaculture association for use as mere investment funds. The idea was that earnings on these funds would be used for salmon enhancement projects in the future; however, there was nothing in law requiring use of those funds for any particular project. The absence of any linkage to particular projects, and the absence of any "guarantee that the funds will eventually be used for a public purpose," were fatal to the proposal.

And, in 1983 *Inf. Op. Atty. Gen.* (July 27; 366-036-84), a Juneau proposal to contribute state grant funds to a private, for-profit corporation to help build a parking garage was invalidated because of the absence of any safeguards designed to ensure that the public benefits received were commensurate with the amount of the city grant.

The capital credit legislation was consciously drafted to avoid both those shortcomings. First, unlike the aquaculture association's earnings, the credit here is linked to specific, concrete investment proposals, the asserted public benefits of which are subject to state review. And, unlike the Juneau parking garage, the state is empowered to disapprove the credit if it won't yield public benefits commensurate with the amount of the credit. The only remaining indictment on

this count, then, is that private businesses will benefit from the legislation--and, as we've seen, that isn't "dispositive." ^{6/}

(b) The Public Won't Have Any Ownership Interest in the Facility Built With the Credit. This particular claim has never troubled the Attorney General. It was specifically dealt with in the context of assisting the ASRC coal project (discussed *ante*). Even though "the borough does not own nor have control over the Project or the mine site," the Attorney General said, the public benefits of coal development justified the appropriation. *Id.* at 3; see also 366-127-85, *supra* (Red Dog Mine assistance); 1983 *Inf. Op. Atty. Gen.* (March 8; J66-463-82) (financial assistance for expansion of private ski area serves a "public purpose"); Lien v. City of Ketchikan, 383 P2nd 721.

(c) There Isn't An Absolute Causal Link Between the Credit and the Investment--the Investment Might Occur Anyway. This topic is included because of 1983 *Inf. Op. Atty. Gen.* (March 8, J66-463-82), which invalidated the proposed forgiveness of a loan to a private ski area. There was no public purpose served by the forgiveness, the Attorney General concluded, because the benefit provided by the private corporation--the provision of skiing facilities--had already occurred:

[T]he behavior for which the money is spent has already occurred. The expenditure of money to 'reward' past behavior is clearly different from the expenditure of money to influence or affect private behavior so as to directly benefit the public.

^{6/} In the cases and opinions cited above, it's often said that the private benefit should be "indirect," while the corresponding public advantages "direct." Each of the holdings, however, proves that distinction illusory. In the ASRC coal project case, for example, the direct benefits of the appropriation went to the corporation. If any benefits were "indirect," they were the energy and employment benefits that might ultimately flow to regional residents. Precisely the same is true for the Red Dog appropriation.

Id. at 2. The opinion, however, went on to uphold future assistance for ski area expansion, since that would plainly "influence or affect" the provision of future benefits.

In the ski area case, it was logically impossible for loan forgiveness to influence the provision of public benefits. Conversely, the Attorney General has never required an absolute certainty that the state-funded incentive be a necessary precondition to provision of future benefits. Obviously, the Attorney General could not know whether the Red Dog Mine or the ASRC coal project might be built anyway, even in the absence of state help. All that was needed was that the incentive appeared to "influence or affect" future investment decisions.

The capital credit legislation is structured to meet that standard by precluding a credit for any pre-existing investment, or for investments that must occur because of legal constraints. These, it should be noted, are safeguards present in neither the Red Dog nor ASRC appropriations. There is thus no court nor Attorney General precedent that could be used to invalidate the capital recovery legislation on this basis.

II. The "Special Legislation" Prohibition

Art II, §19 of the Alaska Constitution provides:

The Legislature shall pass no local or special act if a general act can be made applicable. Whether a general act can be made applicable shall be subject to judicial determination.

The clause does not prohibit special legislation. It only prohibits special legislation when there is nothing in the nature of the specific area that justifies a departure from making the legislation applicable to all similar areas. Abrams v. State, 534 P2nd 91, 94 (Alaska 1975) (law creating a new Eagle-Chugiak Borough

held unconstitutional because nothing in the nature of the Eagle River-Chugiak area justified departing from the general law scheme for incorporating a new borough). ^{7/}

It is hard to fault the capital credit legislation under this clause, because it is not "special"--it applies to any purchaser of royalty oil. It is true that this class is quite small; however, the limited number within the affected class has never been a factor in "special legislation" analysis. In virtually every case in which the "special legislation" indictment has been raised, the legislation, *by its terms*, applied only to a particular geographic area, a particular individual or a particular event. ^{8/}

It is true that the principal direct public benefits of this "general" law will fall on Southcentral and Interior Alaska--through job creation, economic growth and continued reasonable fuel prices. However, as the Attorney General has often reminded, if the goals themselves are a matter of common interest (here, the common interest in economic growth), the fact that the benefits will flow regionally, rather than to every corner of the state, is irrelevant. 1992 *Inf. Op. Atty. Gen.* (June 8; 883-92-0088) (common goal was enhanced oil spill cleanup; benefits were felt most directly in Prince William Sound); 1986 *Inf. Op. Atty. Gen.* (May 28; 883-86-

^{7/} Conversely, if the subject matter is something that, by definition, can only be acted on specially, then a special law is appropriate. 1985 *Inf. Op. Atty. Gen.* (April 10; 166-337-85) (bill authorizing extension of royalty oil contract was addressed only to one particular contract, so "special" legislation was plainly required); see also *Boucher v. Engstrom*, 528 P2nd 456 (Alaska 1974). In that event, the only remaining test under the clause is whether the special treatment given in the legislation is "reasonably related to a matter of common interest to the whole state." *Abrams v. State*, 534 P2nd at 94. The Attorney General has been quite reluctant to substitute his views on what is a "common interest" to Alaskans--stopping short, for example, of recommending a veto of even legislation specially authorizing local gambling events. 1990 *Inf. Op. Atty. Gen.* (April 17; 883-90-022) (legislation specially authorizing Big Lake Ice Classic not "clearly unconstitutional").

^{8/} See 1992 *Inf. Op. Atty. Gen.* (June 8; 883-92-0088) (legislation imposing special oil spill cleanup responsibilities only on Prince William Sound, and on holder of Trans Alaska Pipeline Right-of-Way, was subject to, but survived, "special legislation" analysis); 1986 *Inf. Op. Atty. Gen.* (May 28; 883-86-0104) (legislation relating to reorganization of the debt owed by Delta agricultural projects was geographically limited, but a rational reason existed for disparate treatment).

0104) (common goal was health of agricultural industry; benefits were most directly felt in Delta area).

There are, in fact, relatively few state laws whose direct blessings are spread equally statewide. And accordingly, the fact that the immediate impact of the legislation is limited to even a small geographic area is legally irrelevant. Abrams v. State, 534 P2nd at 94. The "matter of common interest" (see n. 7, *ante*) that must motivate any legislation refers, then, not to the breadth of the legislation's impact, but rather to the legislation's overall goals.

Here, the goal of the capital credit legislation is economic growth and wellbeing--plainly a matter of "common interest" to Alaskans. And even some of the direct, quantifiable impacts of the legislation will fall statewide--such as ECO's projected increase in state corporate income tax revenues from the studied Tesoro investment. Moreover, even to the extent that the benefits of the legislation might be termed only "regional," the regions most directly affected--Southcentral and Interior Alaska--subsume about three-quarters of Alaska's population, and Mapco and Tesoro provide fuel to every region of the state except the Panhandle.

Given that the legislation is thus founded on a "common interest," and that its reach is "general," the "special legislation" clause of the Alaska Constitution really isn't even germane.

III. Conclusion

SB 134 and HB 185 are simply variants of the traditional investment tax credit--the lessening of a governmental obligation in return for the obligee's infusing the foregone debt into the economy. Viewed from that perspective, the legal propriety of the legislation seems apparent. The legislation is motivated by a desire to stimulate the Alaska economy through job creation, wealth generation,

additional tax revenues and reasonably-priced fuel. These are "public purposes," and matters in which all Alaskans have a "common interest."

The wisdom of the legislation, of course, will be debated in the legislative forum. As this paper has shown, however, that debate should proceed unclouded by any *legal* doubts.

We do recommend that the legislature prepare findings explaining the public purposes of the legislation. As the Attorney General has often reminded us, even though both the "public purpose" and "special legislation" clauses are judicially enforceable, it's the legislature that is entrusted with making the judgment call over whether the public benefits of this particular legislation outweigh the private advantages. Explicit findings will memorialize the legislature's conclusions, and those conclusions will be accorded extraordinary deference.

March 1, 1993.

BIRCH, HORTON, BITTNER and CHEROT

Jon K. Tillinghast

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The Fiscal and Economic Impact of New Vacuum and Asphalt Units at the Kenai Refinery of Tesoro Alaska Petroleum Company

Executive Summary

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808 SW Fifth Avenue
Portland, Oregon 97204

Introduction and Impact Summary

Tesoro Alaska Petroleum Company ("Tesoro") analyzed the addition of a new Vacuum Unit and a new Asphalt Unit at its refinery in Kenai, Alaska. The total cost for developing these new facilities (the "Project") is estimated to be \$46.5 million, assuming construction over the years 1993 and 1994. The subsequent, annual operating costs are estimated to be approximately \$5 million per year. In addition, the new units would permit Tesoro to refine approximately 15,000 additional barrels of oil per day, with a current value of \$82 million per year.

Tesoro has no present plan to go forward with this Project; however Tesoro retained ECO Northwest to analyze the economic and tax revenue impacts of the addition of a project of this magnitude to their Kenai, Alaska, refinery. A special input-output model was constructed for the borough of Kenai Peninsula and the state of Alaska to analyze these impacts. From this modeling exercise, ECO estimates that the Project will have the following effects, in present value terms, on the economy of the state of Alaska:

- Industrial output will increase by \$1.2 billion
- Employment will increase by 2,787 person-years, or the equivalent of approximately 200 permanent jobs
- Employee compensation will increase by \$126 million
- Property income will increase by \$632 million

This activity will, in turn, stimulate significant increases in the tax revenue enjoyed by various governmental jurisdictions. In present value terms, the Project will increase total revenues by \$51.3 million. The sources of these increases are as follows:

- Corporate income taxes will increase by \$21.5 million
- Property tax revenues will increase by \$22.8 million
- Sales tax revenues will increase by \$741 thousand
- Fees collected for regulatory costs, worker's compensation, and unemployment insurance will increase by \$6.3 million.

ECO believes that these impacts represent a conservative estimate of the economic and tax revenue effects of the Project.

The Modeling Process

ECO employed a special type of input-output modeling in the preparation of these impact estimates called IMPLAN modeling. IMPLAN is a set of computer programs and economic databases that permit estimation of the impacts of large scale projects such as Tesoro Project.

The use of input-output modeling is ideally suited to analysis of the Tesoro Project. The spending associated with the development and operation of the Project will *directly* stimulate output, employment, and personal and corporate income in the sectors affected by that spending. Those sectors, in turn, will *indirectly* stimulate other sectors with which they are linked in the Alaska economy. Finally, consumers and others that enjoy increases in income will *induce* additional economic activity through the spending of their incomes.

Input-output modeling permits tracing these direct, indirect, and induced effects. The IMPLAN modeling system, originally developed for the US Forest Service and other government agencies, is simply a cost-effective way of building an input-output model. ECO built separate models for the Kenai borough economy and the state of Alaska.

Modeling the Tesoro Project

The engineers at Tesoro and the economists at ECO Northwest first calculated the direct spending impacts of the Tesoro Project, and allocated them to the 528 industrial sectors accommodated by the IMPLAN model. Since the Project would be built over a two-year period, and would operate for approximately 20 years

thereafter, separate spending estimates were made for each of these phases. Spending that was unlikely to be channeled through the Alaska economy was eliminated from the impact analysis. Table 1 displays the spending assumptions, aggregated to eight major industrial sectors.

The Project would have major effects, during its development phase, on the construction, manufacturing, and services sectors. In its operational phase, its primary effect is on the mining sector, because of the expenditures on additional crude petroleum that will be utilized by the new refinery units.

TABLE 1: SPENDING IMPACTS OF THE TESORO PROJECT, BY SECTOR AND YEAR

Industry Sector	Year 1 (\$000)	Year 2 (\$000)	Annual (\$000)
Agriculture, forestry and fisheries	0	0	0
Mining	253	45	82,125
Construction and manufacturing	14,916	2,632	4,967
Transport, comm. and utilities	1,413	431	0
Wholesale and retail trade	0	0	0
FIRE	66	34	0
Services	10,895	4,033	0
Government enterprises	155	128	0
Total, Alaska spending	27,698	7,303	87,092
Total, all spending	37,711	8,791	87,092

Source: Tesoro Alaska Petroleum, ECO Northwest

Estimating Multiplier Effects of the Project

The spending impacts in Table 1 represent the first round, or direct effects of the Project. The size of any indirect, or induced effects depends upon the linkages in the economy. In an economy like Alaska, with relatively little indigenous equipment manufacturing and other heavy industry, some portion of the direct spending on refinery machinery and equipment "leak" out of the state, as purchases are made elsewhere. However, purchases of labor and other services are less likely to be fully dissipated, and generate indirect and induced activity in the Alaska economy.

In addition, the Project is particularly potent in the context of the Alaska economy because it does not come at the expense of

alternative expenditures within the state. Activities such as public infrastructure development or retail or wholesale trade, on the other hand, frequently divert spending from substitute activities or producers. On balance, such spending does not represent net new activity, and impact analysis will tend to overstate impacts. In contrast, in the Tesoro Project, both the development of the Project and the expenditures on operations represent spending that otherwise might not occur, rather than a diversion of spending from other activities.

The IMPLAN models built by ECO permit these effects to be traced throughout the Kenai and Alaska economies. On balance, the Tesoro Project has greater local effect on the Alaska economy than might otherwise be assumed. For each dollar of initial purchase of industrial output, the Project generates an additional 20 to 30 percent of output through indirect and induced effects. This "multiplier" of 1.2 to 1.3 is modest, but consistent with the special circumstances of the Alaska economy.

Job multipliers, which tend to be higher than spending multipliers, are as high as 1.5 —each job created directly by Project spending results in up to 0.5 jobs in other, independent sectors. The direct, indirect, and induced effects on jobs are summarized in Table 2.

TABLE 2: EFFECTS OF THE PROJECT ON KENAI AND ALASKA JOBS, IN PERSON-YEARS

Study Area (for all sectors)	Direct Jobs	Indirect Jobs	Induced Jobs	Total Jobs
Year 1 of Development Phase				
Alaska	358.78	50.00	80.49	489.33
Kenai	233.00	33.04	53.40	319.53
Year 2 of Development Phase				
Alaska	95.14	12.83	21.13	129.10
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Since the impacts of the Project are spread over a 22-year period (2 years of construction and 20 of operation), it is appropriate to calculate the present value, in 1993 dollars, of the impacts. As argued in the Technical Addendum, the use of a four percent real discount rate, coupled with no imputation of inflation to the annual impacts, represents a conservative means of estimating the present value of the Project impacts. These estimates, calculated separately for Kenai and the entire state of Alaska, are presented in Table 3.

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As summarized earlier, the Project has significant impacts in Kenai and in the State of Alaska.

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The impact of the Project on property and corporate income tax revenues contributes significantly to the \$51.3 million of revenue (in present value terms) generated by the Project. These follow, in turn, from the significant stimulus that the Project provides to personal and business income.

The use of conservative assumptions in constructing the IMPLAN model and the tax module suggest that the revenue calculations in Table 4 are conservative, but realistic estimates of the impact of the Tesoro Project.

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Kenai	673.15	14,419.52				15,092.68
All	741.26	22,758.68	21,486.24	3,317.17	3,023.26	51,326.61

Source: ECO Northwest. There may be errors due to rounding. "Alaska" refers to Alaska other than the Borough of Kenai Peninsula area. The various impacts are discounted at a 4 percent real rate, with no imputation of inflation. The construction phase lasts two years, and the operational life of the Project is 20 years. Dollar values are in 1993 dollars.

PROVIDED BY MAPCO
OTG Committee 3/18/93

ROYALTY OIL AND REFINED PRODUCTS :

SUPPLY AND PRICING IMPACTS

March 1993

Robert A. Hermes
Blake T. Eskew

PURVIN & GERTZ, INC.
Dallas - Houston - London
Los Angeles - Calgary

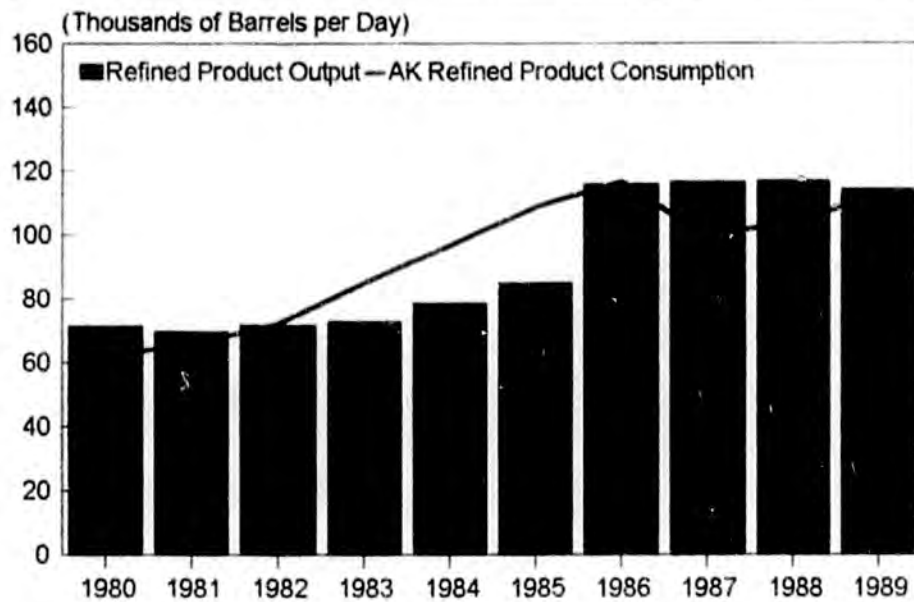
KEY CONCLUSIONS

- **The practice established by the State of Alaska of selling in-kind royalty oil for in-state processing has played a key role in developing a viable in-state refining industry.** As a result, those areas of Alaska served by in-state refineries have enjoyed higher competition and lower prices for refined petroleum products. The only area of the state not supplied by in-state refineries is Southeast Alaska, which still relies on West Coast suppliers for its fuel needs.

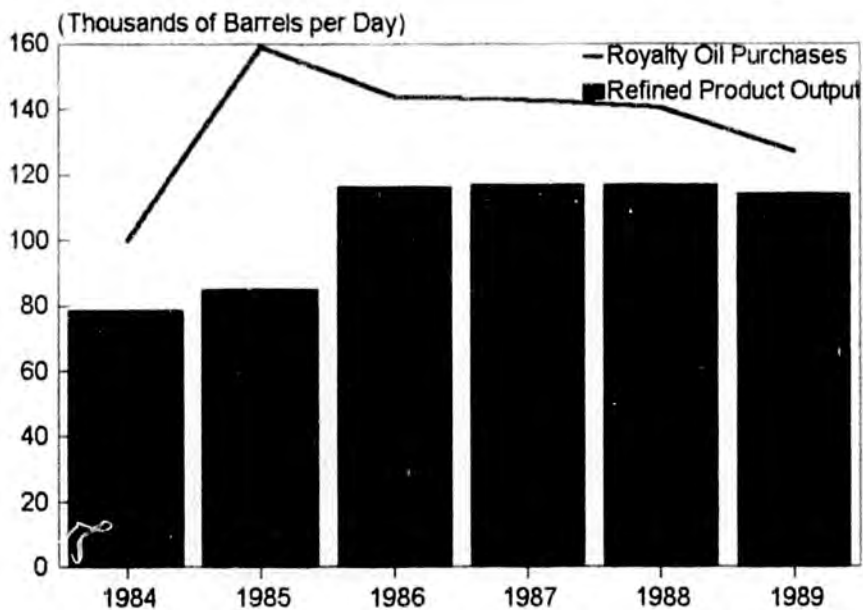
The disparity between Southeast fuel prices and prices in the Railbelt is immediately evident. Juneau's consumers, for example, pay a premium averaging 30¢ per gallon over the price paid in Anchorage for gasoline. If the competition brought on by the in-state refineries did not exist and the rest of Alaska were still supplied from outside the state, even if the premium were only 10¢ per gallon, Alaskan consumers would have paid over \$450 million more for gasoline, heating fuel and diesel over the decade of the 1980s.

- **Due to the close relationship between prices of Alaskan crude oil and refined products, any benefits of lower royalty oil prices have been passed on to Alaska's consumers.** If royalty oil prices were lower than they otherwise might have been, refined product prices were also lower. If historical royalty oil prices had been higher, refined product prices would also have been higher.

ALASKA PETROLEUM CONSUMPTION AND REFINED PRODUCT OUTPUT



REFINED PRODUCT OUTPUT AND ROYALTY OIL PURCHASES



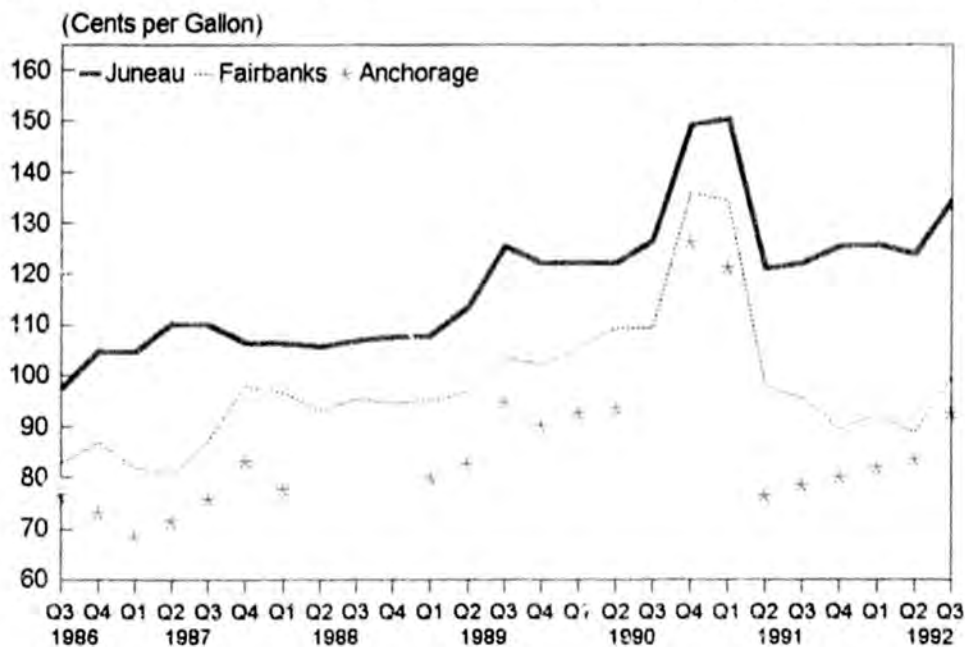
ALASKAN REFINED PRODUCT SUPPLY

- **Alaska's in-state refineries have become the dominant source of refined products to Alaska's consumers.** By the mid-1980s, Alaska became self-sufficient in refined products as in-state refinery supply increased, even though some seasonal imports and exports of products are required to balance supply and demand.
- **Refined products from the Interior and Kenai refineries supply consumers throughout Alaska, except for the Juneau/Southeast region.** Juneau, Ketchikan, and the remainder of Southeast Alaska continue to receive virtually all of their refined products by barge from Puget Sound and California refineries.
- **In the 1980s, the in-state refineries depended on royalty oil to support operations.** Production of gasoline, heating fuel, diesel and other petroleum products increased along with purchases of State of Alaska royalty oil.

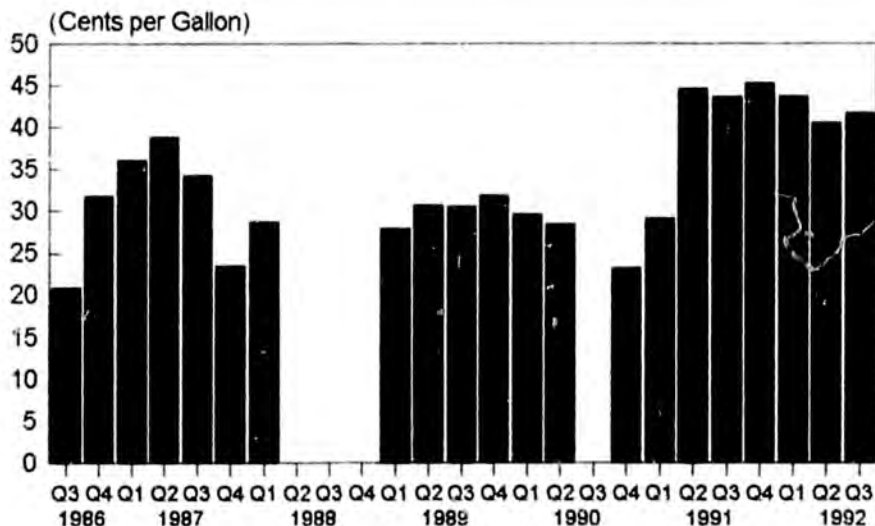
CONCLUSION

- **In-kind royalty oil sales have achieved their goal of building a strong and sustainable in-state refining industry.** Alaska's economy has benefited from increased availability of vital fuels and by the jobs created by the refining industry.

ALASKA EX TAX UNLEADED REGULAR PRICES



JUNEAU MINUS ANCHORAGE RETAIL EX TAX UNLEADED REGULAR PRICES



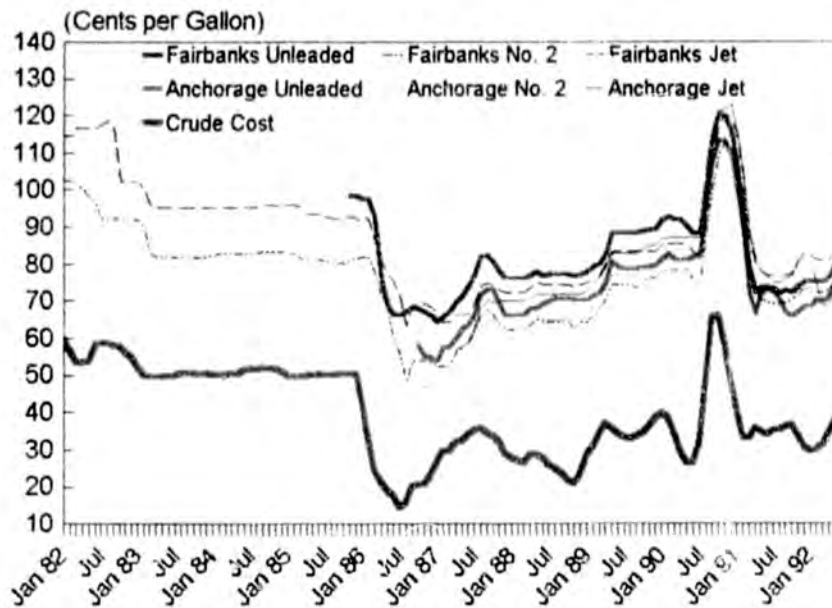
ALASKA RETAIL PRODUCT PRICES

- **Retail gasoline prices in Southeast Alaska are consistently higher than Railbelt prices.**
- **Juneau's higher prices are largely due to two factors: less competition and higher distribution costs.** The number of competitors on both the wholesale and retail levels is quite small. Previous legislative studies have concluded that the Southeast Alaska market exhibits a much lower degree of competition than the Railbelt. In addition, the limited market for refined products in Southeast, along with the area's physical isolation, increase product distribution costs.
- **Compared to Anchorage, consumers in Juneau paid an extra 30¢ per gallon (exclusive of taxes) over the 1986-92 period.** Market competition in Anchorage, as well as other Railbelt and Western Alaska communities, has clearly been enhanced by the availability of local supply from in-state refineries.

CONCLUSION

- **Railbelt and Western Alaska consumers have reaped the benefits of the growth of the in-state refining industry. Southeast Alaska's consumers have not shared in those benefits.** Increased refinery production has resulted in more local competition and, therefore, lower refined product prices in the Railbelt and Western Alaska, compared to Juneau and Southeast.

MAPCO WHOLESALE PRODUCT PRICES
AND CRUDE COST



CRUDE AND PRODUCT PRICES

- **Crude oil prices are the dominant influence on product prices.** Using statistical analysis, the changes in Mapco's crude costs were found to explain over 80% of the variation in posted product prices.

The prices of Mapco's products at Fairbanks and Anchorage, illustrated at left, clearly follow the movements in Mapco's crude costs. The major price movements in 1986, 1990 and 1991, as well as a number of smaller movements, can be seen equally well in both crude and products.

The spread between crude and product prices is indicative of the refiner's margin over the cost of crude, which must cover all operating and financing costs, as well as provide sufficient capital to support the continuing investments typical of the refinery industry.

- **Product price movements tend to lag behind crude price movements by about a month.** This indicates that crude price changes bring about changes in product prices.

CONCLUSIONS

- **Refined product prices and crude costs are firmly linked in Alaska.** Over the years, crude cost increases resulted in higher product prices, and crude cost declines resulted in lower product prices.

CONCLUSIONS

- **Alaska has benefited from the development of a healthy in-state refining industry.** Refined product availability and marketplace competition have increased, and local economies have enjoyed higher employment and improved economic activity.
- **Consumers have also enjoyed lower product prices in those regions supplied by in-state refineries.** Consumers in Southeast Alaska who rely on West Coast products have paid consistently higher retail prices, due to diminished marketplace competition.
- **Without the in-state refineries, all of Alaska's consumers would face the same conditions experienced in Southeast.**
- **Alaska's in-state refineries rely on royalty oil, and compete in the same product markets.** The cost of crude is the major component of any refiner's costs, and has been demonstrated to be the major influence on Alaskan product prices.
- **Higher royalty oil prices would have resulted in higher product prices.** Historical product prices in Alaska have closely followed the cost of crude oil for in-state refineries. Each of Alaska's refineries face those same costs for royalty crude oil. **The benefits of lower past royalty oil prices have already been passed on to Alaska's consumers.**

FEB-26-93 SAT 12:06

ZJ.MOON - Morse Note

Post-it brand fax transmittal memo 7571

of pages >

4

To	Buki Wright	From	Greg Burden
Co.		Co.	Tesoro
Dept.		Phone #	561-3521
Fax #	563-4749	Fax #	561-8218

**A Response to Two Questions Regarding Capital Credit Legislation for
Royalty Oil Purchasers**

Legislation has been discussed that would allow purchasers of royalty oil who find themselves faced with delinquency assessments from the state (as a result of pricing or valuation controversies) to credit against those retroactive assessments the value of qualifying capital investments that the purchaser may make in Alaska in the future. The legislation, which would include a number of safeguards to ensure that the public receives benefits commensurate with the credit, is intended to further these public policy goals:

1.

Encourage job creation, increased tax revenues and economic stimulus by inducing Alaska's in-state refiners to expand their Alaska operations. The legislation proceeds on the premise that the stimulation of specific, long-term capital growth is a prudent investment for the one-time, extraordinary claims that the state has asserted against its in-state royalty oil purchasers. Indeed, a recent study prepared for Tesoro Alaska Petroleum by ECO Northwest indicates that a particular \$46.5 million refinery expansion would return to the state, in 1993 dollars, \$51.3 million in new tax revenues; \$126 million in new employee compensation; \$1.2 billion in increased industrial output; and \$632 million in property income increases. In addition, that investment would create 2,787 new person/years of employment. The report thus suggests that Alaska's return on investment from this legislation would be extraordinary;

2.

Assure the continued provision of reasonably priced refined products to the majority of Alaskans now served by those refiners. For nearly 20 years, the state has successfully pursued a policy of using royalty oil sales to generate

new in-state refining capacity, recognizing that stable and reasonably priced crude supplies were critical to providing Alaskans with reasonably priced refined products. To underscore that linkage between crude supplies and refined product prices, a recent Mapco study found a high correlation (approximately 80%) between crude prices and fluctuations in costs of gasoline and other fuels.

3.

Bring balance to the state's settlement of the Amerada Hess controversy. That litigation involved a dispute over the "value" of North Slope oil. That litigation was settled as a result of negotiations between the state and North Slope producers. The amount of that settlement was financially acceptable to those producers, and represented only 6 percent of the assessed value of their North Slope property. On the other hand, the state is now attempting to apply that settlement to its royalty oil purchasers, even though: (1) the State consistently maintained that these purchasers were precluded from participating in *Amerada Hess* negotiations; and therefore could not protect their interests through that process; and (2) the state's demands represent up to **100%** of the assessed valuation of these purchasers' property in **the entire state**. Moreover, the amount the state would seek to claim from these purchasers--about \$300 million--is nearly half the \$700 million that the state accepted from North Slope producers. This despite the fact that in-state refineries have taken only about 4% of all crude oil from the North Slope since Prudhoe Bay came into production.

* * *

Particularly in light of the ECO Northwest report, it appears that the direct returns to the public from this proposal will substantially exceed any reduction in state revenues. And as an investment in the economy, it is consistent with a number of other state programs designed to stimulate the private economy through government activism. Two questions that have been asked about the

proposed legislation focus on private benefits that could accrue from the legislation; however, there are significant public benefits of the proposals.

I. Isn't this Legislation Just A Subsidy for In-State Refiners?

No. It is, in fact, a firmly engrained concept in both federal and state revenue policy. The federal government long ago enacted the investment tax credit, which foregoes tax revenues when taxpayers devote resources to new capital investment. Not only has Alaska followed suit with a general investment tax credit ^{1/}, it has also enacted a special, more generous tax credit for new gas processing facilities and new mineral exploration. AS 43.20.042. Over the past six years, Alaska has also granted a tax credit from the fisheries tax--for new fisheries investment. AS 43.75.032.

The capital credit legislation now being discussed has a number of safeguards not present in other private-sector investment initiatives: (1) the credit cannot be granted if the particular investment will not yield benefits justifying the credit; (2) the time period for taking these credits is limited; and (3) credits cannot be taken for investments that pre-date passage of the law, or which are already compelled by law (such as mandatory pollution control equipment).

Whenever government proposes to invest in its economy, the issue can't be "is it a subsidy," because every government entry into the private sector will yield direct benefits to some identifiable businesses. The issue, rather, must be "*is it a good investment in terms of public benefits that will result.*" The ECO Northwest report prepared for Tesoro strongly suggests that, more so than in many cases, the capital credit legislation is a very good investment indeed.

^{1/} AS 43.20.021(d).

II. Why Should Only Purchasers of Royalty Oil Have This Program, Rather than All Taxpayers?

No other "taxpayer" has purchased royalty oil, and then been asked to retroactively pay more than they were originally charged. The amount sought from the royalty purchasers covered over ten (10) years of purchases with the oil processed and sold many years ago with the benefits of the lower crude oil prices enjoyed by the Alaska Consumer.

- As we have seen, the royalty oil purchasers are being asked to bear a disproportionate share of the *Amerada Hess* controversy--with demands against them approaching 100% of the assessed value of their Alaska property. And, even though in-state refiners have received only 4% of the North Slope crude oil they are being asked to pay approximately 30% of the total that the state hopes to receive from its *Amerada Hess* claims. The legislation, in part, is therefore aimed not at creating disparity, but curing it.

The issue isn't whether one industrial sector might benefit from a particular legislation program, but whether the public benefits from that program outweigh the costs to the government. Every economic incentive program brought to the legislature must be judged under that yardstick, and we're confident that the capital recovery legislation will pass it.

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

WALTER J. HICKFI, GOVERNOR

P. O. BOX K—STATE CAPITOL
JUNEAU, ALASKA 99811-0300
PHONE: (907) 485-3800

August 17, 1992

Mr. James E. Barnes
Chairman and Chief Executive Officer
MAPCO, Inc.
P. O. Box 645
Tulsa, OK 74101-0645

Dear Mr. Barnes:

To avoid any misunderstanding about our discussions concerning the state's enforcement of its royalty-in-kind claim against MAPCO, I want to relate in writing my understanding of the state's commitment to you. There is too much at stake for us to have anything less than a clear understanding of our "agreement."

You will recall that when we met in Seattle, MAPCO asked for equitable reasons to be exonerated from the \$108 million claim. I replied that as Attorney General I had no authority, statutory or otherwise, to accede to that request. Moreover, I said that in my view, no one in the Executive Branch had that authority. I added, however, that MAPCO could, of course, present its equitable arguments to a court and that the legislature was another forum to which MAPCO may wish to turn.

You then expressed a desire to address your request to the legislature and asked that the state not send a formal bill or sue MAPCO until MAPCO had an opportunity to ask the legislature to forgive the obligation. I responded that the state would defer enforcement actions, provided Commissioner Olds agreed and the state and MAPCO immediately undertake serious settlement negotiations. Underlying my response was my view that the state could not allow itself to be prejudiced by allowing MAPCO this opportunity. You agreed that MAPCO would work cooperatively toward settlement during the interregnum.

We also talked about MAPCO's conversations with other RIK purchasers. The state's representatives expressed concern about

Mr. James E. Barnes
Chairman and Chief Executive Officer
MAPCO, Inc.

August 17, 1992
Page 2

those conversations.¹ At the close of the meeting, I told you that I would consider MAPCO's request to defer action and get back to you in about three weeks.

The state cannot defer formally billing MAPCO and filing suit beyond February 15, 1993. That allows MAPCO ample time to approach legislators before the session begins and to obtain any relief which the legislature is willing to grant. Any further delay will, in my judgment, prejudice the state. So long as MAPCO satisfies the following conditions, the state will not, prior to February 16, 1993, formally bill or sue MAPCO to enforce its royalty-in-kind obligation:

1. Signs the Tolling Agreement sent to MAPCO in July 1992;
2. Produces by September 15, 1992, the documents requested by the state in July 1992, and produces other documents and responds to other discovery requests in accordance with the Civil Rules as if suit had been filed;
3. Agrees not to object to or ask others to object to joinder of MAPCO in the *ANS Royalty Litigation* (1JU-77-847, pending in the Juneau Superior Court and scheduled for trial beginning in 1994), agrees that the state's RIK claim against MAPCO will be tried as part of that action, and agrees that if joinder is not permitted by the court that the action will be filed and tried in the Juneau Superior Court;
4. Negotiates in good faith with the state's settlement team between now and February 16, 1993, to resolve the claim;
5. Refrains from asking other royalty-in-kind purchasers not to pay their obligations or negotiate settlements with the state.

I remain at liberty to oppose MAPCO's request to the legislature and cannot, in good conscience, support MAPCO or remain silent if MAPCO asks the legislature to cancel the obligation. The state sold roughly half of its royalty oil to MAPCO and other royalty-in-kind purchasers. More than \$25 million of MAPCO's

¹ Recently, I have heard of repeated instances in which MAPCO representatives have spoken with other RIK purchasers about the pending claims. Implicit in these conversations, according to reports reaching me, have been urgings by MAPCO that the RIK bills not be paid and settlements not be reached. I find those conversations troubling.

Mr. James E. Barnes
Chairman and Chief Executive Officer
MAPCO, Inc.

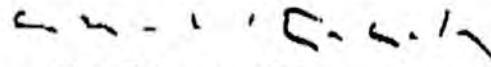
August 17, 1992
Page 3

obligation belongs to the Permanent Fund. The state charged MAPCO less than MAPCO would otherwise have paid. MAPCO knew, in the words of the contract, that a "potentially large" price adjustment was possible and the contract provided for a long term payment of the obligation. MAPCO has the right to pay the obligation over approximately 10 years and we believe it only fair that it do so.

I believe that this proposal fairly accommodates your request without prejudicing the state's position. I have thought through the proposal very carefully and do not wish to negotiate it further. If MAPCO accepts these conditions, please sign the enclosed copy of this letter and return it to me with an executed copy of the Tolling Agreement by August 28, 1992. If MAPCO does not accept these conditions or, having accepted them, fails in the state's judgment to adhere to them, the state will immediately formally bill MAPCO and file suit to enforce its claim.

The state's representatives and I enjoyed the opportunity to meet with you and your group in Seattle. I hope that our next meeting will be before Thanksgiving to sign a settlement agreement.

Very truly yours,



Charles E. Cole
Attorney General

CEC:tg

MAPCO accepts and will abide by the conditions in this letter.

James E. Barnes
August ____, 1992

cc: The Honorable Walter J. Hickel
Governor

Patrick Ryan
Chief of Staff
Office of the Governor

Mr. James E. Barnes
Chairman and Chief Executive Officer
MAPCO, Inc.

August 17, 1992
Page 4

Hon. Glenn Olds, Commissioner
Department of Natural Resources

Jim Eason, Director
Division of Oil and Gas
Department of Natural Resources

Bruce Botelho, Deputy Attorney General
Department of Law

Patrick Coughlin, Assistant Attorney General
Department of Law

Julian Mason
Ashburn & Mason

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

WALTER J. HICKEL, GOVERNOR

REPLY TO:

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☐ KEY BANK BUILDING
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March 23, 1993

MAR 23 1993

The Honorable Loren Leman
Chair
Senate Oil and Gas Committee
Alaska Senate
Room 113
State Capitol
Juneau, AK 99801-1182

Re: State of Alaska
Royalty-In-Kind (RIK)
Oil Sales Agreements

Dear Senator Leman:

This letter responds to questions asked during hearings of the Senate Oil and Gas Committee held on March 16 and 17, 1993, regarding the state's RIK oil sales agreements.

The state has 12 long-term RIK sales contracts with retroactive price adjustment clauses tied to the resolution of the *ANS Royalty Litigation*.¹ These contracts are with Chevron, Golden Valley Electric Association ("GVEA"), MAPCO, Petro Star, and Tesoro.

Purchaser

Contract/Date

Chevron

"Chevron-1" (Mar. 10, 1980)
"Chevron-2" (Nov. 30, 1982)
"Chevron-3" (Dec. 9, 1983)
"Chevron-9" (Dec. 9, 1985)

GVEA

"GVEA-1" (Apr. 12, 1977)
"GVEA-2" (May 9, 1984)
"GVEA-3" (Feb. 8, 1985)

¹ The *ANS Royalty Litigation* was originally captioned *State of Alaska, et al. v. Amerada Hess Corp., et al.* The retroactive price adjustment clause is frequently referred to as the *Amerada Hess* price adjustment provision.

MAPCO²
Petro-Star
Tesoro

"North Pole-1" (Mar. 27, 1978)
"Petro-Star-1" (Dec. 9, 1985)
"Tesoro-1" (Mar. 10, 1980)
"Tesoro-2" (Mar. 10, 1980)
"Tesoro-4" (Feb. 26, 1982)
"Tesoro-5" (Dec. 9, 1983)

The state's claims under these contracts, inclusive of interest through October 1992, totals \$326 million. Table I attached to this letter summarizes these contracts and the amounts the state is owed under each. Table II shows the interest rate to be applied to the debt owed under each contract.

Retroactive *Amerada Hess* price adjustment provision was uniformly inserted into all long-term RIK oil sale contracts under a policy adopted in May 1977 by the Alaska Royalty Oil and Gas Development Advisory Board ("Royalty Board"). This policy declared that the base-line price of any royalty oil or gas taken in kind and sold by the state should be no less than the state would otherwise have received had it taken its royalty in value (i.e., in money).

There have been two limited exceptions to this long-standing practice of inserting *Amerada Hess* clauses into North Slope oil RIK sales contracts. IN December 1980 and in December 1984 the state sold North Slope oil at competitive auction. These were all short-term contracts which provided for delivery periods of a maximum of one year. Obviously, imposing a retroactive pricing provision with an uncertain time for resolution would have had a potentially depressing effect on the prices bid

² Under a February 8, 1985 State-GVEA-MAPCO agreement which was executed contemporaneously with the GVEA-3 contract, MAPCO agreed to assume substantially all of the GVEA's liability for the oil sold under that contract in consideration of the state's consent to GVEA's assignment of that oil to MAPCO.

Representatives of GVEA have recently informed the state's *ANS Royalty Litigation* attorneys that MAPCO has assumed GVEA's entire liability under all three of the GVEA contracts under a separate side agreement between MAPCO and GVEA to which the state is not a party.

MAPCO's contract is identified here as "North Pole 1" because the original purchaser was the North Pole Refining division of Earth Resources Company of Alaska. MAPCO acquired ERCA in late 1980 or early 1981, under a tender offer. That corporate acquisition was the means by which MAPCO succeeded to the North Pole-1 contract.

at those auctions. Accordingly, none of the contracts involving the oil auctioned in December 1980 or December 1984 had Amerada Hess clauses.

All of the contracts itemized above contain interim price formulas. Over the period of time reflected in the attached table, the state has used two different interim price formulas. During the tenure of Robert E. LeResche as Commissioner of Natural Resources, the interim formula was the so-called "Exhibit B" formula. A copy of Exhibit B to the North Pole-1 contract is enclosed with this letter.³

When John Katz succeeded Mr. LeResche as commissioner in July 1981, he concluded that the Exhibit B formula was too hard to administer and too confusing for many potential purchasers of RIK. Accordingly, Katz adopted the so-called "weighted-average" interim formula. With the exception of the December 1984 competitive sale noted above, under this formula, the interim price invoiced by the state equalled the monthly weighted average of the royalty values reported by the North Slope producers. All of the RIK contracts entered into from and after February 1982 contain the weighted-average interim formula.

How the Exhibit B interim pricing mechanism was intended to work and the scope and magnitude of retroactive price adjustments contemplated by Exhibit B is a matter of contention between Tesoro and the state and between MAPCO and the state. In November 1986, Natural Resources Commissioner Esther Wunnicke issued 30 pages of interpretative findings with respect to Exhibit B, which Tesoro then challenged by an administrative appeal. *Tesoro Alaska Petroleum Co. v. State*, Case No. 3AN-86-15298 Civil. On July 19, 1990, following a remand order issued by Judge Shortell in this litigation, Natural Resources Commissioner Lennie Gorsuch issued 84 pages of findings on remand reaffirming the Wunnicke findings. Tesoro's administrative appeal of the Gorsuch finding was settled recently.

On or about September 9, 1992, MAPCO initiated litigation against the state in Anchorage Superior Court which also

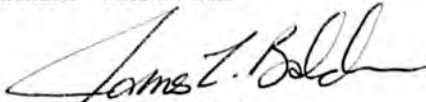
³ The following contracts all incorporated the Exhibit B interim pricing formula: Chevron-1, GVEA-1, North Pole-1, Tesoro-1, and Tesoro-2. In addition, the Alpetco contract (executed February 22, 1978) also incorporated the Exhibit B formula. The Alpetco project, a proposed world-scale petrochemical complex to be located in Valdez, failed in 1981. The state's retroactive price adjustment claims against Alpetco and its successor Alaska Oil Company were settled in bankruptcy proceedings in 1982-1983.

turns on the issue of how Exhibit B was designed to function. *MAPCO Alaska Petroleum Inc. v. State*, Case No. 3AN-98-7813 Civil.⁴ Litigation is also pending between the state and Chevron on similar retroactive reimbursement clauses.⁵ Table III attached to this letter shows the present value of the repayment stream under MAPCO's main (North Pole) contract. Table III depicts the present value under three assumed discount rates. The table also shows the opportunity cost to the state of MAPCO's interest free possession of the reimbursements for approximately 12 years.

If you would like further briefing about Exhibit B or the issues involved in the Tesoro or MAPCO lawsuits, or if anything in this letter is unclear, please do not hesitate to contact me.

Sincerely,

CHARLES E. COLE
ATTORNEY GENERAL

By: 
James L. Baldwin
Assistant Attorney General

JLB:tg
Attachment

⁴ Also, on August 26, 1992, MAPCO's litigation counsel John A. Donovan wrote Natural Resources Commissioner Olds demanding that the state submit to arbitration with MAPCO under the GVEA-1 contract. The state believes that there is no agreement between it and MAPCO under which MAPCO is entitled to arbitrate, and has commenced action in Juneau Superior Court for a judicial declaration to this effect. *State v. MAPCO Alaska Petroleum Inc.*, Case No. 1JU-92-1684 Civil.

⁵ *In the Matter of ANS Royalty Litigation*, (Chevron counter-claim), Case No. 1JU-77-847; *Chevron U.S.A. v. Tesoro Petroleum Co.*, Case No. 949111 (Cal. Superior Court).

TABLE I

Summary of Retroactive Price Adjustments for Royalty In-Kind Contracts¹

Contract For Royalty In Kind Sales	Principal Amount of Retroactive Price Adjustments	Interest On retroactive Price Adjustments ²	Total Interest and Principal
Tesoro 1	\$ 574,649	\$ 827,393	\$ 1,402,043
Tesoro 2	(89,369)	(132,755)	(222,123)
Tesoro 4	86,056,559	64,950,524	151,007,083
Tesoro 4/Chevron	(21,311,855)	(23,529,590)	(44,841,445)
Tesoro 5	<u>(5,596,229)</u>	<u>(4,668,827)</u>	<u>(10,285,056)</u>
Sub Total	\$ 59,633,756	\$ 37,426,745	\$ 97,060,501
Chevron 1	\$ 570,268	\$ 813,453	\$ 1,383,721
Chevron 2	10,526,738	11,456,049	21,982,787
Chevron 3	20,698,620	11,488,629	32,187,250
Chevron 9	4,472,284	1,890,338	6,362,622
Petro Star Purchases	1,209,114	522,831	1,731,945
Tesoro Purchases	<u>21,311,855</u>	<u>23,529,590</u>	<u>44,841,445</u>
Sub Total	\$ 58,788,878	\$ 49,700,891	\$108,489,769
GVEA 1	\$ 4,432,954	\$ 4,767,784	\$ 9,200,738
GVEA 2	1,522,287	1,423,029	2,945,316
GVEA 3	<u>4,591,116</u>	<u>1,831,317</u>	<u>6,422,433</u>
Sub Total	\$ 10,546,357	\$ 8,022,130	\$ 18,568,487
Mapco	\$ 51,224,843	\$ 46,816,531	\$ 98,041,374
Mapco TAPS Interest	<u>1,931,294</u>	<u>1,211,107</u>	<u>3,142,401</u>
Sub Total	\$ 53,156,137	\$ 48,027,638	\$101,183,775
Petro Star	\$ 1,498,397	\$ 596,690	\$ 2,095,087
TOTAL	\$183,623,526	\$143,774,094	\$327,397,620

¹ Subtotals may not foot perfectly due to computer rounding conventions.

² Petro Star interest through settlement in September 1992. Tesoro interest through settlement in December 1992. Mapco, GVEA, and Chevron (except Tesoro purchases) through October 1992 billing.

TABLE II
INTEREST RATES USED FOR EACH CONTRACT

CONTRACT	INTEREST RATE
Tesoro 1 & 2, Chevron 1, Mapco (North Pole-1)	Prime + 1.25 percent
Tesoro 4 & 5, Chevron 2, 3, & Tesoro purchases, and GVEA 2 & 3	Prime + 3 percent
Chevron 9 & Petro Star purchases, GVEA 1, and Petro Star	Statutory*

* Statutory interest is 8 percent simple through June 1980; 10.5 percent simple from July 1980 through November 1991; and 11 percent, compounded quarterly from December 1991 to present.

TABLE III

<u>Discount Rate</u>	<u>Present Value of Repayment Stream</u>	<u>Present Value of Transaction</u>
5%	\$35 million	(\$15 million)
10%	\$25 million	(\$25 million)
15%	\$17 million	(\$33 million)

NOTE: MAPCO currently owes \$101 million under the ERCA contract, of which \$51 million is principal. Receiving the principal under MAPCO's conditions would yield a present value as shown above.

RECEIVED

Department of Law

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DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

March 11, 1986

BILL SHEFFIELD, GOVERNOR

REPLY TO:

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

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

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

The Honorable Bill Sheffield
Governor
State of Alaska
P.O. Box A
Juneau, AK 99811

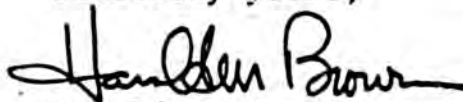
Dear Governor Sheffield:

Enclosed is my office's report on Fairbanks gasoline prices, as requested by your letter of January 13, 1986. As you know, during the last year gasoline prices in Fairbanks have increased, during a time when crude oil prices have decreased substantially.

Our investigation looked at all levels of the gasoline distribution system in Fairbanks: retail, wholesale, distributor, and refinery. Our conclusion is that the higher prices are the result of price increases at the refinery level. That is, the refineries are charging more for refined gasoline, even though they are paying less for the crude oil they use to make the gasoline. This price increase has been entirely passed on through the distribution chain to the Alaska consumer.

There is no law against charging high prices, as far too many Alaskans can testify. However, this situation is particularly deplorable. Alaskans are being paid less and less for the state royalty oil that goes into the refinery, but are being charged more for the product that comes out of the refinery.

Sincerely yours,



Harold M. Brown
Attorney General

HMB:RDM:cck
Enclosure:

cc: Hon. Mike Davis
Alaska State House of
Representatives

FAIRBANKS GASOLINE REPORT

February, 1986

The Fairbanks North Star Borough Assembly passed a resolution on December 9, 1985, requesting that the Governor investigate the price of gasoline and fuel oils in Interior Alaska. The Assembly asked for an explanation of why retail prices for gasoline and fuel oils in Interior Alaska have increased during a time when (1) world oil prices have declined, (2) the supply of crude oil exceeds the demand, and (3) retail gasoline and fuel oil prices have declined in many Lower 48 markets. The Governor referred the matter to the Attorney General for investigation.

The Attorney General's investigation focussed primarily on the price of motor gasoline at the refiner, wholesale, and retail levels in the Fairbanks and North Pole area. Where appropriate, the Fairbanks gasoline market was compared to the Anchorage and Juneau markets. Additionally, the investigation examined the Fairbanks home heating oil market, as requested by the Borough Assembly's resolution.

In preparing this report, the Attorney General's Office interviewed numerous petroleum product distributors, gasoline retailers in Fairbanks and North Pole, state economists, and industry representatives familiar with the Anchorage, Fairbanks,

and Juneau gasoline markets. 1/ Several subpoenas for testimony and documents were issued pursuant to the Attorney General's authority under the Alaska Restraint of Trade Act, AS 45.50.562 -- AS 45.50.596.

This report contains a general summary of our findings. Most of the individuals and corporations who provided information did so under the condition that some or all of the specific information related to us be kept confidential from their competitors. Additionally, information received pursuant to the Alaska Restraint of Trade Act is confidential as a matter of law. AS 45.50.492(e). Therefore, the material presented in this report is of necessity general in nature. In all instances, the prices charged, volumes of gas sold, and other information have been verified independently from more than one source.

A. General Market Characteristics and Comparisons

1. Fairbanks

Most gasoline retailers in Fairbanks purchase their gasoline from independently-owned distributors known as "jobbers," who own bulk fuel storage facilities. The jobbers purchase bulk fuel either from Tesoro's bulk fuel storage

1/ For a more complete description of the Juneau gasoline market, please refer to the Attorney General's report concerning that subject dated May 13, 1985.

facility in Fairbanks, from Tesoro's Nikiski refinery via Alaska Railroad shipments, or from the Mapco refinery in North Pole. The Mapco refinery began selling motor gasoline as of October 31, 1985.

The four motor gasolines sold on the retail level in Fairbanks are Chevron, Tesoro, Texaco, and Union Oil of California. The Chevron, Texaco, and Union jobbers each mix a unique additive package into the Tesoro or Mapco fuel they purchase before selling it as brand-name gasoline.

Within a rough five-mile radius of the downtown Fairbanks core area there are 32 retail gas stations. This area includes the City of Fairbanks and the Chena Gold Stream, University, and Steese fire service areas, and has an approximate population of 48,000 persons. Consequently, there is one gas station in the Fairbanks area for about every 1,500 people. These stations range from complete-service branded gas stations to convenience stores with gas pumps to unbranded "pumps-only" self-serve operations.

2. Anchorage

The Anchorage retail market offers the same four branded motor gasolines sold in Fairbanks. All motor gasolines sold in Anchorage originate from Tesoro's Nikiski refinery. Chevron, Texaco, and Union each have product exchange agreements with Tesoro under which they receive gasoline in Anchorage in

return for delivering a similar quantity of crude oil or refined gasoline to Tesoro at designated Lower 48 locations. Chevron, Texaco and Union "additize" Tesoro gasoline before selling it in the Anchorage area as their own branded product. Unlike the jobber system in Fairbanks, most retailers in Anchorage buy gasoline directly from bulk plants owned by the major companies. There is approximately one gas station for every 2,300 persons in Anchorage.

3. Juneau

Juneau area retailers buy gasoline directly from one of just two bulk fuel suppliers: a Chevron commission agent and a Union distributor. Juneau area gasoline originates from west coast refineries in the Lower 48 and from Tesoro's Nikiski refinery. There is approximately one gas station per 3,200 persons in the Juneau-Douglas area.

B. Alaska Gasoline Retailers Passed on Wholesale Price Increases to Consumers during 1985

According to retail gas price data compiled by the Community Research Center of the Fairbanks North Star Borough, the average per gallon retail price of leaded regular gas in Fairbanks increased by 7.9 cents between January 1985 and December 1985. This figure exceeds the 7.3 cent per gallon increase over the same period in the leaded regular wholesale price by .6 cents per gallon. See Appendix A, Price Comparison Charts, and Appendix B, Price Comparisons.

Fairbanks Community Research Center data shows a 7.4 cent per gallon increase in the average retail price of unleaded regular between January 1985 and December 1985. This also exceeds the 6.8 cents per gallon increase over the same period in the wholesale price paid by Fairbanks retailers by .6 cents per gallon. It appears that Fairbanks retailers passed the wholesale price increases they experienced in the last year on to Fairbanks consumers without significantly increasing their profit margins.

Anchorage retail prices for leaded and unleaded regular gas increased by an average of about 8 cents and 9.7 cents per gallon, respectively, between January 1985 and January 1986. These average retail price increases match the average wholesale price increase of 8.0 cents per gallon during the same period in the case of leaded regular, and slightly exceed the average wholesale price increase of 8.0 cents per gallon in the case of unleaded regular. Thus, Anchorage retailers also passed along wholesale price increases directly to local consumers.

Juneau retail prices for leaded and unleaded gas each increased by an average of 2.5 cents per gallon between January 1985 and January 1986. The retail price increases considerably exceeded the average wholesale price increases of .8 cents (leaded) and 1.8 cents (unleaded) over the same period. Therefore, Juneau retailers not only passed along wholesale price

increases to the local consumer, but increased their profit margins as well.

C. Profit Comparisons

"Gross Profit Margin Per Gallon" is used by the industry to describe the difference between a retailer's per gallon sales price and the per gallon wholesale price, including federal tax (9 cents per gallon), state tax (8 cents per gallon in Alaska) and any local tax (4 percent in Juneau, none in Fairbanks or Anchorage). The "gross profit margin per gallon" is calculated prior to deduction of overhead costs such as utilities, salaries, insurance, rents/mortgages, etc., and often varies according to grade of gasoline (leaded, unleaded, supreme, or diesel), type of service (self-serve or full serve), and method of payment (cash or credit). Many, but not all, stations charge more for credit card purchases than for cash transactions. Sales volume also varies according to grade, type of service, and method of payment.

When the weighted average is computed for all gross profit margins at a particular service station, the result is what the industry refers to as the "pool margin." Pool margins for Fairbanks dealers average about 18 to 22 cents per gallon, as compared to 9 to 11 cents per gallon for Anchorage dealers and about 21 to 23 cents per gallon for Juneau dealers.

FAIRBANKS GASOLINE REPORT

February, 1986
Page 7

Fairbanks dealers pump an average of about 65,000 -- 70,000 gallons of gas per month, although there are a number of gasoline retailers in Fairbanks that sell either substantially above or below that average. At 70,000 gallons per month, and with a 20 cent per gallon pool margin, a Fairbanks retailer's annual gross profits from gasoline sales would total \$168,000.

Anchorage and Juneau dealers, on the average, pump about 100,000 gallons monthly, although as with Fairbanks retailers, there are a number that sell substantially above or below the average. At 100,000 gallons per month, and with a 10 cent per gallon pool margin, an Anchorage retailer's annual gross profits from gasoline sales would total \$120,000. At 100,000 gallons monthly, and with a 22 cent per gallon pool margin, a Juneau retailer's annual gross profits from gasoline sales would total \$264,000. Thus, Fairbanks is squarely in the center of Alaska's three largest cities as far as retail gasoline profits are concerned.

Slightly higher average overall operating expenses translate into an average 3 cents per gallon higher cost of doing business for Fairbanks retailers as compared with their Anchorage counterparts. Utilities and rents/mortgages are chiefly responsible for the operating cost differential between Anchorage and Fairbanks. Salaries paid by Fairbanks retailers are, on the average, only marginally higher than those paid by Anchorage

retailers, and insurance costs run about the same for each location.

Thus, Fairbanks retailers make greater profits per gallon than their Anchorage counterparts. To illustrate, the Fairbanks-Anchorage average retail price differential is 22.5 cents per gallon. Subtracting the 11.8 cent per gallon average wholesale price differential and the 3.0 cent per gallon higher cost of doing business from this figure leaves a 7.7 cent per gallon higher average profit margin for Fairbanks retailers than for Anchorage retailers. This 7.7 cent per gallon difference translates into annual profits of about \$65,000 for the average Fairbanks retailer.

D. Comparative Market Dynamics: Fairbanks and Anchorage

Although Anchorage and Fairbanks are both railbelt communities, the market dynamics of the two cities are quite different. The 22.5 cent per gallon average retail price difference between Fairbanks and Anchorage is only partially explained by the approximately 11.8 cent per gallon higher wholesale prices paid by Fairbanks retailers and the 3.0 cent per gallon higher cost of doing business in Fairbanks.

Anchorage profit margins have been less than half of those of Fairbanks dealers for the last several years. This is primarily because of the presence of high volume discount retailers in the Anchorage market. Low profit margins in

Anchorage means that retail prices there have been held at the lowest levels in Alaska for a protracted period. Industry officials consistently characterize the Anchorage market as "fiercely competitive."

It appears that the absence in Fairbanks of a high volume price cutter along the lines of those currently found in Anchorage has enabled Fairbanks dealers to hold on to their higher profit margins. With one gas station in Fairbanks for every 1,500 people, compared with one for every 2,300 people in Anchorage, competition should be stronger. 2/

E. North Pole: Potential Retail Price Reductions

North Pole is a community of about 1,600 people and is located 13 miles southeast of downtown Fairbanks. There are three gas stations at the intersection of the Richardson Highway and Badger Road/Santa Claus Lane that, according to a November 4, 1985 article in The North Pole Paper, were engaged at the time in a "gas war." All three stations were selling gas at self-serve cash prices of \$1.149 (leaded) and \$1.209 (unleaded), and one

2/ This is not to say that there are no high volume gas stations in the Fairbanks area. Two high volume stations are found in the South Cushman Street area of Fairbanks. However, after differences in wholesale prices and operating costs are taken into account, high volume stations in Fairbanks do not cut prices anywhere near as much as the Anchorage discount stations.

station reportedly claimed to be selling gasoline below cost. During the week of January 13, 1986, prices at these stations had increased slightly to \$1.189 (leaded) and \$1.249 (unleaded). This was roughly 12.5 cents per gallon cheaper than the Fairbanks price.

The prices at the North Pole stations have over a period of months remained at least 12 to 13 cents below average self-serve cash prices in Fairbanks. The station owners we interviewed stated that these low prices were a direct result of intense competition among the three stations for the commuter trade. The North Pole stations still make an approximate 5.0 cents per gallon profit on these sales.

Even though the three North Pole stations are 13 miles from downtown Fairbanks, if this price difference persists over a long period of time, it may very well have a lowering effect on Fairbanks prices. The retailers we interviewed were acutely aware of the North Pole prices. One Fairbanks dealer expressed great concern over this price difference. Another reported that his customers have asked him for explanations of why retail prices are higher in Fairbanks than in North Pole. A third dealer stated that he is watching the gas pricing of the North Pole stations very closely; and that if the North Pole retail marketing strategy of waging gas wars reaches the Fairbanks market, it will have a considerable effect on Fairbanks prices.

F. Heating Oil Prices

Unlike motor gasoline prices, number 1 and number 2 heating oil prices in the Fairbanks areas have been on the decline. The Fall 1985 Community Research Quarterly published by the Fairbanks North Star Borough Community Research Center indicates that the average retail prices for number 1 and number 2 heating oil have decreased by 5.5 cents and 5.2 cents per gallon respectively, between September 1984 and September 1985; (see page 83 of that publication).

The average per gallon price in September 1985 for number 1 heating oil was \$1.098 and the average for number 2 was \$1.04. A January 1986 phone survey of home heating oil prices in Anchorage revealed an average per gallon price for number 1 of \$1.195 and an average price for number 2 of \$1.115. (Both Fairbanks and Anchorage prices cited here are based on automatic delivery of 500 gallons of heating oil.) Thus, home heating oil prices in Fairbanks are not only declining, but also average 9.7 cents (number 1) and 7.5 cents (number 2) per gallon less than Anchorage home heating oil prices.

CONCLUSIONS

A. Higher Margins in Fairbanks Due to Weak Competition

The Attorney General's Office examined the possibility that price differences between Anchorage and Fairbanks are due in part to violations of the state's antitrust laws. However, we have found no evidence to date which indicates any widespread conspiracy on the part of Fairbanks retailers to engage in price fixing, nor is there any indication that such activity has occurred at the jobber or refiner levels. 3/

Instead of uncovering antitrust violations, the investigation revealed that the higher Fairbanks profit margins are the result of unaggressive pricing by retailers. Price competition in the Fairbanks retail gas market is sluggish, despite a comparatively high concentration of retail gas stations. The high per capita gas station ratio in Fairbanks should encourage much more vigorous competition than presently exists.

3/ There are indications that at least one gas station attempted to fix prices by trying to convince a nearby competitor to join in a plan to raise prices. Further investigation, however, revealed that the competitor who was approached with the price-fixing proposal did not agree to it. In the absence of an agreement by two or more competitors to fix, raise, maintain, or otherwise manipulate prices, there is no conspiracy in restraint of trade actionable under state antitrust laws.

Instead, Fairbanks dealers are able to maintain consistently high prices and thus high profit margins. When asked to explain this phenomenon, one Fairbanks dealer offered the following explanation:

Everybody here seems to have a feel for what it costs to operate, and they're not really trying to prove anything to anybody. Tomorrow, if I wanted to, I could knock 10 cents a gallon off of all of my prices. I'll pick up volume for maybe one or two days. But the minute that's up, (my competitors) are going to see that I went down and I guarantee that within two or three days they'll match me. So therefore, there's no advantage for me to be down there. The only advantage is, it would make us all go broke, and that's just common sense. In this area up here, we know that, and we know that's basically how it's worked for years up here. Everybody watches everybody. By watching everybody in that aspect, you really kind of, I would say, control the market. I would never say it's a form of price fixing, but it's a form of maintaining your margins, I would say.

To the extent that these comments are representative of Fairbanks dealers generally, they reflect a less-than-aggressive attitude toward competitive pricing, and are consistent with some of the conclusions reached in a February 1, 1983 report entitled, "Alaska Petroleum Product Pricing" prepared for the Alaska Senate Resources Committee by Louis F. DeLong and Lloyd M. Pernela of Pacific-Alaska, Inc. The DeLong and Pernela report, which covered the period of 1980 -- 1982, arrived at the following conclusions:

The prices of motor gasoline in Fairbanks at the retail level increased significantly during 1980,

a period of increased costs of crude oil. Starting in early 1981 until today (February 1, 1983), gasoline prices have remained steady in spite of significant decreases in crude costs. The motor gasoline retail market has reacted to cost increases on the upside but not on the downside. This lack of a market reaction to declining costs seems to indicate a "structured" noncompetitive retail environment in Fairbanks.

DeLong and Pernela, 1983, at 83.

We were told by several sources that by summer's end this year, between 4 and 12 additional gas stations of various types will have opened in the Fairbanks area. This would result in the highest concentration of gas stations per capita in Alaska, if not in the entire Northwest. There is speculation that these new stations will sell gasoline substantially below current prices to establish a market share. In that event, existing gas stations would be forced to lower prices to preserve their current market share. Whether this scenario actually becomes a reality, of course, remains to be seen.

As matters stand, we conclude that weak competition and tacit agreement between Fairbanks retailers "not to rock the boat" has kept their profit margins high during the last several years. This does not explain, however, why Fairbanks gasoline retail prices have increased during the last year, when in-state oil prices have dropped significantly. The increase in retail prices does not appear to be the result of increased profit margins at the retail level. Rather, the retailers have simply

passed on price increases at the wholesale level to the Fairbanks consumer. These wholesale price increases, we have determined, are due to price increases at the refinery level. 4/

B. Alaska Price Increases Result from High Refinery Prices

The price of crude oil purchased by Tesoro, Alaska's principal in-state refiner of motor gasoline during 1985, is governed largely by a long-term royalty oil supply contract with the State of Alaska. Under this contract, Tesoro's purchase price is set at the weighted average of in value amounts reported monthly by Prudhoe Bay producers and is subject to adjustment in accordance with the current litigation over the value of North Slope oil production. Unlike the rapidly fluctuating world spot prices, the reported in value North Slope royalties, and hence the price under Tesoro's long-term contract, generally react slowly to changes in the world oil market. 5/

4/ See Appendix B. The refinery price for leaded gasoline increased by 6.2 cents per gallon between January, 1985 and January, 1986. The jobbers passed this increase (with a little extra) on to the retailers, increasing the wholesale price by 7.3 cents per gallon during the same period. Unleaded gasoline went up 6.4 cents per gallon at the refinery, and 6.8 cents per gallon at the wholesale level. Thus, the refinery price increase for unleaded was passed-through by the jobbers to the retailers with only a slight surcharge.

5/ Between early December 1985 and mid-February 1986, world spot

The slow decline in royalty contract prices does not provide an explanation of why gas prices in Fairbanks have increased over the last year. Despite a documented one dollar per barrel decline in reported Prudhoe Bay royalty oil prices over the last year, our office has independently verified that Alaska's major gasoline producer has actually raised its selling prices during that time.

Tesoro is the only in-state refiner which produced motor gasoline throughout the entire calendar year 1985. As mentioned earlier, Mapco only started refining motor gasoline as of October 31, 1985. All gasoline sold in Fairbanks and Anchorage is either Tesoro or Mapco gasoline, regardless of what brand name is on the pump. The bulk of Tesoro's Nikiski refinery feedstock in 1985, approximately 40,000 barrels per day, comes

market prices have dropped by more than \$10 per barrel, to the \$15 per barrel range. However, the posted price of a major Prudhoe Bay producer, Sohio, has only fallen \$4 per barrel in that period. Further, that decline did not occur until February 1986.

The decline resistance of North Slope crude oil prices is amplified for in-state refiners since there is a two-month lag period before price changes are passed on to Alaska refiners. This is due to the method used to report and calculate the value of royalty oil. Thus, the current decline in spot market prices will not be reflected in state royalty oil contracts until this spring.

from the long-term state Prudhoe Bay royalty oil contract described above.

Because of the lag in the price changes under the royalty oil contracts, the per barrel price billed to Tesoro for royalty oil in January, 1985 was based on the in value amount reported by the Prudhoe Bay producers for the month of November 1984. That price, as most recently revised, was \$17.96 under Tesoro's 40,000 barrel-per-day contract.

The per barrel price billed to Tesoro under the same contract in January 1986, based on November 1985's reported in value amount, was \$16.99. Therefore, the per barrel price paid by Tesoro for the bulk of its 1985 Prudhoe Bay feedstock decreased by 97 cents between January 1985 and January 1986. This amounts to a 2.3 cent reduction on a per gallon basis.

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.

Conversely, reductions in crude acquisition costs during 1985, insofar as such data is available to us, do not appear to have been passed along by the oil companies. In this regard, the DeLong and Pernela report, on page 82, asserts that one reason Alaska refineries are highly profitable is that "... the reductions in crude pricing are not being reflected in the Alaska market price of the refined products."

A sustained lowering of crude supply prices, in traditional economic theory, should result in an eventual lowering of retail prices to consumers. However, Alaska refiners appear to be stretching their profit margins by increasing their prices despite the lower cost of crude oil. As reported in an Anchorage Daily News article dated February 12, 1986, titled "Alaska Won't See Cheaper Gas Soon," oil industry officials expressed uncertainty as to whether and when Alaska's consumers will benefit from the kind of retail gas price reductions currently enjoyed by consumers in many Lower 48 markets. The consumer certainly will not see lower gas prices at the pump when prices at the refinery are going up.

APPENDIX A
PRICE COMPARISON SHEET
(Self-Serve Cash Prices)

I. January 1985 Leaded Regular Gas Average Per Gallon Prices

	Fairbanks	Anchorage	Juneau
Average Jobber Buying Price	\$1.031	\$0.943	N/A
Average Wholesale Price	\$1.080	\$0.955	\$1.165
Average Retail Price	\$1.237	\$0.990	\$1.405
Average Retail Profit Margin	\$0.157	\$0.035	\$0.240

II. January 1986 Leaded Regular Gas Average Per Gallon Prices

	Fairbanks	Anchorage	Juneau
Average Jobber Buying Price	\$1.093	\$1.008	N/A
Average Wholesale Price	\$1.153	\$1.035	\$1.173
Average Retail Price	\$1.316	\$1.070	\$1.430
Average Retail Profit Margin	\$0.163	\$0.035	\$0.257

III. January 1985 Unleaded Regular Gas Average Per Gallon Prices

	Fairbanks	Anchorage	Juneau
Average Jobber Buying Price	\$1.077	\$0.989	N/A
Average Wholesale Price	\$1.132	\$1.002	\$1.205
Average Retail Price	\$1.301	\$1.070	\$1.464
Average Retail Profit Margin	\$0.169	\$0.068	\$0.259

IV. January 1986 Unleaded Regular Gas Average Per Gallon Prices

	Fairbanks	Anchorage	Juneau
Average Jobber Buying Price	\$1.141	\$1.056	N/A
Average Wholesale Price	\$1.200	\$1.108	\$1.223
Average Retail Price	\$1.375	\$1.167	\$1.489
Average Retail Profit Margin	\$0.175	\$0.059	\$0.266

Note: All prices include 17 cents federal/state tax.

APPENDIX B
PRICE COMPARISONS

I. JOBBER BUYING PRICES

Many fuel purchaser who buy motor gasoline at jobber buying prices hold a qualified dealer's license which enables them to make fuel purchases on a tax-exempt basis. Some companies who are not qualified dealer license holders are able to purchase motor gasoline from an oil company at jobber buying prices, but such purchases are not tax-exempt. For the sake of uniformity and for ease of comparison with wholesale and retail prices presented later in this report, the jobber buying prices presented in this section are inclusive of federal and state tax.

A. Fairbanks

In January 1985, the average per gallon price of gasoline paid by Fairbanks jobbers to the major oil companies, including 17 cents federal/state tax, was \$1.031 for leaded regular and \$1.077 for unleaded regular. By January 1986, the average price for these products had increased to \$1.093 (leaded) and \$1.41 (unleaded). This resulted in an average per gallon increase over the last year of 6.2 cents (leaded) and 6.4 cents (unleaded).

B. Anchorage

Even though most Anchorage retailers do not buy gasoline from jobbers, the major oil companies maintain jobber buying prices for the Anchorage area, as some retailers are served by

jobbers. In January 1985, the average per gallon jobber buying price of gasoline in Anchorage, including 17 cents federal/state tax, was \$.943 (leaded) and \$.989 (unleaded). By January 1986, these averages had increased to \$1.008 (leaded) and \$1.056 (unleaded), representing average per gallon annual increases of 6.6 cents and 6.7 cents, respectively.

C. Juneau

Since branded motor gasolines in Juneau are sold to retailers by bulk facilities owned by Chevron and Unocal rather than by independently-owned jobbers, no jobber buying prices are available for Juneau.

D. Fairbanks/Anchorage Jobber Buying Prices

In January 1985, Fairbanks jobber buying prices averaged 8.8 cents per gallon higher than for both leaded and unleaded gasoline than Anchorage jobber buying prices. In January 1986, Fairbanks jobber buying prices averaged 8.5 cents per gallon higher for both leaded and unleaded gasoline than Anchorage jobber buying prices.

II. WHOLESALE PRICES

A. Fairbanks

In January 1985, the average per gallon delivered wholesale price of gasoline paid by Fairbanks retailers, including 17 cents federal/state tax, was \$1.08 for leaded regular and \$1.132 for unleaded regular. By January 1986, the

average price paid by Fairbanks retailers for these products increased to \$1.153 and \$1.20 respectively. Thus, over the last year, the average wholesale price increased by 7.3 cents per gallon for leaded regular and 6.8 cents per gallon for unleaded regular.

B. Anchorage

In January 1985, the average per gallon delivered wholesale price of gasoline paid by Anchorage retailers was \$.955 for leaded regular and \$1.002 for unleaded regular. By January 1986, these averages increased to \$1.035 and \$1.108 respectively. Thus, over the last year, the average wholesale price increased by 8.0 cents per gallon for leaded regular and 8.0 cents per gallon for unleaded regular. In early 1985, Anchorage average wholesale prices were lower than those in Seattle. However, at present, Seattle wholesale prices average about 10 cents lower than those in Anchorage.

C. Juneau

In January 1985, the average per gallon delivered wholesale price of gasoline paid by Juneau retailers was \$1.165 for leaded regular and \$1.205 for unleaded regular. By January 1986, these figures were \$1.173 and \$1.223 respectively. This represents an average net increase of .8 cents (leaded) and 1.8 cents (unleaded) as between January 1985 and January 1986. However, Juneau wholesale prices actually rose to a mid-1985

average of about 4 cents per gallon higher than 1985 year-end levels.

D. Fairbanks/Anchorage/Juneau Wholesale Price Comparison

In January 1985, Fairbanks retailers paid an average of 12.5 cents per gallon more for leaded regular and 13.0 cents per gallon more for unleaded regular than did Anchorage retailers. At the same time, Juneau retailers paid an average of 8.5 cents (leaded) and 7.3 cents (unleaded) per gallon more than Fairbanks retailers.

In January 1986, Fairbanks retailers paid an average of 11.8 cents per gallon more for leaded regular and 11.8 cents per gallon more for unleaded regular than did Anchorage retailers. In the same month, Juneau dealers paid an average of 2.0 cents (leaded) and 2.3 cents (unleaded) more than Fairbanks retailers.

Freight and loading costs associated with transporting motor gasoline from Anchorage to Fairbanks have ranged from about 9 to 12 cents per gallon, depending upon the quantity of fuel shipped.

III. RETAIL PRICES

A. Leaded Regular

During the week of January 13, 1986, with one or two exceptions, cash prices for self-serve leaded regular gasoline in the Fairbanks area (excluding North Pole) ranged from \$1.279 to \$1.349 per gallon, and averaged \$1.316 per gallon. During the

same week, leaded gas at self-serve cash prices in Anchorage sold at between \$1.039 and \$1.099, with an average of about \$1.07 per gallon. In Juneau, with one or two exceptions, self-serve cash prices for leaded regular ranged from \$1.319 to \$1.469, with an average of \$1.43 per gallon.

B. Unleaded Regular

During the week of January 13, 1986, with one or two exceptions, cash prices for self-serve unleaded regular gasoline in the Fairbanks area ranged from \$1.319 to \$1.409 with an average of \$1.375. Unleaded self-serve cash prices in Anchorage during the same week ranged from \$1.139 to \$1.199, and averaged about \$1.167. In Juneau, with one or two exceptions, unleaded regular cash prices ranged from \$1.369 to \$1.519, and averaged \$1.489. (Note: For about a 35-day period at the end of 1985, several Juneau retailers lowered their prices by approximately 20 cents per gallon.)

C. Average Retail Price Comparisons

Fairbanks leaded regular self-serve cash prices during the week of January 13, 1986 averaged 24.6 cents per gallon higher than those in Anchorage, and 11.4 cents per gallon lower than those in Juneau. Fairbanks unleaded regular self-serve cash prices during the same week averaged 20.8 cents per gallon higher than those in Anchorage, and 10.5 cents per gallon lower than those in Juneau. Overall, Fairbanks self-serve cash prices

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averaged about 22.5 cents per gallon higher than Anchorage prices, and about 11.0 cents per gallon lower than Juneau prices during mid-January 1986.