

ALASKA LEGISLATURE SPECIAL COMMITTEE/SUBJECT FILES 8672

2352 SCOMM 99 • HOUSE SPEC. WORLD TRADE...RELATIONS, 1995-1996 647

reservoir rock. All are currently in a non-producing status and most will require further exploration/delineation before development decisions can be made.

Consequently, where data are missing, comparisons to producing North Slope fields, empirical relationships developed by industry, and personal knowledge are used in forecasting rates, reserves, operating costs, and development investments. It is assumed that existing technology could be adapted to the arctic North Slope developments or that technology can be developed to meet the particular conditions that would be encountered. For example, technology will have to be proven for the development of Northstar and Sandpiper that are about 9 mi offshore in 50 ft of water, and Point Thomson where highly deviated wells will encounter an overpressured reservoir. In addition, it appears that added study would be helpful in determining the best recovery and completion methods for West Sak.

Even the smallest of the five NES fields would be a major economic discovery in the Lower 48. However, the high investment and operating costs on the North Slope and technical constraints such as lack of availability of MI and a gas sales pipeline make development of any of the fields questionable at this time. Even though a large gas reserve exists at Point Thomson, it is not large enough by itself to justify a gas sales line for North Slope gas. A gas cycling project for liquid recovery at Point Thomson was not analyzed, but development on this basis could become feasible if additional large discoveries are made and developed that would support the development of a pipeline and related infrastructure, such as the strike announced on October 15, 1992 by ARCO at the ARCO Kuvlum No. 1 in the eastern Beaufort Sea 60 mi east of Prudhoe Bay and 16 mi offshore.

Investments are forecast taking into consideration each field's particular circumstances, such as location, size of accumulation, possibility of facilities sharing, estimated maximum recovery rate, and timing of development. Total estimated recoverable hydrocarbons are 1,055 MMB and 4.4 TCF (Point Thomson 5 TCF case) of natural gas and total investment requirements are \$9.4 billion in 1992 dollars as shown in Table 2.

Sensitivity Analysis—The components of the economic evaluation are (a) revenue, (b) operating costs, (c) investment, and (c) taxes and royalties. These components are driven by (a) oil and gas prices, (b) technical aspects of the accumulation, (c) environmental and regulatory issues, (d) federal and state revenue needs, (e) cost reduction measures used by the industry, and (f) technical advances. For example, the costs of environmental/regulatory requirements are included in both operating costs and

Table 2. Forecasts of recoverable hydrocarbons and investments for the five NES fields.

Field	Liquids (MMB)	Gas (TCF)	Investments - \$MM (1/1/92\$)	1st Year Production	Forecast Life
West Sak A	502	(a)	4,078	2001	2013
West Sak B	106	(a)	1,085	2008	2013
Point Thomson - 5 TCF ^a	112	4.4	1,579	2008	2035
Point Thomson - 3.4 TCF ^b	99	3.0	1,367	2008	2026
Gwydyr Bay	48	(a)	340	1999	2014
Northstar	200	(a)	1,405	1998	2012
Sandpiper	87	(a)	860	2000	2012

a. No estimate made - gas used in field operations only.
b. Condensate and NGL reserves limited by TAPS shutdown at 200 MBPD (2014) and gas sales less CO₂ and NGL.

investments. Initial planning and coordination with regulating agencies can potentially reduce some of the uncertainty associated with environmental and regulatory costs but cannot be expected to eliminate them. Operating costs are affected through such things as the labor costs to perform environmental assessments, permitting activities, increased fluid handling costs, waste management, and mitigation requirements. Investments, and sometimes reserves, have been affected by requirements for causeway breaches and alternate or less optimum pad locations; e.g., events at Endicott, Point McIntyre, and Niakuk provide examples of effects of the causeway issues and Kuparuk Drillsite 3-L illustrates effects that can result from pad location issues. The comparison of the Niakuk onshore project with the offshore Niakuk project illustrates the effects environmental requirements can have on reserves and economics. The proven and potential reserves for the onshore project are estimated to be 70.4 MMBO compared 99.0 MMBO for the original offshore project resulting in a potential loss of reserves of 29 MMBO. The cash flow to industry and revenue to the state of Alaska and federal government are reduced by a total of \$135 MM (1/1/92\$) using the NES Low oil price scenario. Project delays causing increases in time between investments and production also affect the economics of projects and illustrate the importance of early planning and cooperation by industry and regulating agencies.

Decreases in operating costs and investments and increases in reserves can be achieved through improved technology for drilling, facility design, production technology, streamlining of environmental permitting, reduced costs of environmental compliance, and improved recovery processes.

The magnitude of the impact on project economics by changes (on the order of 10 to 15%) in selected factors and combinations of factors for the five NES fields show that various combinations of reductions in investments and operating costs, reserves increases, and reductions in taxes, royalties, and net profits interests could potentially provide rates of return between 10 and 15% for portions of West Sak, Point Thomson, Gwydyr Bay, and Seal Island/Northstar. Basic technical requirements for development to be feasible include availability of MI for West Sak, a gas pipeline from the North Slope for Point Thomson, confirmation of adequate reserves in Gwydyr Bay, and adaptation of existing offshore pipeline technology to arctic North Slope environments for development of Seal Island/Northstar.

Summary Observations

(1) Under the assumptions used, the economic results for three of the five NES fields (West Sak, Point Thomson, and Gwydyr Bay) indicate that only price forecasts with significant real growth can provide industry with a positive PW at a discount rate of 10%. The two offshore fields (Seal Island/Northstar and Sandpiper) do not provide a positive PW at a 10% discount rate for any of the price scenarios.

(2) The economic sensitivity analyses show that combinations of reduced operating costs, investments, tax and royalty rates, net profits interests, and increased reserves could make development of these five fields potentially economic provided the following requirements are met:

- MI is available for use in West Sak, which will be at least third after PBU and KRU.
- A gas sales line is developed for PBU gas before Point Thomson can be developed.
- The potential reserves at Gwydyr Bay must be proven and the uncertainty of costs related to development in the Kuparuk River delta resolved.
- The Northstar Unit does not appear feasible without removal of the NPI burden.
- Larger reserves at Sandpiper must be confirmed.

(3) The Alaska North Slope production profile (Figure 1) is based on the EIA Mid-level oil price. At these prices, using a cut-off of a 10% discount rate, West Sak, Point Thomson, and Gwydyr Bay provide a positive PW and are included in the production profile. Point Thomson and Gwydyr Bay also provide a 10% rate of return at the NES Low oil price. Seal Island/Northstar and Sandpiper do not meet this economic hurdle rate and are not included. At the EIA Low oil price case none of the five NES fields provide a positive PW at a 10% discount rate and result in an Alaska North Slope production profile as shown in Figure 2.

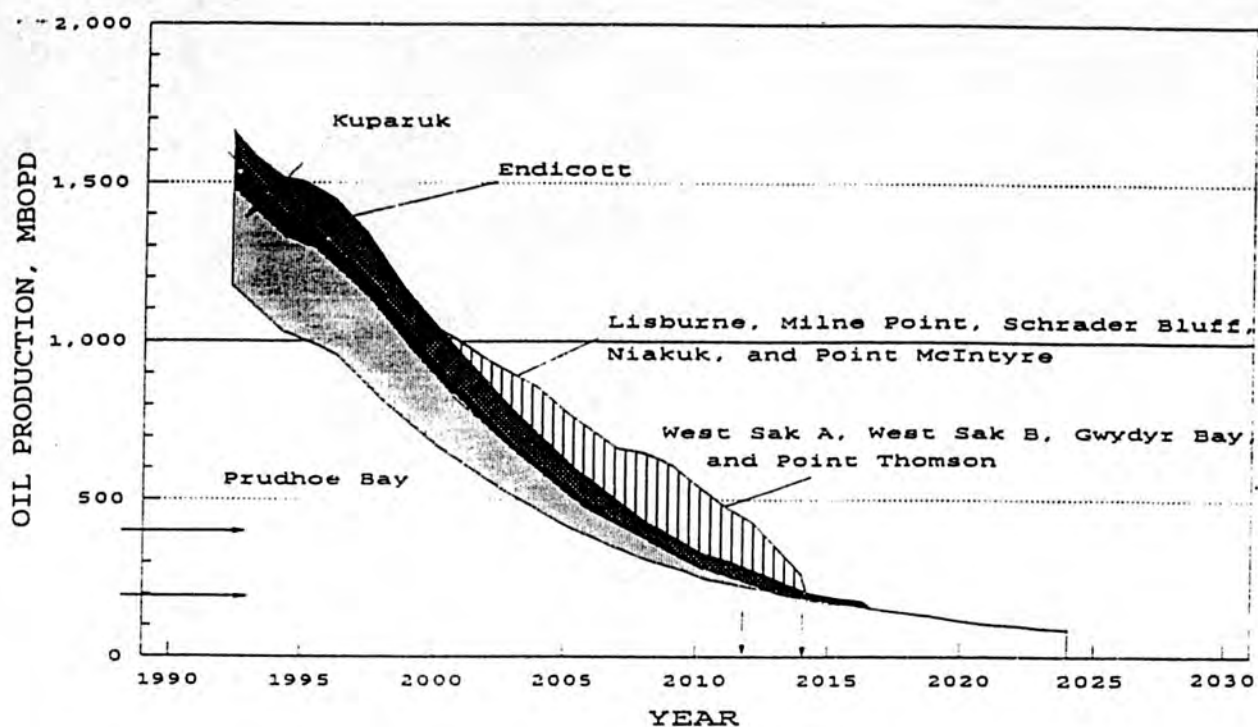


Figure 1. Alaska North Slope production rate forecast including forecasted production from West Sak, Point Thomson, and Gwydyr Bay (arrows indicate the potential range of TAPS shutdown).

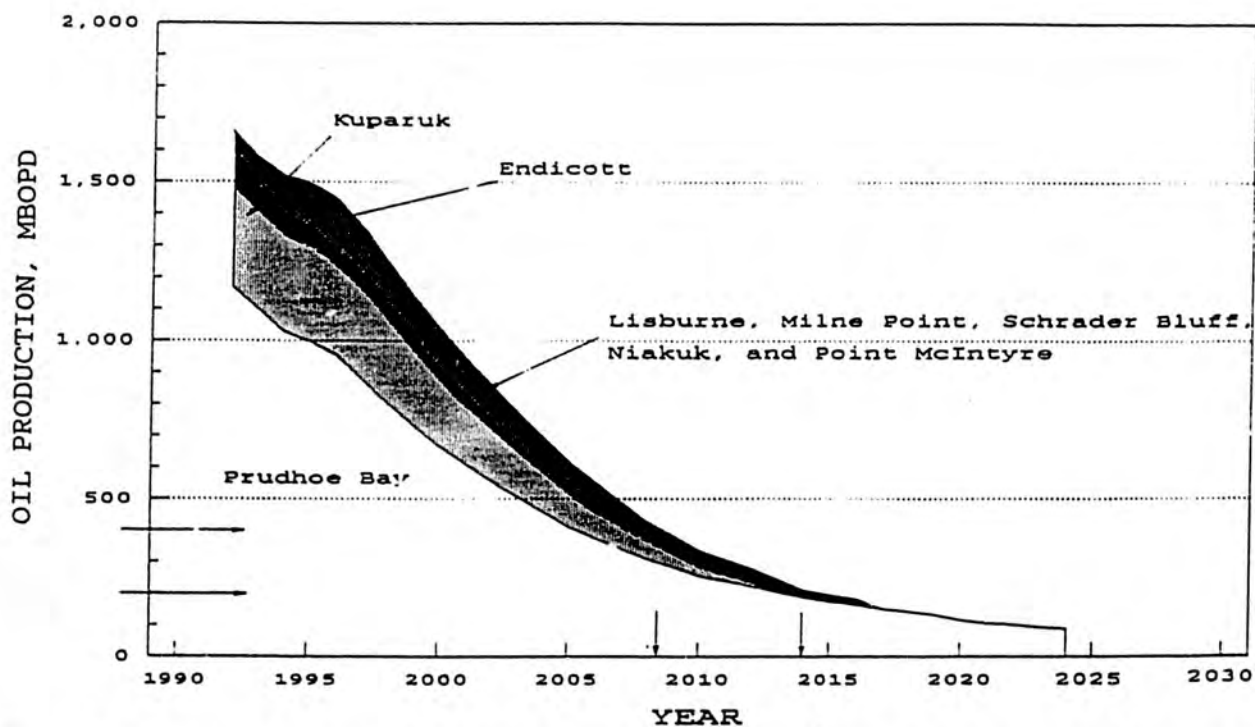


Figure 2. Composite production for seven North Slope fields (arrows indicate the potential range of TAPS shutdown).

(4) ... Alternate investment opportunities would be expected to seriously compete with the investment capital for the five NES fields at any oil price that provides industry with only a 10% rate of return.

(5) State benefits from the development of each of the five NES fields are significant. Federal benefits, although limited at the two lowest oil price cases, are significant at the higher oil price cases. State and federal benefits and those for industry demonstrate the different levels of benefit that accrue to industry and to state and federal governments with the current royalty and tax rates and illustrate the possibility for share redistribution to encourage development.

(6) State and federal benefits from the currently producing fields are significant. Prudhoe Bay has been beneficial to all parties (industry and state and federal governments). The other four producing fields have provided value to the state and to industry. The federal government has benefitted to a lesser degree. However, these four fields, on a stand-alone basis, have not provided a positive cumulative discounted (10%) after-tax cash flow to the industry (1992 base year) and may not unless oil prices increase to levels at or above the EIA Mid-Level oil price scenario. It is significant that the decision to develop all four of these fields was made during the period of time between 1975 and 1986 when world oil prices were about \$30/BBL or above.

(7) Stable world oil prices, high enough to provide adequate rates of return to offset the financial risks involved in development in the harsh environmental conditions of the North Slope, would be the most sure guarantee of development of the five NES fields and other similar fields on the North Slope. However, the sensitivity analyses indicate that reductions in operating costs and investments and increases in recovery volume through combinations of improved technology and streamlined processes for environmental and regulatory requirements or both can feasibly move some of these fields to development. Reductions in tax and royalty rates would provide additional incentive.

Conclusions

- Development of the five fields would result in an estimated total of 1,055 million barrels of oil and 4.4 trillion cubic feet of natural gas and total investment of \$9.4 billion in 1992 dollars.
- It appears that all five of the fields will remain economically marginal developments unless there is significant improvement in world oil prices. However, the analysis indicates that improved

- technology and reduced costs through the combined cooperative efforts of industry and government could make it economically feasible to develop some of these fields.
- Costs of regulatory compliance, mitigation, and costs to reduce or maintain environmental impacts at acceptable levels influence project investments and operating costs and must be considered in the development decision making process. These costs can result in reduced reserves and delays in development. Efforts to reduce these costs and impacts would be beneficial to the development of the five fields and other potential discoveries.
- The development of three of the fields (West Sak, Point Thomson, and Gwydyr Bay) that are marginally feasible would have an impact on North Slope production over the period from about 2000 to 2014 but cannot replace the decline in Prudhoe Bay Unit production or maintain the operation of TAPS beyond about 2014 with the assumption that the Trans-Alaska pipeline (TAPS) will shut down when production declines to the range of 400 to 200 thousand barrels of oil/day.
- Recoverable reserves left in the ground in the currently producing fields and soon to be developed fields, Niakuk and Point McIntyre, would range from 500 million to 1 billion barrels of oil corresponding to the time period of 2008 to 2014 based on the TAPS shutdown assumption.

and, costly because of locations in the Kuparuk River delta. Proximity to the producing infrastructure of Milne Point, Kuparuk, and Prudhoe Bay fields will improve economics. However without a dramatic, and unexpected, increase in the oil exploration potential in Gwydyr Bay area, it appears that the likelihood of significant production is low.

B.7 Seal Island/Northstar History

In 1979, a joint lease sale was conducted by the state of Alaska and the U.S. Mineral Management Service (MMS) in the offshore waters of the Beaufort Sea. One group of successful bidders, with Shell as initial operator, formed a joint effort to explore their state/federal leases centered about 15 miles northwest of Prudhoe Bay. Shell completed the construction of Seal Island in 1982. The first well, BF-47 No. 1, resulted in a discovery testing 4,750 BOPD from the Ivishak formation of the Sadlerochit group, the main producing interval in the Prudhoe Bay field.

Ultimately, four wells were drilled from Seal Island resulting in two certified producers, another that encountered hydrocarbons, and one dry hole (MMS 1989a). In 1985, Amerada Hess constructed Northstar Island about 4½ mi northwest of Seal Island and drilled a successful confirmation well, the BF 46 No. 1 in 1986. This well tested at rates of up to 3,500 BOPD from the Ivishak with oil gravity "similar to that in the Seal Island wells, in the 40°s." A subsequent well, deviated to the southeast, encountered mechanical problems and was abandoned without reaching the Ivishak. Shell estimated the structure held more than 300 MMBO total (OGJ 1986).

B.7.1 Data Summary

In 1989, the working interest owners (Amerada Hess Corporation, Murphy Oil USA, Inc., Shell Western E&P, Inc., and Enterprise Oil Ex Co. Inc.), formed the Northstar Unit (NU) (**Figure B.18**) with Amerada Hess as operator and submitted a POD to the MMS and ADNRR. This plan called for a total expenditure of \$21 MM during the 1990 to 1994 period. The plan included island maintenance, a petrophysical/petrographic study, production facility design, about 250 mi of 2-D seismic, seismic analysis and interpretation, reservoir engineering studies, extension fee payments (in lieu of drilling) that will escalate from \$1 MM to \$4 MM over the 5-year period, and a unit area reevaluation to be conducted in 1993 (MMS 1989a). In 1991, a \$1 MM payment to the state was made in lieu of drilling. The petrophysical/petrographic study and conceptual production facilities design were initiated. Island

maintenance was done in July to August 1991 and the 1991 summer seismic program acquired 210 line miles of data (ADNR 1991d; ADNR 1991e).

During 1991, the petrophysical/petrographic program was completed by Neil Barry and Associates and Core Lab, Inc. The conceptual facilities design was also completed by R.M. Parsons Company. A modification of the seismic plan proposes additional coverage during the 1992 winter season, which will exceed that of the original plan. Because a delineation well was not drilled during 1991, Amerada Hess paid \$2 MM to the state in January 1992 (ADNR 1992a).

At the time NU was formed, an estimated total of \$280 MM had been expended on lease acquisition, island construction, and exploratory drilling. If all estimated expenditures for the POD are spent, the total cost prior to initial development or an eventual decision to cancel the project will exceed \$300 MM.

Limited public technical data, consisting only of well logs and histories, preclude a reliable independent assessment of potential reserve volume. Published data specific to Seal Island/Northstar indicate a range of potential reserves from 150 to 300 MMBO (OGJ 1986; ADNR 1991a). However, data representing undeveloped reserves for the Beaufort Sea published by the state of Alaska in June 1991, indicate a range of 180 to 225 MMBO (mid to high). It is assumed that those reserve estimates apply specifically to Seal Island/Northstar (ADNR 1991). Using the available data, a conservative estimate of 200 MMBO as a potentially recoverable resource is made and used for evaluation purposes (see Figure B.18).

B.7.2 Lease Summary

Leases were acquired at Seal Island/Northstar from both the state of Alaska and the federal government in sale BF-79. Federal leases carried a 10-year primary term with expiration on July 31, 1990 with a 1/6 royalty. State tracts were also for a 10-year primary term expiring January 31, 1990, with four leases carrying a 20% royalty and one carrying a 12.5% royalty. All the state leases also include a net profit share percentage, ranging from 40% to 93.2% (see Figure B.19) (MMS 1989; ADNR 1991f).

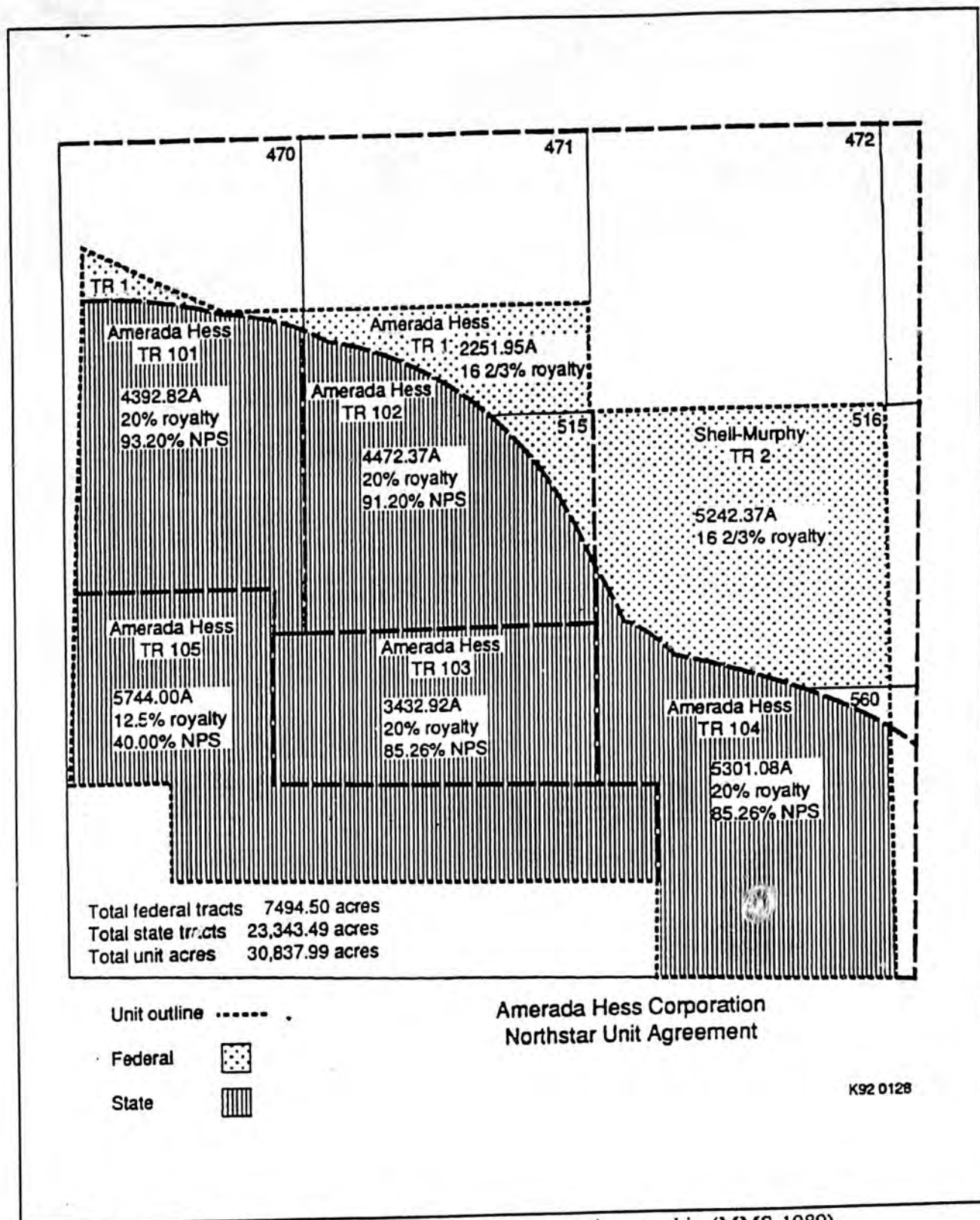


Figure B.19. NU royalties, net-profit share percentages, and ownership (MMS 1989).

B.8 Seal Island/Northstar Issues

As the NU evaluation process continues during the current POD covering the period from 1990 to 1994, the primary technical issues are the size of the accumulation, development costs, and the field production rate.

It appears the NU owners currently think the accumulation is too small to be economically developed. The high test rates in the exploration wells indicate good reservoir rocks in the Sadlerochit and the high gravity reported indicates good quality crude. The economics of construction of development and production facilities, including ice-resistant platforms and subsea pipelines in 50 ft water depths 15 mi offshore, present formidable challenges. For comparison, Endicott field, lies 2 mi offshore in about 4 ft water depths, produces from a gravel island, and is connected to shore by a gravel causeway. Total, ultimate reserves for Endicott are 403.8 MMBO.

Ultimately, the working interest owners will have to decide whether the accumulation is economic to produce. The net profit share provisions of the state leases add a very significant burden to the economic viability of NU.

B.9 Sandpiper Island History

Leases were first acquired in what would eventually be called the Sandpiper Island area in OCS Lease Sale 71 in 1982. It is located approximately 25 mi northwest of Prudhoe Bay. Six leases in the immediate area totaled \$73,731,567 in successful high bids at the federal sale. Shell Western E&P Inc. became the operator for a group consisting of Shell, Amoco Production Co., Murphy Oil USA, Petrofina Delaware Inc., and Koch Industries Inc.

By 1986, Shell had constructed Sandpiper Island to drill the first well on the group's Harvard prospect. The gravel island was built for an estimated cost of \$29 MM (OGJ 1986a). That year Shell drilled the OCSY-370 No. 1 (Sandpiper No. 1) to a total depth of 12,575 ft. During tests of the Sadlerochit, the well flowed at a rate of 2,419 BOPD, 275 BWPD, 3613 GOR, 41.2°API gravity from a lower zone and 409 to 2,325 BPD condensate, 2.9 to 18.6 MCFPD, 49 to 51°API gravity from an upper zone (AOGCC 1986). The well bottomed approximately 3,300 ft north of the island.

SEAL ISLAND / NORTHSTAR, WITH NET PROFITS INTEREST - PAGE 1
 HES LOW OIL PRICE

MILLIONS OF THEN CURRENT \$

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
OIL PRODUCTION RATE, Mbbl/day	0.00	0.00	0.00	0.00	21.92	41.10	54.80	54.80	54.80	54.80	54.80	46.58
OIL PRICE	\$18.94	\$17.89	\$19.95	\$22.14	\$24.45	\$26.90	\$29.49	\$31.91	\$34.46	\$37.17	\$40.01	\$43.01
WELLHEAD OIL PRICE	13.22	12.42	14.66	17.05	19.38	21.61	23.91	26.16	28.37	30.70	33.32	35.99
GROSS REVENUE	\$0	\$0	\$0	\$0	\$155	\$324	\$478	\$523	\$567	\$614	\$666	\$612
TOTAL OPERATING COST	0	0	0	0	51	93	151	157	162	168	174	180
COST SHARING FEE	0	0	0	0	0	0	0	0	0	0	0	0
OPERATING COST IN CONSTANT \$	0	0	0	0	41	72	113	113	113	113	113	113
CUM OP COST IN CONST \$	0	0	0	0	41	113	226	339	452	565	678	791
ROYALTY	0	0	0	0	30	62	92	100	109	118	128	117
SEVERANCE TAX	0	0	0	0	5	10	19	18	19	25	27	15
AD VALOREM	0	0	0	0	28	28	28	28	28	28	27	27
CONSERVATION TAX	0	0	0	0	0	0	0	0	0	0	0	0
CONSERVATION SURTAX	0	0	0	0	0	1	1	1	1	1	1	1
STATE NET PROFIT INTEREST	0	0	0	0	28	89	127	149	170	187	211	186
STATE INCOME TAX	0	0	0	0	0	0	0	0	0	0	0	0
TOTAL STATE	0	0	0	0	91	190	267	297	326	359	394	345
FEDERAL INCOME TAX	0	0	0	0	0	0	0	0	0	0	0	0
OPERATING CASH FLOW	0	0	0	0	13	42	59	70	79	87	98	87
TOTAL INVESTMENT	0	434	450	538	75	78	40	42	14	0	0	0
CUM INVESTMENT IN CONST \$	0	385	770	1,215	1,275	1,335	1,365	1,395	1,405	1,405	1,405	1,405
TOTAL CASH FLOW	\$0	\$-434	\$-450	\$-538	\$-62	\$-36	\$19	\$28	\$65	\$87	\$98	\$87
NOMINAL DISCOUNT RATE IS 10X *****												
CUM PW TOTAL CASH FLOW	\$0	\$-311	\$-603	\$-921	\$-955	\$-972	\$-964	\$-952	\$-929	\$-899	\$-870	\$-846
CUM PW STATE REVENUE	0	0	0	0	49	141	260	380	500	620	739	835
CUM PW FEDERAL REVENUE	0	0	0	0	0	0	0	0	0	0	0	0

SEAL ISLAND / NORTHSTAR, WITH NET PROFITS INTEREST PAGE 2

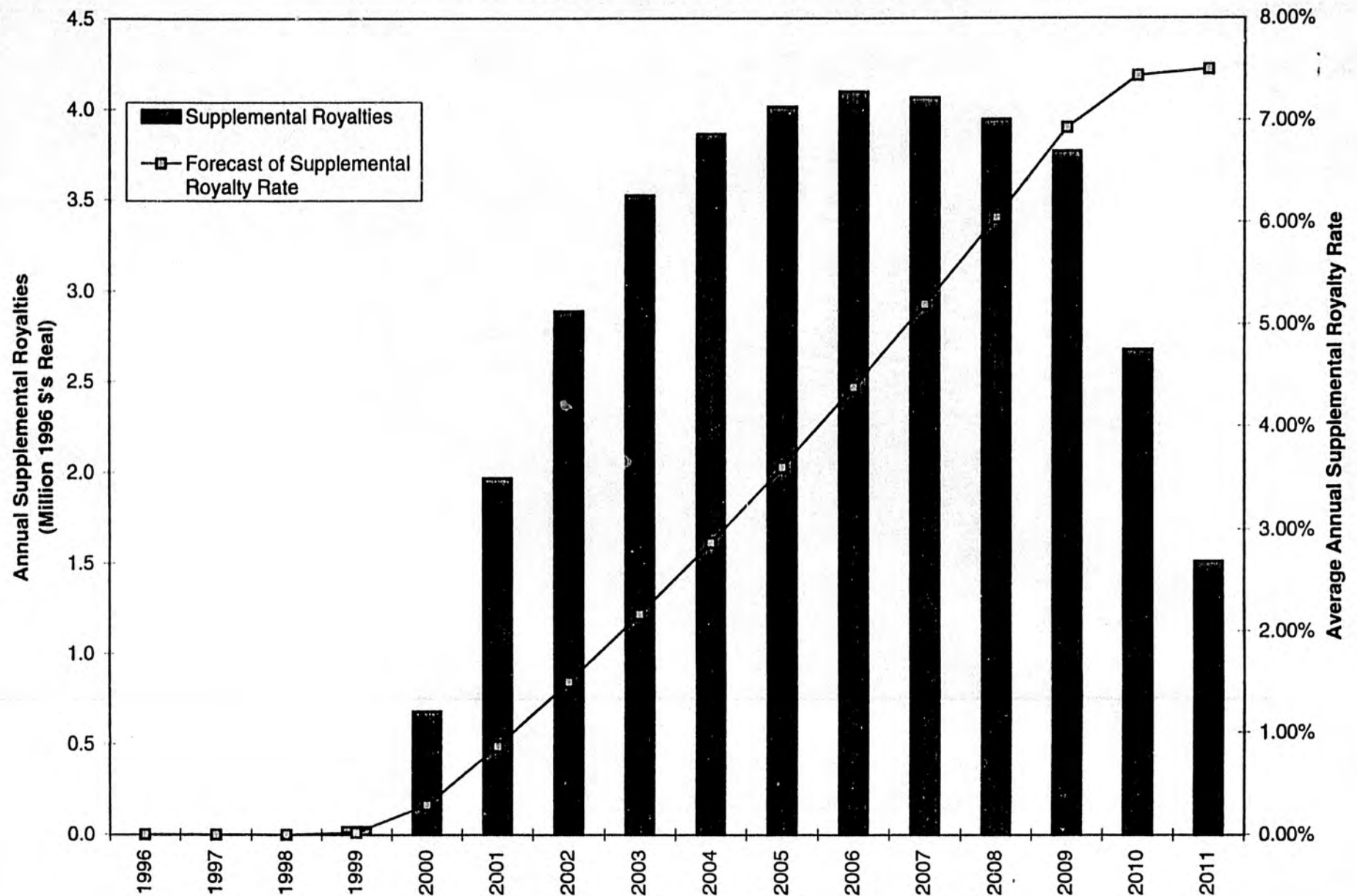
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
OIL PRODUCTION RATE, Mbbl/day	39.59	33.65	28.60	24.31	20.67	17.57	14.93	0.00	0.00	0.00
OIL PRICE	\$45.31	\$47.73	\$50.27	\$52.92	\$55.70	\$58.08	\$60.58	\$63.18	\$65.89	\$68.71
WELLHEAD OIL PRICE	37.90	39.76	41.83	43.66	45.38	46.48	47.05	48.69	46.99	47.88
GROSS REVENUE	\$548	\$488	\$437	\$387	\$342	\$298	\$256	\$0	\$0	\$0
TOTAL OPERATING COST	186	186	186	186	186	186	186	0	0	0
COST SHARING FEE	0	0	0	0	0	0	0	0	0	0
OPERATING COST IN CONSTANT \$	113	109	105	102	98	95	92	0	0	0
CUM OP COST IN CONST \$	904	1,013	1,119	1,221	1,319	1,414	1,506	1,506	1,506	1,506
ROYALTY	105	94	84	74	66	57	49	0	0	0
SEVERANCE TAX	9	8	7	6	5	4	4	0	0	0
AD VALOREM	26	25	25	24	23	22	21	0	0	0
CONSERVATION TAX	0	0	0	0	0	0	0	0	0	0
CONSERVATION SURTAX	1	0	0	0	0	0	0	0	0	0
STATE NET PROFIT INTEREST	150	119	92	66	43	19	-2	0	0	0
STATE INCOME TAX	0	0	0	0	0	0	0	0	0	0
TOTAL STATE	291	247	208	170	136	103	71	0	0	0
FEDERAL INCOME TAX	0	0	0	0	0	0	0	0	0	0
OPERATING CASH FLOW	70	56	43	31	20	9	-1	0	0	0
TOTAL INVESTMENT	0	0	0	0	0	0	0	0	0	0
CUM INVESTMENT IN CONST \$	1,405	1,405	1,405	1,405	1,405	1,405	1,405	1,405	1,405	1,405
TOTAL CASH FLOW	\$70	\$56	\$43	\$31	\$20	\$9	\$-1	\$0	\$0	\$0
NOMINAL DISCOUNT RATE IS 10X										

CUM PW TOTAL CASH FLOW	\$-828	\$-815	\$-807	\$-801	\$-797	\$-796	\$-796	\$-796	\$-796	\$-796
CUM PW STATE REVENUE	908	964	1,007	1,039	1,062	1,078	1,089	1,089	1,089	1,089
CUM PW FEDERAL REVENUE	0	0	0	0	0	0	0	0	0	0

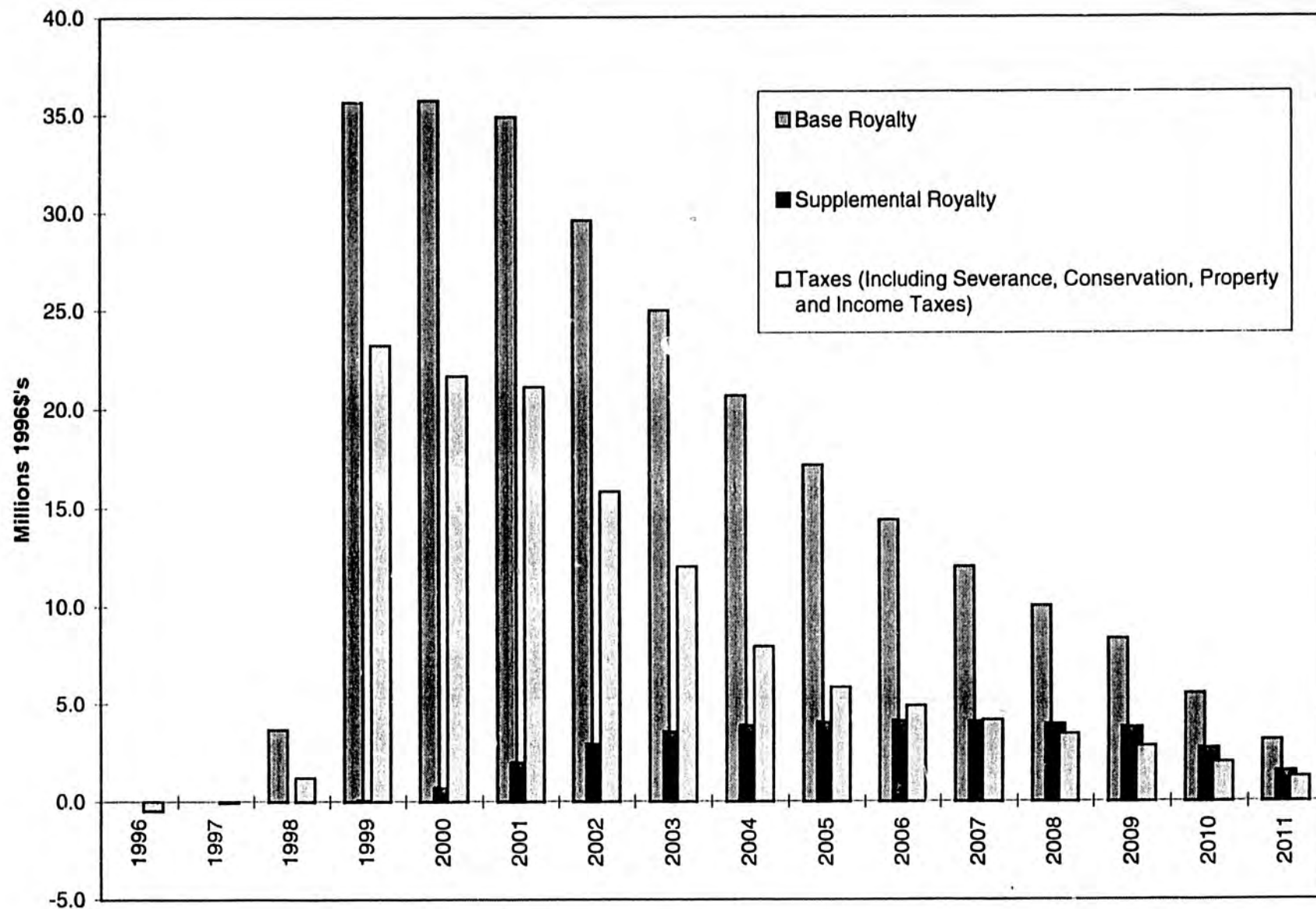
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Northstar Proposal

Forecast of Supplemental Royalties and Rates



Northstar Proposal Forecast of State Revenues



(This chart is based on BPXA's most likely estimate of reserves,
capital and operating costs, and DOR's Fall '95 Base Price Forecast.)

Northstar Economic Evaluation



Estimated Total Revenues

	With Supplemental Royalty and Early Development	With Net Profit Share and Early Development	With Net Profit Share and Delayed Development
(Real 1996 Dollars)			
<u>State Revenues</u>			
State Royalty	256	256	257
State Supplemental Royalty	37	0	0
NPSL	0	85	41
State Share of Federal Royalty	16	16	16
Severance Tax	58	58	59
Spill & Conserv. Tax	3	3	3
Ad Valorem Tax	42	42	46
Income Tax	24	22	23
Total	435	481	444
<u>Federal Revenues</u>			
Royalty (Net of State Share)	44	44	44
Income Tax	215	198	213
Total	259	243	258
<u>BPXA Cash Flow</u>			
After Tax Funds Flow	349	318	346
Real Rate of Return	20.0%	19.9%	20.4%

Totals may not add due to rounding.

Northstar Economic Evaluation



Estimated Total Revenues

	With Supplemental Royalty and Early Development	With Net Profit Share and Early Development	With Net Profit Share and Delayed Development
(Nominal Dollars*)			
<u>State Revenues</u>			
State Royalty	317	317	350
State Supplemental Royalty	51	0	0
NPSL	0	127	69
State Share of Federal Royalty	20	20	22
Severance Tax	67	67	75
Spill & Conserv. Tax	3	4	4
Ad Valorem Tax	53	53	63
Income Tax	30	27	32
Total	541	615	615
<u>Federal Revenues</u>			
Royalty (Net of State Share)	55	55	61
Income Tax	273	247	295
Total	328	302	356
<u>BPXA Cash Flow</u>			
After Tax Funds Flow	478	429	516
Real Rate of Return	20.0%	19.9%	20.4%

*Assuming 3.2 percent inflation rate from DOR Fall 1995 Base Price Forecast. Totals may not add due to rounding.

Northstar Economic Evaluation



Estimated Total Revenues

	With Supplemental Royalty and Early Development	With Net Profit Share and Early Development	With Net Profit Share and Delayed Development
(Discounted Net Present Value*)			
<u>State Revenues</u>			
State Royalty	169	169	140
State Supplemental Royalty	20	0	0
NPSL	0	37	14
State Share of Federal Royalty	11	11	9
Severance Tax	43	43	36
Spill & Conserv. Tax	2	2	1
Ad Valorem Tax	27	27	25
Income Tax	15	14	12
Total	286	303	237
<u>Federal Revenues</u>			
Royalty (Net of State Share)	29	29	44
Income Tax	133	127	213
Total	162	156	258
<u>BPXA Cash Flow</u>			
After Tax Funds Flow	167	155	139

*Assuming 10 percent nominal discount rate. Totals may not add due to rounding.

Northstar Economic Evaluation



Estimated Total Revenues

Accounting for the effects of "Price Volatility"	With Supplemental Royalty and Early Development	With Net Profit Share and Early Development	With Net Profit Share and Delayed Development
(Real 1996 Dollars)			
State Revenues			
State Royalty	255	256	257
State Supplemental Royalty	50	0	0
NPSL	0	107	41
State Share of Federal Royalty	16	16	16
Severance Tax	56	58	59
Spill & Conserv. Tax	3	3	3
Ad Valorem Tax	40	40	46
Income Tax	24	22	23
Total	444	502	444
Federal Revenues			
Royalty (Net of State Share)	44	44	44
Income Tax	218	198	213
Total	262	242	258
BPXA Cash Flow			
After Tax Funds Flow	355	319	346
Real Rate of Return	20.8%	21.1%	20.4%

*Assuming 3.2 percent inflation rate from DOR Fall 1995 Base Price Forecast. Totals may not add due to rounding.

Northstar Economic Evaluation



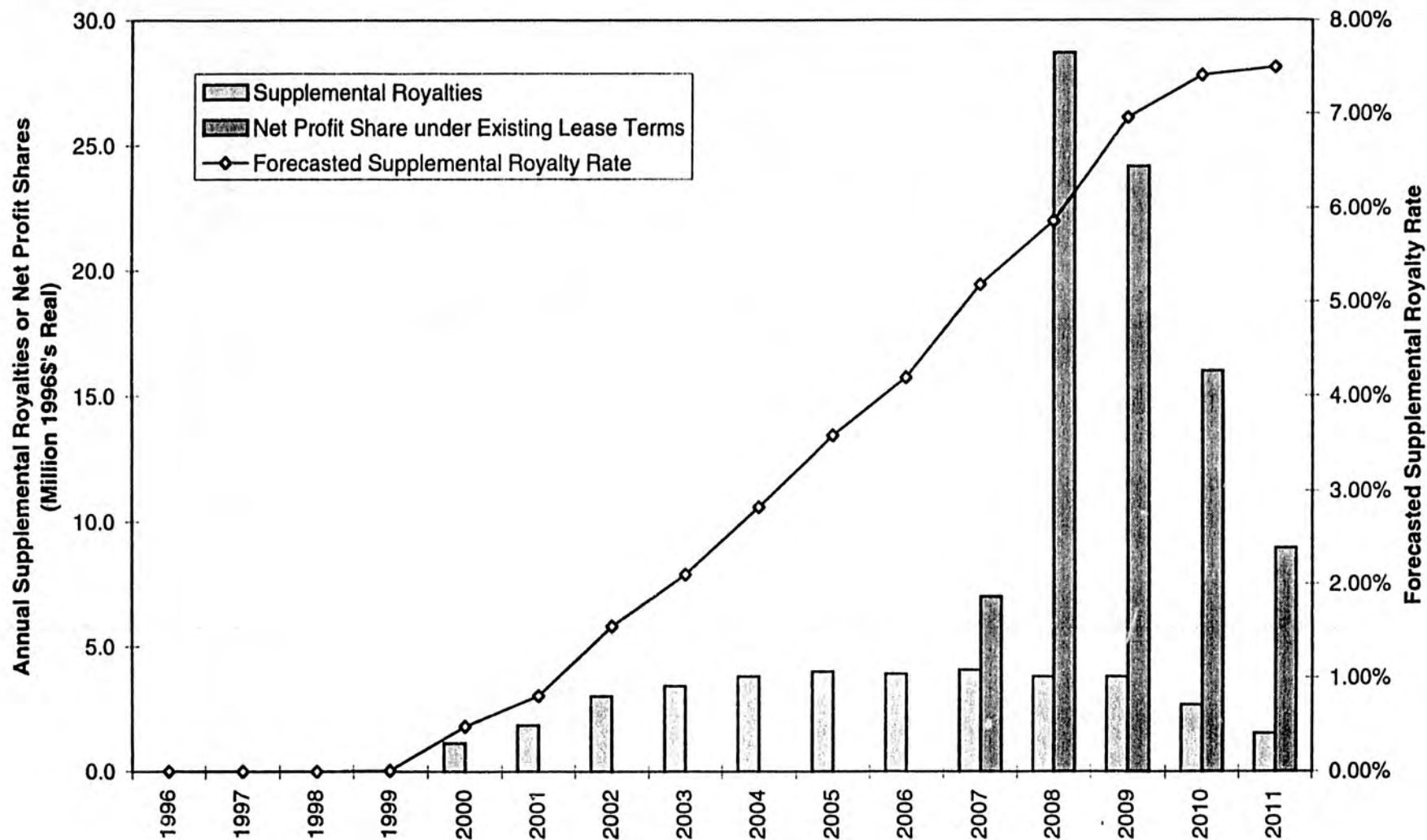
Estimated Total Revenues

Accounting for the effects of "Price Volatility"	With Supplemental Royalty and Early Development	With Net Profit Share and Early Development	With Net Profit Share and Delayed Development
	(Nominal Dollars*)		
<u>State Revenues</u>			
State Royalty	317	318	350
State Supplemental Royalty	64	0	0
NPSL	0	158	69
State Share of Federal Royalty	20	20	22
Severance Tax	65	67	75
Spill & Conserv. Tax	3	4	4
Ad Valorem Tax	50	50	63
Income Tax	30	27	32
Total	551	643	615
<u>Federal Revenues</u>			
Royalty (Net of State Share)	55	55	61
Income Tax	277	245	295
Total	332	300	356
<u>BPXA Cash Flow</u>			
After Tax Funds Flow	486	427	516
Real Rate of Return	20.8%	21.1%	20.4%

*Assuming 3.2 percent inflation rate from DOR Fall 1995 Base Price Forecast. Totals may not add due to rounding.

Northstar Proposal

Forecast of Net Profit Shares, Supplemental Royalties and Rates



(This chart is based on BPXA's most likely estimate of reserves, capital and operating costs, and DOR's Fall '95 Base Price Forecast.)

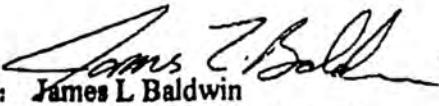
MEMORANDUM**State of Alaska**
Department of Law

TO: Honorable John T. Shively
Commissioner
Department of Natural Resources

DATE: March 26, 1996

FILE NO.: 663-96-0441

TELEPHONE NO.: 465-3600

FROM: 
James L. Baldwin
Assistant Attorney General
Governmental Affairs - Section

SUBJECT: Necessity for legislation to
implement net profit share
reduction

We were asked whether the Commissioner of Natural Resources has the statutory authority to reduce the net profit share payments required under the Northstar leases held by BP Exploration (Alaska) Inc. After considering that question, we conclude it would be prudent to seek express statutory authority for this action. We also discuss other legal issues that bear on proposed remedial legislation.

1. Authority Under Existing Law.

Alaska Statute 38.05.180 is a comprehensive statute which sets out the Commissioner of Natural Resources' authority regarding oil and gas leasing. Section 180 contains express authority in two subsections for the commissioner to modify the royalty provisions of an oil and gas lease. However, neither section 180 nor the Alaska Land Act (AS 38.05) defines the meaning of the term "royalty." To add to the difficulty of statutory construction, section 180 lacks express authority for reduction of a net profit share interest.

The Northstar leases are within the Northstar unit. To implement unitization of a field,

The commissioner may, with the consent of the holders of the leases involved
... change ... royalty requirements of the leases ...

AS 38.05.180(p); (emphasis added). Section 180(p) provides that a change may be made "in connection with the institution and operation of a cooperative unit plan." The Department of Natural Resources (department) interprets section 180(p) to be applied only at the institution of a unit. For this reason, section 180(p) is not germane to the instant transaction. In any case, section 180(p) was amended during the first session of the Nineteenth Alaska State legislature to provide in part that the commissioner

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"may not decrease royalty on leases in connection with a cooperative or unit plan except as provided in (j) of this section.

Sec. 3, ch. 85, SLA 1995. Section 180 (j) permits the commissioner to

provide for an increase or decrease or otherwise modify royalty, to allow for production that would not otherwise be economically feasible. . . .

Section 180(j) contains intrinsic evidence that the legislature meant only to cover the royalty share in amount or value of production removed from the lease. For example, in section 180(j)(3)(C)(i) and (4)(A) limits are imposed on the commissioner's power to reduce a royalty using the terms "royalty percentage" or "royalty rate." The use of these terms is evidence that the legislature meant section 180 (j) to apply only to a share in the amount or value of production, not to a reduction of a share of the net profit derived from the lease. The foregoing intrinsic evidence of meaning is consistent with your testimony given when section 180(j) was under consideration before enactment by the legislature. You testified, "there was no reference made in [SB 207] to 'net profits leases'. . . . There could be negotiation on the base royalty, but not the net profit portion." Senate Finance Committee Minutes, SB 207, May 11, 1995. Senate Bill 207 was never subsequently amended to cover the omission highlighted by the commissioner. Senate Bill 207 was passed by the legislature was signed into law by the governor and became ch. 85, SLA 1995.

There is no commonly understood definition of a net profit share.¹ A net profits interest may be interpreted to be either the equivalent of a royalty which is an interest in land, or it could be considered only a contract right which is severable from an interest in realty. We would be remiss if we did not acknowledge that the department has without discussion, on occasion, interpreted the term "royalty requirements" in section 180 (p) to include a net profit share interest. Similarly, the Minerals Management Service, the federal agency equivalent to the Division of Oil & Gas, has interpreted the term "royalty," in the context of a royalty reduction, to include net profit share payments. See 30 C.F.R. § 203.50. The past administrative interpretations of the department are limited in number and of fairly recent origin. For this reason, we are unable to conclude there has been a contemporaneous construction that a net profit share is included within the meaning of "royalty." For these reasons and the analysis of the relevant provisions discussed above, we believe there is substantial doubt that section 180 prescribes a method for reducing a net profit share interest.

We believe that it would not be prudent to assume that the term "royalty," as used in subsection (p), includes net profit share payments. If that were the case, the commissioner's only statutory authority to reduce the net profit share payments required under the Northstar Unit leases

¹ See Christy v. Petrol Resources Corp., 691 P.2d 59, 61 (N.M. App. 1984)("net profits interest" has no independent meaning, and nature of the interest must be determined from provisions of the instrument creating it).

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is set out in AS 38.05.180(j). For the reasons stated above, we believe that a decision to reduce a net profit share using the authority contained in section 180(j) would be vulnerable to a judicial challenge. Further, under section 180 (j), the commissioner may reduce royalty on unitized leases if the lessee makes a "clear and convincing showing that a modification of royalty meets the requirements of this section and is in the best interests of the state." AS 38.05.180(j)(2). The purpose of subsection (j) is "to allow for production that would not otherwise be economically feasible." You have informed us that the Northstar Unit development does not meet this standard. It would be preferable to seek independent authority for the Northstar net profit share reduction in a way that would bring certainty to the state and the leaseholder while avoiding these difficult legal issues.²

2. Local or Special Legislation

The department intends to seek the narrowest possible provision to specifically authorize amendments to only the Northstar leases. Consistent with your instructions, we have prepared a bill to accomplish this goal. You ask whether such a bill would violate the Alaska Constitution. The prohibition against local or special legislation 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.

Alaska Const. Art. II, Sec. 19.

Section 19 has not been recently applied by the Alaska Supreme Court. In 1975, section 19 was applied to invalidate a statute that mandated the creation of an Eagle River-Chugiak Borough. Abrams v. State, 534 P.2d 91 (Alaska 1975). In Abrams, the court recognized that a statute may affect only one of a few areas and yet relate to a matter of statewide concern or common interest.

In 1977, section 19 was again applied to validate a statute authorizing a trade of land between the federal government, the state, and a Native regional corporation. State v. Lewis, 559 P.2d 630 (Alaska 1977), cert. denied, 432 U.S. 901 (1977). The court found that the land trade was unique, but of statewide concern. The Lewis court propounded a test to be used in determining whether a statute violates the special or local prohibition. It was substantially the same as the test used to determine the validity of nonsuspect classifications challenged as violative of equal protection. The state merely had to show a rational basis, a good reason, to justify the special treatment.

² There may be implied authority to amend the net profit share term of an oil and gas lease granted under AS 38.05.180. While that authority may exist, it has never been used to reduce a net profit lease. On a matter of such significance, this transaction should not become the test case.

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In 1978, the court articulated a unified equal protection analysis that avoids distinguishing between suspect and nonsuspect classifications by using a sliding scale to weigh the interests involved in any classification. State v. Erickson, 574 P.2d 1 (Alaska 1978). The court applies a single test that is flexible and dependent on the importance of the rights involved. The more fundamental the right involved, the more compelling the interest the state must have for preferring one classmember over another. Commercial Fisheries Entry Commission v. Apokedak, 606 P.2d 1255 (Alaska 1980).

There has not been a case involving the local or special legislation prohibition since the unified equal protection test was adopted by the court. It remains to be seen how the court will apply an equal protection analysis to a statute claimed to violate section 19.

According to the department, there are approximately 39 leases carrying net profit share provisions. It is possible that other leaseholders will claim discrimination if they are not also given relief from a corresponding net profit share provision. We doubt that a leaseholder would prevail in a claim that a statute permitting the reduction of a leaseholder's net profit share interest implicates a fundamental right. It is not a foregone conclusion that the other leaseholders are similarly situated to the Northstar leaseholder. We doubt there is a class of similarly situated leaseholders who would be discriminated against by a bill that only applies to the Northstar leases. The effect of a net profit share on a specific field will be subject to different economic assumptions (except price).

The state's interest advanced by the proposed statute is to bring the Northstar leases into production in a way that also encourages other employment and economic activity in the state. The state depends on petroleum revenues for approximately 85 percent of its general fund revenues. For this reason, a statute specifically directed to the Northstar leases can be said to have statewide significance. The reduction in net profit sharing is tied to promises of local manufacture and assembly of facilities to develop the leases. This will lead to substantial economic activity in the railbelt region of the state in which over half of the population of the state resides. There will be a direct economic benefit to the North Slope Borough derived from increased tax revenues. Production from the Northstar Unit will decrease the TAPS tariff for all existing North Slope fields and will likely extend the life of TAPS thereby making it more likely that fields not currently in production can be brought into production.

It will be the department's responsibility to carefully articulate the state's interest during legislative hearings on the bill proposing the net profit share reduction. This must be done with the goal in mind of establishing a detailed legislative history supporting the interests of the state. The legislative history will be important because the ultimate decision "whether a general act can be made applicable" rests with the Alaska Supreme Court.

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3. Public Purpose.

The proposed reduction in the net profits share provisions of the Northstar leases raises the question of whether there might be an expenditure of future state revenues without a valid public purpose. It is debatable how much revenue, if any, would be foregone if the reduction in net profit share takes effect. The amount is dependent on when the leases go into production, the value of oil and other production from the lease, and when the leases become profitable under 11 A.A.C. 83.210 - .295.

The Alaska Constitution requires that state money be expended only for public purposes. Alaska Const. art. IX, sec. 6. To satisfy the public purpose doctrine, the benefit to the public must be the direct and primary purpose of an expenditure. It is permissible if the expenditure also has an indirect private benefit. However, the reverse (direct private benefit with only secondary, indirect public benefit) constitutes violation of the public purpose doctrine.

The analysis is similar to a determination whether there is adequate consideration to support a contract. If there is valuable consideration received by both the state and the leaseholder, the benefit to the state may be characterized as direct. In the case of the Northstar leases, there is a trade-off between expedited development of the leases and the loss of uncertain future revenue. The expedited development comes combined with in-state manufacture and assembly of production facilities. The magnitude of the loss in revenue is highly speculative because the value of production from the leases depends on the whims of the marketplace.

Because the State leased the oil rights at the Northstar field pursuant to the constitutional mandate to obtain the maximum public benefit, an effort to expedite production vitally affects the public interest. See Swindel v. Kelly, 499 P.2d 291, 298 n.27 (Alaska 1972)(ruling that State Constitution recognizes value of all public lands); Alyeska Ski Corp. v. Holdsworth, 426 P.2d 1006, 1011 (Alaska 1967)(ruling that "our constitution reflects . . . the importance of our land resources and of the concomitant necessity for observance of legal safeguards in the disposal or leasing of state lands.") See also Trustees For Alaska v. State, 736 P.2d 324, 335 (Alaska 1987)(finding that State was granted large land holdings under the Statehood Act to "ensure the economic and social well-being of the new state.") Given the public's vital interest in deriving the maximum benefit from the leasing of state lands, the court would likely liberally construe the proposed net profit share reduction provisions in the State's favor. See State v. Moncrief, 720 P.2d 470, 475 (Wyo. 1986)(stating that if a governmental mineral lease is ambiguous, a court must then recognize that the government officials' duty "to realize the largest possible proceeds is a surrounding circumstance which must be considered when interpreting these leases.")

The Alaska Supreme Court tends to give a certain amount of deference to the judgment of the legislature concerning whether and how state resources may be expended for a particular purpose. See, DeArmond v. Alaska State Development Corporation, 376 P.2d 717, 721

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(Alaska 1962)(court will not set aside finding of public purpose unless it clearly appears that such finding is arbitrary and without any reasonable basis in fact). To be sure, there will be some uncertainty if this question is litigated. The Alaska Supreme Court has stated that the phrase "public purpose" represents a concept which is not capable of precise definition. DeArmond, 376 P.2d at 721; Walker v. Alaska State Mortgage Association, 416 P.2d 245 (Alaska 1966). The concept is an evolving one for which "it would be a disservice to future generations for [the Supreme Court] to attempt to define" Id. The court will examine the "entire factual and governmental context to determine whether a particular plan of action serves a public purpose." Wright v. City of Palmer, 468 P.2d 326, 330 (Alaska 1970)(citation omitted). In essence, a determination of public purpose must be made in each case on the basis of the particular facts and circumstances. DeArmond, 376 P.2d at 721.

We believe that a compelling case can be made that there is adequate consideration to support a finding of a direct and substantial public benefit flowing from the reduction of the net profit share. We assign a low probability to the possibility of a successful challenge based on the public purpose doctrine.

4. Competitive Bidding Principles

It may be possible to consider a net profit share to be a contract right of the leaseholder. A public contract can be amended by the contracting parties. The power to amend a public contract is a necessary element of contract administration. It is not certain that judicial constructions of the ability of an administrative officer to amend a public contract will apply to the power to amend a contract right conveyed along with an oil and gas lease.

The power of amendment has its limits. The ability to amend is greatly restricted if the contract was awarded through the competitive bidding process. The reason for this is the premise that a material change in a competitively bid contract amounts to a new contract. McKinnon v. ALPETCO, 633 P.2d 281, 287 (Alaska 1981). A new contract can only be awarded through another round of competitive bids. Id.

The rule against material amendments was applied in Kenai Lumber Co., Inc. v. LeResche, 646 P.2d 215 (Alaska 1982). In Kenai Lumber, the Alaska Supreme Court offered factors for determining when an amendment is material. These factors include:

- (1) the legitimacy of the reasons for the change;
- (2) whether the reasons for the change were unforeseen at the time the contract was made;
- (3) the timing of the change;

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- (4) whether the contract contains clauses authorizing modifications; and
 - (5) the extent of the change relative to the original contract.
- 646 P.2d at 221.

It may be possible to formulate an argument that the reasons for amending the Northstar leases are legitimate and were unforeseen at lease formation. The timing of the change is sufficiently distant from formation of the leases to negate any claim that it is a pretext to avoid resolicitation of the leases. However, the extent of the change is substantial enough to raise serious questions as to whether factor (5) above can be satisfied. Other persons who competed for the leases may claim that since the net profit share was the sole variable in the lease sale, it is such a material term that a change cannot be made without violating the competitive bidding statute. Uncertainty concerning the state's prospects for prevailing in any litigation on this issue gives an additional basis for our advice that the department seek independent statutory authority for the Northstar transaction. The Alaska Supreme Court has held that competitive bidding is not necessary unless "required by constitution, statute, ordinance or regulation." McKinnon, 633 P.2d at 287. If the legislature were to directly authorize the amendments to the Northstar leases, that authorization would take precedence over any other statute requiring competitive bids, just as section 180(j) takes precedence over any other competitive bidding statute.

We hope that the foregoing memorandum adequately addresses the reasons why it would be prudent to seek specific authority from the legislature to reduce the net profit share provisions applicable to the Northstar leases. We are prepared to assist the Department of Natural Resources in seeking passage of a bill to accomplish this purpose.

JLB/clh

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MEMORANDUM

March 25, 1996

SUBJECT: Renegotiation of State Oil and Gas Lease

TO: Senator Doug Pearce
President of the Senate

FROM: Jack Chasewich
Legislative Counsel

I am responding to three questions set out in your March 22 memo.

1. I have not found explicit statutory or regulatory authority to renegotiate an oil and gas lease as seems to be contemplated in the North Star field lease. See, by way of specific example, 11 AAC 71.205 authorizing amendment of timber and materials contracts except that the amendment "may not materially affect or change the meaning or intent of the contract," 11 AAC 71.205(b). The lease documents applicable to the North Star field lease may authorize or provide for renegotiation under specific circumstances, but I don't know this.

Even absent an explicit statute or regulation or provision in the lease, as a matter of general law, negotiations may be initiated to amend a competitively bid public contract. 72 C.J.S. Supp., "Public Contracts," sec. 24. However, amendments to competitively bid contracts are prohibited if the amendments proposed are "material," that is to say, competitively bid contracts may not be materially amended. *McKinnon v. Alpetso*, 633 P.2d 281, 287 (Alaska 1981), *Koral Lumber Company v. Laksaka*, 646 P.2d 215, 221 (Alaska 1982). Amendments to a contract are "material" if they involve the alteration of factors that influence the judgment or decision on the award of the contract. *Brown v. Ward*, 593 P.2d 247, 250 (Alaska 1979), *Cousins v. Walker*, 613 P.2d 608, 613 (Alaska 1980). Based on the pre-lease analysis, the state's choice of leasing method--including the decision to take net profit share using the amount reserved as the bid variable (which I think is what is at work in the award of the original North Star field lease)--seems to be "material" by any measure.

2. Without having a notion of what the administration may choose to offer, still, I think the administration will, in one way or another, ask the legislature to ratify or validate modifications proposed to the North Star lease.

Senator Don Pearce

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An Act of public enactment to validate the modification of a public contract is a form of curative legislation. *Yellon v. Platts*, 89 N.E.2d 540 (Indiana 1950); *C. Sands, Sutherland Statutory Construction*, sec. 71.07. As a general rule, curative legislation is valid (1) when the legislature originally had power to authorize the acts that were done and (2) the curative legislation does not impair a vested right in violation of constitutional provisions prohibiting impairment of contract. *Fairbanks North Star Borough v. State*, 753 P.2d 1158, 1160 (Alaska 1988). The legislature might have authorized renegotiation of public contracts, and, depending on what is submitted, it is more probable than not that the proposed legislation would not impair a vested right (assuming that the state administration is prepared to waive the right to receive revenue under the original lease by shifting from one choice of leasing method to another).

A validating or curative act is usually subject to the "local or special" act limitations of a state constitution. *C. Sands, Sutherland Statutory Construction*, secs. 41.11 - 41.13. Even if it was a consideration in this instance, there is, it seems to me, good chance that the court would find the test of *Abraham v. State*, 534 P.2d 91 (Alaska 1975) to control and determine that the modification of an oil and gas lease with significant potential revenue-producing capacity is a matter of common interest to the whole state, having, through the contributions to the state treasury, probable statewide interest and impact, and therefore not subject to the local and special legislation prohibition provision.

It is also possible, of course, that the legislation sponsored by the administration will be general, in that it will authorize renegotiations of all or some types of oil and gas leases. That type of legislation, potentially applying to other leases as well as the North Star lease, would avoid the "local or special act" question altogether.

3. Your memo describes legislation that addresses the possibility that the state may receive less revenue than originally anticipated. It does not propose to withdraw money from the state treasury, therefore an act addressing renegotiation of the lease is not to be regarded as an appropriation.

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waiver, either expressly¹² or impliedly.¹³ We have no difficulty finding a waiver under the facts of this case. The plaintiffs diligently sought adjudication of the class action issues by twice moving for certification. The defendants initiated summary judgment proceedings while plaintiffs' second motion for certification of the class action was pending. Under these circumstances, the trial court did not err in ruling on the merits and then certifying the class.

B. Did the Trial Court Err in Finding that the Named Plaintiffs Provided Adequate Representation for the Class?

Civil Rule 23(a)(4) provides that a class action can be maintained only if "the representative parties will fairly and adequately protect the interests of the class." The defendants contend that the plaintiffs could not provide adequate representation for the class because they had interests antagonistic to other members of the class.

[7] First, the determination of the adequacy of representation in a class action is a question of fact. *Guerine v. J & W Investment, Inc.*, 544 P.2d 863, 864 (5th Cir. 1977); 7 C. Wright & A. Miller, *Federal Practice and Procedure* § 1765, at 622-23 (1972). As a question of fact, the trial court's finding will not be reversed unless clearly erroneous; in other words, the trial court will not be reversed unless, in light of the whole record, it can be said with a definite and firm conviction that the trial judge was clearly mistaken. *Alaska Foods, Inc. v. American Mfrs. Mut. Ins. Co.*, 442 P.2d 842, 848 (Alaska 1971).

[8] Second, in order to bar a suit, the antagonism "must be as to the subject matter of the suit." *Berman v. Narragansett Racing Ass'n*, 414 P.2d 311, 317 (1st Cir. 1969), cert. denied, 396 U.S. 1037, 90 S.Ct. 682, 24 L.Ed.2d 681 (1970); 7 C. Wright & A. Miller, *supra*, § 1768, at 639; 3B J. Moore, *supra* note 8, § 28.07[3], at 23-237.

12. *Culwell Co. v. Superior Court*, 50 Cal.App.3d 32, 123 Cal.Rptr. 228, 230 (1975). *Kutz v. Carte Blanche Corp.*, 496 F.2d 747, 762 (3d Cir. 1974) (en banc), cert. denied, 419 U.S. 845, 95 S.Ct. 152, 42 L.Ed.2d 125 (1975).

Third, it should be noted that in a suit to strike down a statute as unconstitutional, the requirement of adequate representation loses vitality. The effect of a finding of unconstitutionality will affect everyone, not just the parties before the court. "Thus, even if [x] plaintiff is not a proper representative in the traditional sense, striking a class claim will not effectively change the end result if the party successfully procures an individual basis." 7 C. Wright & A. Miller, *supra*, § 1771, at 664. See also 3B J. Moore, *supra* note 8, § 23.40[3], at 23-299 n.15. In the present case, this would simply mean that the named plaintiffs would be burdened with the expenses of the suit without reimbursement from a class recovery. The effect of the action on the defendants and the rest of the class is the same whether the suit is brought as a class or as an individual action.

Finally, it should be noted that in a suit seeking to have a statute declared unconstitutional, there are only two sides to the argument; either the statute is constitutional or it is not. In such a case where there are no inherent conflicts *inter se* among class members (such as rights to differing shares in a limited fund), the interests of class members antagonistic to the representatives' constitutional attack will usually be adequately represented by the defendants.

[9] In the present case, the trial court was not clearly erroneous in finding the representation of the class to be adequate. First, the major antagonism claimed was that most of the fishermen in the region had supported, by their votes, mandatory assessments. Since the basis of this suit is the seeking of a declaration of the constitutionality of a statute, the rights of all class members are affected in the same way, whether or not it is brought as a class action. Moreover, the defendant associa-

13. *Civil Serv. Emps. Ins. Co. v. Superior Court*, 22 Cal.3d 312, 149 Cal.Rptr. 260, 584 P.2d 497, 502-04 (Cal.1978); *Petite*, 523 F.2d at 354 n.4; 3B J. Moore, *supra* note 8, § 23.50, at 23-425 to 23-428.

tions and the state have vigorously opposed the constitutional attack of the plaintiffs and have thereby necessarily represented the interests of antagonistic class members to have the statute declared constitutional.

V. DID THE TRIAL COURT ERR IN FINDING THE DOCTRINE OF LACHES INAPPLICABLE?

The trial court held that the doctrine of laches was inapplicable on the facts of the present case. On appeal the defendants have contested this finding and both sides have extensively argued the traditional elements of laches, unreasonable delay and resulting prejudice. However, the discussion of the elements of laches is irrelevant since laches is simply inapplicable to any of the remedies sought in this case.

[10, 11] The suit seeks three basic forms of relief. First, a refund of all assessments paid under the statute is sought on a common count. Since this is a general assumption common-law cause of action for the refund of taxes wrongly paid, the six-year statute of limitations contained in AS 09-10.05(3) would apply to this action at law. *State v. Wukfield Fisheries, Inc.*, 495 P.2d 166, 172 (Alaska 1972). The other two types of relief sought, a declaratory judgment and a permanent injunction, are prospective in application and seek to prevent future threatened harm. A laches analysis is simply inappropriate, since each new assessment would give rise to a new cause of action.

VI. DID THE COURT ERR IN FINDING THE DOCTRINE OF EXHAUSTION OF ADMINISTRATIVE REMEDIES INAPPLICABLE?

[12] The trial court was correct in holding inapplicable the doctrine requiring the exhaustion of administrative remedies before seeking relief in the superior court. See Davis, *Administrative Law Treatise* § 20.04 (1st ed. 1958). This was not an administrative adjudicatory proceeding which had various routes of administrative appeal. Rather, the implementation of the salmon assessment was administrative leg-

islative action not subject to appeal. The only action which the fishermen could take in the administrative process was to vote in the election on a proposed amendment. There simply were no administrative remedies to exhaust.

The judgment of the superior court is **AFFIRMED** in all respects.



**KENAI LUMBER COMPANY,
INC., Appellant,**

v.

**Robert LeRESCHIE, Commissioner of
Dept. of Natural Resources of the State
of Alaska; Geoffrey Haynes, Director of
Division of Lands of Dept. of Natural
Resources; Frederick H. Bonow, Deputy
Commissioner of Dept. of Natural
Resources; and South-Central Timber
Development, Inc., Appellees.**

**SOUTH-CENTRAL TIMBER DEVELOP-
MENT, INC., Cross-Appellant
and Appellee,**

v.

**KENAI LUMBER COMPANY, INC.,
Cross-Appellee and Appellant.**

Nos. 5733, 5755.

Supreme Court of Alaska.

June 11, 1982.

Competitor timber company brought action challenging amendment to timber harvesting contract. The Superior Court, Third Judicial District, J. Justin Ripley, J., entered summary judgment, and appeal was taken. The Supreme Court, Matthews, J., held that: (1) rule prohibiting material modifications in competitively bid contracts did not apply to amendment to timber harvesting contract insofar as the amendment

waived primary manufacturing requirement and altered harvesting economies by removing certain lands from contract area and substituted other lands; (2) timber harvesting contract amendment substituting land for land originally included in contract area was not "material" for purposes of rule prohibiting material changes in public contracts let under competitive bidding, even though substituted land was never subject of competitive bidding process; (3) fact that losing party's attorney fees amounted to far less than sum prevailing party paid its attorneys did not demonstrate that award to prevailing party of attorney fees was manifestly unreasonable; and (4) competitor timber company's economic incentive to bring action challenging amendment of public timber harvesting contract, even if suit did not involve issue of alleged circumvention of competitive bidding process prevented claimed public interest from precluding award of attorney fees.

Affirmed.

Rabinowitz, C. J., dissented and filed opinion.

1. States — 106

Rule prohibiting material modifications in competitively bid contracts did not apply to amendment to timber harvesting contract insofar as the amendment waived primary manufacturing requirement and altered harvesting economies by removing certain lands from contract area and substituting other lands where price of timber harvested was, at time of amendment, to be determined by state appraisals, such appraisals were to be based on current market and cost condition and were not indexed to original bid price, primary manufacturing requirement detracted from rather than added to value of end product, and changes in harvesting economies were conditions to be reflected in price reappraisals to be made under the contract. AS 38.05.115, 38.05.120.

2. States — 106

Timber harvesting contract amendment substituting land for land originally included in contract area was not "materi-

al" for purposes of rule prohibiting material changes in public contracts let under competitive bidding, even though substituted land was never subject of competitive bidding process, where reason for amendment was discovery by Department of Fish and Game that included area contained important winter habitat for mountain goats, the Department requested the sale be modified by deleting such area, and importance of the deleted area as wildlife habitat was not appreciated when original contract was made. AS 38.05.115, 38.05.120.

3. Public Contracts — 18

Not all amendments to competitively bid contracts are prohibited, only those regarded as material. AS 38.05.115, 38.05.120.

4. Appeal and Error — 984(5)

The determination of court-awarded attorney fees is committed to discretion of trial court and reviewable on appeal only for abuse of discretion; such abuse is regarded as present only where trial court's decision appears to be manifestly unreasonable or motivated by inappropriate purpose.

5. Costs — 172

Fact that losing party's attorney fees amounted to far less than sum prevailing party paid its attorneys did not demonstrate that award to prevailing party of attorney fees was manifestly unreasonable.

6. Costs — 172

Competitor timber company's economic incentive to bring action challenging amendment of public timber harvesting contract, even if suit did not involve issue of alleged circumvention of competitive bidding process, prevented public interest from precluding award of attorney fees.

Richard Helm and Mark L. Figure, Rurr, Poase & Kuris, Inc., Anchorage, for appellant.

Shelley J. Higgins, Asst. Atty. Gen., Anchorage and Wilson L. Condon, Atty. Gen., Juneau, for appellee.

Leroy DeVaux and James N. Wanumaker, Wanumaker, DeVaux & Crabtree, Anchorage, for cross-appellant, South-Central.

Chen, Alaska, 646 P.2d 218

Before RABINOWITZ, C. J., and CONNOR, BURKE, MATTHEWS and COMPTON, JJ.

OPINION

MATTHEWS, Justice.

In this case we are asked to review the legality of a negotiated amendment to a long term timber sale contract between the State of Alaska and South-Central Timber Development, Inc. The amendment has been challenged by Kenai Lumber Company, Inc., which operates a currently underutilized sawmill in Seward, and competes with South-Central in the purchase of timber. The basis for Kenai's claim is that the changes which the amendment makes are so significant that they amount to a circumvention of the competitive bidding process under which the original contract was let. The trial court on cross motions for summary judgment ruled that the amendment was lawful. We agree for the reasons expressed herein.

1

The original timber sale contract, designated Icy Cape No. 1, was made on December 1, 1969 following advertisement for

1. The prices were \$7.00 per 1,000 board feet (m.b.f.) for Sitka spruce saw logs and \$2/m.b.f. for hemlock saw logs.

2. Of this amount approximately 100,200 m.b.f. were Sitka spruce saw logs and 100,600 m.b.f. were hemlock saw logs.

3. Section 406.104 of the Timber Sale Regulations in existence as of the date of execution of the contract provides:

Primary Manufacture.

The Director may require that primary manufacture of logs, cordwood, bolts, or other similar products be accomplished within the State of Alaska.

The term primary manufacture means manufacture which is first in order of time or development. When used in relation to sawmilling, it means:

(a) The breakdown process wherein logs have been reduced in size by a head saw or gang saw to the extent that the residual cants, slabs, or planks can be processed by saw equipment of the type customarily used in log processing plants, or

(b) Manufacture of a product for use without further processing, such as structural

public bids pursuant to AS 38.05.120. South-Central was the only bidder at the auction and received the award at the minimum stumpage prices established by the state.¹

The sale area consists of approximately 33,760 acres in a remote location on the coast of south-central Alaska adjacent to Icy Bay. The contract estimates that some 206,800,000 board feet of timber can be taken from this area.² The contract requires all timber within the boundaries of the sale area meeting certain minimum specifications to be cut. The contract is to expire 20 years from the date of execution unless extended by the state. It contains a provision concerning the primary manufacture of the timber cut as follows:

Timber cut under this contract shall not be transported for primary manufacture outside the State of Alaska without written approval of the state. Primary manufacture shall be as defined under Section 406.104 of the "Timber Sale Regulations" and as further defined in the Governor's Policy Statement for primary manufacture dated April 8, 1968, a copy of which is attached hereto and hereby made a part of this contract.³

timbers (subject to a firm showing of an order or orders for this form of product.)

Primary manufacture, when used in reference to pulp ventures, means the breakdown process to a point where the wood fibers have been separated. Chips made from timber processing wastes shall be considered to have received primary manufacture. With respect to veneer or plywood production, it means the production of green veneer. Poles and pilings, whether treated or untreated, when manufactured to American Standards Association specifications are considered to have received primary manufacture.

The Governor's Policy Statement for primary manufacture, referred to in the contract, provides:

Cants may be manufactured from all species for export and shall be considered to have received primary manufacture when sawed up to a maximum thickness of 12 inches and may be of any width. Timber cut thicker than 12 inches must be squared on four sides along their entire length with allowances for one-third of each dimension (thickness and width) allowed to warp.

The contract calls for reappraisal of the price of the timber at the end of five years after the effective date of the contract and thereafter in three year intervals.⁴ A section of the contract incorporates by reference the state timber sale regulations. Of interest here is section 166 of the regulations pertaining to amendments and modifications:

Amendments to and modifications of the contract may be made in writing and become a part of the contract upon mutual agreement of the director and the purchaser; provided that such amendment or modification does not materially affect or change the meaning or intent of the contract.⁴

From 1970 through 1978 South-Central cut timber from the sale, squared it in compliance with the primary manufacturing requirement at its mill on Jakolof Bay, several hundred miles from the sale area, and exported the squared timber, called "cants," to Japanese markets. During this period the contract was amended on six occasions. These amendments included two price changes under the reappraisal provision of the contract,⁴ and one amendment allowing 3,200,000 board feet of spruce and hemlock to be exported as round logs, that is, logs not subjected to primary manufacture.

The 7th amendment, agreed to in January of 1979, is the amendment in question in this case. The most important change it makes is that it waives the primary manu-

facturing requirement. Another important change deletes from the sale area all lands at an elevation above 400 feet and substitutes additional acreage. The deleted lands contain approximately 40,000,000 board feet of timber. About 14,000,000 board feet may be cut from the added acreage. The amendment also changes the stumpage prices, increasing the price of spruce to \$80.00/m.b.f. and of hemlock to \$28.00/m.b.f. Other aspects of amendment No. 7 include a provision that South-Central must also take logs suitable only for the manufacture of wood pulp or pay a fine; a provision which on the whole increases the penalty imposed on South-Central for failing to remove trees meeting the contract specifications; a provision increasing the penalty for leaving high stumps; and a provision making the new state Forest Resources and Practices Act, AS 41.17.010.950, applicable to the sale immediately rather than one year following the amendment as would otherwise be the case. At the time of the amendment it was estimated that the total harvestable timber remaining was some 87,000,000 board feet.

Due to a change in the administration of the air pollution control laws it became apparent in 1978 that South-Central's Jakolof Bay mill could not continue to operate beyond June of 1979 without making extensive changes in the burner used to dispose of the slabs created by primary manufacture. These changes were judged by

Chips made from timber processing wastes shall be considered to have received primary manufacture and export will be permissive action of the Commissioner. Timber, processing wastes is hereby defined as all timber, mill residue, logging residue or other material not presently being utilized or in demand for higher-valued products.

With the advance approval of the Commissioner, limited quantities of all species, excluding spruce and hemlock, may be exported in the form of mixed logs for experimental purposes only, e.g. to introduce a new product to market. Round logs may not be exported as a marketable commodity. The above statement is intended to clarify and/or define Section 406.104 of the "Timber Sale Regulations" and supersedes all previous policy statements and/or resolutions.

4. Apparently the intent of the contract was to allow two years for construction of the roads and loading facilities which would be needed before timber cutting and transportation could take place. A special provision of the contract required that a minimum of ten million board feet be cut and paid for by the end of the third year.

5. 11 A.A.C. 76.155.

6. The first, effective December 1, 1974 changed spruce saw logs to \$16.25/m.b.f. and hemlock saw logs to \$12.00/m.b.f. and the second effective December 1, 1977 changed the price for spruce saw logs to \$25.00/m.b.f. and hemlock saw logs to \$18.00/m.b.f.

South-Central to be economically unfeasible. South-Central therefore sought a waiver of the primary manufacture requirement from the state. The state granted the waiver, making the following findings:

FINDINGS AND WAIVER OF PRIMARY MANUFACTURE

Based on a review of the experience since this sale was let in 1969, the following findings are made:

(1) Actually, only four jobs, those of sawyer, off-bearer (of slab), millwright and night watchman, are added by the primary manufacture milling operations.

(2) That the waiver of primary manufacture will provide economic incentive for the more intense utilization of additional timber and will create at least as many jobs in the woods as were created through the milling operation.

(3) That given the limited volume in this sale, it will not be economic to install chipping operations or pneumatic shiploading facilities. Also, there is no other economic method of salvaging the slab created by primary manufacture.

(4) The one known economic method of disposing of the slab is by burning in a wigwam burner.

(5) That since Icy Bay is an area of pristine air quality at present, it is doubtful that the required permit could be obtained (see the case of *National Asphalt Pavement Assoc. v. Train* [D.C. Cir.], 539 F.2d 776 (1976)).

(6) That, rather than continue a practice which requires waste of commercially valuable sawwood (by slabbing) and also causes potential air quality deterioration (by burning), it is submitted that it may be preferable to permit round-log export.

(7) That the outer ring, or sawwood, of the log is the most commercially valuable portion because of close grain, freedom from knots and consistent color and grain.

7. There is no finding numbered 8.

(9) That under present primary manufacture requirements, a significant percentage of the valuable sawwood, cut, burned, and wasted.

(10) It is further found that there is a strong market for the valuable wood and because of that strong market there will be a higher utilization of the forest products from this sale round log export is permitted.

(11) Also a higher price will be obtained for the state's timber resources if primary manufacture is waived.

(12) Also, there will be benefit to the long term management of Alaska forest lands resulting from higher utilization.

The justification for deleting those portions of the sale area lying above 400 feet and for making a partial substitution of adjacent low lands is also expressed in the findings made by the state:

REDUCTION OF SALE AREA FOR PROTECTION OF GOAT HABITAT

Based upon the representations of the Habitat Division of the Alaska Department of Fish & Game, the following findings are made:

(1) That at the time this Contract was let in 1969, there had been insufficient funds for studying the fish and goat habitat protection. Accordingly, areas received less intensive study than might otherwise have been the case.

(2) That subsequent investigation has revealed that timber stands at certain elevations and along certain shorelines are vital to the protection of the goat population at Icy Bay.

(3) That these designated slopes are necessary for providing a proper wintering habitat for the goat population of Icy Bay.

(4) That it will support the conservation of wildlife resources at Icy Bay if these needed habitat areas are deleted from the Timber Sale.

(5) That although the timber purchaser has made certain capital investments based on the volume of timber within the contracted sale area, the purchaser is willing to amend the sale area by deleting the area essential to goat habitat if the stumpage is amortized over the lower volume.

II

Kenai's challenge to amendment No. 7 in this court is based solely on the ground that the amendment violates the rule that material modifications may not be made to a contract let under a competitive bidding statute. This sale was made pursuant to AS 38.05.120 which requires that timber sales larger than 500,000 board feet be made by competitive bidding.⁹ We alluded to the rule relied on by Kenai in *McKinnon v. Alpetco Co.*, 633 P.2d 281, 287 (Alaska 1981):

[G]enerally a government contract that was initially competitively bid cannot be materially amended because that is tantamount to forming a new contract, which should be accomplished by starting all over again with competitive bidding.

This rule has been judicially imposed in order to guard against circumvention of competitive bidding requirements. Competitive bidding itself is designed to ensure that government obtains the most favorable terms possible in its contracts, and to protect the public from the possibility of favoritism, fraud, and corruption on the part of public officials. *Libby v. City of Dillingham*, 612 P.2d 35, 42 (Alaska 1980) (plurality opinion); *id.* at 44 (Rabinowitz, C. J., concurring).

A. AS 38.05.120 provides in relevant part:

Timber and other materials shall be sold either by sealed bids or public auction, depending on which method is determined by the commissioner to be in the best interests of the state, to the highest qualified bidder as determined by the director.

The 500 mb.f. exception is expressed in AS 38.05.115.

B. This does not mean that the state officials are entirely free to modify long term timber sale contracts after the first reappraisal date has passed. As we have previously noted, 11 A.A.C. 76.156 prohibits contract amendments

[1] Under the terms of this contract, competitive bidding can only be effective to accomplish these purposes for the first five years of the contract. Thereafter, the price of the timber is to be determined by state appraisals. These appraisals are based on current market and cost conditions and are not indexed to the original bid prior. Kenai has not challenged this aspect of the contract and we therefore assume it to be legal for the purposes of this case. Based on this assumption we believe that, with one exception which we will discuss later, the rule prohibiting material modifications of competitively bid contracts has no application to amendment No. 7. That rule could not operate to ensure that the state receive the best price possible because prior under this contract is determined privately; nor could it prevent favoritism, fraud or corruption on the part of state officials for the same reason.¹⁰

The evidence in this case indicates that the primary manufacture requirement detracts from rather than adds to the value of the end product. Thus a prospective purchaser of state timber would be willing to pay a higher stumpage price if there were no such requirement. If, therefore, an amendment to the contract had been made eliminating primary processing within the initial five year period a persuasive argument could be made that the protections which are meant to be afforded by competitive bidding had been by-passed. However, once the initial period is over the competitively established price is no longer effective and the removal of the primary pro-

cessing requirement is merely another market condition to be taken into account during reappraisal.

which "materially affect or change the meaning or intent of the contract." Kenai, however, did not brief in its opening brief the question whether amendment No. 7 violates this regulation and we therefore do not pass on this point. In its reply brief it made no more than a conclusory assertion that § 155 prohibits material modifications, with no analysis or citation of authority. Under these circumstances we consider this point to have been waived. See *Hitt v. J. B. Cophill, Inc.*, 641 P.2d 211, 213 n.4 (Alaska 1982); *State v. O'Neill Investigations, Inc.*, 609 P.2d 520, 528 (Alaska 1980).

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cessing requirement is merely another market condition to be taken into account during reappraisal.

Essentially the same observations can be made with respect to the economic aspects of the change removing from the sale lands above 400 feet and substituting adjacent low lands. Kenai contends, quite plausibly, that the costs of harvest are less and the product value is higher in the newly substituted acreage than in the lands deleted from the sale. If those changes had been made during the first five years of the contract a legitimate question whether competitive bidding had been improperly circumvented would be presented. As it is, however, those changes are now simply new conditions to be reflected in each reappraisal.

[2] The one aspect of amendment No. 7 to which the rule prohibiting material changes potentially applies is the physical addition of timber land in partial substitution for the deleted acreage. The additional land has never been subject to the competitive bidding process. However, for the following reasons, the rule does not prohibit this change.

[3] Not all amendments to competitively bid contracts are prohibited, only those regarded as material. The concept of materiality in this context has not been satisfactorily captured in a single phrase. One court has spoken of "an essential change of such magnitude as to be incompatible with the general scheme" of competitive bidding;¹¹ another has phrased the question to be whether the amendment "so varied from the original plan, was of such importance,

or so altered the essential identity purpose of the contract, that it constituted a new undertaking."¹² These courts simply recognize that the materiality concept prohibits those changes which would be subversive of the purposes of competitive bidding. In determining whether an amendment has this tendency, courts found the following factors to be relevant:

(1) the legitimacy of the reason for the change;¹³

(2) whether the reasons for the change were unforeseen at the time the contract was made;¹⁴

(3) the timing of the change;¹⁵

(4) whether the contract contained authorizing modifications;¹⁶

(5) the extent of the change, relative to the original contract.¹⁷

Applying these factors to the substitution of timber lands in this case leads to the conclusion that the substitution is not material for purposes of the rule prohibiting material changes.

The reason for the change was the Department of Fish and Game's desire to remove the mountain goat habitat after the contract was awarded. The mountainside included in the sale contained important winter habitat for mountain goats. The Department requested that the sale be modified deleting this area. Since this would eliminate an area containing 40,000,000 board feet which the state contractually committed to South-Central it was necessary in order to obtain agreement of South-Central to purchase timberland.

10. *Morse v. City of Boston*, 253 Mass. 247, 148 N.E. 613, 815 (1925), on later appeal 290 Mass. 255, 157 N.E. 523 (1927).

11. *Albert Elia Building Co., Inc. v. New York State Urban Development Corp.*, 54 A.D.2d 337, 388 N.Y.S.2d 462, 467 (1976).

12. See *Myers v. Wood*, 173 Mo App. 564, 158 S.W. 809, 912 (1912).

13. See *Sekerer v. Lake County Board of Commissioners*, 345 N.E.2d 865, 868-69 (Ind.App. 1976); *Myers v. Wood*, 158 S.W. at 812.

14. See *Albert Elia Building Co., Inc. v. New York State Urban Development Corp.*, S.2d at 467.

15. *Myers v. Wood*, 158 S.W. at 813. A clause authorizing modifications may so broadly read as to negate the statutory requirement of competitive bidding. *City of Boston*, 148 N.E. at 816.

16. See *Albert Elia Building Co., Inc. v. New York State Urban Development Corp.*, S.2d at 467.

This appears to be a legitimate rather than a pretextual reason for modifying the contract. It furthers the state's strong interest in maintaining or increasing existing population levels of game animals.¹⁷ Nor was the importance of the deleted area as wildlife habitat appreciated when the original contract was made. There is nothing suspicious about the timing of the change since it was made more than nine years after the initial contract was entered into, and timber cutting had taken place under the contract for seven years with about 58% of the total estimated volume in the original sale having by then been cut.¹⁸ While the contract does not specifically authorize replacing one timber area with another, the change here was relatively small, the substituted timber amounting to less than 7% of the total originally sold.

In a contract of this magnitude and duration it is to be expected that changes in circumstances will occur and that new perceptions concerning needed environmental protections will develop. A measure of flexibility is obviously required to be able to respond intelligently to the needs created by those changes. The substitution of timber here does not exceed permissible bounds.

III

The court awarded attorney's fees to South-Central of \$40,000.00. Kenai challenges this as unreasonable, and contends further that no attorney's fees should have been awarded since this case is within the public interest exception to the rule that the prevailing party is entitled to an award of partial attorney's fees.¹⁹

[4, 5] The determination of court awarded attorney's fees is committed to the discretion of the trial court and reviewable on appeal only for an abuse of discretion. Such an abuse is regarded as present only where the trial court's decision appears to

be manifestly unreasonable or motivated by an inappropriate purpose. *Alaska State Bank v. General Insurance Co.*, 579 P.2d 1862, 1370 (Alaska 1978). South-Central's attorneys expended some 845.8 hours in the defense of this case and South-Central paid them \$75,624.00. The only argument made by Kenai that the court's award of \$40,000.00 is unreasonable is that Kenai's actual attorney's fees were less than that sum. This, however, does not demonstrate that South-Central's attorneys' billings were unreasonable for opposing sides in a lawsuit do not necessarily have equal burdens. We therefore conclude that Kenai has not demonstrated that the court's award was manifestly unreasonable.

[6] We have recognized that in cases involving issues of genuine public interest an unsuccessful plaintiff should not be burdened with payment of a part of his opponent's attorney's fees under Civil Rule 82. *Thomas v. Rainey*, 611 P.2d 536, 539 (Alaska 1980); *Horowitz v. Alaska Bar Association*, 609 P.2d 39, 42 (Alaska 1980); *Gilbert v. State*, 526 P.2d 1131, 1136 (Alaska 1974). This exception has been made because of a fear that "awarding fees in this type of controversy will deter citizens from litigating questions of general public concern for fear of incurring the expense of the other party's attorney's fees." *Id.* at 1136. Accord, *Anchorage v. McCabe*, 668 P.2d 996, 990 (Alaska 1977).

In *Anchorage v. McCabe*, we identified three criteria useful in identifying public interest litigation:

- (1) Is the case designed to effectuate strong public policies?
- (2) If the plaintiff succeeds will numerous people receive benefits from the lawsuit?
- (3) Can only a private party have been expected to bring the suit?

18. *Seep* 218 supra.

19. Kenai argues that the public interest it has sought to vindicate lies in protecting the integrity of the competitive bidding process.

668 P.2d at 991. Accord, *Thomas v. Bailey*, 611 P.2d at 539 n.7. The foregoing can arguably be answered favorably to Kenai in this case. However, our cases establish what can be regarded as a fourth criterion which excludes this case from the public interest exception.

In *Weaver Bros., Inc. v. Alaska Transportation Commission*, 688 P.2d 819, 823 (Alaska 1978); *Lynden Transport, Inc. v. State*, 532 P.2d 700, 717 (Alaska 1975), and *Mobil Oil Corp. v. Local Boundary Commission*, 518 P.2d 92, 104 (Alaska 1974), we upheld attorney's fees awards against parties who had raised important questions of public interest but did not prevail. In *Mobil* we stated:

Because the sums at stake in this controversy are large enough to prompt a suit without consideration of the public interest, the superior court could have concluded that the property owners were acting in their private interests and not in behalf of the public.

Id. at 104. In *Lynden* we quoted with approval the foregoing language, 532 P.2d at 717, and in *Weaver Bros* we stated, citing *Lynden* and *Mobil Oil*:

[I]t appears to us that the competitive advantage sought by appellant in this litigation takes the case outside of the notion of public interest litigation.

688 P.2d at 823. Based on these authorities what we have called the fourth criterion may be expressed as whether the litigant claiming public interest status would have had sufficient economic incentive to bring the lawsuit even if it involved only narrow issues lacking general importance. Such a litigant is less apt than a party lacking this incentive to be deterred from bringing a good faith claim by the prospect of an adverse award of attorney's fees.

On this record, since Kenai was a competitor of South-Central and was seeking a continuing source of timber to process in its

1. AS 26.05.115, .120.

2. See Section 406.104 of the timber sale regulations, 11 AAC 76.130, the full text of which is reproduced at note 3 of the court's opinion.

mill, the court could have concluded that sufficient economic reasons to litigate the amendment regardless of grounds for the challenge. Under circumstances we decline to hold that award of attorney's fees to South-Central was an abuse of discretion.

AFFIRMED.

RABINOWITZ, Chief Justice, dissenting.

I do not agree with the court's ruling that the state and South-Central were to eliminate the primary manufacture requirement of their timber sale contract. The court places its imprimatur precisely the kind of modification to a competitively bid contract that the judicially imposed rule against material modification is designed to prevent.

The Alaska legislature has decreed an important state resource and asset, is to be disposed of only by competitive bidding.¹ This legislative mandate underlying policies are rendered ineffectual if the state and South-Central may at their competitively bid contract and substitute in its stead a significantly different agreement. On the record presented in this case I must conclude that the primary manufacture requirement was an important term of the timber sale contract and a waiver of that requirement wrought a permissible material change to the contract so as to conclude for several reasons. First, the primary manufacture requirement was an express condition of the state's request for bids, and the state candidly admits the requirement was "a significant part of consideration for the State's agreement to sell timber to South-Central." Second, administrative regulation authorizing primary manufacture requirement in timber sale contracts² and the governor's statement urging primary manufacture both of which were incorporated into the contract between the state and South-

3. This policy statement, which provides that "[r]ound logs may not be exported marketable commodity," is set forth at the end of the court's opinion.

17. See *Frank v. State*, 604 P.2d 1065, 1073 (Alaska 1978); *State v. Tanana Valley Sportsmen's Ass'n*, 583 P.2d 854, 859 n.16 (Alaska 1978).

view, that limit was exceeded when the state and South-Central removed the primary manufacture requirement from their contract.



Supreme Court of Alaska

June 18, 1982

I further disagree with the majority's conclusion that the question of the materiality of the primary manufacture requirement need not be reached because the original contract authorized renegotiation of its terms after five years and at regular intervals thereafter. If the statutory competitive bidding requirements are to have any continuing viability, the parties to a competitive bid contract may not circumvent the legislature's mandate by including in their contract a provision which authorizes any and all modifications.⁸ I recognize that the parties to a long-term contract for the sale of state-owned timber must be afforded a fair degree of latitude to make good faith modifications to their agreement in order to account for inevitable fluctuations in the market for timber and to respond to a myriad of factors which may not have been foreseeable at the time the timber was placed on bid. It does not follow, however, that the parties must be afforded unfettered license to rewrite their agreement; the judicially-imposed rule proscribing material modifications limits the power to alter a competitively bid contract and, in my

Plaintiff brought suit in connection with default on promissory note which purchaser had executed in favor of plaintiff when they purchased his mobile home. The Superior Court, Third Judicial District, Anchorage, James K. Singleton, J., granted summary judgment in favor of defendant bank, and plaintiff appealed. The Supreme Court, Diamond, Senior Justice, assigned, held that mobile home, which was moved once, from dealer's lot to mobile home park, was not within exemption in Motor Vehicle Act for vehicles which "crossed the highway," and therefore, was subject to registration under that Act, and filing and notation on certificate of title provisions of Act were exclusive method of perfecting security interest in mobile home.

Affirmed.

Burke, J., concurred in result.

4. I note also that both California and Oregon prohibit the export of state owned timber without primary manufacture. See Cal Pub. Res. Code § 4650 (West Supp. 11M2); Or. Rev. Stat. § 526.805 (1979).

5. South-Central was the only bidder on the contract in question.

6. The court recognizes that "a clause authorizing modification may not be so broadly read as to negate the statutory requirement of competitive bidding" but in my view fails to apply this rule to the state's and South-Central's power to alter their competitively bid contract.

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Mobile home, which was moved once, from dealer's lot to mobile home park, was not within exemption in Motor Vehicle Act for vehicles which "crossed the highway," and therefore, was subject to registration under that Act, and filing and notation on certificate of title provisions of Act were exclusive method of perfecting security interest in mobile home. AS 28.10.040, 28.10.040(1), 28.10.480, 28.10.510, 28.10.530 (Repealed).

M. Ashley Dickerson, Anchorage, for appellant.

Thomas R. Tylka, Anchorage, for appellee.

Before RABINOWITZ, C. J., CONNOR, BURKE and MATTHEWS, JJ., and DIMOND, Senior Justice.*

OPINION

DIMOND, Senior Justice.

Appellant Leslie Newell brought this action against Ray and Samantha Charlton, the National Bank of Alaska (NBA), and one other party in connection with the default by the Charltons on a promissory note which they had executed in favor of Newell when they purchased his mobile home or house trailer¹ in 1978. The suit against the Charltons sought judgment against them on the note, and asserted a lien against the mobile home which, Newell contended, served as security on the promissory note. NBA was later joined as a party in the suit when Newell learned that NBA also claimed a security interest in the mobile home.

The sole issue between Newell and NBA concerns which party has the superior se-

curity interest. NBA sought to perfect interest by filing the requisite document with the Motor Vehicle Division, according to the certificate of title provisions of Motor Vehicle Code. Newell sought to effect his interest by filing the promissory note with the Anchorage district recorder several months later.⁴ Such party claims that its method of filing its respective security interest was the exclusive method of perfecting a security interest in the automobile. Summary judgment was granted in favor of NBA, and Newell has appealed.

Perfection of security interests and priority of perfected interests in personal property and fixtures is generally governed by the provisions of the Uniform Commercial Code—Secured Transactions.² Under UCC, the filing of a financing statement perfects a security interest in property covered by this code would properly be made in the office of the recorder in the record district of the debtor's residence, or in case of fixtures, in the office where a mortgage on the real estate concerned would filed or recorded. AS 44.09.001 (former 45.05.783).

There are certain exceptions to the fil provisions of the UCC. AS 45.00.302 (1 mer AS 45.06.734) provides in part:

(c) The filing provisions of AS 45.101-45.09.507 do not apply to a security interest in property subject to a state

(2) of this state which provides for central filing of, or which requires indication on a certificate of title of, the known interests in the property, unless the property is inventory held for sale by a dealer which has not been previously sold at retail and for which no certificate of title has been issued.

* *Dimond*, Senior Justice, sitting by assignment made pursuant to article IV, section 11 of the Constitution of Alaska, and Alaska R. Admin. P. 23(a).

1. Newell, throughout his brief, refers to the mobile home as a trailer or house trailer.

2. Although the validity of Newell's security interest, a promissory note, was challenged NDA in the superior court, this issue is raised on appeal.

3. At the time of the transactions in question UCC—Secured Transactions was set out in 45.05.690—794. The article has since been renumbered and is now AS 45.06.101—807.

FIRST AMENDMENT TO THE NORTHSTAR UNIT LEASES BETWEEN THE STATE
OF ALASKA AND BP EXPLORATION (ALASKA) INC.

The State of Alaska ("State") and BP Exploration (Alaska) Inc. ("BPXA") are parties to the following leases in the Northstar Unit: ADL 312798, effective February 1, 1980; ADL 312799, effective February 1, 1980; ADL 312808, effective February 1, 1980; and ADL 312809, effective February 1, 1980 (collectively the "1980 Leases"); as well as ADL 355001, effective August 1, 1983 (the "1983 Lease"). The parties agree to amend the 1980 Leases and the 1983 Lease as set forth in this first amendment to the Northstar Unit leases.

1980 Leases

- 1) Paragraph 6(b) is replaced in its entirety as follows:

(b) Annual rental paid in advance is a credit on the royalty or supplemental royalty due under this lease for that year.

- 2) Paragraph 7 is replaced in its entirety as follows:

7. SUPPLEMENTAL ROYALTY. (a) In addition to the royalty paid and computed under paragraphs 8, 10, and 11 below, Lessee shall pay to the State a supplemental royalty ("supplemental royalty"). Lessee shall pay the supplemental royalty, if owed, upon the same production volume for which royalty is paid ("production volume"). The supplemental royalty payment for a given month equals the supplemental royalty value times the supplemental royalty percentage rate ("percentage rate") times the production volume for that month. The percentage rate shall be calculated monthly by reference to: (1) an ANS West Coast spot price ("spot price"); and (2) a supplemental royalty trigger price ("trigger price"). If the spot price is equal to or less than the trigger price, then the percentage rate equals zero. If the spot price is greater than the trigger price, then the percentage rate equals [the spot price per barrel minus the

trigger price per barrel] times 1.5 per cent per dollar per barrel. The percentage rate may never exceed 7.5 per cent.

(b) The spot price is the price per barrel calculated in Article 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement Agreement ("ANS Agreement"), dated December 31, 1991, between the State and BPXA, for the crude oil referred to as "ANS (USWC)" in the ANS Agreement. The trigger price is \$17.35 per barrel through April 30, 1997. On May 1, 1997, and each May 1 thereafter, the trigger price shall be adjusted by an inflation factor equal to fifty percent of the "inflation rate" defined as the Producer Price Index for Industrial Commodities ("PPI") for December of the previous year, as reported by April 30 of the current year, divided by the PPI for December of 1995, as reported by April 30, 1996. The supplemental royalty value for oil, gas, natural gas liquids and associated substances is defined in paragraphs 10 and 11 below. Exhibit B is a sample calculation to demonstrate the method of calculating supplemental royalty for oil.

- 3) Paragraph 9 is replaced in its entirety as follows:

9. REDUCTION OF ROYALTY. Except as provided in paragraph 7 above, Lessee shall not be entitled to any reduction of royalty paid under paragraph 8 above or supplemental royalty paid under paragraph 7 above based on any current or future agreement, State statute, or State regulation.

- 4) Paragraph 10 is replaced in its entirety as follows:

10. ROYALTY IN VALUE. Unless the State elects to receive all or a portion of its royalty or supplemental royalty in kind as provided in paragraph 12 below, Lessee shall pay to the State the value of all royalty and supplemental royalty oil, gas and associated substances as determined under paragraph 11 below. Royalty and supplemental royalty paid in value shall be free and clear of all lease expenses (and any portion of such expenses which is incurred away from the leased area), including, but not limited to, expenses for separation, cleaning dehydration, gathering, saltwater disposal, and preparing the oil, gas or associated substances for transportation off the leased area. All royalty and supplemental royalty that may become payable in money to the State shall be paid on or before the last day of the calendar month following the month in which the oil, gas or associated substances are produced. Royalty and supplemental royalty payments shall be accompanied by copies of run tickets or such other information relating to valuation of royalty and supplemental royalty as the State may require, which may include, but is not limited to, evidence of sales, shipments, and amounts of gross oil, gas and associated substances produced.

- 5) Paragraph 11 is replaced in its entirety as follows:

11. VALUE. For purposes of computing supplemental royalty due under this lease, the value of supplemental royalty oil, gas, natural gas liquids and associated substances shall be the value used in computing royalty on said substances.

(a) To compute the value of oil for royalty and supplemental royalty purposes, this lease shall be deemed an "ANS Lease" under the terms of the ANS Agreement, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(b) To compute the value of gas and natural gas liquids for royalty and supplemental royalty purposes, this lease shall be deemed a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation Settlement Agreement between BPXA and the State dated as of April 1, 1995, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(c) To compute the value of associated substances (which shall be deemed to exclude oil, gas, and natural gas liquids) for royalty and supplemental royalty purposes, the value of such associated substances shall not be less than the highest of:

(1) the field price actually received by Lessee for such associated substances;

(2) Lessee's posted price in the field for such associated substances;

(3) the volume weighted average field price actually received by other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area; or

(4) the volume weighted average posted price in the field of other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area.

If associated substances are sold away from the leased or unit area, the term "field price" above shall be the actual price for such associated substances received from the purchaser thereof less the actual cost of transportation away from the leased or unit area to the point of delivery.

Minimum Value Determinations. The State may establish minimum values for purposes of computing royalties on associated substances obtained from this lease, with consideration being given to the price actually received by Lessee, to the price or prices paid in the same field or area for production of like quality, to posted prices, to prices received by Lessee and/or other producers from

sales occurring away from the leased area, and to other relevant matters. Each such determination will be made only after Lessee has been given notice and a reasonable opportunity to be heard. Under this provision, it is expressly agreed that the minimum value of royalty associated substances under this lease may not necessarily equal the price of such associated substances.

- 6) The following provision shall be added to the end of paragraph 12:

(e) Supplemental royalty under paragraph 7 above may be taken in kind under the same terms and conditions as royalty may be taken in kind under this paragraph 12.

- 7) Paragraph 14 is replaced in its entirety as follows:

14. APPORTIONMENT OF ROYALTY FROM APPROVED UNIT. The landowner's royalty and supplemental royalty share of the unit production allocated to each separately owned tract shall be regarded as royalty to be distributed to and among, or the proceeds of it paid to, the landowners, free and clear of all unit expense and free of any lien for it. Under this provision, the State's royalty and supplemental royalty share of any unit production allocated to the leased area shall be regarded as royalty to be distributed to, or the proceeds of it paid to, the State, free and clear of all unit expenses (and any portion of such expenses which is incurred away from the unit area), including, but not limited to, expenses for separation, cleaning, dehydration, gathering, saltwater disposal, and preparing oil, gas or associated substances for transportation off the unit area, and free of any lien for it.

- 8) Paragraph 28 (c) is added as follows:

(c) Notwithstanding any other provisions of this lease, the Northstar Unit Agreement, State statute, or State regulation, this lease shall terminate automatically without notice, an opportunity to be heard, or judicial proceeding, if the Lessee fails to comply with the project schedule set forth in Exhibit C ("project schedule"), attached and incorporated by reference. Automatic termination shall occur whether or not there is a well on the leased area capable of producing oil or gas in paying quantities, the lease is committed to a unit agreement, or the Lessee is drilling or conducting reworking operations, on the date performance under the schedule is due. Furthermore, upon termination BPXA shall promptly file of record appropriate lease relinquishments. The automatic termination shall occur at 11:59 P.M., Alaska Time, on the day performance of an obligation under the project schedule is due. The State may waive performance of an obligation required under the project schedule by prior written consent. The performance of any obligation

required under the project schedule is subject to the provisions of paragraph 32.

- 9) Paragraph 32 is replaced in its entirety as follows:

32. **FORCE MAJEURE.** If the State determines that Lessee has been prevented, after diligent efforts made in good faith, from complying with any express or implied promise, term, condition or covenant of this lease, from conducting drilling operations, or from producing or marketing oil or gas from the leased area, by reason of war, riots, acts of God, unusually severe weather, or any other cause beyond Lessee's reasonable ability to foresee or control (including delays caused by judicial decision or lack thereof or inability to obtain local, State, or federal permits or environmental impact statements), whether similar to those enumerated or not, Lessee's obligation to comply with such provision shall be suspended, but not voided, and Lessee shall not be liable for damages for failure to comply therewith. If Lessee's obligations to conduct drilling or reworking operations are suspended under this paragraph and the continuation of such operations without suspension would have had the effect of preventing the expiration or termination of this lease, this lease shall not terminate during the period which the obligation to perform such operations is suspended. Nothing in this paragraph shall be construed to suspend the obligation to pay rentals, or to suspend the obligation to pay royalties, supplemental royalties or other production payments from operations on the lease area which are not suspended or from operations which are not affected by any such suspension, to the State.

- 10) Paragraph 41 is replaced in its entirety as follows:

41. **EMPLOYMENT OF ALASKAN RESIDENTS.** Lessee shall comply with all valid federal, State and local laws in hiring Alaska residents and contractors and shall not discriminate against Alaska residents or contractors. Within the constraints of law, Lessee shall employ Alaska residents and contractors to the extent they are available and qualified. Subject to the foregoing:

Lessee voluntarily agrees to adopt a program to hire residents of Alaska. Lessee shall advertise for available positions locally and use Alaska job service organizations to notify the Alaskan public. For work in connection with this lease, Lessee shall use best efforts to contract with Alaska firms and fabricate modules in Alaska, whenever feasible. Lessee shall encourage its contractors to employ and train, when necessary, residents of Alaska. In determining feasibility, Lessee shall consider commercial, health, safety, and environmental conditions and requirements to ensure maintenance of Lessee's operational standards. Lessee shall submit annually to the Director, Division of Oil and Gas, for transmission to the Department of

Labor, a report that details the specific measures Lessee and its contractors and subcontractors have taken or are planning to take to recruit qualified Alaska residents for available jobs, describes on-the-job training opportunities, and describes Lessee's efforts to hire Alaska firms for work in connection to this lease. Lessee shall furnish the Department of Labor a quarterly report regarding the employment of Alaska residents on the leased area in compliance with regulations by the Commissioner of Labor. The report must also include statistical data concerning the number of resident personnel hired within the past year for this lease.

1983 Lease

- 1) Paragraph 4(f) and paragraph 34(7) are deleted and replaced in their entirety with the following paragraph 4(f):

(f) FORCE MAJEURE. If the state determines that lessee has been prevented, after diligent efforts made in good faith, from complying with any express or implied promise, term, condition or covenant of this lease, from conducting drilling operations, or from producing or marketing oil or gas from the leased area, by reason of war, riots, acts of God, unusually severe weather, or any other cause beyond lessee's reasonable ability to foresee or control (including delays caused by judicial decision or lack thereof or inability to obtain local, state, or federal permits or environmental impact statements), whether similar to those enumerated or not, lessee's obligation to comply with such provision shall be suspended, but not voided, and lessee shall not be liable for damages for failure to comply therewith. If lessee's obligations to conduct drilling or reworking operations are suspended under this paragraph and the continuation of such operations without suspension would have had the effect of preventing the expiration or termination of this lease, this lease shall not terminate during the period which the obligation to perform such operations is suspended. Nothing in this paragraph shall be construed to suspend the obligation to pay rentals, or to suspend the obligation to pay royalties, supplemental royalties or other production payments from operations on the lease area which are not suspended or from operations which are not affected by any such suspension, to the state.

- 2) Paragraph 5(b) is replaced in its entirety as follows:

(b) Annual rental paid in advance is a credit on the royalty or supplemental royalty due under this lease for that year.

- 3) Paragraph 7 is replaced in its entirety as follows:

7. APPORTIONMENT OF ROYALTY FROM APPROVED UNIT. The state's royalty and supplemental royalty share of the unit production allocated to each separately owned tract must be regarded as royalty to be distributed to or among, or the proceeds of it paid to, the state, free and clear of all unit expenses and free of any lien for them. Under this provision, the state's royalty and supplemental royalty share of any unit production allocated to the leased area will be regarded as royalty to be distributed to, or the proceeds of it paid to, the state, free and clear of all unit expenses (and any portion of those expenses incurred away from the unit area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering, saltwater disposal, and preparing oil, gas, or associated substances for transportation off the unit area, and free of any lien for them.

- 4) A new paragraph 20(c) is added as follows:

(c) Notwithstanding any other provisions of this lease, the Northstar Unit Agreement, state statute, or state regulation, this lease shall terminate automatically without notice, an opportunity to be heard, or judicial proceeding, if the lessee fails to comply with the project schedule set forth in Exhibit C ("project schedule"), attached and incorporated by reference. Automatic termination shall occur whether or not there is a well on the leased area capable of producing oil or gas in paying quantities, the lease is committed to a unit agreement, or the lessee is drilling or conducting reworking operations, on the date performance under the schedule is due. Furthermore, upon termination BPXA shall promptly file of record appropriate lease relinquishments. The automatic termination shall occur at 11:59 P.M., Alaska Time, on the day performance of an obligation under the project schedule is due. The state may waive performance of an obligation required under the project schedule by prior written consent. The performance of any obligation required under the project schedule is subject to the provisions of paragraph 4(f).

- 5) Paragraph 31 is replaced in its entirety as follows:

31. EMPLOYMENT OF ALASKAN RESIDENTS. Lessee shall comply with all valid federal, state and local laws in hiring Alaska residents and contractors and shall not discriminate against Alaska residents or contractors. Within the constraints of law, lessee shall employ Alaska residents and contractors to the extent they are available and qualified. Subject to the foregoing:

Lessee voluntarily agrees to adopt a program to hire residents of Alaska. Lessee shall advertise for available positions locally and use Alaska job

service organizations to notify the Alaskan public. For work in connection with this lease, lessee shall use best efforts to contract with Alaska firms and fabricate modules in Alaska, whenever feasible. Lessee shall encourage its contractors to employ and train, when necessary, residents of Alaska. In determining feasibility, lessee shall consider commercial, health, safety, and environmental conditions and requirements to ensure maintenance of lessee's operational standards. Lessee shall submit annually to the Director, Division of Oil and Gas, for transmission to the Department of Labor, a report that details the specific measures lessee and its contractors and subcontractors have taken or are planning to take to recruit qualified Alaska residents for available jobs, describes on-the-job training opportunities, and describes lessee's efforts to hire Alaska firms for work in connection to this lease. Lessee shall furnish the Department of Labor a quarterly report regarding the employment of Alaska residents on the leased area in compliance with regulations by the Commissioner of Labor. The report must also include statistical data concerning the number of resident personnel hired within the past year for this lease.

- 6) Paragraph 35 is replaced in its entirety as follows:

35. ROYALTY ON PRODUCTION. Except for oil, gas, and associated substances used on the leased area for development and production or unavoidably lost, the lessee shall pay to the state as a royalty 20 percent in amount or value of the oil, gas, and associated substances saved, removed, or sold from the leased area and of the gas used on the leased area for extraction of natural gasoline or other products from the leased area.

- 7) Paragraph 36 is replaced in its entirety as follows:

36. VALUE. For purposes of computing supplemental royalty due under this lease, the value of supplemental royalty oil, gas, natural gas liquids, and associated substances shall be the value used in computing royalty on said substances.

(a) To compute the value of oil for royalty and supplemental royalty purposes, this lease shall be deemed an "ANS Lease" under the terms of the ANS Agreement, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(b) To compute value of gas and natural gas liquids for royalty and supplemental royalty purposes, this lease shall be deemed a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation Settlement Agreement between BPXA and the State dated as of April 1, 1995, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(c) To compute the value of associated substances (which shall be deemed to exclude oil, gas, and natural gas liquids) for royalty and supplemental royalty purposes, the value of such associated substances shall not be less than the highest of:

(1) the field price actually received by lessee for such associated substances;

(2) Lessee's posted price in the field for such associated substances;

(3) the volume weighted average field price actually received by other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area; or

(4) the volume weighted average posted price in the field of other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area.

If associated substances are sold away from the leased or unit area, the term "field price" above shall be the actual price for such associated substances received from the purchaser thereof less the actual cost of transportation away from the leased or unit area to the point of delivery.

Minimum Value Determinations. The state may establish minimum values for purposes of computing royalties on associated substances obtained from this lease, with consideration being given to the price actually received by lessee, to the price or prices paid in the same field or area for production of like quality, to posted prices, to prices received by lessee and/or other producers from sales occurring away from the leased area, and to other relevant matters. Each such determination will be made only after lessee has been given notice and a reasonable opportunity to be heard. Under this provision, it is expressly agreed that the minimum value of royalty associated substances under this lease may not necessarily equal the price of such associated substances.

8) Paragraph 37 is replaced in its entirety as follows:

37. ROYALTY IN VALUE. Unless the state elects to receive all or a portion of its royalty or supplemental royalty in kind as provided in paragraph 38, lessee shall pay to the state the value of all royalty and supplemental royalty oil, gas and associated substances as determined under paragraph 36. Royalty and supplemental royalty paid in value shall be free and clear of all lease expenses (and any portion of such expenses which is incurred away from the leased area), including, but not limited to, expenses for separation, cleaning

dehydration, gathering, saltwater disposal, and preparing the oil, gas or associated substances for transportation off the leased area. All royalty and supplemental royalty that may become payable in money to the state shall be paid on or before the last day of the calendar month following the month in which the oil, gas or associated substances are produced. Royalty and supplemental royalty payments shall be accompanied by copies of run tickets or such other information relating to valuation of royalty and supplemental royalty as the state may require, which may include, but is not limited to, evidence of sales, shipments, and amounts of gross oil, gas and associated substances produced.

- 9) The following provision shall be added to the end of paragraph 38:

(f) Supplemental royalty under this lease may be taken in kind under the same terms and conditions as royalty may be taken in kind under this paragraph 38.

- 10) Paragraph 39 is replaced in its entirety as follows:

39. REDUCTION OF ROYALTY. Except as provided in paragraph 40 below, lessee shall not be entitled to any reduction of royalty paid under paragraph 35 above or supplemental royalty paid under paragraph 40 below based on any current or future agreement, state statute, or state regulation.

- 11) Paragraph 40 is replaced in its entirety as follows:

40. SUPPLEMENTAL ROYALTY. (a) In addition to the royalty paid and computed under paragraph 35, 36, 37 above, lessee shall pay to the state a supplemental royalty ("supplemental royalty"). Lessee shall pay the supplemental royalty, if owed, upon the same production volume for which royalty is paid ("production volume"). The supplemental royalty payment for a given month equals the supplemental royalty value times the supplemental royalty percentage rate ("percentage rate") times the production volume for that month. The percentage rate shall be calculated monthly by reference to: (1) an ANS West Coast spot price ("spot price"); and (2) a supplemental royalty trigger price ("trigger price"). If the spot price is equal to or less than the trigger price, then the percentage rate equals zero. If the spot price is greater than the trigger price, then the percentage rate equals [the spot price per barrel minus the trigger price per barrel] times 1.5 per cent per dollar per barrel. The percentage rate may never exceed 7.5 per cent.

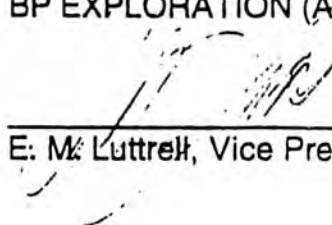
(b) The spot price is the price per barrel calculated in Article 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement Agreement ("ANS Agreement"), dated December 31, 1991, between the State and BPXA, for the crude oil referred to

as "ANS (USWC)" in the ANS Agreement. The trigger price is \$17.35 per barrel through April 30, 1997. On May 1, 1997, and each May 1 thereafter, the trigger price shall be adjusted by an inflation factor equal to fifty percent of the "inflation rate" defined as the Producer Price Index for Industrial Commodities ("PPI") for December of the previous year, as reported by April 30 of the current year, divided by the PPI for December of 1995, as reported by April 30, 1996. The supplemental royalty value for oil, gas, natural gas liquids and associated substances is defined in paragraphs 36 and 37 above. Exhibit B is a sample calculation to demonstrate the method of calculating supplemental royalty for oil.

These amendments do not affect: (1) any future agreements which may be reached for the handling of outside substances as that term is used in the Northstar Unit Agreement effective January 24, 1990 or (2) the current valuation methodology for royalty for any other Alaska Net Profit Share leases between the State and BPXA or any affiliates or any future agreements which may be reached regarding a future valuation methodology for Alaska Net Profit Share leases. These amendments take effect when and if an Act(s) substantially similar to the act, attached as Exhibit D and incorporated by reference, takes effect. This amendment is dated for reference purposes as of March 22, 1996.

LESSEE: -

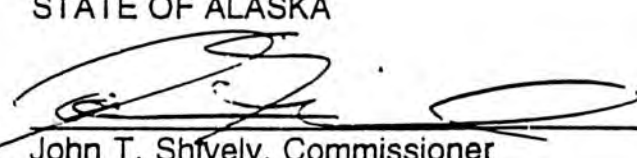
BP EXPLORATION (ALASKA), INC.



E. M. Luttrell, Vice President

LESSOR:

STATE OF ALASKA



John T. Shively, Commissioner
Department of Natural Resources

STATE OF ALASKA

Third Judicial District

)
) ss.
)

On March 22, 1996, before me appeared John T. Shively, Commissioner, State of Alaska, Department of Natural Resources, and who executed this lease and acknowledged voluntarily signing it on behalf of the State of Alaska, as lessor.

Dianne A. Pitts
Notary Public in and for the State of Alaska
My Commission Expires: 1/16/99



STATE OF ALASKA

Third Judicial District

)
) ss.
)

On March 22, 1996, before me appeared E. M. Lutrell, Vice President of BP Exploration (Alaska), Inc., and who executed this lease and acknowledged voluntarily signing it on behalf of the BP Exploration (Alaska), Inc., as lessee.

Dianne A. Pitts
Notary Public in and for the State of Alaska
My Commission Expires: 1/16/99



Exhibit B
Calculation of the Supplemental Royalty Payment for Oil

- 1) The calculation of the ANS West Coast spot price is derived from Platt's "Oilgram Price Report" Spot Crude Price Assessments:

Date	Platt's Reported Daily Assessment (\$/barrel)		ANSWC Daily Average	ANSWC Daily Average (After Rounding) ¹
	ANSWC Low	ANSWC High		
01/02/96	\$17.97	\$18.06	\$18.015	\$18.02
01/03/96	\$17.94	\$18.03	\$17.985	\$17.98
01/04/96	\$17.96	\$18.03	\$17.995	\$18.00
01/05/96	\$18.60	\$18.64	\$18.620	\$18.52
01/09/96	\$18.23	\$18.29	\$18.260	\$18.26
01/10/96	\$17.99	\$18.05	\$18.020	\$18.02
01/11/96	\$17.10	\$17.17	\$18.135	\$17.14
01/12/96	\$16.64	\$16.71	\$18.675	\$16.68
01/15/96	\$16.75	\$16.83	\$16.690	\$16.79
01/16/96	\$16.60	\$16.66	\$16.730	\$16.63
01/17/96	\$16.91	\$16.97	\$16.940	\$16.94
01/18/96	\$17.46	\$17.54	\$17.500	\$17.50
01/19/96	\$17.28	\$17.37	\$17.325	\$17.32
01/22/96	\$17.02	\$17.08	\$17.050	\$17.05
01/23/96	\$17.10	\$17.16	\$17.150	\$17.13
01/24/96	\$17.35	\$17.41	\$17.380	\$17.38
01/25/96	\$16.76	\$16.81	\$17.785	\$16.78
01/26/96	\$16.43	\$16.53	\$17.480	\$16.48
01/29/96	\$16.16	\$16.24	\$16.200	\$16.20
01/30/96	\$16.30	\$16.38	\$16.340	\$16.34
01/31/96	\$16.46	\$16.56	\$16.510	\$16.51

Monthly Average calculated from ANSWC Daily Average (After Rounding) =

\$17.2271 per barrel

ANS West Coast spot price for the January 1996 month of production =

\$17.23 per barrel

- 2) The inflation factor shall be calculated as follows: Assume that by April 30, 1996, the U.S. Department of Labor reports a PPI for December 1995 as 126.2. Assume that by April 30, 1998, the PPI for December 1997 is 134.2. The inflation factor for 1998 is calculated according to the following formula:

¹ All source and calculated numbers shall be rounded as required in the ANS Agreement.

Inflation Factor for May 1, 1998 through April 30, 1999

$$= [(PPI \text{ December of the previous year} \div PPI \text{ December 1995}) - 1] \times 0.5$$

$$= [(134.2 \div 126.2) - 1] \times 0.5 = 0.0317 = 3.17 \text{ percent}$$

3) The trigger price for May 1, 1998 through April 30, 1999 is calculated by adjusting \$17.35 per barrel by the inflation factor as follows:

$$\text{Trigger price for the current year} = \$17.35 \text{ per barrel} \times (1 + \text{inflation factor})$$

$$= \$17.35 \text{ per barrel} \times (1 + 3.17 \text{ percent})$$

$$= \$17.35 \times 1.0317$$

$$= \$17.90 \text{ per barrel}$$

4) Assuming the current month ANSWC spot price is \$21.40, the supplemental royalty percentage rate is calculated as:

$$\text{Supplemental royalty percentage rate} = (\text{ANSWC spot price} - \text{trigger price for the current year}) \times (1.5 \text{ percent per dollar per barrel})$$

$$= (\$21.40 \text{ per barrel} - \$17.90 \text{ per barrel}) \times 1.5 \text{ percent per dollar per barrel}$$

$$= (21.40 - 17.90) \times 0.015$$

$$= 0.05250 = 5.25 \text{ percent}$$

5) The calculation of the supplemental royalty payment for the current month is the product of the production volume times the royalty value and the supplemental royalty percentage rate. Assume that 1,550,000 barrels of oil were produced in the Northstar unit in the current month and that the royalty value is \$17.71. The supplemental royalty is:

$$\text{Supplemental royalty payment} = \text{production volume} \times \text{royalty value} \times \text{supplemental royalty percentage rate}$$

$$= 1,550,000 \text{ barrels} \times \$17.71 \text{ per barrel} \times 5.25 \text{ percent}$$

$$= \$1,441,151.25$$

EXHIBIT C
PROJECT SCHEDULE

The Northstar Development Project ("the Project") is described in the document titled "Northstar Development Project, Conceptual Engineering Report" dated February 1996. BPXA shall comply with the following schedule for the Project and shall provide satisfactory evidence of compliance within fifteen days of the date performance is due under the schedule:

BPXA shall receive Project sanction within twelve (12) months after passage by the legislature of an Act approving the First Amendments to the Northstar Unit Leases for the Project. "Project sanction" means approval in writing by the highest appropriate authority in BPXA or its parent entity necessary for the total amount of expenditures required for the Project. Satisfactory evidence of receipt of sanction shall be tendered to the State in the form of the sanctioning entity's documents approving the expenditure of funds for the Project. If Project sanction is withdrawn for any reason whatsoever, BPXA shall notify the State within three working days by letter from an authorized officer and BPXA shall be deemed to have failed to comply with this schedule.

EXHIBIT D

ACT

— BILL NO. —

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE — RULES COMMITTEE BY REQUEST OF THE GOVERNOR

Introduced:

Referred:

A BILL

FOR AN ACT ENTITLED

1 "An Act authorizing, approving, and ratifying the amendment of Northstar Unit
2 oil and gas leases between the State of Alaska and BP Exploration (Alaska)
3 Inc.; and providing for an effective date."

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

5 " Section 1. The legislature finds that

6 (1) the production of oil and gas from state land is a matter of statewide
7 interest and effect because it is an important source of revenue to the state and job
8 opportunities for the people of the state;

9 (2) BP Exploration (Alaska) Inc. holds state oil and gas leases in the Northstar
10 Unit that include net profit share provisions;

11 (3) with the current and projected price of oil, BP Exploration (Alaska) Inc.
12 maintains that the net profit share provisions of the Northstar Unit leases prevent the timely
13 development of the unit;

14 (4) existing law set out in AS 38.05 does not provide the commissioner of the

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1 Department of Natural Resources with sufficient express authority to amend the net profit
2 share provisions of the Northstar Unit leases held by BP Exploration (Alaska) Inc.;

3 (5) unless the net profit share provisions of the Northstar Unit leases are
4 amended, production of oil and gas from the unit is unlikely to begin until the year 2002;

5 (6) the Department of Revenue currently forecasts that production will not
6 begin from the unit until the year 2002;

7 (7) if the net profit share provisions of the Northstar Unit leases are amended,
8 full production of oil and gas from the unit may begin as early as the year 1999;

9 (8) amending the net profit share provisions of the Northstar Unit leases to
10 provide for a supplemental royalty will maximize the economic benefits of oil and gas
11 production to the people of the state by encouraging timely production from the unit;

12 (9) the development of the unit and the associated construction of unit facilities
13 within the state will provide additional revenue to the state and increased job opportunities;

14 (10) BP Exploration (Alaska) Inc. has committed to use its best efforts to hire
15 Alaska residents and contractors and to fabricate modules for the unit in Alaska;

16 (11) the timely development of the unit may result in increased state revenue
17 in future lease sales;

18 (12) the timely development of the unit may result in technological
19 breakthroughs and other cost savings that may make other development opportunities in
20 Alaska economically feasible; and

21 (13) the development of the unit will include the first truly offshore Arctic
22 island construction and Arctic subsea pipeline for oil.

23 * Sec. 2. (a) The State of Alaska and BP Exploration (Alaska) Inc. are parties to the
24 following leases in the Northstar Unit:

25 (1) ADL 312798, effective February 1, 1980;

26 (2) ADL 312799, effective February 1, 1980;

27 (3) ADL 312808, effective February 1, 1980;

28 (4) ADL 312809, effective February 1, 1980; and

29 (5) ADL 355001, effective August 1, 1983.

30 (b) The commissioner of the Department of Natural Resources may amend the
31 Northstar Unit leases described in (a) of this section to the extent set out in the "First

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MAR-22-96 FRI 17:12

DIV OF OIL AND GAS

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- 1 Amendment to the Northstar Unit Leases Between the State of Alaska and BP Exploration
- 2 (Alaska) Inc.", dated March __, 1996.
- 3 (c) Notwithstanding any other provision of law, the "First Amendment to the Northstar
- 4 Unit Leases Between the State of Alaska and BP Exploration (Alaska) Inc.", dated March _
- 5 __ 1996, is approved and ratified.
- 6 * Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

FIRST AMENDMENT TO THE NORTHSTAR UNIT LEASES BETWEEN THE STATE
OF ALASKA AND BP EXPLORATION (ALASKA) INC.

The State of Alaska ("State") and BP Exploration (Alaska) Inc. ("BPXA") are parties to the following leases in the Northstar Unit: ADL 312798, effective February 1, 1980; ADL 312799, effective February 1, 1980; ADL 312808, effective February 1, 1980; and ADL 312809, effective February 1, 1980 (collectively the "1980 Leases"); as well as ADL 355001, effective August 1, 1983 (the "1983 Lease"). The parties agree to amend the 1980 Leases and the 1983 Lease as set forth in this first amendment to the Northstar Unit leases.

1980 Leases

- 1) Paragraph 6(b) is replaced in its entirety as follows:

(b) Annual rental paid in advance is a credit on the royalty or supplemental royalty due under this lease for that year.

- 2) Paragraph 7 is replaced in its entirety as follows:

7. SUPPLEMENTAL ROYALTY. (a) In addition to the royalty paid and computed under paragraphs 8, 10, and 11 below, Lessee shall pay to the State a supplemental royalty ("supplemental royalty"). Lessee shall pay the supplemental royalty, if owed, upon the same production volume for which royalty is paid ("production volume"). The supplemental royalty payment for a given month equals the supplemental royalty value times the supplemental royalty percentage rate ("percentage rate") times the production volume for that month. The percentage rate shall be calculated monthly by reference to: (1) an ANS West Coast spot price ("spot price"); and (2) a supplemental royalty trigger price ("trigger price"). If the spot price is equal to or less than the trigger price, then the percentage rate equals zero. If the spot price is greater than the trigger price, then the percentage rate equals [the spot price per barrel minus the

trigger price per barrel] times 1.5 per cent per dollar per barrel. The percentage rate may never exceed 7.5 per cent.

(b) The spot price is the price per barrel calculated in Article 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement Agreement ("ANS Agreement"), dated December 31, 1991, between the State and BPXA, for the crude oil referred to as "ANS (USWC)" in the ANS Agreement. The trigger price is \$17.35 per barrel through April 30, 1997. On May 1, 1997, and each May 1 thereafter, the trigger price shall be adjusted by an inflation factor equal to fifty percent of the "inflation rate" defined as the Producer Price Index for Industrial Commodities ("PPI") for December of the previous year, as reported by April 30 of the current year, divided by the PPI for December of 1995, as reported by April 30, 1996. The supplemental royalty value for oil, gas, natural gas liquids and associated substances is defined in paragraphs 10 and 11 below. Exhibit B is a sample calculation to demonstrate the method of calculating supplemental royalty for oil.

- 3) Paragraph 9 is replaced in its entirety as follows:

9. REDUCTION OF ROYALTY. Except as provided in paragraph 7 above, Lessee shall not be entitled to any reduction of royalty paid under paragraph 8 above or supplemental royalty paid under paragraph 7 above based on any current or future agreement, State statute, or State regulation.

- 4) Paragraph 10 is replaced in its entirety as follows:

10. ROYALTY IN VALUE. Unless the State elects to receive all or a portion of its royalty or supplemental royalty in kind as provided in paragraph 12 below, Lessee shall pay to the State the value of all royalty and supplemental royalty oil, gas and associated substances as determined under paragraph 11 below. Royalty and supplemental royalty paid in value shall be free and clear of all lease expenses (and any portion of such expenses which is incurred away from the leased area), including, but not limited to, expenses for separation, cleaning dehydration, gathering, saltwater disposal, and preparing the oil, gas or associated substances for transportation off the leased area. All royalty and supplemental royalty that may become payable in money to the State shall be paid on or before the last day of the calendar month following the month in which the oil, gas or associated substances are produced. Royalty and supplemental royalty payments shall be accompanied by copies of run tickets or such other information relating to valuation of royalty and supplemental royalty as the State may require, which may include, but is not limited to, evidence of sales, shipments, and amounts of gross oil, gas and associated substances produced.

- 5) Paragraph 11 is replaced in its entirety as follows:

11. VALUE. For purposes of computing supplemental royalty due under this lease, the value of supplemental royalty oil, gas, natural gas liquids and associated substances shall be the value used in computing royalty on said substances.

(a) To compute the value of oil for royalty and supplemental royalty purposes, this lease shall be deemed an "ANS Lease" under the terms of the ANS Agreement, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(b) To compute the value of gas and natural gas liquids for royalty and supplemental royalty purposes, this lease shall be deemed a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation Settlement Agreement between BPXA and the State dated as of April 1, 1995, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(c) To compute the value of associated substances (which shall be deemed to exclude oil, gas, and natural gas liquids) for royalty and supplemental royalty purposes, the value of such associated substances shall not be less than the highest of:

(1) the field price actually received by Lessee for such associated substances;

(2) Lessee's posted price in the field for such associated substances;

(3) the volume weighted average field price actually received by other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area; or

(4) the volume weighted average posted price in the field of other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area.

If associated substances are sold away from the leased or unit area, the term "field price" above shall be the actual price for such associated substances received from the purchaser thereof less the actual cost of transportation away from the leased or unit area to the point of delivery.

Minimum Value Determinations. The State may establish minimum values for purposes of computing royalties on associated substances obtained from this lease, with consideration being given to the price actually received by Lessee, to the price or prices paid in the same field or area for production of like quality, to posted prices, to prices received by Lessee and/or other producers from

sales occurring away from the leased area, and to other relevant matters. Each such determination will be made only after Lessee has been given notice and a reasonable opportunity to be heard. Under this provision, it is expressly agreed that the minimum value of royalty associated substances under this lease may not necessarily equal the price of such associated substances.

- 6) The following provision shall be added to the end of paragraph 12:

(e) Supplemental royalty under paragraph 7 above may be taken in kind under the same terms and conditions as royalty may be taken in kind under this paragraph 12.

- 7) Paragraph 14 is replaced in its entirety as follows:

14. APPORTIONMENT OF ROYALTY FROM APPROVED UNIT. The landowner's royalty and supplemental royalty share of the unit production allocated to each separately owned tract shall be regarded as royalty to be distributed to and among, or the proceeds of it paid to, the landowners, free and clear of all unit expense and free of any lien for it. Under this provision, the State's royalty and supplemental royalty share of any unit production allocated to the leased area shall be regarded as royalty to be distributed to, or the proceeds of it paid to, the State, free and clear of all unit expenses (and any portion of such expenses which is incurred away from the unit area), including, but not limited to, expenses for separation, cleaning, dehydration, gathering, saltwater disposal, and preparing oil, gas or associated substances for transportation off the unit area, and free of any lien for it.

- 8) Paragraph 28 (c) is added as follows:

(c) Notwithstanding any other provisions of this lease, the Northstar Unit Agreement, State statute, or State regulation, this lease shall terminate automatically without notice, an opportunity to be heard, or judicial proceeding, if the Lessee fails to comply with the project schedule set forth in Exhibit C ("project schedule"), attached and incorporated by reference. Automatic termination shall occur whether or not there is a well on the leased area capable of producing oil or gas in paying quantities, the lease is committed to a unit agreement, or the Lessee is drilling or conducting reworking operations, on the date performance under the schedule is due. Furthermore, upon termination BPXA shall promptly file of record appropriate lease relinquishments. The automatic termination shall occur at 11.59 P.M., Alaska Time, on the day performance of an obligation under the project schedule is due. The State may waive performance of an obligation required under the project schedule by prior written consent. The performance of any obligation

required under the project schedule is subject to the provisions of paragraph 32.

- 9) Paragraph 32 is replaced in its entirety as follows:

32. **FORCE MAJEURE.** If the State determines that Lessee has been prevented, after diligent efforts made in good faith, from complying with any express or implied promise, term, condition or covenant of this lease, from conducting drilling operations, or from producing or marketing oil or gas from the leased area, by reason of war, riots, acts of God, unusually severe weather, or any other cause beyond Lessee's reasonable ability to foresee or control (including delays caused by judicial decision or lack thereof or inability to obtain local, State, or federal permits or environmental impact statements), whether similar to those enumerated or not, Lessee's obligation to comply with such provision shall be suspended, but not voided, and Lessee shall not be liable for damages for failure to comply therewith. If Lessee's obligations to conduct drilling or reworking operations are suspended under this paragraph and the continuation of such operations without suspension would have had the effect of preventing the expiration or termination of this lease, this lease shall not terminate during the period which the obligation to perform such operations is suspended. Nothing in this paragraph shall be construed to suspend the obligation to pay rentals, or to suspend the obligation to pay royalties, supplemental royalties or other production payments from operations on the lease area which are not suspended or from operations which are not affected by any such suspension, to the State.

- 10) Paragraph 41 is replaced in its entirety as follows:

41. **EMPLOYMENT OF ALASKAN RESIDENTS.** Lessee shall comply with all valid federal, State and local laws in hiring Alaska residents and contractors and shall not discriminate against Alaska residents or contractors. Within the constraints of law, Lessee shall employ Alaska residents and contractors to the extent they are available and qualified. Subject to the foregoing:

Lessee voluntarily agrees to adopt a program to hire residents of Alaska. Lessee shall advertise for available positions locally and use Alaska job service organizations to notify the Alaskan public. For work in connection with this lease, Lessee shall use best efforts to contract with Alaska firms and fabricate modules in Alaska, whenever feasible. Lessee shall encourage its contractors to employ and train, when necessary, residents of Alaska. In determining feasibility, Lessee shall consider commercial, health, safety, and environmental conditions and requirements to ensure maintenance of Lessee's operational standards. Lessee shall submit annually to the Director, Division of Oil and Gas, for transmission to the Department of

Labor, a report that details the specific measures Lessee and its contractors and subcontractors have taken or are planning to take to recruit qualified Alaska residents for available jobs, describes on-the-job training opportunities, and describes Lessee's efforts to hire Alaska firms for work in connection to this lease. Lessee shall furnish the Department of Labor a quarterly report regarding the employment of Alaska residents on the leased area in compliance with regulations by the Commissioner of Labor. The report must also include statistical data concerning the number of resident personnel hired within the past year for this lease.

1983 Lease

- 1) Paragraph 4(f) and paragraph 34(7) are deleted and replaced in their entirety with the following paragraph 4(f):

(f) FORCE MAJEURE. If the state determines that lessee has been prevented, after diligent efforts made in good faith, from complying with any express or implied promise, term, condition or covenant of this lease, from conducting drilling operations, or from producing or marketing oil or gas from the leased area, by reason of war, riots, acts of God, unusually severe weather, or any other cause beyond lessee's reasonable ability to foresee or control (including delays caused by judicial decision or lack thereof or inability to obtain local, state, or federal permits or environmental impact statements), whether similar to those enumerated or not, lessee's obligation to comply with such provision shall be suspended, but not voided, and lessee shall not be liable for damages for failure to comply therewith. If lessee's obligations to conduct drilling or reworking operations are suspended under this paragraph and the continuation of such operations without suspension would have had the effect of preventing the expiration or termination of this lease, this lease shall not terminate during the period which the obligation to perform such operations is suspended. Nothing in this paragraph shall be construed to suspend the obligation to pay rentals, or to suspend the obligation to pay royalties, supplemental royalties or other production payments from operations on the lease area which are not suspended or from operations which are not affected by any such suspension, to the state.

- 2) Paragraph 5(b) is replaced in its entirety as follows:

(b) Annual rental paid in advance is a credit on the royalty or supplemental royalty due under this lease for that year.

- 3) Paragraph 7 is replaced in its entirety as follows:

7. APPORTIONMENT OF ROYALTY FROM APPROVED UNIT. The state's royalty and supplemental royalty share of the unit production allocated to each separately owned tract must be regarded as royalty to be distributed to or among, or the proceeds of it paid to, the state, free and clear of all unit expenses and free of any lien for them. Under this provision, the state's royalty and supplemental royalty share of any unit production allocated to the leased area will be regarded as royalty to be distributed to, or the proceeds of it paid to, the state, free and clear of all unit expenses (and any portion of those expenses incurred away from the unit area), including, but not limited to, expenses for separating, cleaning, dehydration, gathering, saltwater disposal, and preparing oil, gas, or associated substances for transportation off the unit area, and free of any lien for them.

- 4) A new paragraph 20(c) is added as follows:

(c) Notwithstanding any other provisions of this lease, the Northstar Unit Agreement, state statute, or state regulation, this lease shall terminate automatically without notice, an opportunity to be heard, or judicial proceeding, if the lessee fails to comply with the project schedule set forth in Exhibit C ("project schedule"), attached and incorporated by reference. Automatic termination shall occur whether or not there is a well on the leased area capable of producing oil or gas in paying quantities, the lease is committed to a unit agreement, or the lessee is drilling or conducting reworking operations, on the date performance under the schedule is due. Furthermore, upon termination BPXA shall promptly file of record appropriate lease relinquishments. The automatic termination shall occur at 11:59 P.M., Alaska Time, on the day performance of an obligation under the project schedule is due. The state may waive performance of an obligation required under the project schedule by prior written consent. The performance of any obligation required under the project schedule is subject to the provisions of paragraph 4(f).

- 5) Paragraph 31 is replaced in its entirety as follows:

31. EMPLOYMENT OF ALASKAN RESIDENTS. Lessee shall comply with all valid federal, state and local laws in hiring Alaska residents and contractors and shall not discriminate against Alaska residents or contractors. Within the constraints of law, lessee shall employ Alaska residents and contractors to the extent they are available and qualified. Subject to the foregoing:

Lessee voluntarily agrees to adopt a program to hire residents of Alaska. Lessee shall advertise for available positions locally and use Alaska job

service organizations to notify the Alaskan public. For work in connection with this lease, lessee shall use best efforts to contract with Alaska firms and fabricate modules in Alaska, whenever feasible. Lessee shall encourage its contractors to employ and train, when necessary, residents of Alaska. In determining feasibility, lessee shall consider commercial, health, safety, and environmental conditions and requirements to ensure maintenance of lessee's operational standards. Lessee shall submit annually to the Director, Division of Oil and Gas, for transmission to the Department of Labor, a report that details the specific measures lessee and its contractors and subcontractors have taken or are planning to take to recruit qualified Alaska residents for available jobs, describes on-the-job training opportunities, and describes lessee's efforts to hire Alaska firms for work in connection to this lease. Lessee shall furnish the Department of Labor a quarterly report regarding the employment of Alaska residents on the leased area in compliance with regulations by the Commissioner of Labor. The report must also include statistical data concerning the number of resident personnel hired within the past year for this lease.

- 6) Paragraph 35 is replaced in its entirety as follows:

35. ROYALTY ON PRODUCTION. Except for oil, gas, and associated substances used on the leased area for development and production or unavoidably lost, the lessee shall pay to the state as a royalty 20 percent in amount or value of the oil, gas, and associated substances saved, removed, or sold from the leased area and of the gas used on the leased area for extraction of natural gasoline or other products from the leased area.

- 7) Paragraph 36 is replaced in its entirety as follows:

36. VALUE. For purposes of computing supplemental royalty due under this lease, the value of supplemental royalty oil, gas, natural gas liquids, and associated substances shall be the value used in computing royalty on said substances.

(a) To compute the value of oil for royalty and supplemental royalty purposes, this lease shall be deemed an "ANS Lease" under the terms of the ANS Agreement, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(b) To compute value of gas and natural gas liquids for royalty and supplemental royalty purposes, this lease shall be deemed a "Lease" under the terms of the 1995 ANS Gas Royalty Litigation Settlement Agreement between BPXA and the State dated as of April 1, 1995, irrespective of any provision(s) of such agreement which would otherwise exclude this lease therefrom.

(c) To compute the value of associated substances (which shall be deemed to exclude oil, gas, and natural gas liquids) for royalty and supplemental royalty purposes, the value of such associated substances shall not be less than the highest of:

(1) the field price actually received by lessee for such associated substances;

(2) Lessee's posted price in the field for such associated substances;

(3) the volume weighted average field price actually received by other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area; or

(4) the volume weighted average posted price in the field of other producers in the same field or area for associated substances of like kind and quality at the time such associated substances are removed from the leased or unit area.

If associated substances are sold away from the leased or unit area, the term "field price" above shall be the actual price for such associated substances received from the purchaser thereof less the actual cost of transportation away from the leased or unit area to the point of delivery.

Minimum Value Determinations. The state may establish minimum values for purposes of computing royalties on associated substances obtained from this lease, with consideration being given to the price actually received by lessee, to the price or prices paid in the same field or area for production of like quality, to posted prices, to prices received by lessee and/or other producers from sales occurring away from the leased area, and to other relevant matters. Each such determination will be made only after lessee has been given notice and a reasonable opportunity to be heard. Under this provision, it is expressly agreed that the minimum value of royalty associated substances under this lease may not necessarily equal the price of such associated substances.

8) Paragraph 37 is replaced in its entirety as follows:

37. ROYALTY IN VALUE. Unless the state elects to receive all or a portion of its royalty or supplemental royalty in kind as provided in paragraph 38, lessee shall pay to the state the value of all royalty and supplemental royalty oil, gas and associated substances as determined under paragraph 36. Royalty and supplemental royalty paid in value shall be free and clear of all lease expenses (and any portion of such expenses which is incurred away from the leased area), including, but not limited to, expenses for separation, cleaning

dehydration, gathering, saltwater disposal, and preparing the oil, gas or associated substances for transportation off the leased area. All royalty and supplemental royalty that may become payable in money to the state shall be paid on or before the last day of the calendar month following the month in which the oil, gas or associated substances are produced. Royalty and supplemental royalty payments shall be accompanied by copies of run tickets or such other information relating to valuation of royalty and supplemental royalty as the state may require, which may include, but is not limited to, evidence of sales, shipments, and amounts of gross oil, gas and associated substances produced.

- 9) The following provision shall be added to the end of paragraph 38:

(f) Supplemental royalty under this lease may be taken in kind under the same terms and conditions as royalty may be taken in kind under this paragraph 38.

- 10) Paragraph 39 is replaced in its entirety as follows:

39. REDUCTION OF ROYALTY. Except as provided in paragraph 40 below, lessee shall not be entitled to any reduction of royalty paid under paragraph 35 above or supplemental royalty paid under paragraph 40 below based on any current or future agreement, state statute, or state regulation.

- 11) Paragraph 40 is replaced in its entirety as follows:

40. SUPPLEMENTAL ROYALTY. (a) In addition to the royalty paid and computed under paragraph 35, 36, 37 above, lessee shall pay to the state a supplemental royalty ("supplemental royalty"). Lessee shall pay the supplemental royalty, if owed, upon the same production volume for which royalty is paid ("production volume"). The supplemental royalty payment for a given month equals the supplemental royalty value times the supplemental royalty percentage rate ("percentage rate") times the production volume for that month. The percentage rate shall be calculated monthly by reference to: (1) an ANS West Coast spot price ("spot price"); and (2) a supplemental royalty trigger price ("trigger price"). If the spot price is equal to or less than the trigger price, then the percentage rate equals zero. If the spot price is greater than the trigger price, then the percentage rate equals [the spot price per barrel minus the trigger price per barrel] times 1.5 per cent per dollar per barrel. The percentage rate may never exceed 7.5 per cent.

(b) The spot price is the price per barrel calculated in Article 3.3 of and Exhibit 4 to the ANS Royalty Litigation Settlement Agreement ("ANS Agreement"), dated December 31, 1991, between the State and BPXA, for the crude oil referred to

as "ANS (USWC)" in the ANS Agreement. The trigger price is \$17.35 per barrel through April 30, 1997. On May 1, 1997, and each May 1 thereafter, the trigger price shall be adjusted by an inflation factor equal to fifty percent of the "inflation rate" defined as the Producer Price Index for Industrial Commodities ("PPI") for December of the previous year, as reported by April 30 of the current year, divided by the PPI for December of 1995, as reported by April 30, 1996. The supplemental royalty value for oil, gas, natural gas liquids and associated substances is defined in paragraphs 36 and 37 above. Exhibit B is a sample calculation to demonstrate the method of calculating supplemental royalty for oil.

These amendments do not affect: (1) any future agreements which may be reached for the handling of outside substances as that term is used in the Northstar Unit Agreement effective January 24, 1990 or (2) the current valuation methodology for royalty for any other Alaska Net Profit Share leases between the State and BPXA or any affiliates or any future agreements which may be reached regarding a future valuation methodology for Alaska Net Profit Share leases. These amendments take effect when and if an Act(s) substantially similar to the act, attached as Exhibit D and incorporated by reference, takes effect. This amendment is dated for reference purposes as of March 22, 1996.

LESSEE: -

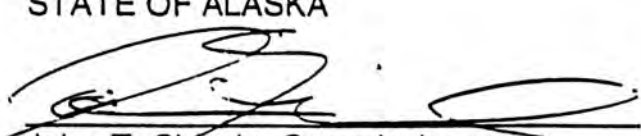
BP EXPLORATION (ALASKA), INC.



E. M. Luttrell, Vice President

LESSOR:

STATE OF ALASKA



John T. Shively, Commissioner
Department of Natural Resources

STATE OF ALASKA

Third Judicial District

)
) ss.
)

On March 22, 1996, before me appeared John T. Shively, Commissioner, State of Alaska, Department of Natural Resources, and who executed this lease and acknowledged voluntarily signing it on behalf of the State of Alaska, as lessor.

Dianne A. Pitts
Notary Public in and for the State of Alaska
My Commission Expires: 1/16/99



STATE OF ALASKA

Third Judicial District

)
) ss.
)

On March 22, 1996, before me appeared E. M. Lutrell, Vice President of BP Exploration (Alaska), Inc., and who executed this lease and acknowledged voluntarily signing it on behalf of the BP Exploration (Alaska), Inc., as lessee.

Dianne A. Pitts
Notary Public in and for the State of Alaska
My Commission Expires: 1/16/99



Exhibit B
Calculation of the Supplemental Royalty Payment for Oil

- 1) The calculation of the ANS West Coast spot price is derived from Platt's "Oilgram Price Report" Spot Crude Price Assessments:

Date	Platt's Reported Daily Assessment (\$/barrel)		ANSWC Daily Average	ANSWC Daily Average (After Rounding) ¹
	ANSWC Low	ANSWC High		
01/02/96	\$17.97	\$18.06	\$18.015	\$18.02
01/03/96	\$17.94	\$18.03	\$17.985	\$17.98
01/04/96	\$17.96	\$18.03	\$17.995	\$18.00
01/05/96	\$18.60	\$18.64	\$18.620	\$18.62
01/09/96	\$18.23	\$18.29	\$18.260	\$18.26
01/10/96	\$17.99	\$18.05	\$18.020	\$18.02
01/11/96	\$17.10	\$17.17	\$18.135	\$17.14
01/12/96	\$16.64	\$16.71	\$18.675	\$16.68
01/15/96	\$16.75	\$16.83	\$16.690	\$16.79
01/16/96	\$16.60	\$16.66	\$16.730	\$16.63
01/17/96	\$16.91	\$16.97	\$16.940	\$16.94
01/18/96	\$17.46	\$17.54	\$17.500	\$17.50
01/19/96	\$17.28	\$17.37	\$17.325	\$17.32
01/22/96	\$17.02	\$17.08	\$17.050	\$17.05
01/23/96	\$17.10	\$17.16	\$17.150	\$17.13
01/24/96	\$17.35	\$17.41	\$17.380	\$17.38
01/25/96	\$16.76	\$16.81	\$17.785	\$16.78
01/26/96	\$16.43	\$16.53	\$17.480	\$16.48
01/29/96	\$16.16	\$16.24	\$16.200	\$16.20
01/30/96	\$16.30	\$16.38	\$16.340	\$16.34
01/31/96	\$16.46	\$16.56	\$16.510	\$16.51

Monthly Average calculated from ANSWC Daily Average (After Rounding) = \$17.2271 per barrel

ANS West Coast spot price for the January 1996 month of production = \$17.23 per barrel

- 2) The inflation factor shall be calculated as follows: Assume that by April 30, 1996, the U.S. Department of Labor reports a PPI for December 1995 as 126.2. Assume that by April 30, 1998, the PPI for December 1997 is 134.2. The inflation factor for 1998 is calculated according to the following formula:

¹ All source and calculated numbers shall be rounded as required in the ANS Agreement.

Inflation Factor for May 1, 1998 through April 30, 1999

$$= [(PPI \text{ December of the previous year} \div PPI \text{ December 1995}) - 1] \times 0.5$$

$$= [(134.2 \div 126.2) - 1] \times 0.5 = 0.0317 = 3.17 \text{ percent}$$

3) The trigger price for May 1, 1998 through April 30, 1999 is calculated by adjusting \$17.35 per barrel by the inflation factor as follows:

$$\text{Trigger price for the current year} = \$17.35 \text{ per barrel} \times (1 + \text{inflation factor})$$

$$= \$17.35 \text{ per barrel} \times (1 + 3.17 \text{ percent})$$

$$= \$17.35 \times 1.0317$$

$$= \$17.90 \text{ per barrel}$$

4) Assuming the current month ANSWC spot price is \$21.40, the supplemental royalty percentage rate is calculated as:

$$\text{Supplemental royalty percentage rate} = (\text{ANSWC spot price} - \text{trigger price for the current year}) \times (1.5 \text{ percent per dollar per barrel})$$

$$= (\$21.40 \text{ per barrel} - \$17.90 \text{ per barrel}) \times 1.5 \text{ percent per dollar per barrel}$$

$$= (21.40 - 17.90) \times 0.015$$

$$= 0.05250 = 5.25 \text{ percent}$$

5) The calculation of the supplemental royalty payment for the current month is the product of the production volume times the royalty value and the supplemental royalty percentage rate. Assume that 1,550,000 barrels of oil were produced in the Northstar unit in the current month and that the royalty value is \$17.71. The supplemental royalty is:

$$\text{Supplemental royalty payment} = \text{production volume} \times \text{royalty value} \times \text{supplemental royalty percentage rate}$$

$$= 1,550,000 \text{ barrels} \times \$17.71 \text{ per barrel} \times 5.25 \text{ percent}$$

$$= \$1,441,151.25$$

EXHIBIT C

PROJECT SCHEDULE

The Northstar Development Project ("the Project") is described in the document titled "Northstar Development Project, Conceptual Engineering Report" dated February 1996. BPXA shall comply with the following schedule for the Project and shall provide satisfactory evidence of compliance within fifteen days of the date performance is due under the schedule:

BPXA shall receive Project sanction within twelve (12) months after passage by the legislature of an Act approving the First Amendments to the Northstar Unit Leases for the Project. "Project sanction" means approval in writing by the highest appropriate authority in BPXA or its parent entity necessary for the total amount of expenditures required for the Project. Satisfactory evidence of receipt of sanction shall be tendered to the State in the form of the sanctioning entity's documents approving the expenditure of funds for the Project. If Project sanction is withdrawn for any reason whatsoever, BPXA shall notify the State within three working days by letter from an authorized officer and BPXA shall be deemed to have failed to comply with this schedule.

EXHIBIT D

ACT

— BILL NO. —

IN THE LEGISLATURE OF THE STATE OF ALASKA

NINETEENTH LEGISLATURE - SECOND SESSION

BY THE — RULES COMMITTEE BY REQUEST OF THE GOVERNOR

Introduced:

Referred:

A BILL

FOR AN ACT ENTITLED

1 "An Act authorizing, approving, and ratifying the amendment of Northstar Unit
2 oil and gas leases between the State of Alaska and BP Exploration (Alaska)
3 Inc.; and providing for an effective date."

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

5 " Section 1. The legislature finds that

6 (1) the production of oil and gas from state land is a matter of statewide
7 interest and effect because it is an important source of revenue to the state and job
8 opportunities for the people of the state;

9 (2) BP Exploration (Alaska) Inc. holds state oil and gas leases in the Northstar
10 Unit that include net profit share provisions;

11 (3) with the current and projected price of oil, BP Exploration (Alaska) Inc.
12 maintains that the net profit share provisions of the Northstar Unit leases prevent the timely
13 development of the unit;

14 (4) existing law set out in AS 38.05 does not provide the commissioner of the

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- 1 Department of Natural Resources with sufficient express authority to amend the net profit
2 share provisions of the Northstar Unit leases held by BP Exploration (Alaska) Inc.;
- 3 (5) unless the net profit share provisions of the Northstar Unit leases are
4 amended, production of oil and gas from the unit is unlikely to begin until the year 2002;
- 5 (6) the Department of Revenue currently forecasts that production will not
6 begin from the unit until the year 2002;
- 7 (7) if the net profit share provisions of the Northstar Unit leases are amended,
8 full production of oil and gas from the unit may begin as early as the year 1999;
- 9 (8) amending the net profit share provisions of the Northstar Unit leases to
10 provide for a supplemental royalty will maximize the economic benefits of oil and gas
11 production to the people of the state by encouraging timely production from the unit;
- 12 (9) the development of the unit and the associated construction of unit facilities
13 within the state will provide additional revenue to the state and increased job opportunities;
- 14 (10) BP Exploration (Alaska) Inc. has committed to use its best efforts to hire
15 Alaska residents and contractors and to fabricate modules for the unit in Alaska;
- 16 (11) the timely development of the unit may result in increased state revenue
17 in future lease sales;
- 18 (12) the timely development of the unit may result in technological
19 breakthroughs and other cost savings that may make other development opportunities in
20 Alaska economically feasible; and
- 21 (13) the development of the unit will include the first truly offshore Arctic
22 island construction and Arctic subsea pipeline for oil.
- 23 * Sec. 2. (a) The State of Alaska and BP Exploration (Alaska) Inc. are parties to the
24 following leases in the Northstar Unit:
- 25 (1) ADL 312798, effective February 1, 1980;
- 26 (2) ADL 312799, effective February 1, 1980;
- 27 (3) ADL 312808, effective February 1, 1980;
- 28 (4) ADL 312809, effective February 1, 1980; and
- 29 (5) ADL 355001, effective August 1, 1983.
- 30 (b) The commissioner of the Department of Natural Resources may amend the
31 Northstar Unit leases described in (a) of this section to the extent set out in the "First

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MAR-22-96 FRI 17:12

DIV OF OIL AND GAS
ANCH AGO OGM
10:507-455 2417

FAX NO. 9075623852

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- 1 Amendment to the Northstar Unit Leases Between the State of Alaska and BP Exploration
- 2 (Alaska) Inc.", dated March __, 1996.
- 3 (c) Notwithstanding any other provision of law, the "First Amendment to the Northstar
- 4 Unit Leases Between the State of Alaska and BP Exploration (Alaska) Inc.", dated March _
- 5 __ 1996, is approved and ratified.
- 6 * Sec. 3. This Act takes effect immediately under AS 01.10.070(c).

SCOMM

99:6

Agenda



Common Goals

International Competitiveness

What it Takes

Immediate Actions

Next Steps

Common Goals



The State and ARCO Share Important Common Goals

Jobs for Alaskans

Incremental Revenues

- **No Changes in Producing Reservoirs in Existing Fields**
- **Opportunity to Increase Permanent Fund Contributions, While Maintaining Current Contribution Levels**

Achieved By Sustained Economic Development

- **Exploration**
- **Marginal Developments**
- **Extension of Field Lives**

To Achieve Sustained Economic Development the Environment Must be Competitive

Worldwide Fiscal Regimes are Getting More Competitive



EXAMPLES:

Australia introduced Resource Rent Tax in 1985 for offshore projects.

Venezuela:

Income tax rate for extra heavy crude developments lowered from 67% to 34%

Removal of onerous tax provisions for multinational firms

Alberta/Canada: Fiscal reformations lead to oil&gas industry turnaround after 1986 crash.

Norway abolished royalties on new fields in 1986. Removal of Sliding Scale state participation for new leases in 1992.

UK abolished royalties on new fields in 1984 and PRT for new fields in 1993, leading to a revival of UK oil industry.

Fiscal Regime Comparison as of 1994 (New Fields)

**Low Cost
& Long Term**

	<u>Alaska</u>	<u>U.K.</u>	<u>Australia (Offshore)</u>
Profit taxes			
Corp. Income Tax	39%	33%	33%*
Revenue Taxes			
Royalty	13%	0% after 1984	0% after 1985
Production Tax	0-15%	-	-
Other			
Ad Valorem Tax	2%	-	-

* In addition a Resource Rent Tax kicks in once oil co's earned a return on investment. For marginal developments, this would add 0 to 5%pts at today's prices, and about 10%pts at \$20 WTI.

Summary of Worldwide Fiscal Regimes (Petroconsultants, 1994)



Number of Fiscal Systems by Category

<u>Production Sharing Contract</u>			<u>Tax/Royalty System</u>			<u>Total</u>
Standard PSC	<u>w/ Royalty</u>		Profit- Based Tax Only	<u>Royalty</u>		
	Variable	Fixed		Variable	Fixed	
19	7	9	8	10	17	<u>70</u>

Countries > 200 MBOPD

9	1	5	3	1	3	<u>22</u>
Indonesia Oman Qatar Egypt Ecuador India Libya Angola Syria	China	Yemen Malaysia Algeria Columbia Gabon	U.K. Norway Australia	Canada	U.S. Argentina Nigeria	

What it Takes



Work With the State to Develop That Competitive Environment

- **Support State's Effort to Achieve Soft Landing**
- **Develop Competitive Tax / Royalty Structure**
- **Transition to More Flexible Regulatory Environment**
- **Industry Must Focus on Keeping Cost Structure Low**

Immediate Actions for the Short Term



Review / Clarify Legislative Intent for Application of Existing Incentives

- **Exploration Incentive Credits**
- **Lease Sale Schedule**
- **Discovery Royalty Credit**

Review / Support Flexibility in DNR to Provide Royalty Relief

- **Lease Sale Terms**
- **Smaller Discoveries**
- **Prolonging Economic Life**

Support Calls for Federal Tax Incentives for Oil and Gas Development

Next Steps for the Long Term



Implement the Process Described Below to Examine Alaska's Long Term International Competitive Position and Recommend Alternative Proposals for Legislative Consideration

- **Legislative / Administrative / Industry Cooperation**
- **Focus First on Gathering Information on Competitive Fiscal Regimes**
- **Develop a Broad Range of Options**
- **Narrow Finally to Specific Proposals for Legislative Action**

Conceptual "Fixed-Variable" Royalty

**Low Cost
& Long Term**

