

ALASKA LEGISLATURE COMMITTEE FILES 2011 2012 2007 2

1891 SRES POWER BRIEFING 2/9/81 - ROYALTY OIL 3/25/82

1891

October of 1980 and to date nine utilities servicing over 60 communities have applied for assistance.

Mr. Yould stated that in 1979 statewide electrical generation totalled 4.8 billion kilowatt hours. There were five sources of that energy: gas (56%), oil (1%), coal (11%), hydroelectric (9%) and wood pulp (6%). It has been the recommendation of the Authority that Alaska gradually move away from energy sources which the state has relatively little control over supply and/or price. This is one of the reasons the Authority has been pursuing hydroelectric. Although in the early years the cost is high, over the long term it is less expensive because it is relatively insulated from inflation.

Dave Hutchens stated that the question often asked is why build Susitna? why not a series of smaller hydroelectric projects in the area? The reason for Susitna is that in Central Alaska other resources are not available. The streams that could be used are heavily populated with fish and small projects are more expensive. The purpose of Susitna is not for new capacity to handle population growth but to replace capacity now fired by fossil fuels. He stated that the average price of gas is 35¢ per mcf and predicted that it would reach \$4.50 per mcf in the relatively near future. He quoted Dr. Wm Wood: "Susitna is not for development it is for survival." He indicated that his Association is in favor of Susitna but their main function is to provide the electric service needs of the State.

In response to the question, what type of controls are on the Authority? Mr. Yould stated that the legislature maintains control through oversight of projects because legislation has to be enacted prior to initiating a project.

In response to the question, what is the time-table for Susitna? Mr. Yould, stated a contract was let January 1, 1980 for the field studies. In March 1981, a preliminary report will be issued to the legislature with their recommendation to go forward with further field studies. In March 1982, a report will be issued to the legislature of findings from field studies. If approved by the legislature, the Authority will then make application to FERC. Once the license is received from FERC, it will take 7 years to construct the Watana portion of the project.

In response to the question, are alternative energy sources to Susitna being considered? Mr. Yould, stated that under FERC regulations they are required to look at all of the alternatives. Under SB 25 there is an escrow account set up for a number of projects around the state. If a project is not feasible, the funds are available for alternative energy sources in that particular area.

In response to the question, is the Power Authority required

to have back-up diesel generation for hydro projects?  
Mr. Yould stated it is required to have back-up diesel  
generation capabilities.

The Committee adjourned at 3:25 p.m.

# Where Energy Costs Hit Hardest

**E**NERGY COSTS, after outpacing overall inflation in 1980, will continue escalating in 1981 as a result of President Reagan's decision to end controls on oil and fuel prices.

That's bad news for consumers, because a study by *USN&WR's* Economic Unit shows that energy costs shot up

18.1 percent in 1980, adding 1.9 to the overall 12.4 percent rate of inflation.

Hardest hit were homeowners and businesses that used heating oil. The Economic Unit study found that heating-oil prices jumped 20.2 percent to an average of \$1.07 a gallon.

Gasoline prices rose 18.3 percent to an average of \$1.23 a gallon. Electricity was 17.4 percent more expensive, increasing to \$30.97 per 500 kilowatts. Natural gas had the smallest rise—14.6 percent.

The impact of higher energy costs varied widely across the country. The average price of a gallon of gasoline ranged from a low of \$1.16 in Houston

and Kansas City to a high of \$1.41 in Honolulu.

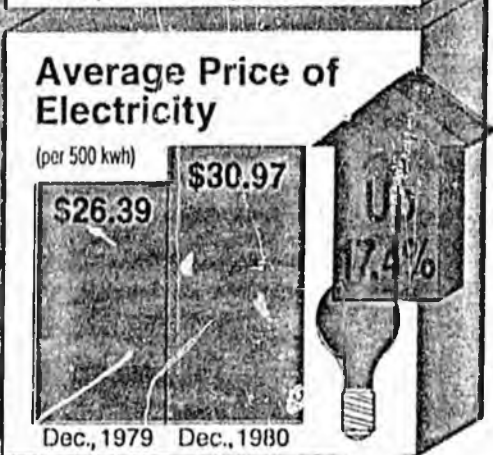
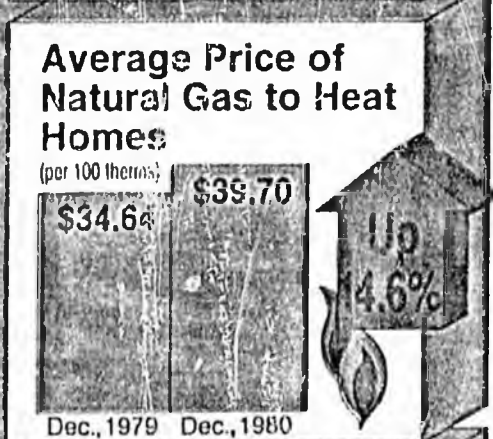
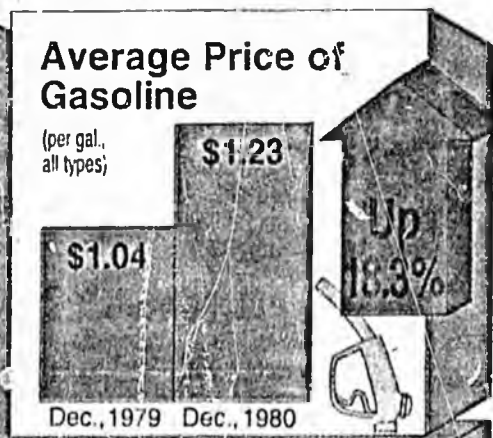
The price of 500 kilowatts of electricity ranged from \$9.79 in Seattle, which gets much of its power from cheap hydroelectric plants, to \$52.07 in New York City, which is more dependent on oil-fired power plants.

Higher gasoline and heating-oil prices stemming from President Reagan's decontrol action may not be the only government-related jolt to consumers in 1981. The President is under pressure to ask Congress for approval to end price ceilings on natural gas, a move that would mean higher utility bills for those who heat with gas. □

## What's Happened to Prices in 27 Areas

Metropolitan Area	Gasoline		Natural Gas		Electricity	
	(per gal.) Dec., 1980	Change in Past Year	(per 100 therms) Dec., 1980	Change in Past Year	(per 500 kwh) Dec., 1980	Change in Past Year
Anchorage	\$1.31	+18.0%	\$ 19.62	+ 2.7%	\$21.44	- 1.8%
Atlanta	\$1.25	+19.0%	\$ 35.52	+ 4.2%	\$25.26	+11.1%
Baltimore	\$1.24	+18.1%	\$ 43.36	+11.8%	\$31.81	+13.3%
Boston	\$1.23	+19.4%	\$ 56.00	+16.3%	\$38.93	+26.6%
Buffalo	\$1.25	+14.7%	\$ 42.03	+ 9.5%	\$26.56	+ 9.1%
Chicago	\$1.28	+15.3%	\$ 38.47	+ 9.9%	\$35.13	+31.2%
Cincinnati	\$1.20	+17.6%	\$ 37.07	+16.8%	\$23.47	+ 5.9%
Cleveland	\$1.20	+17.6%	\$ 35.72	+ 6.9%	\$32.46	+ 6.9%
Dallas— Fort Worth	\$1.17	+20.6%	\$ 35.48	+31.0%	\$24.77	+ 4.7%
Denver	\$1.17	+15.8%	\$ 49.23	+54.7%	\$35.14	+28.2%
Detroit	\$1.28	+17.4%	\$ 39.60	+16.5%	\$33.16	+17.0%
Honolulu	\$1.41	+7.6%	\$139.72	+19.7%	\$44.88	+45.5%
Houston	\$1.16	+13.6%	\$ 38.93	+16.6%	\$26.88	+ 3.6%
Kansas City	\$1.16	+13.7%	\$ 30.11	+28.8%	\$28.20	+ 5.9%
Los Angeles	\$1.26	+16.7%	\$ 31.23	+15.4%	\$34.17	+21.3%
Miami	\$1.22	+17.3%	\$ 45.43	No change	\$29.35	+11.0%
Milwaukee	\$1.17	+15.8%	\$ 43.02	+19.0%	\$23.25	+12.0%
Minneapolis— St. Paul	\$1.20	+14.3%	\$ 37.58	+21.5%	\$27.19	+14.5%
New York	\$1.27	+17.6%	\$ 61.08	+15.2%	\$52.07	+21.5%
Philadelphia	\$1.23	+17.1%	\$ 54.07	+32.9%	\$35.02	+12.7%
Pittsburgh	\$1.25	+20.2%	\$ 35.47	+13.5%	\$28.96	+ 5.8%
Portland, Oreg.	\$1.23	+17.1%	\$ 53.42	+ 7.7%	\$19.26	+11.5%
San Diego	\$1.26	+17.8%	\$ 31.49	+ 1.8%	\$49.02	+70.0%
San Francisco— Oakland	\$1.20	+18.3%	\$ 30.98	+23.3%	\$26.78	+37.8%
Seattle	\$1.25	+16.8%	\$ 54.02	+12.1%	\$ 9.79	+ 5.5%
St. Louis	\$1.17	+13.6%	\$ 40.81	+ 6.2%	\$23.23	- 4.4%
Washington, D.C.	\$1.27	+24.5%	\$ 47.53	+10.5%	\$30.80	+10.1%

Note: Propane instead of natural gas used in Honolulu.  
USN&WR chart—Based on U.S. Dept. of Labor



*File Copy*

RESOURCE  
INVENTORY,  
DNR  
BRIEFING

3-17-82



# Alaska State Legislature

## Senate Resources Committee

Official Business

Pouch V  
State Capitol  
Juneau, Alaska 99811

March 17, 1982  
1:35 p.m.

Beltz Room  
Room 211 - Capitol

### MEMBERS PRESENT

Senator Fahrenkamp  
Senator Fischer  
Senator Eliason  
Senator Gilman  
Senator Mulcahy  
Senator Sturgulewski

---

### Hearing:

Briefing - Resource Inventory Program - Department of Natural Resources

SSSB 608 - An Act making a special appropriation to the power development fund of the Alaska Power Authority for the Susitna River hydroelectric project and other hydroelectric projects; and providing for an effective date.

---

### Briefing:

Jeff Haynes, Deputy Commissioner, Department of Natural Resources, explained that the Department received a capital appropriation last year to search for new resources, and would present a progress report today.

Ross Shaff, State Geologist, Department of Natural Resources, stated that a cooperative arrangement had been worked out with other state and federal agencies for collecting data for the Resource Inventory Program. An initial goal is compiling the existing information, which involves a literature search of everything collected in the state on resources, and putting it into a digitized format. Surface resources being studied include archeological sites, agriculture, and forestry, in coordination with the land disposal program. The water data collection program has been developed in conjunction with the United States Geological Survey, which matches the State dollar for dollar in funding the program. Subsurface studies include geothermal potential, minerals, coal, and petroleum. Areas selected for study are those in which development is most likely to take place. The State produces maps of areas inventoried, with detailed mapping in particular locations.

AGO 886909

SSSB 608

Senator Fischer explained that he had prepared a Committee Substitute incorporating suggestions he had received from various people, and organized the bill to group related items.

The Committee discussed the adequacy of the amounts of the various appropriations. Senator Fischer stated the bill was designed to bring the ideas before the Finance Committee. Senator Fahrenkamp suggested a letter of intent be sent with the bill explaining that more analysis needs to be done on the amounts appropriated.

Senator Eliason moved and asked unanimous consent for the adoption of an amendment appropriating \$200,000 for a new power distribution system in Tenakee Springs.

Senator Eliason moved and asked unanimous consent for the adoption of an amendment appropriating \$1.1 million for the Hoonah Intertie.

Senator Gilman moved and asked unanimous consent for the adoption of an amendment appropriating \$35,000,000 for construction of the Bradley Lake hydroelectric project.

Senator Fischer moved the Committee Substitute for SSSB 608 as amended, with individual recommendations.

The meeting was adjourned at 2:50 p.m.

# STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

## DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

POUCH M  
JUNEAU, ALASKA 99811

PHONE: 465-2400

MAR 18 1982

March 16, 1982

The Honorable Vic Fischer  
Senator  
Alaska State Senate  
Pouch V  
Juneau, AK 99811

Dear Senator Fischer:

Thank you for your letter of February 24 which pointed out your concerns for making gravel and materials from State lands available for vital activities in the State, such as the Alaska Railroad or oil and gas development. The Department shares your view that a 50-100 year timeframe in managing these resources is necessary.

Our Resource Inventory Capital Improvement Project is designed to accomplish the collection of data necessary to provide for long-term rock and gravel needs. This project received \$8.6 million of funding during FY 82; the Governor's budget request includes \$7.6 million for funding in FY 83. Some funding for this work is also provided in the operating budget.

You asked what legislative action would be necessary to ensure adequate gravel supplies for the future. Support of the Resource Inventory Project in the Governor's capital budget would help accomplish the objectives you seek. However, operating budget cutbacks, made by the House Finance Committee, will eliminate some of the work done by the Division of Geological & Geophysical Survey to identify sand and gravel deposits. Jeff Haynes and Ross Schaff of our Department will be briefing the Senate Resources Committee

3/17

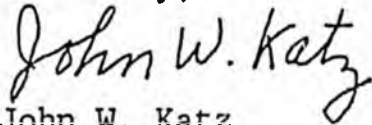
AGO 886911

The Honorable Vic Fischer  
Page Two  
March 16, 1982

on these issues on Wednesday, March 17 at 1:30 p.m. I am also asking Departmental staff to begin work on formulating a policy that will ensure the availability of sand and gravel resources for the immediate and distant future. I will report back to you on the results of this work.

Again, thank you for letting me know of your concerns. Please let me know if you would like further information, or if we can provide other assistance.

Sincerely,

A handwritten signature in cursive script that reads "John W. Katz". The signature is written in dark ink and is positioned to the right of the typed name.

John W. Katz  
Commissioner

ROYALTY  
OIL  
CONTRACTS

3-25-82



# Alaska State Legislature

## SENATE Resources Committee

POUCH V  
STATE CAPITOL  
JUNEAU, ALASKA 99811  
(907) 465-3834  
(907) 465-3835

### Official Business

BETTYE FAHRENKAMP, Chairman  
VIC FISCHER, Vice-Chairman  
BRAD BRADLEY  
DICK ELIASON  
DON GILMAN  
BOB MULCAHY  
ARLISS STURGULEWSKI

March 25, 1982  
5:00 p.m.

House Finance Committee Room  
Room 519 - Capitol Building

### Meeting with House Joint Committee on Oil and Gas

#### MEMBERS PRESENT

Senator Fahrenkamp  
Senator Gilman  
Senator Fischer  
Senator Mulcahy  
Senator Sturgulewski

Representative Halford  
Representative Cotten  
Representative Randolph  
Representative Rogers  
Representative Fanning

-----  
Hearing: Presentation by the Department of Natural Resources, the Alaska Royalty Oil and Gas Development Advisory Board, Doyon, Ltd., and Tesoro Alaska Petroleum Co., on the proposed Alaska royalty oil contracts.  
-----

The meeting was called to order by Rep. Halford, Chairman.

Dick Lyon, Chairman, Alaska Royalty Oil and Gas Development Advisory Board, presented two resolutions passed by the Board, recommending that the Legislature approve the Tesoro contract, and disapprove the Doyon contract. Mr. Lyon stated that the function of the Board was to make the extensive contract negotiations as public as possible while still holding private negotiations. The conclusions of both resolutions were read into the record.

John Katz, Commissioner, Department of Natural Resources, presented the Tesoro contract for approval, with the full support of the administration. The Commissioner stated that the Department agrees with Board's recommendation on the Doyon contract, while disagreeing with one of their premises for the recommendation.

Mr. Katz outlined the procedural criteria used by the Department in its contract negotiations: that the decisions must be fair and be perceived to be fair by all participants and the public; that there should be an effort to institutionalize the royalty oil and gas decision-making process; that there should be a clear paper trail documenting the decision-making process; that the process should

AGC 785903 +

increase the knowledge of state royalty oil and gas decision makers; that the standard form for royalty oil and gas contracts should be improved; that the Department should improve its working relationship with the Board.

The culmination of the effort was a very tough, workable contract form and the findings document.

Commissioner Katz testified that when he came on-board, the Department revised the pending solicitation to reflect the in-state preference in the statutes. They received 29 responses. In a winnowing process, they met with all respondents who wanted to, made a series of findings, and allowed rejected respondents a chance to refute the Department's conclusions. They continued negotiations with 8 or 9 serious proposals.

Mr. Katz reviewed the policies applied in the negotiations:

- 1) a clear--but not absolute--preference for in-state taking of royalty oil and gas;
- 2) parity between all parties in terms of major contract conditions;
- 3) adopting a weighted average field pricing system for the North Slope, with contractual adjustments pending the result of the Amerada Hess litigation, with 3% above the higher of the state treasury rate or the prime rate to be paid;
- 4) a twelve year term;
- 5) retain a significant uncommitted volume for future options;
- 6) establish an option fee to be paid on contractually committed oil not taken by the processor;
- 7) no interim taking--no state oil to finance a project that wouldn't be otherwise financable;
- 8) the state is willing to be the 100% supplier of royalty oil to in-state processors, to provide a secure base for operations and future expansion;
- 9) return oil--oil that is left at the end of the refining process--requires the payment of a quality penalty if put back in the trans Alaska pipeline for downstream use;
- 10) attempted to gain concessions for rural Alaska;
- 11) attempt to use royalty oil to complement coal development through the development of petrocokes.
- 12) there is a definite negative impact on in-value price and severance taxes from Alaskan oil due to displacement of west coast oil, that could amount to \$10 million per year, as a rough estimate, but that this possible loss to the state is outweighed by other benefits;
- 13) royalty oil should not be used as leverage to enter into other than the petroleum market;
- 14) all contracts should have adequate security.

March 25, 1982

Page 3

Commissioner Katz made the following observations:

- 1) that the Department was negotiating the contracts at a time when their leverage for negotiation couldn't have been worse; there is an oversupply of oil, and potential purchasers have alternative sources of supply; however, the state had a satisfactory alternative in that the state could let the producers take the oil in-value and sell it for the state; the producers are the best long-term marketers of Alaskan crude oil;
- 2) in some situations it would be to the state's advantage to offer royalty oil for purchase by competitive auction, but two factors work against it; first, auctioned oil would displace west coast oil, with a negative effect on in-value and well-head price; second, while the state did well in some competitive solicitations last summer, oil producers are still the best long-term marketers of oil.

Commissioner Katz summarized the current status of the contract negotiations. There are five contracts still pending. The Tesoro contract is recommended for approval. The Doyon contract will be recommended for approval if they can have the financing in place in a few weeks. There are three other good possibilities being negotiated, with Chevron, Provident Oil, and Suneel. There are a number of questions to be answered on the Provident and Suneel contract proposals. The state intends to commit itself to a written process to address these questions, preparatory to further contractual negotiations.

Bob Maynard, Assistant Alaska Attorney General, addressed the issue of pricing systems. The "exhibit B" purchasing system attached to the Alpetco contract presents a regrettable position with respect to the Amerada Hess litigation, requiring the purchaser to pay the higher of either the price reported to the state by the producer, or the average of all other producer prices, resulting in a term higher than the weighted average price but lower than the highest price.

The basic difference between the exhibit B pricing and the system used in the proposed Tesoro contract is that by the exhibit B system, Alpetco paid the state as if the state had won the lawsuit, and Alaska will have to pay them back if the case is lost; Tesoro will pay the state as if the state had lost the lawsuit, and pay the state the difference should the state win.

Commissioner Katz, in response to a question from Senator Fischer, addressed the issue of alternative pricing systems. There are negative impacts on state revenues by using the weighted average field price, but the contractual adjustments pending resolution of the Amerada Hess litigation, with the 3% above prime aspect will recapture the difference.

All pricing system alternatives were examined, and exhibit B pricing was rejected for two basic reasons: first, the recapture mechanism currently being used is good; second, exhibit B pricing impairs in-state oil utilization because of the uncertainty regarding the price

for long periods after the actual transaction. To serve in-kind taking, the Department felt the state should deviate from exhibit B pricing, recognizing that there will be adjustments in the aftermath of the Amerada Hess litigation.

Jeff Haynes, Deputy Commissioner of Natural Resources, stated that the market situation has changed considerably in the last twelve years, and would change considerably in the next twelve. The basic decision regarding the pricing was to tie it to the price that seven-eighths of North Slope crude was sold for. The two-tier pricing system is in place for specific and economically justifiable reasons. It is possible that exhibit B pricing without the Amerada Hess adjustment could be a premium price in twelve years; the situation could change; it is hard to predict. Given the market influences, however, it is more likely to be less. The Department believes that its estimates are as accurate as possible.

Commissioner Katz, in response to a question from Senator Fahrenkamp, stated that there is no direct assurance that the lower price to processors will be reflected in consumer costs. That sort of guarantee would be difficult to negotiate. That is why the Department continues to negotiate with Doyon--it is good for the state to promote competition, to increase benefits to consumers.

In response to comments from Rep. Halford, Commissioner Katz pointed out that there is an inherent statutory conflict between maximum revenues for the state and the preference for in-state use. In the case of the Doyon contract, there is no question that another refinery would lead to significant price competition in the greater railbelt area. The trade-offs are difficult to quantify, but the Department will provide the legislature with such figures for cost-benefit analysis as are available.

In response to questions from Rep. Rogers, Commissioner Katz stated the legislature should enact a statute to approve the contracts. If Doyon can get financing satisfactorily in place in the next few weeks, the Department would recommend legislative approval. If, however, the legislature enacted legislation approving the Doyon contract without adequate financing in place, the Department would recommend that the Governor veto the bill.

In response to further questioning, Mr. Katz stated that if the Doyon contract is not approved this session, the Department would continue to pursue it over the interim. The Attorney General's office advises the Department that this solicitation can continue until terminated at the Commissioner's discretion. Commissioner Katz would like to bring this solicitation to a conclusion in the next few months, with an outside limit at the end of Governor Hammond's current term. After that conditions will change, and warrant a new solicitation.

The Department has been advised that Tesoro would have to enter a new solicitation for additional oil for expanded facilities, such as a hydrocoker. This is also relevant in the light of the policy only to provide royalty oil for "imminent" projects; which is another reason the Department wants to terminate this solicitation in a timely manner. It was with this situation in mind that the Department retained a quantity of oil for future options.

Deputy Commissioner Haynes pointed out that paragraph 2.13 of the Tesoro contract contains a provision recognizing the statutory preference for in-state use of royalty oil and the manufacture of petroleum products; which means that Tesoro would automatically be involved in future solicitations.

Commissioner Katz stated that the current solicitation could be amended simply, to allow continued negotiations with Tesoro, and that the statutes, while favoring mass solicitations, do allow for individual negotiations, which could be used to allow for supply for further Tesoro expansion.

Bob Maynard pointed out that it is a problem of wording; Tesoro's expansion can't come under the current solicitation, but the solicitation can be amended to allow for it.

Commissioner Katz, in response to question from Rep. Rogers, pointed out that if the state wanted to renegotiate the contract with Doyon, they could go about it two ways: (1) withdraw the contract, make the desired changes, and send it back through the Board process; or (2) the Legislature could waive that procedure in the enacting legislation for the renegotiated contract.

Mr. Katz stated that the return oil situation was not as serious a problem for processors on the trans-Alaska pipeline, who can put residual oil back into the line. The state has a good policy of selling all title to royalty oil at Pump Station #1. The Department looked at cooperative agreements for Doyon to sell the return oil to a downstream processor, but the arrangement did not work out. Chevron dropping out of the negotiations had a real effect on the Doyon contract.

Mapco's return oil under existing contracts is owned and sold by them. Depending on market conditions, this can either be a benefit or a drag to the processor.

Deputy Commissioner Haynes stated that it depended on the market; in the case of the Fairbanks refinery, they can dump residual oil back into the pipeline, and pay a quality penalty, but then sell it as Alaska North Slope (ANS) crude at Valdez, in competition with the producers. It has been both a good and bad deal for them in past years. With the failure of the Chevron to buy the return oil, Doyon will have to sell ANS crude.

John Katz, in response to a question from Rep. Cotten, pointed out that although he did not agree that it is constitutionally required, the Governor has set a clear policy that he wants a legislative decision for

the approval or disapproval of royalty oil contracts.

Bob Maynard pointed out an additional advantage to statutory approval, that in doing so, the Legislature would be "ratifying" the contracts, curing any procedural faults that may have occurred up to that point.

John Katz stated that the state is selling at the weighted average of what all North Slope producers charge. Sohio made an offer to buy most of the royalty oil at a greater than weighted average price for resale to in-state processors, but policy dictated that the state couldn't allow a private concern to make what should properly be public decisions regarding state royalty oil.

In response to a question from Senator Fahrenkamp, the Commissioner stated that the Suneel proposal is still active, but not the highest priority. The unanswered questions on this project will not be resolved in time for consideration by this Legislature. If the questions could be resolved in time, the Legislature would have the option of allowing the contract to go through the usual royalty oil procedure, or waiving the process in enacting legislation this session.

Senator Halford noted that the Department recommends that the Legislature approve the Tesoro contract, and approve the Doyon contract, with a four-year moratorium on option fees, if a financing package goes through. Two separate pieces of enacting legislation should be introduced.

Jeff Haynes presented a summary of highlights of both contracts:

The Tesoro contract calls for the purchase of 46,000 barrels per day, which is about the maximum the Tesoro refinery can handle. Tesoro also currently contracts for about 8,500 barrels per day of royalty oil from the Cook Inlet. These reserves are declining. Tesoro can vary the amount to be taken, up to 46,000 barrels per day, on six month's notice. The state can impose a permanent top-limit equal to the greatest amount taken in the first five years of the contract. Tesoro can permanently terminate the contract on nine months notice. The price is the producer's weighted average field price, subject to adjustment as a result of the Amerada Hess litigation. Any money owed the state would be paid at the higher of the state treasury rate or the prime rate plus three percent. The contract term is twelve years, and the oil is to be processed in-state, with an equal-value exchange provision. The oil will have to be processed at the Nikiski refinery, and there are standards for how much of certain products they shall produce. Tesoro is committed to completion of feasibility studies for expansion, to include a petroleum coker. The state retains an option on the residual oil and petrocoker, and can assign its use. The performance and guarantee reservation structure is a fee paid to the state on contractually committed oil, if not actually taken--about fifteen cents per barrel per day. The security terms require a letter of credit worth two month's supply of oil. The Attorney General's Office thinks that the local hire provision in the contract goes as far as the state is constitutionally allowed.

Doyon had two contracts in the course of negotiations: one to purchase the Mapco refinery; one to build a new refinery. The contract to take over the Mapco refinery was withdrawn.

The volume of the Doyon contract is 50,000 barrels per day; the price and term are the same. The in-state processing provision is similar, except that it includes a definition of a required schedule; they are required to build, open and operate a new refinery by December 1, 1983, or the contract will terminate. The contract contains a provision for a future new refinery or new royalty oil contracts, and contingencies to cover the state's interests should Doyon acquire the Mapco refinery.

In response to Senator Sturgulewski, Mr. Haynes stated that unlike the Charter Oil contract, which had many complexities and procedures for legislative review of the fulfillment of the conditions of the contract, the Doyon proposal was not for a world-class facility, and was simpler to track.

Bob Maynard pointed out that the contracts have a conflict clause, similar to the procedure for administrative review of regulations, whereby contract disputes or ambiguities regarding a term of the contract shall be determined by the Commissioner first, and that the buyer must adhere to the Commissioner's decision, unless there is a preponderance of evidence to the contrary.

The Committee adjourned at 7:00 p.m.



# Alaska State Legislature

## SENATE Resources Committee

### Official Business

BETTYE FAHRENKAMP, Chairman  
VIC FISCHER, Vice-Chairman  
BRAD BRADLEY  
DICK ELIASON  
DON GILMAN  
BOB MULCAHY  
ARLISS STURGULEWSKI

POUCH V  
STATE CAPITOL  
JUNEAU, ALASKA 99811  
(907) 465-3834  
(907) 465-3835

March 26, 1982  
8:15 a.m.

House Finance Committee Room  
Room 519 - Capitol Building

### Meeting with House Joint Committee on Oil and Gas

#### Members Present

Senator Fahrenkamp  
Senator Gilman  
Senator Sturgulewski

Representative Halford  
Representative Cotten  
Representative Kandolph  
Representative Rogers

Agenda: Presentation by the Department of Natural Resources, the Alaska Royalty Oil and Gas Development Advisory Board, Doyon, Ltd., and Tesoro Alaska Petroleum Co., on the proposed Alaska royalty oil contracts (continuation from March 25, 1982).

The meeting was called to order by Rep. Halford, Chairman.

Avrum Gross, General Counsel for Doyon, Ltd., stated that the contract had been negotiated by Dick Edwards and Marco Pignalberi. Doyon has worked since its inception to put together a competing refinery in Fairbanks. They have acquired the equipment and completed the engineering and land-acquisition work, simultaneously negotiating with the state for the last five or six months.

Mr. Gross became involved in early January. At that point, Doyon had the opportunity to negotiate to purchase the North Pole refinery, and switched over to negotiating both contracts with the state. Negotiations for purchase collapsed after about six weeks. By this time, the status of the refinery construction financing had changed. The financiers had pushed Doyon to pick-up the refinery. The return oil was the main problem in negotiations; for every 30,000 barrels to pass through the refinery, 20,000 barrels are returned to the pipeline, and would have to be sold by Doyon. Marketing that amount of oil without a substantial loss is difficult. They were originally intending to dispose of return oil to Chevron under contract, but that contract fell through. This has been the major snag in obtaining financing; Doyon will have

AGO 785910

March 26, 1982

Page 2

a much better idea of their ability to dispose of return oil in two to three weeks.

Mr. Gross noted that this is not a contract like the Alpetco contract, where Doyon could market oil as it sees fit. The contract requires Doyon to build a refinery and get it on line by December 1, 1983. As a new project, it is difficult, amounting to a \$100 million investment in a world oil situation not conducive to major investment.

Mr. Gross suggested that the Legislature put the Doyon contract on hold for two or three weeks, and Doyon will make another presentation to the Legislature at that time.

In response to a question from Rep. Halford, Mr. Gross stated that he was surprised at the Advisory Board's reaction to the four-year waiver on option fees. Mr. Tim Wallace, President of Doyon, testified before the Board in Fairbanks, and was asked no question regarding the waiver. The negotiations for the contract took 5 months, and Doyon made trade-offs to gain this concession. The only way to determine if the clause is indeed anti-competitive would be to do an analysis of Mapco's situation. To come "out of the blue" and pick on one term without considering the other factors and the conditions of the Mapco contract is not a correct procedure.

In response to Senator Fahrenkamp, Mr. Gross recommended that the Legislature put the contract into legislation, and hold in committee, awaiting financing. At some point, the Legislature will have to make a judgement on the good-faith and viability of the Doyon proposal. In the interim until the refinery is completed, the royalty oil would be marketed by the producers, at no loss to the state.

In response to Rep. Randolph, Mr. Gross stated that the financing for refinery construction had been in place with the Continental Bank in Chicago. As the emphasis shifted to negotiating for the Mapco refinery, the bank made a financial commitment to the purchase, and withdrew its commitment to construction. When it became clear that the purchase might not go through, the situation for construction had changed. Continental wanted to change the terms and seek involvement by others in the financing, primarily because of the risk involved with the return oil. Return oil has been the major drain on the North Pole refinery profits. When Mr. Gross last spoke to Continental, they were willing to finance a major portion of the project, insisting on the financial involvement of others. If Doyon can find a way to dispose of the return oil, he sees no problem in putting together a financing package.

In response to Rep. Rogers, Mr. Gross stated that provision had been made to store the purchased equipment until financing was available, and that on-site work had been shut down for the time being. If Doyon is able to continue work in this construction season, they could have the refinery in place before the December 1983 deadline.

In response to Rep. Cotten, Mr. Gross stated that not having the contract approved until the next legislative session would create a problem, in that the contract is an integral part of the financing package. However, the Doyon proposal is not a speculative proposition; they are committed to follow through on the project.

Mr. Gross stated that Tim Wallace was negotiating with several oil companies for a contract for the return oil. There is the problem caused by the current oil glut. Doyon is not concerned with making a profit on the return oil, but with avoiding a loss. The North Pole refinery has had enormous losses in the past, but has recently made arrangements to avoid more serious losses.

Jeff Haynes stated that the Department made the four-year option waiver concession to Doyon as a new entrant. The most difficult philosophical question in the negotiations was reconciling being totally market neutral and yet encouraging competition. The bottom line for the Doyon contract is the Mapco contract. Doyon would prefer to have the Mapco contract for competitive reasons, but the Mapco contract has provisions that are not recognized as being in the best interest of the state at this time. The Department was under intense pressure from Doyon throughout the negotiations to make concessions; but the only significant concession was the waiver on reservation fees.

Mr. Haynes stated that there was an advantage to a refinery on the transAlaska pipeline, in terms of return oil. They have to sell Alaska North Slope crude oil with a quality penalty, rather than residual oil, which is a bigger problem. The Department tried to work out a deal with Chevron to use the residual oil from the Mapco refinery, which would have been to Doyon's advantage on some occasions, but Mapco didn't want to give up their absolute rights to the return oil, so the contract fell through.

Deputy Commissioner Haynes stated that in terms of Doyon's financing, the Department was applying the criteria that they would contract for royalty oil only for projects that were operating now or were imminent. The Department concurs with the Advisory Board's recommendation to postpone the Doyon contract if financing is not in place in short order, but disagrees with the Board's stand on the reservation fee issue.

In response to Senator Fischer, Mr. Haynes stated that it might not be appropriate for the Legislature to pass an approval bill for the Doyon contract, conditioned on a finding by the Commissioner or Governor that financing was in place, because the Department does not want to see a group with a supply contract but no deal put together, using the contract as leverage for financing. They prefer to have the issue settled in the course of the Legislature.

Avrum Gross pointed out that the contract has a built-in time limit. With the construction season in Fairbanks being what it is, if Doyon

March 26, 1982

Page 4

cannot begin construction next year, the new refinery might not happen. If the Legislature were to approve the contract the time limit for completion is built-in.

Jeff Haynes, in response to questions, stated that there could be problems with conditional legislative approval of the contract. At some point after this session, stretching the solicitation procedure out would be unfair to other parties to the negotiations. The Department has used the standard that processing facilities must either be operating or imminent. A supply contract will not make a project viable if it were not viable otherwise. In terms of conditional approval, the state has to look at the other proposals. Others wanted more barrels for expansion, which could yield more competition. The total amount requested added up to more than the state has available; the state rejected their proposals. It would be unfair to them to extend the time for Doyon too long.

Dick Lyons, Chairman, Alaska Royalty Oil and Gas Development Board, stated that in the Board's perspective, the imminency of a project was a concern. They did not want to commit state crude to any project which wasn't going forward. There was the issue of competition. Both proposed contracts--Tesoro and Doyon--involve about \$1 million per day in royalty oil. The crude would be sold for dissimilar prices under similar conditions and terms. If it were a private supplier, and not the state, federal law would prohibit it.

In response to Rep. Halford, Mr. Lyons stated that if the Legislature were to introduce bills for both contracts, the Board could meet in short order to consider a financing package for the Doyon project, if one were to come forward.

Rep. Halford stated that the Legislature should move forward with both proposals this session, and hear from the Department of Natural Resources and the Advisory Board on the financing package for Doyon, if one is forthcoming.

Mr. Gross stated that the Legislature is probably just as qualified to judge on the merits of a financing package as the Board and could speed the decision process by waiving Board review.

Dennis Jurin, President, Tesoro Alaska Petroleum Company, testified that Tesoro has the capacity to supply over 100 percent of the gasoline required in the state at present. The company started in 1969 with an 18,000 barrel per day capacity refinery in Kenai, and has expanded it to almost 50,000 barrels per day. They did it on the basis of a relatively small Cook Inlet royalty oil contract, and each expansion after inception had no other subsidy than an opportunity to buy royalty oil on a competitive basis.

Mr. Jurin stated that Tesoro was a respondent in the 1977, when the North Pole refinery requested a contract. The Tesoro proposal was not approved, and Tesoro did not push the issue, which, in hind-sight, the company should have. Due to rapid growth through aggressive marketing, Tesoro has placed itself in a vulnerable position, with most of their

March 26, 1982

Page 5

supply of crude coming from foreign sources and spot market purchases. The Cook Inlet supply is dropping at a rate of about one percent per month. The majority of the supply is either foreign or domestic short-term contracts, subject to interruption. Tesoro wants a relatively secure long-term supply contract not subject to rapid changes.

Mr. Jurin stated that Tesoro is considering expansion of their facilities. They began research in November, 1981 on market growth in Alaska, the probable product-mix and preliminary engineering. It is possible that as much as 70,000 barrels per day could not be fully utilized until 1995 and Tesoro might settle on about 55,000 to 60,000 barrels per day. One primary consideration in their planning is what happens to the Advisory Board recommendations here. A gasoline producing refinery in Fairbanks would effectively close that market to Tesoro in the Interior, as is the diesel and turbine fuel market already, due to production by the North Pole refinery. It costs Tesoro eight to nine cents per barrel to transport gasoline to the Interior and an on-site refinery there would have an unbeatable competitive edge. Therefore the decisions here have a lot to do with what Tesoro builds in the Kenai.

Mr. Jurin discussed the return oil situation. The west coast utilities are the largest users of residual oil; they will have abundant supplies from other sources. Tesoro intends to convert the residual oil to petcoke or use a hydrogenation process to convert it to turbine or diesel fuel. They are currently running a pilot plant project on their feedstocks to test the processes. Union Oil Research is the licensor of Tesoro's first hydrocracker in Kenai; they are negotiating with them for a possible second facility, and have engaged engineers for design investigation.

Mr. Jurin stated that Tesoro's corporate finance group is meeting with financial institutions to determine the best way to finance the expansion. All the decisions will probably be made this year. The proposed contract requires Tesoro to periodically report to the Commissioner on the progress of evaluation, planning and development of the project. The contract would remove a degree of vulnerability in supply, and help maintain Tesoro as a formidable competitor in Alaska. The difference between the Tesoro proposal and others is that Tesoro is not planning to go ahead in the future, but are proceeding with the project on its own merits at this time, not because of the benefit of some sort of subsidy. Tesoro has an unblemished record in dealing with the state on its existing contract.

Senator Fahrenkamp stated that estimates of the price break for a processor buying royalty oil from the state run from one to three dollars per barrel, and asked if a long-term contract would result in cost reductions passed on to consumers.

March 26, 1982

Page 6

Mr. Jurin replied that he didn't know what the future price situation would be; the cost of raw materials is not the only factor. A long-term contract would mitigate abrupt shortages in supply, which have been brought on in the past by economic supply shortages, requiring that Tesoro reduce production runs. Tesoro will do whatever possible to maintain the competitive or below market pricing.

In response to Rep. Halford, Mr. Jurin stated that Tesoro currently supplies 27 to 28 percent of the market directly, with the remainder being supplied by Chevron, Union, Texaco and independent operators. Tesoro will probably never supply the whole state, due to competitive differentials in transportation costs. Tesoro serves mainly the lower railbelt and Kenai area. They provide 78 percent of the turbine fuel at the Anchorage International Airport, and will probably supply more with an arrangement for another hydrocracker plant. The potential loss to the state by the west coast offset may change; the gulf coast prices have been traditionally higher than the west coast. Tesoro would not be looking for a long-term contract if they thought that there would be an ample future supply of oil. Projections predict that there will be more shortages than surpluses over the long run.

In response to Rep. Cotten, Mr. Jurin stated that Tesoro has a contract with San Deigo Gas and Electric to purchase the return oil. The contract began in 1972, and has been renewed through 1984. Tesoro intends to expand their facilities to process the return oil. They don't have a guaranteed market in the pipeline.

Jim Smith, President, Tesoro Alaka Crude Oil Company, in response to Rep. Cotten, stated that whether the price Tesoro would pay for oil would be greater than the average weighted price, if they purchased it from a producer other than the state depends upon variable market conditions. Tesoro is currently buying ANS crude from Sohio on the spot market, probably paying more than they would pay other producers, but the other producers are not willing to sell.

The Committee was adjourned at 9:50 a.m.

HOUSE OIL AND GAS COMMITTEE  
AND  
SENATE RESOURCES COMMITTEE

JOINT MEETING ON ROYALTY OIL DISPOSITION

March 25, 1982

CHAIRMAN HALFORD: The joint meeting of the House Oil and Gas Committee and the Senate Resources Committee, would you please come to order? Present we have the Senate Resources Committee chairman, Bettye Fahrenkamp. We also have Senator Fischer, Senator Mulcahy, and Senator Gilman. Present on the House Oil and Gas Committee are Representative Cotten, Representative Randolph, Representative Rogers, and myself, Rick Halford. We are here to consider the proposal of contracts for disposal of a portion of Alaska's royalty oil, and our agenda calls for the first presentation to be from the Alaska Royalty Oil and Gas Development Advisory Board. If Dick Lyon would come forward and present us with those recommendations.

MR. LYON: Thank you very much, Representative Halford, Senator Fahrenkamp, and other members. I don't have a formal presentation. I have copies of the two resolutions which the Alaska Royalty Oil and Gas Development Advisory Board just passed this afternoon, and I don't know to what extent you want me to go into detail about what the board has done concerning the string of negotiations, or the series of negotiations,

that the Department of Natural Resources has been doing. I'm sure that Commissioner Katz is going to bring you along in good detail. These are his findings, and basically the board's deliberations. I don't know if you have copies or not, but the board's deliberations included dealing with the findings which are quite extensive and detailed and give you an excellent and very strong background about why he has concluded what he has concluded. The board's actions were to recommend that the legislature approve the contract with Tesoro and not at this time approve the contract proposed with Doyon. If you'd like I can read the resolutions, or if you just want them entered into the record, I can perhaps read the pertinent parts about the basis of the conclusions.

CHAIRMAN HALFORD: We have copies of the resolutions. I don't know if ...

OFF RECORD: [Discussion among committee members regarding whether or not they have copies.]

CHAIRMAN HALFORD: Are the whereases the same until you get back down to the last page?

MR. LYON: Let's see. The first two pages of whereases are. Correct. I'm not sure if -- At one public hearing - the Anchorage public hearing - there was no testimony.

At the Fairbanks public hearing there was testimony, and if that's in the whereases, then that's the only distinction between the whereases.

CHAIRMAN HALFORD: Okay, and the first one deals with Tesoro and the second one deals with Doyon?

MR. LYON: Yes, that's correct.

CHAIRMAN HALFORD: I guess it might be appropriate to just go ahead and read into the record just the therefores at this time.

OFF RECORD: [Discussion among committee members about having copies.]

MR. LYON: Let me say, as just prefatory remarks, that the commissioner has met with the board regarding these contracts on, let's see, at least half a dozen occasions. The function of the board involves exposing the negotiation process to the public to the extent that it is possible to do so and still have a private negotiation, but the board has been brought along as the negotiations have proceeded.

The conclusion on the Tesoro Alaska contract is as follows: The Commissioner of Natural Resources has followed the board policies and applicable statutes and regulations relating to the disposal of oil and gas royalty interests; two, that the board agrees that the sale of royalty oil interests to Tesoro Alaska

Petroleum Company, as per the agreement, is in the best interest of the state because (a) the oil is to be refined or processed or traded for other oil to be processed in the existing Tesoro refinery near Kenai, Alaska; (b) Tesoro Alaska's in-state refinery supplies products to the Alaska market with price or supply benefits to state citizens; (c) the price that the state will receive for this royalty interest appears to be substantially equivalent to or greater than the price the state would receive by taking this royalty in value; (d) that Tesoro Alaska is a highly qualified company who has been operating its refinery to produce products for the Alaska market for over thirteen years; (e) that adequate security provisions have been included in the agreement; (f) that this agreement is consistent with the criteria outlined in AS 38.06.070. Therefore, be it resolved that the Alaska Royalty Oil and Gas Development Advisory Board recommends to the Twelfth Alaska Legislature that the agreement for the sale and purchase of royalty oil between the State of Alaska and Tesoro Alaska Petroleum Company dated February 26, 1982, be approved.

The motion carried unanimously. Would you like to deal with the two contracts separately?

CHAIRMAN HALFORD: I think we're going to deal with the contracts once we get ...

MR. LYON: All the information. Okay.

CHAIRMAN HALFORD: ... [indiscern.; simultaneous conversation]  
... introductions, but if you would go through the  
findings section on the second contract ...

MR. LYON: Surely.

CHAIRMAN HALFORD: ... [indiscern.] ... resolutions .

MR. LYON: All right. The motion ends by saying: The board  
finds as follows: (1) that the Commissioner of Natural  
Resources has followed the board policies and  
applicable statutes and regulations relating to the  
disposal of oil and gas royalty interests; (2) that the  
board favors increased in-state use of its royalty  
interests, such as construction of a new refinery; (3)  
that the board disagrees that the sale of the royalty  
oil interests to Doyon, Ltd. as per the agreement, is  
in the best interests of the state because (a) the  
financing and therefore, timing, of the proposed  
project is currently uncertain, and it is not in the  
state's best interests to conclude a contract until the  
project is ready to move forward; (b) the provision for  
delayed payment of the reservation fee according to  
paragraph 2.10 of the contract creates an unacceptable  
bias against competitors. And therefore, be it  
resolved that the Alaska Royalty Oil and Gas  
Development Advisory Board recommends to the Twelfth  
Alaska Legislature that the agreement for the sale and

purchase of royalty oil between the State of Alaska and Doyton, Ltd. dated February 26, 1982, be disapproved.

This motion carried unanimously. However, the record should reflect that Commissioner Williams, who seconded the Doyon contract resolution, was unable to continue and be present at the time of the vote. He had a meeting conflict.

CHAIRMAN HALFORD: Okay. I think at this time we can just go on. I think the Department of Natural Resources can really give us the biggest piece of the background and the conditions of the negotiations, and also the statutory provisions under which the negotiations were conducted, and what the intents were; and then when we get down to the contracts, we'd like to have you possibly come back to respond to anything on the specific contract proposals for Tesoro and Doyon. Representative Cotten?

REP. COTTEN: You said that Tom Williams had seconded the motion to approve the contract?

MR. LYON: Yes. He ...

REP. COTTEN: Who made the motion to approve it?

MR. LYON: The motion to approve it was made by Dr. Triplehorn.

REP. COTTEN: But then he ended up voting against it, didn't he?

MR. LYON: No, no. What we did was we prepared two resolutions for each contract so that we would be prepared to move: one resolution to approve - to recommend approval - and one resolution to recommend disapproval; so the motion recommended disapproval.

SENATOR MULCAHY: Mr. Chairman, I don't know about anybody else, but I've only got one resolution.

OFF RECORD: [Discussion among committee members; waiting for arrival of copies.]

MR. LYON: Are you finished with me?

CHAIRMAN HALFORD: Yes, thank you.

SENATOR FAHRENKAMP: But not forever.

REP. ROGERS: Mr. Chairman?

CHAIRMAN HALFORD: Representative Rogers?

REP. ROGERS: It's fairly obvious to me from the -- now receiving it, that there were some substantial -- that they had a proposal, but it all -- all the findings got rewritten as they went through. Maybe I'll look through the [indiscern.], but I would like to ask some questions about the ...

CHAIRMAN HALFORD: Yes, I have some questions on, particularly, the second resolution, but I thought we would hear from Doyon, and then go through the questions with the royalty board.

REP. ROGERS: Okay. Apparently there were some other changes very late in the process.

CHAIRMAN HALFORD: Um-hum. Mr. Katz, if you would go through the entire process?

MR. KATZ: Thank you, Mr. Chairman. I am pleased to present to you today the Tesoro contract which has the full support of the administration. In the case of the Doyon contract, as I'll indicate a little further on in my testimony, we agree with the result of the royalty oil and gas board. We agree with one of the premises for that conclusion, and we disagree with the other. With your indulgence, Mr. Chairman, I am going to take just a few minutes and run through the process we used and the underlying policies that guided our negotiations of all the contracts because this is the one point I think in the legislative process where that would be appropriate.

The first thing I want to deal with is process. We set several criteria for ourselves, and these, among others, are ones that hopefully you will utilize in ascertaining whether the process meets your requirements. The first is that the process be fair to all participants and be perceived by them and by the public as being fair. Secondly, that we make a real effort to institutionalize a decision-making process in the Department of Natural Resources for making royalty oil

decisions; in a sense to depersonalize that process, and to create an interdisciplinary presence with respect to examination of royalty oil issues. Next, that from start to finish we create a paper trail that documents each and every point in the decision-making process, and why we chose to go one route as opposed to another. Next, that we increase the knowledge of the key decision makers in the royalty oil area through the process, and in fact we did that through a number of means. Next, that we improve upon the standard form royalty oil contract. That involved an inter-administration examination of the prior contract, and a very significant effort at amendment, and then just to cross check what we'd done, we exposed our contract to one of the best commercial law firms in our judgment in the United States, and to some people who trade in royalty oil just to get their judgment. I think that the net result was a very tough contract, but a contract that I think serious royalty oil bidders were willing to sign. The next goal that we had in mind procedurally was to improve our DNR's - relationship with the royalty oil and gas board, and I think we've done that. They in our judgment represent a real reservoir of knowledge and expertise on royalty oil, and we sought to take advantage of that expertise at each stage in the process. The culmination of all of

these procedural efforts is the findings document that has been presented to the committee, consisting of over two hundred pages of background and findings and conclusions. We have sought to summarize that document in a fourteen-page briefing paper which has been previously provided to the committee.

Very briefly, here are the major policies that underlie all of our negotiations. First, that we recognize -- Let me start back just one step and give you a feel for how that process works pragmatically. We revised our pending solicitation when I came on board to more, in my judgment, accurately reflect the in-state preference that exists in the state statutes. That solicitation was put out on the street in the period from August 1 to September 1. We got some twenty-nine responses to the state solicitation. We then began a winnowing process. We met with everybody that desired to meet with the state to back up orally their written proposal. Later we made a series of findings of our own and gave the parties who we rejected at that point in the process the opportunity to refute our conclusions, and in two or three cases we reconsidered, although coming to the same conclusion. We then continued on in our negotiations with the people that we felt presented serious proposals. There were some eight or nine in number at that point in

time. Regrettably, those negotiations continued beyond the time frame that we had originally projected, and I apologize for that in terms of the very stringent deadlines that I know that all of you have set for yourselves, but it really wasn't possible I think in the pragmatic business world to move much quicker than we did. Unlike a situation where two private parties are dealing with each other, we could not negotiate, in my judgment, a contract with one party, and then move on and negotiate another contract with another party, and so forth all the way through the process. The reason for that is that all of the people that we were dealing with in one way or another compete with each other. and we didn't want to purposefully or inadvertently create a competitive advantage or disadvantage by negotiating a contract with one and then going on separately, so while we maintained confidentiality in all of our negotiations, we tried to move everybody forward together; and we learned on the basis of that experience, and will profit in the future, that it simply takes more time than we projected for that to occur.

Now on to the substantive policies. As I began to indicate, we reflected a clear preference for in-state taking. That preference, in our judgment, though not absolute, and we did not treat it as

absolute, is reflected in the Alaska Statutes. Secondly, we sought to achieve parity among all the parties that were negotiating for state royalty oil in terms of all the major provisions. Obviously, each proposal reflects a different set of circumstances, but in terms of term and price and those kinds of major elements, we sought to achieve parity. The one instance where we deviated from that was to grant a four-year moratorium on an option fee that I will explain later in our discussion, in the case of the Doyon refinery proposal; and we did that very consciously. That decision involved a conflict of a number of competing policies which in isolation all of us, I think, would endorse, but in this situation they came together in conflict. One of those was to achieve parity among all participants, but another one, in our judgment, was to help facilitate entry into the market to increase competition, and thereby hopefully achieve benefits for a broader range of Alaska citizens. I don't want right this second to go into any further detail on that, except to indicate that that was a very conscious decision on our part, and it is the only point where we are in conscious disagreement with the decisions of the royalty oil and gas board.

The next issue was price. We departed from the older exhibit B price mechanism. Instead we adopted

the weighted average field price on the North Slope, but with a contractual adjustment for whatever occurs in the pending Amerada Hess litigation and with a three percent above prime, or above the treasury rate, sum to be paid over and above whatever the results of Amerada Hess may be. The decision to depart from the exhibit B price was very conscious on our part. For one thing, that price does penalize in-state takers, because it is very difficult for them to know what the price is until a period of about sixty days after the transactions occur. That uncertainty makes it very difficult for them to plan. Also, given the pendency of the Amerada Hess litigation, we felt that a court will make a definitive decision, hopefully in the not-too-distant future, and whatever decision that is, it will govern these contracts. In the interim, we preferred a solution which gave us the three-percent-above-prime approach, rather than the alternative which would otherwise existed where we would have had to pay a percent and a quarter above prime if we were to lose in a situation where most of the state's investments don't achieve that objective.

The next decision related to term. We decided on a twelve-year term. We looked at other alternatives; for example, terminating all these contracts on the day of Prudhoe Bay wind down. But the twelve-year

term does make sense in terms of what will -- what the supply situation is likely to be at that point in time. We wanted to maximize the options that were available to future legislatures and governors at some point in time, and the twelve-year time frame was virtually as good as the eight-year time frame, in our judgment.

The next decision was respecting volume. We wanted to retain a significant uncommitted volume, no matter what occurred in the solicitation, in order not to preclude options that may materialize two or three years from now, and that we simply cannot foresee; and whether or not the Doyon contract is approved, I think that we will achieve that objective.

The next issue relates to what we called the option fee. We felt that there was a significant benefit to people in the commitment of oil by the state, and conversely, the state lost certain opportunities once that commitment occurred, even if oil were not provided, and so an element of our contractual negotiations was to obtain a fee once our oil was committed if that volume of oil were not taken at any given point in time. As Chairman Lyon indicated, the one exception to that was a four-year moratorium in the Doyon contract, which we did as a concession to a new entrant. We picked four years because that's the

period of time in which Mapco has had an opportunity to penetrate the market.

The next policy that we adopted was a very conscious decision against interim taking. We did not want state royalty oil to be the vehicle for financing a project that was otherwise not financeable. Trying to draw on the experience of the past, our policy in all instances was to supply oil only to projects that were imminent and at the time the refinery door opened. Here is where we began to have trouble in the Doyon arrangement and so did the royalty oil board today. At the time we negotiated the contract with Doyon, Ltd., their construction financing was in place. They had spent a considerable amount of money in the purchase of equipment, and they had acquired a site across the street from the Mapco refinery. Given that movement forward, we felt that it was not necessary for the government to interpose benchmarks that would have been very difficult, as they would have been in the Alpetco situation, for the government to really monitor properly; and given that substantial commitment by a private concern of its own money, operating in its own self interest, it had every impetus to move forward. Since the contract was negotiated, however, for reasons that perhaps Doyon will choose to explain, their construction financing has lapsed, and at this point in

time does not exist. They are doing everything within their capacity to reacquire construction financing, so it was not a speculative sort of venture that we chose to negotiate with, in our judgment. At the time we negotiated the contract, everything was in place. On that basis, we would have, and did, advise the royalty oil and gas board of our discomfort. We would have indicated that to you as well. In our judgment, if the financing situation comes together conclusively within the next couple of weeks and prior to final legislative approval, then if we were certain that that were the case on the basis of our own independent analysis, we could then recommend to you in good conscience that the contract be approved, but not unless and until that occurs.

The next decision that we made was to be willing to be a one-hundred-percent supplier of royalty oil to in-state refiners. The reasons for that were a couple. First, the state statutes do provide a preference for in-state refining and processing. Secondly, we considered a sort of arbitrary approach of saying: Well, we won't provide more than eighty percent or seventy percent to a refinery; but that would have significantly provided a significant detriment to the companies involved without really giving the state, in our judgment, a real benefit. The difference in volume

was not all that great, and one of the things that we were trying to do, particularly for example in the case of Tesoro, was to provide a really secure foundation for their present operation and for their hope for future development. Some of the companies that we were dealing with have had to be out on the world market, constantly searching for oil, and that's not a very secure situation to permit a real commitment to the state and a commitment to the future.

The next issue that we dealt with was return oil. I will touch on that only briefly. Return oil is oil that in a pipeline refinery like Mapco comes out at the other end of their process. They pay a quality penalty, and the return oil in theory is available for other uses further downstream. We tried to maximize the volume that the state was dealing with by incorporating the return oil as well as the Pump Station One oil in our discussions and deliberations. For a number of reasons that didn't work out, and so Doyon would be responsible for selling the return oil as a result of its refinery operation, unless the state on a one-time basis chose to exercise an option to take that oil, but it would not be initially ours.

Next, although nobody was willing to construct a refinery in rural Alaska, we in every set of negotiations tried to obtain concessions that we thought would

be for the benefit of rural Alaska. Unfortunately, some of the contractual discussions that would have best yielded that result fell through for other reasons, but I think that that should be an objective of every set of negotiations that the state enters into.

The next thing was petroleum coke. Unfortunately, in my judgment, the discussion of petrocoke has tended to dominate the discussion of some of these other issues, and I think that some of these other policy issues relating to the disposition of state royalty oil are at least as important, if not more important, than petrocoke. But we did adopt a policy in the department of trying to use royalty oil to complement the development of another state resource, which was coal, and we felt that if the technology existed to blend petrocoke with royalty oil - I mean, excuse me, with coal - somewhere on the Pacific Rim, and that that would accelerate the development of Alaska coal, that was a very important policy for us. We chose to approach that policy on the basis of developing contractual provisions that would have provided a benefit to any concern that was mining Alaska coal, rather than providing royalty oil to any one concern. Unfortunately, the generalized discussions fell through, and at this point in time we

don't have a contract to present to you which provides the petrocoking approach.

The next matter that I want to raise with the committee concerns the impact on the end value price which results from in-kind taking of Alaska oil. We document this fully in our findings, and frankly, it represents -- raising this issue with you represents the way that we have approached the legislature on all issues since I've been here and I think, hopefully, and I know the department has done it before that. We are not approaching these contracts in a hard advocacy vein, to the point of denying you access to information, to negative information, that would bear upon these contracts; and there is no question that any in-kind taking has a negative impact on the end-value price of Alaska oil because, or in most instances, that will be the case, not necessarily in all instances. The basic reason for that, without going into a whole lot of detail, is that there is a two-tier price system now for ANS [Alaska North Slope] crude. The West Coast price is higher than the Gulf Coast price. In most scenarios, but not all scenarios, it is likely that in-kind taking, of the kind that is authorized by our statutes, will replace oil from the West Coast. The West Coast price is higher. Therefore, it will have an impact both on severance taxes and on the in-value

price. It is for that reason that we chose not to dispose of all of our royalty oil in this solicitation. The exact impact of that kind of effect is not really ascertainable with any certainty because it involves a number of factors and those factors constantly fluctuate, including the differential between the West Coast price and the Gulf Coast price. We think that the best figure to apply to this, and it's my understanding that we've discussed it with legislative staff people as well, is that if you were to adopt both the Doyon contract and the Tesoro contract, the impact on severance taxes and the in-value price would be about \$10 million a year. It would be roughly half if you adopt one contract or the other. We considered that in our findings. We found that other considerations outweighed that negative consideration, but we wanted you to be aware of it. And of course, our state statutes reflect a preference for in-state -- in-kind taking for in-state use, and therefore, at least implicitly, the legislature considered that in enacting the original statutes.

Second we were -- Next, we were determined that Alaska royalty oil not be used as market leverage for something that was really unrelated to royalty oil. There is no question that a company building widgets would like to use Alaska royalty oil as a lever to get

into the widget market, but we didn't necessarily think that that was in the state's best interest. The thing that we did feel was in the state's best interest, as I mentioned before, was to try to use royalty oil to aid and abet the coal industry in ways that we thought were more related to each other.

The next thing that we were determined to have was adequate security, particularly given the situation that confronted Jeff Haynes and me last summer in the aftermath of the competitive solicitation that the state held at that time. We do have, in our judgment, adequate security in these contracts in the form of letters of credit and other legal mechanisms. For me this was a legal question. The two issues that I posed to the attorney general's office were, one, you tell me when you think that we have both adequate security now and that that security is readily assessable, and it was only when they felt comfortable in the security provision that we signed off.

I next just want to conclude this statement of policy very briefly by making a couple of observations. One is that we negotiated these contracts at a point in time when frankly our negotiating leverage couldn't have been any worse. There is an oversupply of oil in the world, as all of you know. That oil is readily accessible to most people that were involved in our

solicitation, and they had lots of alternatives. Conversely, we had what in my judgment is a very satisfactory alternative, and that is to permit the producers to take that oil in value and to sell it for us. Really, pragmatically speaking, the producers are going to be better marketers of our oil than we do. They have hundreds and thousands of people doing what we have basically four or five people doing, and the price -- They have a motive in terms of their own economic self interest, in terms of the seven-eighths of it that they own, and we tax along with the one-eighth that we own; and given that and the negative impact on in-state taking, we felt that the in-value alternative for the oil that we have elected not to propose to you for sale at this point was a very viable alternative on our part, and I think it will be the case in the next one to two or three years that the market conditions will harden a little bit and the state will be in a much better position to negotiate tough contracts.

Another thing that members have posed to me is a question that I just thought I would deal with very briefly, and that is: Why don't we just sort of auction all this oil on a competitive bid basis? There are circumstances where I think it is clearly in the state's interest to auction on a competitive bid basis,

but there are a couple of factors that I think we ought to note in response to that question. One is that oil that is auctioned in that manner usually results in the displacement effect on the West Coast that I mentioned earlier, and therefore has a negative impact on the in-value price and the wellhead price and if we auctioned a lot of our oil on that basis, the price would of course be exacerbated. Secondly, while there is no question that in certain instances we did well in the competitive solicitation last summer, over any longer term arrangement, for better or worse it is true that the major producers are going to be probably the best marketers of oil; and unless there is some really anomalous situation other folks, particularly the small folks that bid in our last competitive solicitation, aren't going to be able to hold a candle in the long term to that marketing situation.

So where are we now? We have in essence five proposals still pending. The first one is the Tesoro contract that we feel very comfortable in recommending to you in its present form, and believe that it properly and adequately protects the public's interest. The second is the Doyon contract. If the financing situation can be definitively resolved on a very short-term basis, we would feel comfortable in the legislature adopting that contract. Doyon has been

very forthcoming with the state, and we've been able to monitor their efforts pretty carefully. They are not there right now. The only other policy issue that I know of in connection with the Doyon contract is the one that Dick Lyon mentioned about whether there ought to be a four-year moratorium on this opportunity cost fee that we have in there, and you all are in a very good position to judge the major policy considerations in this fee, entering of a new market versus possibly some negative impact in terms of the competitive situation. As I say, we felt in total result that it was in the state's best interest to negotiate that contract.

In addition, we have ongoing discussions with three other firms that we want to bring to your attention just so that you know where we are. We will not be presenting royalty oil contracts to you with respect to any of these firms in this legislature and we have so advised the parties involved. However, if we are successful in resolving the concerns that we have now, we would feel comfortable in supplementing our findings and recommending to the next governor and the legislature that the contracts be approved or not at that point in time. The first of those firms is the Chevron Corporation. We had a series of very amicable negotiations with Chevron. In fact, frankly I feel

that all of our discussions have been on that same plane, and hopefully that will be reflected to you by other participants in this process. In the case of Chevron, we were willing immediately to recommend to you that we supply 18,000 barrels of oil today to the Nikiski refinery for in-state refining and processing. Another 20,000 barrels was under discussion. That would have been exported from Alaska to California with a return in terms of product. The state statute on that score requires a special price or supply benefit. We did not feel that the state was receiving enough consideration at this point in time for the extra 20,000 barrels. The discussion tended to surround the petrocoke option, but in my judgment it was broader than that, just an inquiry about the consideration that the state would receive, so that the offer that's on the table now is for 18,000, and the other 20,000 will remain for further discussion and we're hopeful that we will be able to consummate an arrangement with Chevron later.

The second firm that I want to mention to you briefly is the Provident Oil Company. Provident and Koniag have a joint venture arrangement that involves construction of a refinery in Arizona. That proposal involves export of oil, and as I indicated earlier that was not a preferred policy in the array of policies

that I have discussed with you. However, they have been willing to offer such a premium price for the export of oil that we did not feel that we could reject that proposal without further consideration. However, we feel that there are a number of fundamental questions that have to be addressed and have not addressed. We have provided I think now a letter that we sent to the Provident people outlining those questions and indicating that we believe that either we in some instances, or we and they in others, must address those questions before the state could really consider any arrangement of that sort.

The last pending proposal is the Suneel proposal for royalty oil to be used as leverage to obtain petrocoke from California, to transship petrocoke from California and coal from Alaska for blending in refineries in the Orient. Again, we felt that there were a number of questions that needed to be addressed. Perhaps they can be addressed, but we did not have time to do it within the confines of this negotiation, given the fact that we were pursuing what we felt was a more general and equitable alternative prior to recently; that is, an arrangement that would have made petrocoke available to any firm in Suneel's situation. The questions that we are pursuing with Suneel now are, first, the technology of blending petrocoke with coal.

Suneel feels that there are some good answers to that, but there are at least two schools of opinion and we feel that we need to know more about it. Secondly, we need to examine with Suneel the West Coast market and determine why it is not sufficient to just purchase with cash petrocok that we think is available. Again, Suneel has done a lot of research on the West Coast market, and is prepared I think to provide those answers. The third thing about Suneel is the imminence of their proposal. Certain factors have materialized recently that we think at least require some further exploration before the state would enter into any definitive arrangement. With respect to Provident and Suneel, we intend to commit ourselves with those two firms to a process which will be embodied in writing, where we systematically seek to address the outstanding questions and by some date certain to come to a conclusion which would then lead to the serious contractual negotiations or to a decision to reject the contract.

With that sort of overblown explanation of everything, Mr. Chairman, I think I'll stop and see if the committee has questions.

CHAIRMAN HALFORD: Representative Cotten?

REP. COTTEN: You mentioned something that -- I'm not sure what the definition of exhibit B price is, and I had a

question about the pricing, but I wasn't sure what exhibit B price was.

MR. KATZ: Just so that you have it absolutely accurate in terms of our current litigation in Alaska, Bob Maynard will explain what we mean.

MR. MAYNARD [Not at a microphone]: Exhibit B was originally attached to the Alpetco contract. In their contract we've always been wanting in-value prices, but the question of what in value is, of what the methodology is for the producers ... [indiscern.] ... the prices ... in value is in litigation right now. Exhibit B was attached to the Alpetco contract and is attached to all other contracts, and basically presents a position that we will ... [indiscern.] ... position in the Amerada Hess litigation. It's basically a case of the higher alternative of what the producer reports to us or the weighted average of all other producers, so that ... is the higher of two prices, so it ... result of ... price term, which is higher than the weighted average of the in-value price, but lower than the highest price reported, somewhere in between -- ratcheted up ...

REP. COTTEN: So it would be higher than the actual producers' weighted average?

MR. MAYNARD: Yes.

REP. COTTEN: That was all that we ... [end of tape].

MR. MAYNARD: The basic difference between the Alpetco contract price term and this contract price term is in the Alpetco contract price term, Alpetco paid us as if we won the lawsuit, and we would pay them back if we lost. In this price term they pay us as if we lost the lawsuit, but would pay us back if we win.

REP. COTTEN: Under these contracts?

MR. MAYNARD: Yes.

MR. KATZ: And the premium that they pay us back with is much higher than what we would -- than the reverse situation if we had won.

REP. COTTEN: Okay. So you get the weighted average unless you win the lawsuit. In that case you get the actual -- the exhibit B price.

MR. MAYNARD: Right. Exactly.

REP. COTTEN: Okay. That's what you meant when you said that you'd get a higher price than what we're getting for it now.

MR. MAYNARD: Yes, sir.

REP. COTTEN: And actually the people who would be buying the oil would be paying -- In this case, Tesoro, if they were buying it from the producers they would have to pay more than they would be paying the state under this contract.

MR. MAYNARD: If we were successful in the litigation.

REP. COTTEN: No, it has nothing to do with the litigation, does it? Like, if Tesoro had to buy right now from -- We were getting ...

MR. MAYNARD: Oh. Yeah.

REP. COTTEN: ... Exxon is taking oil and selling it to Tesoro. Tesoro has to pay more ... [indiscern.] ... if they bought it from the state. By a factor of how much? Is that something that's easily determined?

MR. MAYNARD: That's correct. That's not specifically Exhibit B, that's just the way ...

REP. COTTEN: No, it has nothing to do with exhibit B. I understand that the West Coast price is cheaper.

MR. MAYNARD: Correct.

REP. COTTEN: How much does that amount to?

MR. MAYNARD: Right now it's two to three dollars.

REP. COTTEN: Two to three dollars. So actually if we were -- if we could find a buyer, and we were selling it, if Tesoro were still willing to buy it from us we could probably get two to three more dollars per barrel.

MR. HAYNES [Not at a microphone]: Well, I don't think that's the case, because first of all it depends on which producer you're buying it from. Secondly, unless we just flatly lose out on the Amerada Hess case, which I don't believe we're going to do, the adjustment that comes from that is going to bring it closer to whatever the West Coast commercial price is to the producer; so

there is some difference ... [indiscern.] ...  
particular position on the Amerada Hess case is going  
to recapture ....

REP. COTTEN: I think your fourteen-page memo suggested about  
a dollar a barrel. I wonder if that was ...

MR. HAYNES: I think that's probably more realistic.

MR. MAYNARD: That's exhibit B over weighted average in value.

REP. COTTEN: [Indiscern.]

MR. HAYNES: It's very hard to tell because our royalty  
reports don't show what the West Coast commercial price  
is ... [indiscern.] ... but we don't actually know ....

CHAIRMAN HALFORD: Senator Fischer?

SENATOR FISCHER: Mr. Chairman, pursuing the same intent, we  
have been trying to figure out exactly what's going on  
here, and the -- You mentioned before, John, that the  
-- if you took both the Tesoro and the Doyon contracts,  
it might cost the state -- the difference might be  
about \$10 million, and taking, let's say, Doyon only,  
it would be about \$4 or 5 million which is sort of  
taking a minimal position, which would be more than  
\$50 million over the period of the contract. If you  
take the difference between in value and exhibit B over  
a different period -- Let's say we looked at April  
through September 1980, the difference averaged \$1.47,  
which just statistically for Doyon alone would come to  
\$20 million a year, and close to \$250 million for the

life of the project. If you took both Doyon and Tesoro at the higher differential, you come to more than half a billion dollars difference over the life of the contract. Now, would it not be possible, or appropriate even, to set the sales price at exhibit B regardless of the outcome of Amerada Hess?

MR. KATZ: Well, let me respond in this way to your question. As you have pointed out, you're really dealing, I think, with two separate factors. The first is the difference between the weighted average field price and the exhibit B price, which, you know, in terms of the contracts that we have negotiated would be adjusted in terms of Amerada Hess, and with the three percent above prime aspect we think we'll really recapture that. There is no question, as we point out in our findings, that there is a negative impact in terms of the in-kind taking aspect, and you, in our judgment, accurately articulated that. Could you mention just -- You ended your observations with a very specific question.

SENATOR FISCHER: My point basically is that if, let's say the differential becomes the same as it was in 1980, we may be leaving just for Doyon alone a quarter of a billion dollars on the table. For the two contracts, we may be leaving a half a billion dollars on the table, simply because my assumption is that these companies, when they are negotiating with the state are taking into account

the possibility that they will be paying exhibit B prices, so that essentially it would be just leaving that money on the table.

MR. KATZ: We looked at just the alternative of maintaining the exhibit B price term really carefully. The first thing we did in this whole effort was to look at every possible alternative for pricing our oil. We looked, for example, at using market crudes, market basket crudes. We looked at evergreen kinds of arrangements, the kinds that the companies sometimes use, and looked very carefully at exhibit B also. We rejected that I think for a couple of reasons, and Jeff may want to elaborate. One is that we felt that the recapturing mechanism we were using was a good one - the one that we described earlier. Secondly, the exhibit B price approach really does impair in-state utilization of oil, because of the uncertainty about the price for a very long period after transactions occur, and we felt that if we were really going to do more than pay lip service to in-kind taking, that we ought to think about deviating from that approach, recognizing that adjustments would occur in the aftermath of Amerada Hess.

CHAIRMAN HALFORD: [Indiscern.]

MR. HAYNES [Not at microphone]: Only that the purpose of laying this information out with regard to these dispositions is to show you all of the factors that we

tried to consider in making these dispositions, and to perhaps, a more important point, and that is to not look at a contract in isolation. You have to look at the ... [indiscern.; someone coughing] ... to see what's going on. These are the current market conditions. But remember again that these are twelve-year contracts. Now, twelve years ago it was 1970 and nobody had heard of OPEC or ever heard of oil embargoes or anything like that. Circumstances were very different then. I think we can probably all agree on one thing, and that is twelve years from now they will be very different. For example, up until the first of February everybody might have agreed that maybe the state should hike its prices to agree with, say, OPEC country prices. Well, that's fine unless the United States government puts an import fee on foreign crude, and all of a sudden domestic crude prices are higher than foreign crude, which they were in fact in the late 1960s, and then that doesn't work. I think our basic decision was to tie the prices ... to where seven-eighths of the oil was going or what seven-eighths of the oil is going for. That two-tier pricing system is there now for a number of specific and frankly justifiable economic reasons, but those reasons could disappear, and they could even reverse under certain circumstances, if we do something else. So we tried to

come as close as we could; but charging, say, exhibit B without an Amerada Hess adjustment could very easily end up being a premium over that twelve-year period. It could end up penalizing the companies that we're selling to. It's just very hard to predict exactly what the market is going to do, and, you know, those figures that you used are theoretically possible, but given the influence of the market it is more likely it will be way, way less than that, and we think that our estimates are accurate, or as close as we can come.

SENATOR FISCHER: You don't feel then that you're in effect leaving money on the table because the companies assume that they will ... [indiscern.; someone coughing] ... are likely to pay the exhibit B prices?

MR. HAYNES: I don't have that feeling.

CHAIRMAN HALFORD: Senator Fahrenkamp?

SENATOR FAHRENKAMP: John, I agree wholeheartedly, even if we were leaving money on the table with the concept of the in-state use and that type of thing. I think you are aware of the sensitivity, especially in my area, concerning the pricing of the products, and I'm wondering if we have any assurances at all - if there is any way of achieving assurances - that with not using the pricing, with using this type of approach, we can have some of that lessening of price that goes to the companies reflected in the prices here in the state.

MR. KATZ: There is no direct assurance in the contract to that effect. I think that might have been very difficult to articulate and negotiate, but certainly the situation that you described was the principal reason for our continuing on with the Doyon negotiations through some fairly tough sledding from time to time on the theory that without intervening more than was appropriate in the marketplace, the best thing that the government could do was sort of promote competition and while it may be true that over the long haul two refineries could not survive in interior Alaska unless they significantly expand their markets, the public would have a significant benefit in the interim, and that benefit might even be long term if they could both survive.

CHAIRMAN HALFORD: Just to try and figure out where we are on the cost figures, I think what you're saying is that there isn't any reduction in state revenue except through the West Coast offset. The companies that are buying, may be buying at a lower price than they can buy it from the producers, but they are buying it at the same price that we would be selling it.

MR. KATZ: I think that's what we're saying.

CHAIRMAN HALFORD: So they are getting a benefit that is not a cost to us, except for the West Coast offset which is a

potential cost to us depending on how much of that oil is really offset from the West Coast ...

MR. KATZ: That's correct.

CHAIRMAN HALFORD: ... which is an unknown factor.

MR. KATZ: And in recognition, Mr. Chairman, of the consideration that Senator Fischer raised before, and I agree with the conclusions that you came to that the -- it's not out of our pocket, but there is a significant benefit, and in recognition of that benefit we were frankly a little tougher in some of these negotiations than we would have been had we not been aware of that, and I think that may be why at least one firm that I can think of walked away from the table. We wanted to see something in exchange for what we knew was a benefit to them, even though not a cost to us.

CHAIRMAN HALFORD: Okay. 38.05.182 and 183 kind of conflict with each other in the way they say that there is a preference for maximum dollar yield and there's also a preference for in-state use. There seems to be some conflict there, but if we're talking basically a potential maximum loss of \$5 million in each of these contracts, the statute requires an assessment of benefits and how they relate to that cost. I wonder if you could go through that assessment, or who would be appropriate to go through that assessment of benefits: if it comes back down to dollars per job, dollars per

supply, this sort of thing - if we could get some kind of a cost-benefit analysis on that.

MR. KATZ: Okay, let me start that analysis and then I'll ask my colleague to the right here of me to elaborate. You're correct that there is an inherent conflict in our statutes, and something that ought to occur in the longer term - I don't think that the time exists this year, and certainly all of our efforts have been devoted to this solicitation - would be for the administration and the legislature to cooperatively take an overview of our royalty statutes and see if in the light of experience that there are things that we might choose to change. The way we rationalized that conflict for now was that at this point in time it was in the state's best interest to look at a solicitation in which price was not the only factor. Price was a very important factor in our negotiations, but we were trying to look at other things. I think in the case of both refinery situations it's very hard to quantify, and we'll certainly do as much as you want us to try to do to accomplish that. The Tesoro refinery is an existing operation, so the people are there, the supply contracts are there, et cetera. Nevertheless, I think that there is a very significant benefit for the state that is perhaps not quantifiable in dollars. What we are doing is really assuring Tesoro's commitment to the

State of Alaska. We are giving them a security that they have rarely had in their existence, where for the most part they have been in and out of the world market trying to find supplies on a short-term arrangement, and I think that we have set a secure basis, or laid a secure basis, that is going to assure not only their existing commitment, but I think will be a premise to really serious discussions and planning for future expansion. We didn't feel in the context of this negotiation that we could compel a private concern to do something like expansion, that it would not at this point have independently determined was in its own economic self interest, but we tried to do the second best in terms of the best efforts clauses, et cetera, and I think that the economic basis of the existing contract that we're proposing will significantly help in that. In terms of Doyon, being a new entrant I think the situation is a little different. For one thing, there is no question that there would be significant price competition, and our studies indicate that price competition would occur not only in interior Alaska, but as already occurs in the case of Mapco, would extend through the greater railbelt area, and both concerns would be likely to compete in an area where more than seventy-five percent of the state's citizens live. Now, I don't know what the

differentials would be or anything because the factors, as Jeff indicated before, are uncertain. Secondly, they would be constructing a new refinery, and would, as most of the regional corporations do, give a preference to in-state residents. They would also be seeking, I'm sure, to utilize in-state people in the operation of the refinery. So that one is more readily ascertainable at this moment in time. Do you have anything to add to that?

MR. HAYNES [Not at microphone]: Only that that royalty statute was written strictly on the basis of, you know, competitive bid type of work, and what we've presented to you is a ledger with a bunch of entries and a dollar figure at the end, but that is not what it says, and it certainly conflicts that -- There are both quantifiable and unquantifiable benefits ... [indiscern.]. Tesoro provides a tax base; it provides jobs; it provides security of supply; it provides competition in state for other companies that are really just in-state suppliers; and that goes into the equation as well, and again, it was our opinion that although there, at least now, the way ... [indiscern.] ... right now ... price break or, I should say, some displacement which you mentioned, of West Coast sales by our in-kind taking, therefore having an effect on the way that the royalties and severance taxes are calculated. That

isn't enough to outweigh the benefits ... the way the statute is written ....

CHAIRMAN HALFORD: Basically, I think you said it's difficult to quantify, and yet I think we've got to have some way to understand just what you use to quantify that to some degree anyway. I mean, for example, in the Doyon contract what kind of construction work force is it going to take? What kind of operational work force is it going to take? What kind kind of capital is it going to require? Where is that capital going to come from? I think we at least need some kind of a feel for those benefits in a little bit more specific way.

MR. KATZ: Well, we can seek to do that. Certainly our findings document was an effort to put all that we considered in our deliberations out in a public form for everybody to look at. We can certainly try to get some of the figures that you're talking about, but it is very difficult to quantify some of the factors that should be relevant.

CHAIRMAN HALFORD: For my own sake, I'd like to have as much of that as possible, realizing that it's difficult, but at least the best indications that you can get.

MR. KATZ: Sure.

CHAIRMAN HALFORD: Representative Rogers?

REP. ROGERS: I just have a couple of questions on the process from here on. Does the administration believe that the

legislature needs to pass a resolution or a statute ...  
[indiscern.].

MR. KATZ: We believe that you need to pass a statute and we're going to submit separate statutes so that you will have the opportunity to consider each one individually.

REP. ROGERS: Okay, and on the Doyon proposal - that's going to be interesting to see how it gets introduced into the house - when you -- You still have it in as a -- even though you're now -- you said that you agree with the results of the royalty board. I assume that's so that if they do come up with the financing, you can proceed and it doesn't get held up for a year. Is that correct?

MR. KATZ: That's right. We agree with the conclusion of the royalty board and one of the two premises. What we want to avoid, though, is a situation, you know, where there's sort of a last-minute revelation - you know, now we have the financing type of thing, and nobody has the chance really to analyze that assertion before you all go home, but, you know, you all are in a very good position to judge for yourselves whether that's a valid assertion at the time and we'll certainly do our best to independently help you do that. I have not talked to the governor, to be honest, in the aftermath of our discussions with the royalty board today. I presume

that as long as he knows that you all are aware of the conclusions that both we and the royalty board have come to that procedurally he would feel comfortable putting the contract before you so long as you knew what the problems were.

REP. ROGERS: At what point, if any, would you withdraw the contract from consideration? Are you saying that you will, even if no financing comes up, you know, as of the last day of the session, that that bill would still be in and ...?

MR. KATZ: I don't know mechanically how it would work, but I was prepared before and prepared and felt duty bound. I would recommend that you not enact that statute unless we all have independently determined that really secure financing is available.

REP. ROGERS: And yet we'll have an administration bill before us through the very end that could be acted upon, and the legislature could pass on. Would the governor then veto it?

MR. KATZ: Well, I can't speak for him. I think that in the way he likes to do business with the legislature, if you all, knowing of the risk, were to pass it in any event, that he might view that as sort of the collective judgment. For whatever its worth, if the financing situation were as it is today, we would

recommend -- Jeff Haynes and I would recommend that he veto it.

REP. ROGERS: Is there any time period that you would think would be necessary once Doyon came in? If Doyon were to come in with a statement saying here's the financing, how much time do you think it would take to review that to where you felt secure? You know, in other words, at some point we should -- What you're saying is at some point we should stop considering the Doyon contract. It may be that a week is enough time to analyze it; maybe two weeks. From whatever the end of the session is working backward, there is some time at which point it would seem to me that we shouldn't pay any more attention to it, following ....

MR. KATZ: Well, I would agree. In deference to Doyon, they are out even as we speak, you know, working with and contacting possible equity partners and financiers, and they are, in my judgment, making a really sincere effort to put this together. I cannot give you a precise day because it depends to some extent on who the partner might be and what sort of financing arrangement. The more obvious it is that they have achieved a threshold level, you know, the less I'm concerned about the time that would be needed to check it out before you went home. If they came in with a really, really substantial equity partner in the

aftermath of letting the financing lapse now, and really secure commitments from the banks that we could review very quickly, that would be easy. If it were less certain than that, we'd need more time, and I guess that's, at least in our way of suggesting to the legislature that you appropriate, that's sort of Doyon's risk.

REP. ROGERS: Thank you, Mr. Chairman.

CHAIRMAN HALFORD: Representative Cotten.

REP. COTTEN: What can you tell us about what happened to their financing? Was it the [indiscern.] problem? I understand there may be some sensitive areas there, but if it were a problem with the person who was supplying the money, that would be one question, and if it were a problem with Doyon, that would be another question. What can you tell us about that?

MR. KATZ: Well, let me say as much as I feel comfortable saying, given the confidentiality that we are required to bring to our negotiations, and Doyon's attorney is here, and hopefully might be prepared to elaborate where he feels comfortable. They had construction financing secure in the form of a very respectable bank that we thought was very capable of providing the requisite financing. For reasons that are best known to Doyon, that construction financing lapsed, and I think it may have been a couple of factors, but I would

prefer that they speak on that. Sort of simultaneously with that, they had purchased some very expensive equipment that made us think that they were really seriously moving toward the construction of the refinery.

REP. COTTEN: They still have that equipment?

MR. KATZ: Yes, they do.

REP. COTTEN: The construction financing lapsed. They had a commitment for a certain period of time?

MR. KATZ: Yes, sir.

REP. COTTEN: And then when that time period came, well then it wasn't renewed? Was that the arrangement, that it had to have been renewed?

MR. KATZ: Here's where I would prefer that you hear from them, but it's my understanding without being too detailed that it wasn't as conscious as that - that it wasn't, you know, that the bank looked at Doyon and said: No, there's a project that's really gone sour; I want to get out. It was less purposeful and more inadvertent than that.

CHAIRMAN HALFORD: Senator Mulcahy.

SENATOR MULCAHY: Mr. Chairman. Commissioner, I would then understand, or am I correct in assuming, that Doyon then would fall into the ranks of the other three and there would be four that you would be pursuing over the

interim, and one that you'd be approving to go forward at this time, or would it just fall out completely?

MR. KATZ: No, sir. I think it would be more the former. We would continue to believe that there is a real advantage to the railbelt area in having another refinery. We felt that other than the financing issue we negotiated a contract that was in the public interest, and having gotten this far down the road it would at least be my judgment that we not reject them but rather see what we could do in terms of presenting something to the next legislature and the governor. We have, as I indicated earlier, retained a substantial volume of oil, not only for those kinds of contingencies but for anything else that the legislature and the next governor might think is sound public policy.

SENATOR MULCAHY: Thank you.

CHAIRMAN HALFORD: Senator Gilman.

SENATOR GILMAN: Commissioner, would that also include Chevron and Suneel during the interim?

MR. KATZ: Yes, sir.

SENATOR GILMAN: Then I have a question. That is, then, under the same - essentially the same - offering of oil? You would not be anticipating that you go back for another round, so to speak, and have another seventy people bid or whatever?

MR. KATZ: At some point in time I think that's going to become required as the circumstances really change, but we are advised by the attorney general's office that as a matter of law we can permit this solicitation to move forward as I've described for a period of time, and it is basically within the commissioner's discretion about when to terminate it. I would like to bring all of these things that are sort of blowing in the wind to a definitive conclusion in the next few months no matter what, and it will be at some point, I guess a little bit beyond that, where I suspect that circumstances will change not only in the market but also in some of the companies that either didn't participate in the solicitation the first time around, or who we rejected, recognizing that they had a sound proposal that just hadn't gone far enough, and I think at that point in time to do equity to them we'd have to terminate the solicitation and start a new one.

SENATOR GILMAN: Would that also then include the additional oil that Tesoro had in their original -- I'm not saying the entire amount; I'm saying additional oil. If for instance they came in and said it looks like it's in the cards for a coker, you would -- The point I'm getting to is they then would not have to go back through the entire process again, as long as it's still in this ...

MR. KATZ: I'm advised that we would have to do that in that circumstance because we've negotiated a contract at this point in time. We discussed this with Tesoro as the process went forward, and we had policies, and still do, of providing royalty oil only to really imminent sorts of projects, and it is for that reason, among others, that I would not want to let the solicitation elongate itself very far, or that I would feel comfortable with a Doyon royalty contract that is sort of out there but with no firm financing after the legislature goes home; so I think that would be part of a new solicitation, but it was partly with that in mind that we retained a pretty high quantity of oil, knowing of Tesoro's plans.

SENATOR GILMAN: So, if that were the case, the only potential method for, under this solicitation of oil, for coking, would be the Suneel contract. Is that correct?

MR. KATZ: Yes, sir. Jeff reminds me too that there's a contractual provision relating to future disposition that I think aids to some extent. Why don't you just briefly explain that, Jeff?

MR. HAYNES: Well, I'll just read it.

SENATOR GILMAN: Which piece of paper are you referring to?

MR. HAYNES: The actual Tesoro contract, paragraph 2.13.

SENATOR GILMAN: Paragraph -- No, I don't have the contract.

MR. HAYNES: Okay. It's real short, so ...

SENATOR GILMAN: It isn't that I don't trust you. [Pause.]

What reference?

MR. HAYNES: Okay. It's on page twelve, paragraph 2.13: The seller recognizes that AS 38.05.183, which governs disposition of royalty oil by the State of Alaska, establishes a statutory preference for disposition proposing (1) in-state processing of royalty oil and (2) in-state supply of products generated from processing of royalty oil, in that order. The seller represents that, in conjunction with future dispositions of royalty oil, purchaser will be afforded the consideration contemplated by that statute. This means that in any future solicitation, that Tesoro is automatically brought to the table to discuss the sale. It is not a guarantee that there will be a sale, but it is a recognition that the state processors are going to be part of any future solicitation.

MR. KATZ: Senator, in further response to your question, our lawyer here advises me of two things which I think are important. One is that the current solicitation, I'm told, can be amended very simply, and that sort of amendment, which Bob estimates might take no more than a week, would permit us to continue on with our negotiations with Tesoro. Also, it's worth noting under the statute that while I favor generally the disposition of oil through a process like this, because I think it

does basic equity to a number of folks that either are distant competitors or might potentially compete against each other, that we are permitted under the statutes to enter into individual negotiations for the sale of royalty oil; and frankly, if we're going to deviate from the current approach of these, you know, sort of grandiose solicitations, I could think of no better instance to do it than in a situation where an existing refiner wanted and was prepared to undertake immediate expansion.

SENATOR GILMAN: It sounded to me like I got two conflicting answers then. The first time I asked is there some -- would there be a method for Tesoro to have consideration for additional oil and I thought the answer was no, and then Maynard said something else, or maybe he didn't.

MR. MAYNARD: Senator, it's a problem more of wording than it is a practicality. The original question was, could they come in ... [indiscern.]. No, but it would be extremely easy to amend it, and do some other procedural mechanism ...

SENATOR GILMAN: Okay, amend what?

MR. MAYNARD: Amend our present solicitation.

SENATOR GILMAN: Oh, amend the present ...

MR. MAYNARD: The present document that started these negotiation processes is called a solicitation ...

SENATOR GILMAN: Yes?

MR. MAYNARD: ... [indiscern.] by the commissioner, and it has certain conditions. That can be amended very quickly. In fact it's already been amended once, so ...

SENATOR GILMAN: But if you amend the solicitation, then all the parties that have come to the table under that solicitation have to be given the same ...

MR. MAYNARD: ... to come back in again.

SENATOR GILMAN: How long is this solicitation going to be laying out there on the table? And that goes back to the discussion I suppose of Doyon and others. It's going to be a matter of three or four months - maybe; six months - maybe; sometime before next session - maybe.

MR. KATZ: No, it's certainly not -- I don't know what my future is - personal future - but it's not a set of loose ends that I'm going to leave on the table for some subsequent governor and legislature. I feel an obligation to tie it up one way or the other, and if the next governor wants to pursue the same or a different course, he'll be free to do that. So that I would say that the outward extremity of the solicitation is Governor Hammond's current term, and I'd like to wind it up before that.

CHAIRMAN HALFORD: Going back to price terms, it was fairly late in the process that the effect of the West Coast-

Gulf Coast offset became apparent in terms of dollars. Now I wonder if that had been apparent earlier in the negotiations would the price term have been negotiated any differently?

MR. KATZ: No, and Mr. Chairman I think it was something that we were apprised of virtually from day one because two of the three producers as I recall in the very first set of discussions we had with them apprised us in very general terms of that kind of impact and we could not discuss it further. Because of antitrust problems that could of involved us all we did not, but both that and our own knowledge, both Maynard and Haynes' very detailed knowledge of the situation, it is in fact the case that that was before us at the very beginning, and I don't think that it would have changed our deliberations on the price term because, as I indicated in response to a prior question, we really went through every possible permutation that we could think of in an effort to find a term that was fair to the state and fair to the companies involved, and for whatever it's worth, after that whole process this is the one we came up with.

MR. HAYNES: In fact we did send out, at one point, at least a sort of discussion draft price ... [indiscern.] ... on top of the ... weighted average ... universal conclusion. We sent those to all of the people who we

were dealing with in the solicitation. The universal conclusion was that that made a complicated situation even more complicated ... [indiscern.] ... present mechanism, at least. Really the only way that you can get at the kind of problem that we're talking about is to use a different mechanism.

CHAIRMAN HALFORD: Representative Rogers.

REP. ROGERS: Yes, I'd like to get back to the profit question, and then I have a couple of others. The royalty board has recommended no on the Doyon contract for two reasons, one of which is that four years. If you chose to, and you've indicated that you disagree with the royalty board, but if you wanted to renegotiate, what would be the process? Could you negotiate an amendment that might involve other things as well and then re-present that to the royalty board and re-present it to the legislature, or ...?

MR. KATZ: I think there are two ways to go on that. One of them is that if that were a strong sentiment, we would have to withdraw the contract at that term and then send the contract through the whole process again, involving the royalty board et cetera. That would inevitably I think go beyond this session of the legislature. The other one, and it's not something we'd recommend under normal circumstances, but the legislature is always free in essence to draft

legislation to do what it wants, and you could specifically waive that whole process in the preamble to whatever statute you enacted and then in that way circumvent the more lengthy process.

REP. ROGERS: And, if you'd refresh my memory, can we give conditional approval?

MR. KATZ: No, it's my understanding, Representative Rogers, that your vote is up or down on these contracts.

REP. ROGERS: As you were going through the, oh, about a dozen different issues you were going for, one of them was on return oil, and you said you were trying to maximize the return oil in discussions that did not work out. Doyon would have to sell the return oil, according to my notes here.

MR. KATZ: Yes.

REP. ROGERS: Does Tesoro have to sell the return oil?

MR. KATZ: No, the ...

REP. ROGERS: No, or ...

MR. KATZ: The return oil problem only arises in connection with pipeline refineries, either Mapco or Doyon, and it results from their putting the oil back into the pipeline. The state has always had a policy of - and I think it's a good policy - of giving up custody, title, and jurisdiction of Pump Station One, but what we were looking to is mutual arrangements that could have involved either Tesoro or Chevron further downstream to

make use of the Doyon or, when we were negotiating with Mapco, Mapco return oil; so in essence, the gross refinery charge in Fairbanks would have been X amount, but Doyon or Mapco would only have used a certain amount in its refining process. Y amount would have come out the back end and then that Y amount could have been available to Tesoro or Chevron further downstream to utilize and Doyon and Mapco would pay a quality penalty to put that oil back in the pipeline, but that was the only really negative impact; and so we did explore those reciprocal arrangements, but it didn't work out, particularly when Chevron dropped out.

REP. ROGERS: So Chevron's dropping out has a fairly material effect, then, on the Doyon contract as well?

MR. KATZ: Yes, sir.

REP. ROGERS: And what happens with Mapco? What happens to their return oil on the existing contract?

MR. KATZ: It's theirs.

REP. ROGERS: It's theirs and they market it.

MR. KATZ: Yes, sir.

REP. ROGERS: How about -- Well, that's it. Thank you, Mr. Chairman.

MR. KATZ: And depending on what year and what day it is that the marketing occurs, it's either a significant benefit or a significant drag. I think it was true at a point in time that it was very significant for a company to

retain the return oil and sell it itself. Given the current market situation, I don't think that's the case any longer.

REP. ROGERS: Do you have any idea what the projections might be in the coming few years? Obviously, the further out on anything on oil that you get, the less the ... [indiscern.]. What is the direction of return oil? I mean, is it getting worse for a refiner or better for a refiner?

MR. HAYNES: Well, it's really the same situation as oil generally, because the sort of unique twist to the Fairbanks refinery is that they can -- Everybody has residual oil that's left over after they process. In the case of Tesoro, they have residual oil they actually have to sell as residual oil, which is not a real great thing to have to do these days. In the case of the Fairbanks refinery, with the pipeline they are able to basically dump the resid back into the pipeline. They pay a quality penalty, but when it comes out at Valdez it's ... [indiscern.] ... crude oil, so depending on what the prospects are for selling ANS crude oil, that's how valuable or nonvaluable ... [indiscern.; coughing]. But, of course, they are competing with the producers as a marketer of crude oil at Valdez, and, basically, to answer your question, over the last twelve years there have been a couple of

two-year periods when it's been a real good deal, and there have been other times when it's been a bad deal.

REP. ROGERS: So, with the failure, then, of the Chevron contract, Loyon is in the position of having to sell ANS crude?

MR. KATZ: Yes.

REP. ROGERS: Thank you, Mr. Chairman.

CHAIRMAN HALFORD: Representative Cotten?

REP. COTTEN: Yes, I have a couple of questions here, and Brian asked one of them, and I don't want to make it a -- or dwell on any jurisdictional questions here, but do you agree with the requirements of 055? Do you agree that the legislature really does have to approve these contracts if they're for over a year? I mean, is that the administration's position, that it's a -- that we have to, or are you just going along with this?

[Laughter.]

MR. KATZ: We'd never do that. [Laughter.] We don't agree that as a matter of constitutional law the legislature can enact that statute. This governor firmly believes that - as a matter of policy - that he wants the legislature to vote yea or nay on these contracts, that they in his view and in my view reflect major resource allocation decisions that the people who have selected representatives ought to have a role in deciding. Bob says that ...

MR. MAYNARD: And it goes to Representative Rogers' prior statement about amending the contract or whatever. Another advantage of having the legislature pass a statute is you are ratifying the contract, and by doing so you are curing any procedural defects that these contracts may have incurred along the line of the ... [indiscern.]. There is, for example, some confusion in the statute even if that position is constitutional ... [end of tape].

REP. COTTEN: I've got a couple of quick ones here on [indiscern.]. The -- No, I can find that out later. Wait a minute. I lost my question. I'll pass.

CHAIRMAN HALFORD: Representative Rogers.

REP. ROGERS: As we're passing a law, then, in this case, then, in the same law that we approve the contracts we could clean up at least the resolution versus ... [indiscern ] ... statute.

CHAIRMAN HALFORD: Representative Cotten.

REP. COTTEN: Okay. This is, again, sort of a -- Well, I'm not sure whether it's a statement or a question, but it appears to me that if we - and we are technically a producer, since we own that portion of oil, so as we make a business decision to sell this, we're really not doing it totally on a business basis, because we're not selling it for as much as the other people who own oil

are selling it for. We're selling at a lower rate. Is that a correct analysis of what we're doing?

MR. KATZ: I don't think that is. We are, in essence, by adopting the weighted average field price approach, selling it exactly at what a weighted average of all the producers on the North Slope can get for that oil.

REP. COTTEN: Well, I mean -- I'll give you an example. One of the producers probably sells more on the West Coast -- a higher percentage of his oil on the West Coast than in Galveston or on the East Coast, so that person has one weighted average ... [indiscern.] ... that company compared as to another company, compared to a third company, so each of them had a different weighted average, or ...

MR. KATZ: In the interest of full disclosure, I should mention that, you know, of all those producers, some, you know, some obviously outmarket the others. The company that over time seems to market its oil at least as well as anybody is Sohio, and Sohio did make a proposal to us in the context of these negotiations. Basically we sell most of the solicitation to them. They would have paid a price which could have been no less than the weighted average field price, but would have been their price in most circumstances, and their price is higher than the weighted average field price. That would have been a way for us to get more ...

[indiscern.; coughing] ... is the weighted average price. They were then willing to resell oil to bona fide in-state users, and we rejected that approach, not on the price mechanism, which would have been more favorable than anything else we could have negotiated, but rather because we just didn't feel that the state could permit any private company, even one as well motivated as Sohio, to sort of make its policy within certain parameters by reselling to in-state uses.

REP. ROGERS: To make its policy -- What was that again?

MR. KATZ: Well, you know, we could have put in some contractual provisions that would have sought to limit or expand what Sohio would otherwise have sought to do with its oil, you know, in reselling, but we couldn't predict everything that would occur and we felt real uncomfortable putting the government in that sort of position vis-à-vis a private concern; so, in essence we saw the fatal flaw in that, as really allowing any private company to make decisions that more appropriately on that basis should have been made in a public form.

REP. ROGERS: Okay.

MR. HAYNES: Just, if I could add one more thing to that.

Again, when we're talking about this concept of West Coast displacement and so forth, we're talking about, you know, hundreds of transactions in the two markets,

the West Coast and the Gulf Coast. There's probably thirteen companies who are producers, and although the average West Coast weighted average price is higher than the average Gulf Coast weighted average price, the prices are not all the same. They vary considerably, and they vary considerably on the West Coast; and so, therefore, somebody, you know, an in-state refiner from Alaska, conceivably maybe Sohio's been their supplier, and maybe they're paying a higher price than they would be to the state. On the other hand, they might be supplying from somebody who's now selling their oil in the Gulf, you know, for a different price. It just depends on what their circumstances are now. The other element to add in is that crude oil transactions are very, very complicated. Again it depends on the individual companies. The most common part of it that you don't think about right away is the fact that an awful lot of it is exchanged. Something like a third of the ANS crude oil that is marketed is exchanged for another crude oil. Sometimes the crude oils in the course of one transaction will be exchanged six or eight or ten or twelve times for other crude oils back to -- before it finally shows up in a refinery, so it's very -- although we can talk about averages here, it's very difficult to make too many categorical statements because it really depends on the circumstances of the

individual purchaser, and that's one of the reasons why, although there are some really serious scenarios that you can draw up, that we don't feel that they're valid.

CHAIRMAN HALFORD: Senator Fahrenkamp.

SENATOR FAHRENKAMP: John, if -- In light of the fact that individual contracts can proceed or that amendments can be made after offering, would there still then be consideration of Suneel and their proposal, or at this point would that be considered dead?

MR. KATZ: No, it isn't dead. I think, though, that -- and we frankly -- no, not put that on the back burner, but not on the front burner, because we focused our primary attention on the contracts we knew we were going to provide. Now, you know, we have a little bit more breathing space. I don't think that the questions that, and perhaps I'm wrong, I'd like to be proven wrong, but I don't think that the questions that we've posed can be answered in the next couple of weeks in time to get that contract to you, but we are going to propose a process to Suneel and pursue it as vigorously as we can. If we were able successfully to answer all our questions and feel comfortable, you would then, Senator, have the choice, I guess, as I indicated to Representative Rogers before, of awaiting the usual royalty oil process which would put it I think beyond