ALASKA LEGISLATURE COMMITTEE FILES 1983-1984 8672

2751 HRES HB 320 (FILE 1)

2751

Tesoro Alaska Petroleum Company

December 13, 1982

Jeff: Duration life of the field. Jack

Ms. Esther Wunnicke
Commissioner
State of Alaska
Department of Natural Resources
Pouch M
Juneau, Alaska 99811

Dear Commissioner Wunnicke:

On November 16, 1982, the Department of Natural Resources solicited proposals for the purchase of Cook Inlet Basin royalty crude oil. Attached in contract form is Tesoro Alaska's response. Crude oil from the Cook Inlet Basin has been the principal feedstock for Tesoro Alaska's refinery on the Kenai Peninsula since it was built in 1969. Our refinery is the natural market for the Cook Inlet crude oil based on proximity to the production facilities. Tesoro Alaska is the only in-state refiner manufacturing the full range of petroleum products required by Alaskans.

During January, 1983, Tesoro Alaska will initiate purchases of State royalty crude oil from the Alaskan North Slope under a twelve year contract approved last year by the Legislature. Under the contract for Alaskan North Slope crude oil, Cook Inlet royalty crude oil reduces the volume available for purchase by Tesoro of ANS. In other words, Tesoro Alaska will not have any larger amount of State royalty crude oil by virtue of the State continuing sales of Cook Inlet royalty crude oil to us.

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The principal points of the attached Cook Inlet contract proposed for your review are as follows:

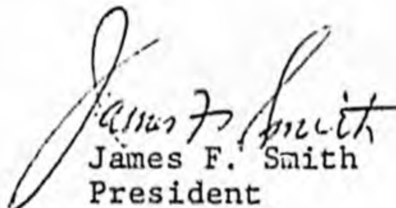
Volume - 100% of the royalty oil available to the State from leases in the Cook Inlet Basin.

Term - Eleven years beginning January 1, 1984 and ending December 31, 1995 concurrent with the end of the existing purchase agreement for State royalty oil from the Alaskan North Slope.

Price - The weighted average price which the State would have received had it elected to take its royalty "in-value" based on prices paid and information provided by the producers of the Cook Inlet crude oil.

We look forward to meeting with you to discuss any point of the contract with the expectation that a mutually beneficial contract will be approved by the Legislature in its next session.

Sincerely,



James F. Smith
President

JFS:pw
Attachment

MW

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

POUCH M
JUNEAU, ALASKA 99811
PHONE: 907/465-2400

April 14, 1983

Donald H. Triplehorn
Chairman
Alaska Royalty Oil and Gas
Development Advisory Board
620 East Tenth St.
Anchorage, Alaska 99501

Dear Chairman Triplehorn:

I very much appreciated the comments of you and the other Board members at our April 5th meeting. During our discussion, several questions concerning the proposed long-term Prudhoe Bay royalty oil agreements with Tesoro and Chevron were raised. I thought it might aid the consideration of the Board to have the key points of our rationale for the two contracts before you in writing, along with a response to your questions.

The contract with Tesoro is the more controversial of the two. It would commit the State to providing 13.867% of Prudhoe Bay Unit production, or approximately 26,000 barrels a day (b/d) at current production levels, if Tesoro expands the capacity of their refinery to process the oil by 1986. The agreement expires on January 1, 1995; at the same time Tesoro's existing royalty oil contract for 46,000 b/d terminates. The basic rationale for this contract is fairly straightforward - providing a long-term guaranteed crude supply enables Tesoro to make a significant, new in-state investment, with attendant employment, supply, and tax base benefits.

The Board has understandably questioned the recent acquisition by two Charter Co. life insurance subsidiaries of 20% of Tesoro's stock, and the placing of Charter directors Raymond Mason and Gerald Ford on the Tesoro board. The involvement of a corporation with which the State has significant litigation was a cause of serious concern to us at the time of contract negotiations. In response to that concern, we took the following measures to protect the State from possible harm because of the involvement of Charter:

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1. A "third-party control" provision in the royalty agreement allows the Commissioner to unilaterally terminate the contract if Charter gains a greater degree of influence over the management of Tesoro.

2. An agreement between Tesoro and Charter requires that Charter vote its shares in the same proportion as the shares held by all other Tesoro stockholders, and prevents Charter from seeking proxy votes.

3. Tesoro may not take the oil unless the Commissioner determines that the refinery will be capable of processing the additional crude; the contract terminates if the refinery expansion has not been completed by July 1986; and all oil taken under the contract must be run at the Tesoro Kenai refinery, and may not be traded, exchanged or otherwise disposed of.

4. The State retains the option to purchase and resell the substantial volumes of residual oil produced by the refinery.

5. Tesoro owns facilities worth over a hundred million dollars in Alaska.

We would hope that the concerns expressed do not stem from a desire to "punish" Charter by rejecting this agreement. We do not believe that Charter would be much affected by rejection of this contract. A vigorous legal effort to collect the money owed the State by Alaska Oil Co. seems to us to be the proper course at this point. Tesoro is a long-standing Alaska business, and deserves to have its contract treated on the merits.

The Chevron contract would furnish their Kenai refinery with 9.6% of Prudhoe Bay production, currently 18,000 b/d, until 1995. The Kenai refinery is not an economic component of Chevron's West Coast refining system, and the company has threatened to close it without a long-term supply of oil from the State. Chevron has consistently requested a 38,000 b/d contract, and will continue to seek an additional 20,000 b/d for processing on the West Coast and return to Alaska in the form of products. The 18,000 b/d agreement will enable the company to operate the Kenai refinery for as long as possible; that volume of oil must be processed at the Kenai plant to maintain the effectiveness of the contract.

The Board has also questioned the duration (eleven years) of the Chevron and Tesoro contracts. The reasons for the concern, to our knowledge, include a desire to leave royalty oil uncommitted so that it can later be offered as an incentive for economic development projects, or so that it can be sold in Japan or elsewhere at a higher price, or a

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general desire to retain flexibility in the face of ever-changing oil markets and the future decline in Prudhoe Bay production. We agree that these are valid points, but feel that they have been addressed in the following ways:

1. The contracts provide for a certain <u>percentage</u> of Prudhoe production, not a certain volume. As Prudhoe production declines, so will the contract volumes. At current levels, the contracts leave available 62,500 b/d of Prudhoe royalty production, as well as all Kuparuk royalty oil (currently 12,000 b/d) and any future royalty oil. Approximately 50,000 b/d of residual oil may also be available for sale by the State as a result of the option that the State retains for that oil in most of its royalty oil agreements.

2. Chevron's competitors in Alaska, Mapco and Tesoro, have royalty contracts until 2005 and 1995, respectively, for their base volumes. Although those contracts were consummated by the previous Administration, we felt that Chevron's request for a contract at least as long deserved some consideration in the interest of preserving equity among competing refineries.

3. The term was a negotiated item; although the State originally sought a shorter term, the additional premium over the in-value price of $.30 was agreeable to the companies partially because the State was willing to offer the eleven-year term.

4. The contract's price term is tied to the in-value price, based on producer sales. If Japanese exports become a reality, the price to royalty purchasers will increase if sales to Japan result in higher average prices for North Slope oil.

5. We have reviewed the previous Administration's determination that the highest and best use for royalty oil is for in-state processing, all other things being equal, and concur with it, in light of the existing royalty oil statutes. These contracts are for that use.

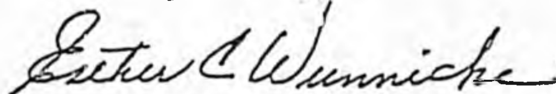
The Board has also questioned the meaning of the "future dispositions" clause of the current contracts. I have attached a written opinion by the Attorney General which should clarify that clause. I do not intend to include the provision in any future royalty oil contracts.

The Governor has asked a Cabinet group composed of Attorney General Gorsuch, Commissioner Lyon, and myself to report to him on the petroleum product pricing report which was

submitted in February to the Senate Resources Committee. We should be able to provide you with our written report before the Board's April 20th meeting.

I appreciate all the time you have devoted to royalty oil issues during the past months. Please let me know if we can be further assistance in any way.

Sincerely,



Esther C. Wunnicke
Commissioner

Attachment

MEMORANDUM State of Alaska

TO: Esther Wunnicke
Commissioner
Department of Natural Resources

DATE: April 8, 1983

FILE NO: 366-541-83

TELEPHONE NO: 465-3600

FROM: Norman C. Gorsuch
Attorney General

SUBJECT: Royalty Oil Contract's Preference Provision

By: Robert M. Maynard RMM
Assistant Attorney General
Oil and Gas-Juneau

You have asked for our opinion on the effect of the following clause in proposed state royalty oil contracts:

"2.13 FUTURE DISPOSITIONS OF ROYALTY OIL. Seller recognizes that AS 38.05.183, which governs disposition of Royalty Oil by the State of Alaska, established a statutory preference for dispositions proposing: (1) in-state processing of Royalty Oil, and (2) in-state supply of products generated from processing of Royalty Oil, in that order. Seller represents that, in conjunction with future dispositions of Royalty Oil, Purchaser will be afforded the consideration contemplated by AS 38.05.183."

You have asked whether this provision will in some manner tie the State's hands in future dispositions of Royalty Oil if the statutes were subsequently changed to reflect a different legislative policy.

The answer to your question is no. This contract term enbodies in contractual form an administrative interpretation of a statutory scheme. As such, this language would bind the state as long as the present statutory scheme is not altered. This contractual term cannot, however, be read to bind the legislature's hands in changing the statutory scheme to impose a different policy or preference than that expressed in the contractual clause.

Article VIII of the Alaska Constitution, and particularly Article VIII, sections 2 and 9, give the legislature exclusive authority over prescribing the policy and procedures in the sale of state resources including royalty oil. Article VIII, section 2 provides that "the legislature shall provide for the utilization, development, and conservation of all natural resources belonging to the State, including land and waters, for

the maximum benefit of its people." Article VIII, section 9 provides that

> "subject to the provisions of this section, the legislature may provide for the sale or grant of state lands, or interests therein, and establish sales or sales procedures.

Consequently, the commissioner's only authority is to interpret and execute existing statutory schemes: the commissioner does not have authority to go beyond the express authorization of these statutes and tie future legislature's hands. See, e.g., Udall v. Oil Shale Corp., 406 F.2d 759, 764 (10th Cir. 1969) r'vsd on other grounds Hickel v. Oil Shale Corp., 400 U.S. 48 (1970):

> The Government here argues in effect that the Secretary [of Interior] has all the powers mentioned in the Constitution relating to public lands, but this cannot be. The powers are not in the Secretary, but are vested in Congress and he has what the statutes provide that he have and no more.

Consequently, the commissioner would be acting outside the scope of his or her authority by agreeing to a provision that did actually tie the ability of the legislature to provide for the disposition of state resources. The present law only authorizes the commissioner to dispose of interests for present sales under that law. It does not authorize the commissioner to contractually grant his or herself the power to ignore future laws that may be passed by the legislature. Such a term would be inconsistent with the present law or, more accurately, would be outside the limits presently authorized by law. Such a provision would be invalid and of no effect. Union Oil Company of California v. Morton, 512 F.2d 743, 748 (9th Cir. 1975) (and cases cited therein); Burke v. Southern Pacific Railroad Company, 234 U.S. 669, 693-706, (1941); Central Advertising Co. v. Michigan Highway Commission, 172 N.W. 2d 432 (Mich. 1969); Schoenbroad v. United States, 410 F.2d 400, 404 (Ct. Cl. 1969); Hickman v. Mylander, 362 P.2d 500, 502 (N.M. 1961).

Instead, this clause must be read or construed so as to conform to the statute and the constitution of the state. Wood v. Lovett, 313 U.S. 362, 370 (1941); Hobbs v. McLean, 117 U.S. 567 (1886); Wright v. Paine, 289 F.2d 766, 789 (D.C. Cir. 1961); Sheridan-Wyoming Coal Co. v. Krug, 172 F.2d 282 (D.C. Cir. 1949), r'vds on other grounds 338 U.S. 621; Union Oil Company of California v. Morton, 512 F.2d 743, 749 (9th Cir. 1975).

Generally, 1 McBride & Wectal, Government Contracts, §2.120 (1972); 81 C.J.S. "States" §168(b) at pp. 635-636. See also Skagway City School Board v. Davis, 543 P.2d 218, 222 (Alaska 1975); 3 Corbin on Contracts §551 at 200-201. Here that reading is the reading that we believe is actually intended--namely that the commissioner is merely putting in writing an administration interpretation of the present statute.

This intent and more limited effect of the clause can be seen by its history. This clause first appeared in royalty oil contracts entered into during the early part of 1982. At that time, the state entered into royalty oil contracts with Tesoro Alaska Petroleum Company and Doyon, Inc. In conjunction with those contracts, the commissioner of Natural Resources issued his "Review of Alaska Royalty Oil Policy and Findings for Proposed Disposition of Royalty Oil", dated February 26, 1982. In those findings and review, the comissioner discussed at some length the policies guiding the disposition of royalty oil, including AS 38.05.183. In particular, the commissioner noted that the present royalty oil statutes were not totally clear. In particular, the commissioner stated:

> Although the royalty statute envisions transactions through which royalty oil is used in state, it also demonstrates the inherent conflicts and the many desires expressed by the legislature and the people of the State for the disposal of royalty oil. On the one hand, the statute does not permit sales for export unless there is a determination that present and anticipated in-state domestic and industrial needs are met. Further, there is a preference for in-kind taking and in conjunction with any sale, the commissioner is required to consider the effects on the economy, the projected benefits of any refining or processing, the ability of any prospective buyer to provide products in-state with price or supply benefits. On the other hand, the statute expresses a preference for competitive bidding with the award to go to the highest responsible bidder, and competitive bidding [can] not be waived without a finding that it is in the state's best interests. Examination of the cash value of any proposed transaction is also a primary factor in the determination of whether an award should be made. Consequently, the royalty statute speaks both to in-state development and enhancement of the state's finances as primary objectives for state royalty oil dispositions.

Findings and Review at pp. 121-122.

At that time, and in those contracts, the commissioner of Natural Resources interpreted these conflicting interests by stating in those findings and in the contracts that the statute should be read to give a preference for in-state processing and in-state supply in that order. In the Findings and Review, the commissioner stated that

> "on balance however, it is evident from both the text and the history of the royalty statute that the legislature intended a preference for in-kind taking and for proposals focusing on in-state processing and supply unless a compelling showing can be made that such an approach is contrary to the state's interest.

The contractual provision at Article 2.13 is merely a companion statement of that interpretation. The provision was originally inserted in the standard form contract during the 1982 negotiations with Doyon and Tesoro. At that time, the companies were requesting amounts of oil not only for their base charge, but also for planned increases in refinery capacity. The commissioner would not consider committing royalty oil for future expansions. He told the companies that if an expansion would take place, then under the statutes they would be first in line for royalty oil to meet their increased base needs at that time. Doyon, in particular, was not satisfied with the commissioner's statement or the mere existence of the statutes because of perceived difficulties with their bankers. Doyon was afraid that the bankers would not accept simply Doyon's word that the statutes presently gave Doyon a preference for future calls on royalty oil if an expansion of the domestic refinery occurred. Other in-state refineries also expressed similar, but not as strenuous, concerns. As a result, the commissioner agreed that although he would not grant an option on future royalty oil, he would embody his interpretation of the present statute in the contract. As such, and like a contemporaneous and long-standing administrative interpretation, the state will be bound in the future to that interpretation as long as the present statutory scheme remains essentially unaltered. And, also like administrative interpretations of statutes, that interpretation will not be binding or effective when the legislature changes the underlying statute to eliminate the basis for that interpretation. Not only was this the intent of the provision, but any contrary reading would be invalid and of no effect under the Alaska Constitution and its statutes.

We would also like to note that the preference expressed both in the contract and by the commissioner's previous findings do not create an absolute preference for either in-state processing of royalty oil or in-state supply of products generated from the processing of royalty oil. As the contractual provision states, the preference is only to the extent of that "contemplated by AS 38.05.183." As was noted in the commissioner's findings in February of 1982, 38.05.183 envisions a balancing of many considerations, including monetary value. The statutory interpretation is only that, <u>on balance</u>, the statutes prefer in-state processing of royalty oil or in-state supply of products generated from the processing of royalty oil. This finding is largely based on the express provisions of AS 38.05.183 that "oil and gas taken in kind by the state as its royalty share may not be sold or otherwise disposed of for export from the state until the commissioner determines that the royalty-in-kind oil or gas is surplus to the present and projected intrastate domestic and industrial needs." This particular provision in combination with the criteria set forth in AS 38.05.183(e) and, by reference, AS 38.06.070(a) led the commissioner to make his interpretation of the statute. But a reading of all those provisions, in context, along with other provisions such as the preference for competitive bid and sale to the highest responsible bidder in AS 38.05.183(a), shows that the preference is by no means absolute. In fact, the preference may be outweighed if competing concerns are found by the commissioner to be of greater importance under that particular sale.

PROPOSED DISPOSITION OF ROYALTY OIL
TESORO ALASKA PETROLEUM COMPANY

FINDINGS AND DETERMINATIONS REQUIRED FOR DISPOSALS OF ROYALTY OIL

Under AS 38.05, AS 38.06, and 11 AAC 03, I must make various determinations and findings before I may dispose of royalty oil. This document constitutes those determinations and findings regarding the proposed disposal of Prudhoe Bay royalty oil to Tesoro Alaska Petroleum Company (TAPC).

Under the relevant statutes and regulations I must make the following findings and determinations prior to the execution of an agreement for the disposal of royalty oil:

(1) That the disposal is in the best interest of the State. 11 AAC 03.010(d); AS 38.05.020(2).

(2) If the disposal necessitates a taking in-value (such as return of the oil to the producers) that that taking in-value is in the best interest of the State. 11 AAC 03.010(c); AS 38.05.182.

(3) If the disposal would allow for the export of royalty oil from the State, that that royalty oil is surplus to present and projected intrastate domestic and industrial needs. 11 AAC 03.010(e); AS 38.05.183(d).

(4) If the royalty oil is disposed of to relieve storage or market conditions, that the agreement will relieve the storage or market condition. 11 AAC 03.010(f).

(5) If the disposal is other than by competitive bid, either that no competition exists, or the best interest of the State requires noncompetitive disposals. 11 AAC 03.030(a); AS 38.05.183(c).

(6) That a proposal or proposed disposition offers the maximum benefits to the State. 11 AAC 03.060(a); AS 38.05.183(e).

The determination that a proposal reasonably offers the maximum benefits to the citizens of Alaska is the best interest determination described in 11 AAC 03.010(d). 11 AAC 03.060(b). In making that determination I must consider the criteria described in AS 38.05.183(e), state which of those criteria apply to the proposed disposition, and discuss the weight given to the applicable criteria in determining the maximum benefit to the State. The criteria described in AS 38.05.183(e) are:

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1. the cash value offered;

2. the projected effects of the sale, exchange, or other disposal on the economy of the State;

3. the projected benefits of refining or processing the oil and gas in the State;

4. the ability of the prospective buyer to provide refined products or by-products for distribution and sale in the State with price or supply benefits to the citizens of the State;

5. the criteria described in AS 38.06.070(a).

The criteria described in AS 38.06.070(a) are:

1. the revenue needs and projected fiscal condition of the State;

2. the existence and extent of present and projected local and regional needs for oil and gas products and by-products, the effect of state or federal commodity allocation requirements which might be applicable to those products and by-products, and the priorities among competing needs;

3. the desirability of localized capital investment, increased payroll, secondary development, and other possible effects on the sale, exchange, or other disposition of oil and gas or both;

4. the projected social impacts of the transaction;

5. the projected additional costs and responsibilities which could be imposed upon the State and affected political subdivisions by development related to the transaction;

6. the existence of specific local or regional labor or consumption markets which should be met by the transaction;

7. the projected positive and negative environmental effects related to the transaction;

8. the projected effects of the proposed transaction upon existing private commercial enterprise and patterns of investments.

In addition, AS 38.06 and 3 AAC 56 govern the actions of the Alaska Royalty Oil and Gas Development Advisory Board and require, among other things, that they hold public hearings

on proposed disposals of royalty oil to determine compliance with AS 38.06.070.

Background and Chronology

The State currently receives 187,500 barrels per day (b/d) of royalty oil from the Prudhoe Bay Unit. Since the commencement of production in 1977, the State has entered into a variety of contracts for the disposition of its royalty oil. (See Review of Alaska Royalty Oil, dated January 1, 1983 and prepared by the Deputy Commissioner of Natural Resources Geoffrey Haynes, for a detailed discussion of these dispositions.) In 1981, a general solicitation for proposals was issued for disposition of Alaska North Slope royalty oil, and a contract with Tesoro Alaska Petroleum Company (TAPC) for approximately 46,000 b/d was ratified by the state legislature and the governor in 1982 as a result of that solicitation. The contract runs for twelve years beginning January 1983.

During the discussions with TAPC that occurred during 1981 and 1982, the company sought to obtain a total of 70,000 b/d of royalty oil, to provide for both existing refinery needs and a proposed expansion. At that time, the State determined that it was not in the State's best interest to provide for uses which were not imminent, and so declined to provide the prospective expansion volumes.

On January 26, 1983, the Tesoro Petroleum Board of Directors met and approved a 80-90 million dollar expansion of the TAPC Kenai refinery, contingent on obtaining a long-term contract from the State for royalty oil for the increased capacity of the refinery. The modification would increase the capacity of the plant from 48,500 b/d to 80,000 b/d and enable it to run solely on Alaska North Slope crude oil. (The refinery currently requires a significant volume of the sweeter, lighter crude oil produced in Cook Inlet.

Based on the firm decision by the company to make the investment at Kenai, State officials met with TAPC representatives to discuss the key provisions of a contract, to determine if a royalty oil contract beneficial to the State could be negotiated. The key areas of discussion were price, term, security, the "trigger" for taking, and the effect of another Tesoro Board action involving the Charter Company.

At the January 1983 meeting, Tesoro directors approved the acquisition of approximately a 20% interest in the company by two life insurance subsidiaries of the Charter Company. The State of Alaska is currently in litigation with the Alaska Oil, a wholly-owned subsidiary of Charter, over non-payment of approximately $60 million under that

company's now-defunct royalty oil contract with the State. Concern on the part of State officials over possible future effects of Charter's interest in TAPC led to the insertion of a third party control provision in the contract.

Negotiations with TAPC on contract provisions were considerably eased by the experience and basis provided by the efforts leading to TAPC's 1982 Prudhoe Bay Unit royalty oil contract. Detailed discussions on contract terms began on February 7, 1983, and continued on an intensive basis throughout the month. The provisions discussed below represent the key issues of consideration.

In general, the information and analysis which guided this disposition is contained in the report, Review of Alaska Royalty Oil, cited above. I hereby include the full body and text of that report as additional background for my findings for this disposal.

Key Provisions of the Proposed Sale

1. Price

TAPC will pay the in-value price, plus a $.30 premium. The State required this premium for all sales entered into this year, as a general policy, in recognition of the uncertainty of the West Coast market at this time. State sales can have a significant influence on that market; the premium should mitigate that effect. It does so by taking into account the fact that the in-value price, on which the sale to TAPC is based, is an average of the wellhead values of both West Coast and Gulf Coast sales. Gulf Coast wellhead prices are currently somewhat lower than West Coast prices, due to the difference in transportation costs. To the extent that a State sale displaces a sale by a producer at a higher price, the State lowers the in-value price on which all royalty and severance tax payments are based. The State sought the premium in light of these factors. (For a more complete discussion of these issues, see Review of Alaska Royalty Oil, cited above, at pp. 68-69 and 86-208.)

The premium will also generally enhance the revenues received by the State during the period of taking under the contract. The premium represents an additional $2.84 million a year in revenues to the State than would have been received at the in-value price.

2. Term and "Trigger" for Taking

The Tesoro contract becomes effective on the date a bill ratifying the contract is enacted into law, which must occur before September 1, 1983, or the contract is void.

Nomination of royalty oil under the contract may not begin unless the State believes that the refinery will be capable of refining the oil (i.e, expanded) in seven months, when actual delivery would occur. If the refinery expansion has not been completed by June 30, 1986, the State may, in its sole discretion, cancel the contract. In addition, if the refinery does not run the oil, a $2.00 per barrel penalty will be paid for each barrel taken but not processed at the refinery.

The contract terminates on January 1, 1995. This date parallels the existing TAPC Prudhoe Bay royalty oil contract. The company proivded information that a period of that duration was necessary to ensure recovery of its investment in the expansion facilities. A term beyond that date was rejected for two reasons. First, the decline in Prudhoe Bay production will be significant by that date. Second, the State should have the opportunity to reevaluate its royalty oil policy as frequently as is consistent with the other objectives stated in the royalty statutes.

3. Third Party Control

During the negotiations which led to the TAPC contract, company officials informed the State that two Charter Security Life Insurance Companies, subsidiaries of the Charter Company, had entered into various agreements with Tesoro to purchase stock and be represented on the Tesoro Board of Directors. Under that agreement, Charter may own up to 30% of the voting interest in Tesoro.

The TAPC contract provides that if a third party acquires control of Tesoro, the State must be notified and may, in its sole discretion, cancel the contract. In particular, if Charter increases its present influence or control over Tesoro beyond that contemplated by the present agreement between Charter and Tesoro, the State may, in its sole discretion, cancel the contract.

4. Other Provisions

All other contract terms, including a State option on the residual oil and petroleum coke production, security, local hire, performance guarantee and reservation fees, in-state processing requirements, and interpretations and definitions, are substantially identical to the provisions contained in the 1982 TAPC Prudhoe Bay contract. These provisions are discussed in detail in Review of Alaska Royalty Oil, at pp. 240-274.

Findings

(1) I find and determine that the taking of royalty oil in-kind and the disposal of that royalty oil to TAPC for

processing in-state is in furtherance of the intent of AS 38.05.1982-183 and AS 38.06, and is in the best interest of the State for the reasons stated above and for the following reasons:

a. The volume is to be run entirely at Nikiski. Therefore, the entirety of the sale is for in-state processing, which is entitled to a high preference under the governing statutes.

b. The price term is that which the State would have received if the State had taken the oil in-value plus a premium, plus a $.30 per barrel premium. Therefore the requirements of AS 38.05.182 and 11 AAC 03.010(c) relating to taking in-value are met.

(2) AS 38.05.183(c) requires that I make public the findings and conclusions for sales not made by competitive bid. Generally, the purpose of seeking competitive bids is to obtain the highest possible price on a standard form contract. The purpose of this disposal is to maximize the variety of benefits to the State cited in AS 38.05.183 and 38.06, including in-state processing and investment. Obtaining and balancing those benefits requires a negotiation process, as opposed to a one-factor bid process. In addition, other concerns which lie beyond the pale of the competitive bid process include the security arrangements to insure payments to the State, provisions designed to forestall any possible responsibility or liability on the part of the State for handling royalty oil at Pump Station One, and provisions unique to the circumstances of each purchaser.

For those reasons, I waive the competitive bid requirement of AS 38.05.183(c) in favor of direct negotiation.

(3) I find and determine that the findings required by AS 38.05.183(d) and 11 AAC 03.010(e) relating to the export of royalty oil from the State are not applicable to this proposed disposal.

(4) With respect to the criteria set forth in AS 38.05.183(e), I make the following findings and determinations for the proposed disposal to TAPC:

The cash value is the Producers' weighted average field price, plus a .$30 per barrel premium. Therefore, as discussed above the cash value is equivalent to, and above, what the State would have received if it did not enter into this agreement.

A disposal to TAPC will have a favorable effect on the economy of the State because it will enable a significant new investment of $80-90 million to be made

in the State, with the attendant employment, local taxation, and other benefits. Crude oil products would be processed in-state, insuring that industries dependent on petroleum products would likely have adequate supplies.

The benefits of the expanded operation of the Nikiski refinery include the aforementioned employment, tax base, and security of supply benefits, and there would therefore be direct favorable results of processing the royalty crude in-state. Secondary industries partially or wholly connected with TAPC's refining operation would also continue to benefit from that relationship.

With respect to the criteria set forth in AS 38.06.070(a), I make the following findings and determinations with respect to the proposed disposal to TAPC:

Regarding the effect of the disposal on the revenue needs and projected fiscal conditions of the State, the matter is covered above.

The supply needs of crude oil products in various localities and regions are generally met by TAPC. The proposed expansion would increase the supply of products in Alaska, and help satisfy any currently-unmet needs for petroleum products.

The continued operation and expansion of the Nikiski refinery would provide payroll and secondary development benefits to the citizens of the State.

The potential adverse social impacts, adverse governmental costs and responsibilities, adverse private impacts, and adverse environmental effects from the proposed expansion will be provided for under existing State statutes and regulations. The expansion will be immediately adjacent to the existing structure, in an existing industrial area, and should therefore result in minimum adverse effects.

The proposed expansion of the TAPC refinery will help alleviate existing unemployment in the Kenai and Southcentral Alaska areas, by creating both short-term construction and long-term operational jobs. Products from the refinery will largely be supplied to the State's largest market, the Railbelt region.

The proposed expansion should have little or no adverse impact on existing commercial enterprise and investment. All the expected effects are beneficial, as described above.

AGO 786557

For the foregoing reasons, I find and determine that the Tesoro Alaska Petroleum Company disposal is in the best interest of the State and maximizes benefits to the State.

Esther C Wunnicke   March 16, 1983
Esther C. Wunnicke, Commissioner   Date
Department of Natural Resources

Corrected for typographical errors April 15, 1983
Esther C Wunnicke

AGREEMENT FOR THE SALE AND

PURCHASE OF ROYALTY OIL

THIS AGREEMENT, entered into as of the 16th day of March, 1983, by and between THE STATE OF ALASKA ("Seller") and TESORO ALASKA PETROLEUM COMPANY, a Delaware corporation ("Purchaser").

ARTICLE I

DEFINITIONS

As used in this Agreement, the following terms shall have the following meanings:

1.1 "Commissioner" means the Commissioner of the Alaska Department of Natural Resources.

1.2 "Day" means a period of twenty-four (24) consecutive hours, beginning at 12:01 a.m., Alaska Standard Time.

1.3 "Leases" means the oil and gas leases which are subject to the terms of the Unit Agreement.

1.4 "Lessee" means any person owning a working interest in any of the Leases.

1.5 "Month" means the period beginning at 12:01 a.m., Alaska Standard Time, on the first day of the calendar month and ending at the same time on the first day of the next succeeding calendar month.

1.6 "Oil" or "crude oil" shall have the same meaning as the word "oil" under the Unit Agreement.

1.7 "Point of Delivery" shall have the meaning set out in Article 2.4.

1.8 "Royalty Oil" means the oil which the Seller may take in-kind (amount) as its royalty under the Leases whether or not Seller has elected to take or is taking that royalty in-kind.

1.9 "Daily Royalty Oil" means the quantity of Royalty Oil produced by the Lessees each day.

1.10 "Unit Agreement" means the Prudhoe Bay Unit Agreement effective April 1, 1977, by and between Seller and the Lessees, as it may be amended from time to time.

ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity. Seller agrees to sell to Purchaser and Purchaser agrees to buy from Seller up to that quantity of oil equal to 13.867% of the Daily Royalty Oil ("Maximum Quantity"). Upon at least nine (9) months' written notice to Seller, Purchaser may increase or decrease the amount of oil to be tendered by Seller at the Point of Delivery, but the amount tendered by Seller under this Agreement shall not exceed the Maximum Quantity. It is understood and agreed that the volume of Daily Royalty Oil available to Seller will vary and may be interrupted from time-to-time, and depends upon a variety of factors, including the

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rate of production from the Leases. Seller disclaims and Purchaser waives any representation, covenant or warranty, express or implied, as to the specific quantity or the total or daily, monthly, average, or aggregate volume of Royalty Oil to be sold or tendered under this Agreement. Seller warrants that it has good title to the oil tendered under this Agreement. Seller shall hold the Purchaser harmless from all liens, encumbrances and valid adverse claims that may affect the Royalty Oil at the time the Royalty Oil is tendered to the Purchaser.

If Purchaser has not taken the Maximum Quantity of oil within five (5) years after the effective date of this Agreement, Seller, at its option, may permanently decrease the Maximum Quantity to the greatest percentage of Daily Royalty Oil tendered by Seller under this Agreement within that five-year period. Purchaser may permanently decrease the Maximum Quantity or terminate this Agreement upon nine (9) months' written notice to Seller.

If Seller underlifts or stores Royalty Oil at Prudhoe Bay, or if Seller recovers underlifted or stored Royalty Oil, the quantity of Royalty Oil tendered under this Agreement shall be calculated as if no Royalty Oil was underlifted or stored or recovered.

2.2 Quality. The Royalty Oil sold shall be the same quality as the oil delivered by the Lessees to the Seller at the Point of Delivery. It is understood and agreed that the quality

of the Royalty Oil sold may vary from time to time. Seller disclaims, and Purchaser waives, any guarantee, representation, or warranty, either expressed or implied, of the merchantability, fitness for use, or suitability for any particular use or purpose, or otherwise, of any of the oil delivered under this Agreement or as to any specific, average or overall quality or characteristic of Royalty Oil to be sold or tendered under this Agreement.

2.3 Price of the Royalty Oil. The price for the oil tendered under this Agreement shall be equal to the amount that Seller would have received from its Lessees for the Royalty Oil tendered if that royalty had been payable in money (taken in value) rather than taken in kind plus $0.30 per barrel plus the Field Cost Allowance incurred by that oil as determined under the Prudhoe Bay Royalty Settlement Agreement (dated April 1, 1980 for reference purposes only), which was entered as part of a final judgment dated August 13, 1980 in State of Alaska, et al. v. Amerada Hess Corp., et al., (Superior Court for the State of Alaska, First Judicial District at Juneau) ("Amerada Hess") ("Settlement Agreement") ("Purchase Price"). The Purchase Price shall be determined by Seller based upon the reports submitted by the Lessees for royalty purposes or, when those reports are unavailable, incomplete, or inaccurate, upon information submitted by the Lessees for production tax or other tax purposes, as may be adjusted from time to time as provided in this Agreement. Buyer will only be entitled to review or request material or information which is not confidential under state law or regulation.

The method, basis and amount of royalty due Seller when it takes its royalty in value from the Leases is presently the subject of litigation in Amerada Hess. One of the issues involved is the proper method to be used by the Lessees in calculating the state's royalty when the royalty is payable in money (in value). Until there is a resolution of that dispute through judicial resolution or settlement, the Purchase Price will be based upon the calculation of an amount per barrel equal to the per barrel volume weighted average of the in-value prices reported by the Lessees to Seller for royalty purposes or, when the royalty reports are unavailable, incomplete, or inaccurate, upon information submitted by the Lessees for production tax or other tax purposes, plus $0.30 per barrel, plus the Field Cost Allowance as determined under the Settlement Agreement. Upon resolution of each of the various issues that are or will be involved in Amerada Hess, adjustments will be made to previous payments in accordance with each resolution.

If, however, the State should prevail on the theory it advances in its Motion for Partial Summary Judgment on Count V of Plaintiff's Amended Complaint by Plaintiff State of Alaska dated September 19, 1980 and filed in Amerada Hess ("Exhibit B Theory"), then the $0.30 per barrel additional amount called for herein shall no longer be owed and the precise amount paid as a result of that $0.30 per barrel additional amount shall be credited against additional adjusted amounts owed by Purchaser due solely to the effectuation of the state's "Exhibit B Theory."

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Purchaser and Seller recognize that other adjustments besides those due under the "Exhibit B Theory" may be necessary upon resolution of Amerada Hess.

If additional amounts are owed by Purchaser to Seller, interest on those amounts will be paid at a variable interest rate which is the higher of: (1) the prime rate as may be announced from time to time by The Bank of America, San Francisco, California, plus three percent (3%); or (2) the rate of return as is realized from time to time in the investment of the State of Alaska's general fund. Amounts owed from Seller to Purchaser shall be repaid at the rate set out in Article 5.6. Buyer will not voluntarily intervene or otherwise participate in Amerada Hess unless Seller expressly consents to that participation in writing. A settlement of Amerada Hess will be binding upon Buyer whether or not Buyer agrees with or consents to the terms of that settlement.

If any applicable law of the United States of America or any rule or regulation promulgated by a federal agency will, in the judgment of Seller, operate to prohibit or prevent Seller from receiving the full amount due under the above provisions, Buyer's obligation to pay the amount of the Purchase Price in excess of the amount permitted will be suspended or adjusted to the minimum extent required for Seller to comply with that law, rule or regulation.

2.4 Point and Time of Delivery. Simultaneous with receipt of its Royalty Oil from its Lessees, Seller shall tender the oil

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to Purchaser at the point at which Seller receives the Royalty Oil from its Lessees. That point as presently agreed to by Seller and its Lessees in Article 2.3 of the Settlement Agreement is the custody transfer meters into the Trans Alaska Pipeline System at Prudhoe Bay.

2.5 Passage of Title and Risk of Loss. Title and risk of loss to the Royalty Oil sold under this Agreement shall pass from Seller to Purchaser for all purposes when Seller tenders the oil at the Point of Delivery.

2.6 Purchaser's Responsibility. Purchaser shall be responsible for the oil after passage of title. Purchaser will indemnify and hold Seller harmless from and against any and all claims, costs, damages (including reasonably foreseeable consequential damages), expenses or causes of action as a result of any loss, injury, or damage incurred by any party as a result of any transaction or event which relates to the crude oil after title has passed to Purchaser.

2.7 Transportation Arrangements. Purchaser shall make all necessary arrangements for transporting the oil sold under this Agreement from the Point of Delivery, including satisfaction of line fill obligations and storage tank bottom requirements of the Trans Alaska Pipeline System, if any. If and as requested by the Seller, Purchaser shall submit specific information concerning the arrangement it has made for transportation of the Royalty Oil sold under this Agreement through and away from the Trans Alaska

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Royalty Oil. Such information may include the specific tenders of oil made to the Trans Alaska Pipeline System and identification of tankers which will transport the Royalty Oil. In addition, Purchaser will provide Seller, if and as requested by Seller, with satisfactory evidence or reasonable assurance of the existence and continuing validity of adequate arrangements for the transportation or disposal of the Royalty Oil subject to this Agreement. Failure to provide information, evidence or assurances requested will, at Seller's election by notice to Purchaser, be a material default under this Agreement.

2.8 Absolute Obligations. The obligations of Purchaser to accept, pay for, and arrange for the transportation of the Royalty Oil tendered or sold under this Agreement are absolute and will not be excused or discharged by the operation of any disability of Purchaser, event of force majeure, impracticability of performance, change in conditions, or any other reason or cause.

2.9 Date of First Delivery. Purchaser may not nominate Royalty Oil under this Agreement until (i) Seller is satisfied that Purchaser's Nikiski, Alaska Refinery is able to process 71,000 barrels per day of Alaska North Slope (ANS) crude oil; or (ii) Seller is satisfied that Purchaser's Nikiski, Alaska Refinery will be able within seven (7) months to process 71,000 barrels per day of ANS crude oil. For each day after receipt at the Refinery

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of crude oil purchased under this Agreement, the Refinery is not able to process 71,000 barrels per day of ANS crude oil, Purchaser will pay Seller a sum equal to $2.00 times the difference between 71,000 barrels and the number of barrels of ANS crude oil actually processed that day (but in no event shall this sum exceed $52,000 per day) until the first day that the Refinery processes 71,000 barrels per day of ANS crude oil from which point in time the $2.00 per barrel assessment shall no longer be in force or effect. "Process" means producing Crude Oil Products in a volume of approximately 32% of the Royalty Oil tendered under this Agreement. "Crude Oil Products" does not include residual fuel oil exported from Alaska, but does include bunker fuel loaded in Alaska.

The foregoing notwithstanding, should however, after initial nomination of Royalty Oil is made by Purchaser under this Agreement, there occur a delay in the completion of the expansion of Purchaser's Kenai, Alaska Refinery, the cause of which is beyond the control of Purchaser, in such event Purchaser shall:

(i) immediately notify Seller of such delay and the circumstances attendant thereto;

(ii) make all efforts to denominate any volumes of Crude Oil possible, given with the time limitations Seller must observe in the Leases.

Under such circumstances, Purchaser's obligation as stated herein to pay Seller $2.00 per barrel for underlifted oil shall be suspended and null for the duration of any such delay.

If by June 30, 1986 Purchaser has not been able to process 71,000 barrels per day of ANS crude oil the Seller, at its sole discretion, may terminate this Agreement.

2.10 <u>Performance Guaranty and Reservation Fee.</u> If Purchaser does not take the Maximum Quantity on the Date of First Delivery, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to 1.25% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the actual quantity tendered to and accepted by Purchaser ("Actual Quantity") for each day Purchaser does not take the Maximum Quantity on and after the Date of First Delivery. The payment of this fee shall end on the day that Purchaser accepts delivery of the Maximum Quantity. When Purchaser accepts the Maximum Quantity, all of the amounts paid under this Acticle 2.12 will be allowed to be credited against future payments for oil tendered under this Agreement except for an amount to be retained by Seller equal to .75% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the Actual Quantity for each day Purchaser did not take the Maximum Quantity on and after the Date of First Delivery. If Purchaser should thereafter decrease the amount of Royalty Oil to be tendered under this Agreement, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to .75% of the Purchase Price per barrel per day after the date that the decrease in the amount of Royalty Oil to be tendered by Seller takes effect on the difference between the Maximum Quantity and the Actual Quantity.

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2.11 <u>In-State Processing.</u> Purchaser agrees that any and all of the Royalty Oil tendered under this Agreement shall be processed through Purchaser's refinery near Kenai, Alaska. "Process" means producing oil products in significant quantities, but which quantities may be less than 32% of the volume of Royalty Oil tendered under this Agreement.

Purchaser's obligation to process Royalty Oil in-state may only be suspended or excused under the provisions of Articles VIII and XI.

Seller may, at its option, waive the in-state processing requirement in whole or in part, if Seller is satisfied that Purchaser is using its best efforts to process the Royalty Oil tendered under this Agreement at Purchaser's refinery and that the waiver would not be contrary to the underlying intent of the other provisions of this Agreement.

2.12 <u>Best Efforts.</u> Purchaser agrees to use its best efforts to produce and market in Alaska an amount of crude oil products not less in volume than 32 percent (32%) of the Royalty Oil tendered under this Agreement. "Crude oil products" does not include residual fuel oil exported from Alaska unless the Commissioner, in his sole discretion, otherwise agrees, but does include bunker fuel loaded in Alaska. Purchaser also agrees to use its best efforts to nominate no more than that amount of Royalty Oil that will be necessary to produce and market crude oil products not less in volume than 32 percent (32%) of the Royalty

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Oil that will be tendered under this Agreement. On or before the 20th (twentieth) day after the end of each month of the term of this Agreement, the Purchaser shall provide to the Seller an affidavit certified by the Purchaser stating the quantity of crude oil products produced and marketed in the State of Alaska from in-state processing of the Daily Royalty Oil tendered under this Agreement.

A determination of "best efforts" under this Article shall include consideration of Purchaser's capabilities and the surrounding business circumstances. Purchaser's obligation to use its best efforts include reasonable, diligent, and good faith efforts, but shall not require Purchaser to produce and market crude oil products in Alaska at a loss. "Best efforts" would, however, require Purchaser to produce and market products in Alaska even though Purchaser could make a greater profit by another disposition of the Royalty Oil or the products refined from that oil.

2.13 Future Dispositions of Royalty Oil. Seller recognizes that AS 38.05.183, which governs disposition of Royalty Oil by the State of Alaska, establishes a statutory preference for dispositions proposing: (1) in-state processing of Royalty Oil, and (2) in-state supply of products generated from processing of Royalty Oil, in that order. Seller represents that, in conjunction with future dispositions of Royalty Oil, Purchaser will be afforded the consideration contemplated by AS 38.05.183.

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ARTICLE III

REPRESENTATION AND OBLIGATIONS OF PURCHASER

Purchaser warrants, represents, and agrees:

3.1 Good Standing and Due Authorization. Purchaser is, and at all times during the operation of this Agreement shall remain, a corporation qualified to do business in, and in good standing with, the State of Alaska. Purchaser has all necessary corporate power to enter into this Agreement and to perform its covenants and obligations under this Agreement. All necessary corporate action has been taken to authorize Purchaser's entering into this Agreement and performing its covenants and obligations under this Agreement.

3.2 Financial Condition. The financial information submitted to Seller is complete and correct and fairly presents Purchaser's financial condition at the time the information was submitted to Seller. The financial information was prepared in accordance with generally accepted accounting principles consistently applied. Since the date the information was submitted, the condition, business and properties of Purchaser have not been materially adversely affected in any way. Purchaser agrees to inform Seller immediately if during the term of this Agreement there is any material adverse change in the condition, business, or properties of Purchaser which would have an appreciable adverse effect on Purchaser's performance under this Agreement. Purchaser, in addition, will immediately inform Seller of any significant change in

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ownership of either the Purchaser or any of its affiliates or parent company, and of any change in Purchaser's operations or agreements, which would appreciably affect Purchaser's performance under this Agreement.

3.3 Financial Statements. As soon as possible after the end of each fiscal year of Purchaser, and in any event within one hundred twenty (120) days thereafter, Purchaser will furnish to Seller, at Purchaser's sole cost and expense, complete financial statements, in the form filed with the Securities and Exchange Commission.

3.4 Expansion/Modification. Purchaser agrees, for so long as Purchaser, in its sole judgment, determines that an expansion or modification of its in-state refining capacity is potentially viable for Purchaser, to conduct feasibility studies concerning the expansion or modification of its in-state refining capacity, including analysis of the various options for producing refined products and by-products, including petroleum coke. Purchaser shall report to Seller annually on the status of such studies.

3.5 Option to Purchase Resid. Subject to Purchaser's existing contracts, Purchaser grants to Seller an option to purchase all, or any quantity, of the residual oil ("resid") produced or refined from the Royalty Oil sold hereunder. Seller shall exercise this option by giving Purchaser written notice nine (9) months in advance of purchase by Seller. The notice shall specify the quantity Seller will purchase. Thereafter

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Seller may increase, decrease, or terminate the quantity of resid by giving written notice nine (9) months in advance, and Seller may again, subject to Purchaser's existing contracts, commence purchases after having terminated such purchase by giving written notice nine (9) months in advance of Seller's purchase. Seller shall take the resid for a period of at least nine (9) months unless the Royalty Oil is run in Purchaser's refinery for a period of less than nine (9) months. In that case, Seller shall be obligated to purchase resid only for that shorter period of time.

This option shall remain in effect for the term of this Agreement. Failure to exercise this option for any period of time shall not affect Seller's right to exercise the option at a later time. This option, in whole or in part and for any term, shall be freely assignable by Seller and such assignment shall release Seller from all obligations to receive or pay for the resid sold under this option; provided, however, that Purchaser shall have the right to demand of an assignee of Seller reasonable security for the resid sold to that assignee. If authorized in an assignment by Seller, an assignee shall have the further right freely to assign that option, however, that assignment shall not release that assignee (or any subsequent assignee) of any responsibilities or liabilities to Purchaser unless agreed to by Purchaser in writing.

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Seller shall pay the same price for resid as the highest price the Purchaser is offered for the same product from any other bona fide buyer of the resid. In the event Purchaser has no similar offer to buy from a bona fide buyer, the price shall be Purchaser's posted price for a like grade of resid in effect on date of loading at its Kenai, Alaska refinery, provided, however, that at no time shall the price be more than the cost of the Royalty Oil purchased hereunder plus actual transportation cost to Kenai, Alaska. Purchaser shall have the right to supply a comparable or better quality of resid from any source, domestic or foreign, so long as the laid-in cost of the resid at Seller's intended destination does not exceed the laid-in cost based upon Seller purchasing the resid at Kenai, Alaska.

3.6 <u>Petroleum Coke.</u> Purchaser agrees that if it modifies or expands its refinery at Kenai, Alaska so that the refinery is able to produce and handle petroleum coke, Purchaser will at that time enter into good faith negotiations with Seller for an option to purchase that petroleum coke.

ARTICLE IV

<u>MEASUREMENTS AND TESTS</u>

4.1 <u>Measurement Standards and Procedures.</u> The quantity and quality of the crude oil sold under this Agreement shall be determined at the Point of Delivery. Procedures and methods for measuring and metering the oil sold under this Agreement shall be

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in accordance with the practices then in effect at Prudhoe Bay, Alaska.

ARTICLE V

PAYMENTS AND ACCOUNTING

5.1 Billing. Seller will send to Purchaser, on or before the 10th (tenth) business day of each month after delivery of Royalty Oil, an invoice statement of account of all Royalty Oil estimated to have been measured at the custody transfer meter into the Trans Alaska Pipeline System and tendered to Purchaser under this Agreement during the immediately preceding month according to the best information available to Seller, the estimated price or prices applicable to those deliveries, and the total amount due ("initial billing"). The estimates will be made by Seller according to the best information reasonably available to Seller. Seller may render its initial billing to Purchaser based in part upon information reported by the Lessees to Seller and information published by the U.S. Government. Seller shall thereafter adjust its initial billing under this Article as soon as more accurate information concerning the quantity and price or prices of Royalty Oil delivered each month is available. Seller, however, shall not be required to adjust the initial billing prior to the sending of the next month's invoice statement of account.

5.2 Initial Adjustment. After the monthly invoice under Article 5.1, the subsequent monthly invoice will also state Seller's initial adjustments to be made, if any, to the invoice rendered in the immediately preceding calendar month, in accor-

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dance with any additional or more accurate information which may have become available to Seller. Whether or not initial adjustments are made, however, subsequent adjustments may be made under Article 5.5.

5.3 <u>Payment.</u> Purchaser will make payment of that amount billed under this Article within ten (10) days after receipt of the invoice statement of account. Payment shall be made without any deduction, set off, or withholding in immediately available funds to Seller at the following address:

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

Credit to: State of Alaska Investment Account

Payment may be made in such other manner or to such other address as Seller may specify in the invoice statement of account or by other written notice. All other payments to be made under this Agreement shall be paid in the same manner. If payment is due on a Saturday, Sunday, or legal holiday of the place where payment is to be received, payment shall be made on the next following business day. It is recognized that Seller may bill, and that Purchaser will pay, amounts that are based upon confidential information held or received by Seller. If confidential information is used as the basis for a billing, then upon request Seller will furnish Purchaser with the certified statement of the Commissioner that the amounts billed are correct based upon the best information available to Seller. Except for obvious clerical

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mistakes, if a dispute concerning a bill arises, it is agreed that Purchaser will pay the full amount billed by Seller pending final resolution of the dispute. Upon final resolution, the amount paid will be refunded to the Purchaser with interest, if such a refund is appropriate.

5.4 Payment to Lessee. Purchaser, at the request of Seller in the invoice statement of account or otherwise in writing, shall pay all or any portion designated by Seller of that payment required to be made to one or more of the Lessees at an address or addresses and in the manner designated by Seller. The payment will be made within the time limit specified in Article 5.3. Seller may authorize and designate a third party to make the request and designate the amount, manner and place of payment under this provision. Unless otherwise specified, the balance of the payment due, if any, and payment for subsequent months, shall be made in accordance with Article 5.3.

5.5 Subsequent Adjustments. Purchaser acknowledges that more accurate information concerning the quantity of or Purchase Price for Royalty Oil tendered may subsequently become available to Seller. In the event that any such information should subsequently become available to Seller, Seller shall promptly furnish a corrected invoice statement of account to Purchaser and the parties will adjust the amount billed and pay or refund the amount of those adjustments.

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In the event that Seller should render a corrected invoice to Purchaser, the parties will adjust the amount previously billed accordingly. Any amount to be refunded from Seller to Purchaser or paid from Purchaser to Seller will be paid within fifteen (15) days after the date of the corrected invoice. The time for paying an adjustment will be different, however, when the adjustment concerns an amount last invoiced more than sixty (60) days before the corrected invoice, in which case the amount will be paid by Purchaser or refunded by Seller, as the case may be, in equal monthly installments over the same period of time as that over which the adjustment accrued or six (6) months, whichever is the shorter period. No adjustment will be made more than twelve (12) months after the date of the last original invoice to which the adjustment relates, except for adjustments resulting from: (i) regulatory or court proceedings (including appeals) commenced or pending during that twelve (12) month period, whether or not Seller or Purchaser is a party to the proceeding, or (ii) bona fide audits by Seller of any Lessee(s) commencing at any time during the period six (6) years after the date of the last invoice to which such adjustment relates, or any resolution of disputes arising out of those audits. Adjustments due to audits or regulatory proceedings or court proceedings may be made at any time. The provisions of this Article 5.5 will survive any termination of this Agreement.

5.6 Interest. Except for adjustments made upon resolution of Amerada Hess under Article 2.3, the amount of all sums which are

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not paid when due under this Agreement or which are subsequently determined to be due under an adjustment under Article 5.5, or refunds, shall bear interest from the date accrued until paid in full at a variable rate per annum equal to the prime rate as announced from time to time by the Bank of America, San Francisco, California, plus one and one-quarter percent (1.25%) per annum.

5.7 Late Payment Penalty. Except for unintentional failures to pay, including clerical mistakes or occurrences not within the reasonable control of Purchaser, or insignificant underpayments, if Purchaser fails to make payment within one (1) day of the date that payment is due, then in addition to the amount due plus interest from the date that payment was due until the date of payment, Purchaser will pay an amount equal to one percent (1%) of the amount owed.

5.8 Payment to Third Parties. Seller may direct that Purchaser pay any amount due or which may become due directly to a third party in the manner and time as may be directed by Seller in written notice to the Purchaser if, in the Seller's sole discretion, the payment to the third party will assist Seller in monitoring or enforcing this Agreement.

ARTICLE VI

TERM

6.1 Term. This Agreement shall become effective upon execution by the parties and after enactment of legislation by the State of Alaska (including approval by the Governor)

approving this Agreement. This Agreement shall be null and void if it is not so approved by September 1, 1983. Subject to the other provisions contained in this Agreement, Seller's obligation to sell and Purchaser's obligation to buy Royalty Oil shall begin as set forth in Section 2.9 hereof, and end January 1, 1995.

ARTICLE VII

DEFAULT OR TERMINATION

7.1 Default. If any one or more of the following events ("Events of Default") occur, then at Seller's option, Seller may terminate or suspend its obligation to tender and sell Royalty Oil and proceed to exercise any one or more of the rights and remedies provided in this Agreement:

(i) except for obvious clerical errors, Purchaser does not pay in full any sum owed under this Agreement at the time when payment is due; or

(ii) Purchaser fails to observe or perform any of its other covenants and obligations under Article II; or

(iii) Purchaser does not perform any act required or contemplated under this Agreement and either: (a) the nonperformance continues for more than thirty (30) days after Seller

has notified the Purchaser of Purchaser's nonperformance; or (b) Purchaser had failed to perform the same or any other act required or contemplated under this Agreement during the immediately preceding twelve (12) month period; or

(iv) there is a material adverse change in Purchaser's condition, business or property which appreciably affects the ability of the Purchaser to perform any of its obligations under this Agreement, and Purchaser is unable to give Seller adequate assurance of continued performance either within fourteen (14) days of a request for such an assurance or within such other shorter time period as Seller may reasonably request under the circumstances; or

(v) any representation or warranty made by Purchaser in this Agreement proves to have been false or incorrect in any material respect at the time that the representation or warranty was made.

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7.2 Failure to Pay Debts. If at any time Purchaser becomes unable to pay any of its debts when those debts are due, or should otherwise become insolvent (without regard to how that insolvency may be evidenced), Purchaser will immediately give notice of that fact to Seller. Whether or not that notice is given, if Purchaser becomes unable to pay any of its debts when those debts are due or should otherwise become insolvent, Seller's obligation to tender and sell Royalty Oil under this Agreement will automatically and immediately terminate without any requirement of notice or other action by Seller; however, Purchaser will nevertheless be and remain liable for payment and performance of all of its obligations and covenants under this Agreement with respect to Royalty Oil actually tendered by Seller to and after any such termination. Within thirty (30) days after receipt of Purchaser's notice or, if no notice is given, after Seller otherwise becomes aware (as determined in Seller's sole discretion) of Purchaser's insolvency, Seller will have the right, upon written notice to Purchaser, to reinstate all of Seller's and Purchaser's obligations under this Agreement retroactively to the date of termination.

7.3 Seller's Remedies. Upon the occurrence of any Event of Default or if Seller's obligation to tender and sell Royalty Oil under this Agreement is terminated or suspended under Articles 7.1 and 7.2, all obligations of Purchaser accrued but not otherwise due and payable under this Agreement will immediately be due and payable in full. In addition, Purchaser

will indemnify and hold Seller harmless from and against all other liability, damages (including reasonably foreseeable consequential damages), costs, losses and expenses (including reasonable attorneys' fees and disbursements) incurred by Seller and arising out of the Event of Default, termination, or suspension. Seller shall have the right cumulatively to exercise any and all other rights and remedies and to obtain all other relief available under applicable law or at equity, including mandatory injunction and specific performance. The Seller, upon occurrence of any Event of Default, in its sole discretion, may arrange for any disposition to third parties of Royalty Oil to be tendered and sold under this Agreement. Upon the occurrence of any Event of Default, the Purchaser is released from the obligations set forth in Articles 2.11 (In-State Processing) and 2.12 (Best Efforts) until the Event of Default no longer exists or the obligation of the Purchaser to take Royalty Oil under this Agreement expires. If upon occurrence of any Event of Default the Seller makes arrangement for disposition to third parties of Royalty Oil or if the Purchaser is released from Articles 2.11 and 2.12, whether or not this Agreement is terminated, Purchaser will nevertheless be and remain liable to Seller for the full amount of the Purchase Price for that Royalty Oil in excess of the Purchase Price over any amount or amounts received by Seller on account of that disposition, net of the expenses of that disposition and for all other costs, expenses (including reasonable attorneys' fees and disbursements), damages (including

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reasonably foreseeable consequential damages) and losses incurred by Seller and arising out of the Event of Default or disposition.

7.4 Purchaser's Exclusive Remedies. Upon any breach of, or default in, the due and timely observance or performance of any of Seller's covenants or obligations under this Agreement, Purchaser acknowledges and agrees that Purchaser's remedies will not include a temporary restraining order or preliminary injunction preventing Seller from taking any action with regard to the Royalty Oil sold under the Agreement.

7.5 Third Party Control. If a third party as hereafter defined acquires control of Purchaser or Tesoro Petroleum Corporation, either alone or through a "group" as defined in regulation 13d-5(b) of the Securities and Exchange Commission under the Securities and Exchange Act of 1934, Purchaser will give notice to Seller of such fact within 15 days of the time that such control is acquired, and Seller will have the right, to be exercised within 30 days of receipt of such notice, to elect, in its sole discretion, to cancel this Agreement by giving notice to Purchaser. As used in this Article: "control" means possession of the power to direct or cause direction of management and policies; "third-party" means a person, corporation, partnership or joint venture and their respective affiliates which, directly or through an affiliate, on the date of this Agreement or thereafter up to the date that "control" was acquired was engaged in litigation with Seller which litigation involved (i) claims in excess of sixty million dollars and (ii) the purchase of crude oil from Seller.

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ARTICLE VIII

DISPOSITION OF OIL

8.1 Disposition of Oil Upon Default or Termination.

Purchaser acknowledges and agrees that under the Unit Agreement and Leases Seller's election to take Royalty Oil in-kind can be revoked or reversed only upon the satisfaction of various conditions, including the giving of six (6) months notice to return all or more than ten percent (10%) of Seller's then current nominations. Purchaser acknowledges and agrees that Seller's election to invoke its rights to return to taking its Royalty Oil in value on less than six (6) months notice, or to attempt to secure a waiver of any condition or requirement, is at Seller's sole and complete discretion. Notwithstanding termination of this Agreement for default or for any other reason, including expiration or termination under any provision contained in this Agreement, Purchaser shall continue to take and purchase Seller's Royalty Oil in the amount and for the price set forth in this Agreement for up to seven (7) months following termination of this Agreement if Seller, in its discretion, so requires.

8.2 Inability to Receive Oil. If for any reason Purchaser is unable or refuses to accept or receive any Royalty Oil tendered under this Agreement, Purchaser shall nevertheless be and remain responsible for the disposal of that Royalty Oil and for paying the Seller for the oil as though it had been received and accepted by Purchaser unless Seller, in its sole discretion, elects to waive this requirement.

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8.3 No Right to Storage or Underlift. Purchaser waives and disclaims any interest or right that it may assert to storage of Royalty Oil, including by underlift or other means, to which Seller is or may come to be entitled under the Leases or any other agreement.

ARTICLE IX

WAIVER

9.1 Waiver. The failure of either party to insist upon strict performance of any provision of this Agreement shall not constitute a waiver of, or estoppel against, asserting the right to require that performance in the future. A waiver or estoppel in any one instance shall not constitute a waiver or estoppel with respect to a later breach of a similar nature or otherwise. A course of performance established by a party shall also not estop the other party from complaining of a later breach similar in nature.

ARTICLE X

VALIDITY

10.1 Validity. If any provision or clause of this Agreement or application of this Agreement to any person or circumstance is held invalid, that invalidity shall not affect other provisions or applications of this Agreement which can be given effect without the invalid provision or application. If, however, an invalidity should operate to impair any material right or remedy of a party

to this Agreement, that party may terminate this Agreement by notice to the other.

ARTICLE XI

FORCE MAJEURE AND CHANGE IN CONDITION

11.1 Effect of Force Majeure. Except for Purchaser's obligations to make payment of money for Royalty Oil tendered under this Agreement and except for Purchaser's obligations to accept and dispose of Royalty Oil, neither party shall be liable for any failure to perform the terms of this Agreement when the failure is due in whole or in substantial part to force majeure. The term "force majeure" as applied to this Agreement shall mean Acts of God, strikes, lockouts and industrial disputes or disturbances, civil disturbances, arrests and restraints from rulers or people, interruptions by government or court orders or by present or future orders of any regulatory body having or asserting jurisdiction, acts of the public enemy, wars, riots, blockades, insurrections, inability to secure materials by reasons of allocations promulgated by authorized governmental agencies, epidemics, landslides, lightning, earthquakes, fires, storms, floods, washouts, explosions, breakage or accident to machinery or lines of pipe, freezing of wells or pipelines, or any other event or condition, whether of the kind herein enumerated or otherwise, not within the reasonable control of the party claiming the benefit of this excuse. If, however, any material obligation of Purchaser is excused or suspended because of a claim of force majeure for a period of three hundred sixty-five (365) successive days or more,

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Seller will have the right to terminate this Agreement. Prior to the Seller exercising its right to terminate this Agreement the Seller and Purchaser shall enter into good faith negotiations to restore, to the fullest extent possible, the Seller and Purchaser to the benefits and obligations that existed under this Agreement before the occurrence of the force majeure condition.

11.2 Responsibility. Upon the occurrence and discovery of an event providing the basis for a claim of force majeure, the party making a claim shall notify the other party to this Agreement of its claim of force majeure. Upon the occurrence of an event constituting force majeure that event shall, so far as possible, be remedied with all reasonable diligence and dispatch. Except for Purchaser's obligations to make payment of money for Royalty Oil tendered under this Agreement and except for Purchaser's obligation to dispose of Royalty Oil, the obligations of the disabled party to perform under this Agreement, insofar as they are affected by that force majeure, shall be suspended from the time that force majeure occurs and for so long as the disability caused should have continued had the party claiming the existence of the force majeure had remedied the event providing the basis of the claim of force majeure with reasonable diligence and dispatch, and for no longer. The settlement of strikes or lockouts or industrial disputes or disturbances will be entirely within the discretion of the party having the difficulty, and the above requirement that any force majeure shall be remedied with diligence and dispatch shall not require the settlement of strikes, lockouts,

or industrial disturbances by acceding to the demands of any opposing party therein when such course is inadvisable in the sole discretion of the disabled party.

ARTICLE XII

NOTICES

12.1 Method. All notices, requests, demands or statements shall be in writing, and may be delivered personally to the party to be notified or may be sent by registered or certified United States mail, postage prepaid, with a return receipt requested to such party. Notice deposited in the mail in this manner shall be effective upon the expiration of seven (7) days after it is so deposited. Notice given in any other manner shall be effective only if and when received by the addressee. For the purposes of notice, the addresses of the parties to this Agreement shall be as follows:

If to Seller:

State of Alaska
Commissioner of Natural Resources
Pouch "M"
Juneau, Alaska 99811

and

Commissioner of Revenue
Pouch "S"
Juneau, Alaska 99811

and

Director, Division of Minerals
and Energy Management
555 Cordova Street
Anchorage, Alaska 99501

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If to Purchaser: Tesoro Alaska Petroleum Company
8700 Tesoro Drive
P. O. Box 17536
San Antonio, Texas 78286

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

ARTICLE XIII

RULES AND REGULATIONS

13.1 Rules and Regulations. This Agreement is subject to all present and future valid laws, orders, rules and regulations of the United States, the State of Alaska, and any duly constituted agency thereof.

ARTICLE XIV

SOVEREIGN POWER OF THE STATE

14.1 Sovereign Power of the State. This Agreement and its covenants shall not be interpreted as a limit on the exercise by the State of Alaska of any of its sovereign or regulatory powers, whether conferred on the State by constitution, statute or regulation, including but not limited to, its regulatory power over the Leases. The exercise by the State of Alaska of any sovereign or regulatory power will not operate or be deemed to enlarge any rights of Purchaser or to limit or impair any obligations or liability of Purchaser under this Agreement except for state statutes enacted after the effective date of this Agreement which have a direct and significant adverse affect on the ability of Purchaser to perform an obligation under this Agreement other than

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the obligations to accept, dispose, and pay for Royalty Oil tendered under this Agreement.

ARTICLE XV

SECURITY

15.1 Letter of Credit. At least ninety (90) days before the Date of First Delivery, unless waived by Seller, Purchaser shall cause to be furnished to Seller an irrevocable stand-by letter of credit for the benefit of Seller, issued by a state or national banking institution of the United States which is a member of the Federal Deposit Insurance Corporation and has an aggregate capital and surplus of not less than One Hundred Million Dollars ($100,000,000), or other banking institution acceptable to Seller in its sole discretion. The principle face amount of the letter of credit shall initially be Thirty-One Million, Two Hundred Thousand Dollars ($31,200,000). The letter of credit shall be substantially in a form satisfactory to the Commissioner, but in any event shall not require any documents to be submitted in support of drafts drawn against this letter of credit other than the certified statement of the Commissioner or his designee and the Attorney General of the State of Alaska or his designee that Purchaser is liable to Seller for a sum equal to the amount of such draft, and that that sum is due and payable in full and has not been timely paid. In the event that Seller should have reasonable grounds for asserting any claims against Purchaser under this Agreement and does assert those claims in an aggregate amount in excess of the aggregate principal face amount of the letter of credit then in

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effect, Purchaser shall upon Seller's request (whether or not Purchaser may deny, reject or otherwise resist such claims) cause the principal face amount of the letter of credit to be increased by an amount equal to the excess. The principal face amount of the letter of credit shall also be automatically increased by Purchaser without request from Seller whenever the face amount is less than the expected Purchase Price of sixty (60) days of Royalty Oil tenders under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Royalty Oil tenders. The principal face amount of the letter of credit may be decreased by Purchaser upon approval of Seller if the face amount is less than the expected Purchase Price of sixty (60) days of Royalty Oil tenders under this Agreement, to an amount equal to the expected Purchase Price of sixty (60) days of Royalty Oil tenders. The Commissioner may accept such other or additional security as he, in his sole discretion, considers adequate to protect Seller.

ARTICLE XVI

PREFERENTIAL HIRING AND NON-DISCRIMINATION

16.1 Compliance with Alaska Law. Purchaser will comply with all applicable Alaska statutes and regulations in effect at the time this Agreement becomes effective, as well as all amendments to them and subsequent enactments, providing for preferential hiring of Alaska residents and non-discrimination against them.

16.2 Preference to Qualified Alaska Residents. To the extent not superceded by or inconsistent with present or subsequently enacted legislation or regulations, Purchaser will use its best efforts to assure that work done by or for it within the State of Alaska in connection with this Agreement shall, to the extent they are available, willing and qualified, be performed by Alaska residents who, at the time of their initial employment by Purchaser, its contractors or subcontractors, fall within one or more of the following employment target groups, as determined by the State or an agency or agencies designated by the State:

(1) "chronically unemployed resident," defined as either:

(A) a resident who has been unemployed for a minimum of eight (8) months, cumulatively, of the twelve (12) months immediately preceding the time of application for determination of status, so long as the individual's income for the 12-month period does not exceed $25,000; or

(B) a resident who has exhausted benefits available under the Alaska Employment Security Act, AS.23.20, within the twelve (12) months immediately preceding the time at which he makes the application for certification

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and is currently not eligible for unemployment benefits;

(2) "economically disadvantaged resident," defined as a resident whose total household income for the twelve (12) months immediately preceding the time of application for determination of status falls below seventy percent (70%) of the minimums set by the U.S. Bureau of Labor Statistics "lower living standard income level" as adjusted for Alaska; and

(3) "training-qualified resident," defined as a resident who, within the twelve (12) months immediately preceding the time of application for determination of status, has successfully completed a program of job training designed to qualify the resident for employment on projects carried out in connection with this Agreement.

16.3 Assurance of Compliance. Purchaser shall use its best efforts to assure that neither it, nor its contractors and subcontractors, hire nonresidents when residents falling within one or more of the employment target groups set out in Article 16.2 are known to be available, willing, and qualified for employment for work performed in connection with this Agreement within the State of Alaska.

16.4 Exceptions. The requirements of this Article do not apply to bona fide administrative, executive or professional employees of the Purchaser or its contractors or subcontractors, as those terms are defined in 8 AAC 15.910.

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16.5 <u>Collective Bargaining Agreements.</u> In implementing the requirements of this Article, Purchaser shall assure that it and its contractors and subcontractors use their best efforts to include in all collective bargaining agreements with labor unions covering work to be performed in connection with this Agreement provisions that will assure employment preference to Alaska residents falling within the target groups set out in Article 16.2 in accordance with the requirements of this Article.

16.6 <u>Non-Discrimination.</u> Purchaser shall assure that neither it nor its contractors or subcontractors engage in discriminatory practices against Alaska residents falling within the employment target groups set out in Article 16.2 who are employed or seeking employment by Purchaser or its contractors or subcontractors. Prohibited discriminatory practices include, but are not necessarily limited to:

(1) rejection of a resident referred to an employer by a collective bargaining agent in favor of a nonresident of similar qualifications in employment covered by a collective bargaining agreement;

(2) rejection of a resident in favor of a nonresident of similar qualifications in employment not covered by a collective bargaining agreement;

(3) termination of a resident in favor of a nonresident of similar qualifications; and

(4) differentiation in payment of wages, salaries, fringe benefits, and working conditions between a resident and nonresident.

16.7 Definitions. In this Article,

(1) "qualified" means able, by education, training and experience or combinations of them, to perform the duties and satisfy the terms and conditions which are usual in the offered employment, provided that the duties, terms and conditions meet the reasonable standards of the industry as required of other employees performing the same type of work in the industry; and

(2) "resident" means a person who:

(A) except for brief intervals, military service, attendance at an educational or training institution, or for absences for good cause, is physically present in the state for a period of at least thirty (30) days immediately before the time that person's status is determined;

(B) maintains a place of residence in the state.

(C) has established residency for voting purposes in the state;

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(D) has not, within the period of required residency, claimed residency in another state; and

(E) shows by all attending circumstances that that person's intent is to make Alaska his or her permanent residence.

ARTICLE XVII

APPLICABLE LAW

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

17.2 Submission to Jurisdiction. Any legal action or proceeding arising out of or relating to this Agreement or for the enforcement of the covenants or obligation of either party must be instituted in a State court of general jurisdiction sitting in the State of Alaska, and Purchaser hereby irrevocably submits to the jurisdiction of that court in any such action or proceeding.

ARTICLE XVIII

WARRANTIES

18.1 No Warranties. The purchase and sale of Royalty Oil under this Agreement is subject only to the warranties of Seller expressly set forth in this Agreement and Seller disclaims and Purchaser waives all other warranties, express or implied in law, whatsoever.

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ARTICLE XIX

AMENDMENT

19.1 Amendment. This Agreement may be supplemented, amended or modified at any time, but only by written instrument duly executed by the parties to this Agreement. In addition, material amendments to this Agreement which appreciably reduce the consideration to Seller must be approved by the Legislature of the State of Alaska.

ARTICLE XX

SUCCESSORS AND ASSIGNS

20.1 General Prohibition. No assignment, pledge or encumbrance of this Agreement shall be made by either party without first obtaining the written consent of the other party. The Commissioner may grant such consent on behalf of the Seller. The Commissioner shall have sole and complete discretion in granting or denying a proposed assignment, pledge or encumbrance. Subject to the above requirements in this Article, this Agreement will be binding upon and inure to the benefit of each of the parties and its successors and permitted assigns. In addition, if Purchaser gains or acquires a controlling interest in an entity which has an agreement with Seller for the sale of Royalty Oil ("Other Agreement"), then upon at least one year's notice Seller, at its option may require Purchaser to terminate either this Agreement or the Other Agreement. The choice of which Agreement to terminate will be Purchaser's. Purchaser may

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request that Seller waive this option in advance of Purchaser gaining a controlling interest in an entity which has an agreement with Seller for the sale of Royalty Oil. The Commissioner has sole and complete discretion in granting or denying the requested waiver.

ARTICLE XXI

HEADINGS

21.1 Headings. Headings used in this Agreement are for convenience only and shall not affect the construction of this Agreement.

ARTICLE XXII

RECORDS

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

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the State of Alaska or make such records available to Seller at Purchaser's principal office in the State of Alaska within thirty (30) days after written request by Seller.

22.2 Inspection of Records of Parties. Purchaser and Seller will accord to each other and to their authorized agents, attorneys, and auditors during reasonable business hours access to any and all property, records, books, documents, and indexes directly relating to the Purchaser's or Seller's performance of this Agreement and which are under the control of the party from which access is desired so that the other party may inspect, photograph and make copies of that property, records, books, documents and indexes. In no event, however, shall Seller be required to disclose any information, data, or records which are required to be held confidential by state law or regulation. If the information obtained by Seller may be held confidential under state or federal law or regulation, Purchaser may request that that information be held confidential by Seller.

ARTICLE XXIII

INTERPRETATION OF TERMS AND CONDITIONS

23.1 Commissioner Finding and Review. In the event that there is a disagreement about the meaning or application of a word, term, or condition in this Agreement, Purchaser will present the arguments supporting its view in writing to the Commissioner for his consideration. The Commissioner will subsequently, within a reasonable time, issue a finding on the meaning or application

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of the disputed word, term, or condition, and setting forth the basis for his conclusions. Purchaser agrees to accept findings by the Commissioner under this Article as long as there is substantial evidence supporting the Commissioner's findings.

DATED this 16th day of March, 1983.

SELLER: THE STATE OF ALASKA

[signature]
Commissioner,
Department of Natural Resources

PURCHASER: TESORO ALASKA PETROLEUM COMPANY

By [signature]
James F. Smith,
President

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PROPOSED DISPOSITION OF ROYALTY OIL
CHEVRON U.S.A. - March 1983

<u>Findings and Determinations Required for Disposals of Royalty Oil</u>

Under AS 38.05, AS 38.06, and 11 AAC 03, I must make various determinations and findings before I may dispose of royalty oil. This document constitutes those determinations and findings regarding the proposed disposal of royalty oil to Chevron USA.

Under the relevant statutes and regulations I must make the following findings and determinations prior to the execution of an agreement for the disposal of royalty oil:

(1) That the disposal is in the best interest of the State. 11 AAC 03.010(d); AS 38.05.020(2).

(2) If the disposal necessitates a taking in-value (such as return of the oil to the producers) that taking in-value is in the best interest of the State. 11 AAC 03.010(c); AS 38.05.182.

(3) If the disposal would allow for the export of royalty oil from the State, that royalty oil is surplus to present and projected intrastate domestic and industrial needs. 11 AAC 03.010(e); AS 38.05.183(d).

(4) If the royalty oil is disposed of to relieve storage or market conditions, that the agreement will relieve the storage or market condition. 11 AAC 03.010(f).

(5) If the disposal is other than by competitive bid, either that no competition exists, or the best interest of the State requires noncompetitive disposal. 11 AAC 03.030(a); AS 38.05.183(c).

(6) That a proposal or proposed disposition offers the maximum benefits to the State. 11 AAC 03.060(a); AS 38.05.183(e).

The determination that a proposal reasonably offers the maximum benefits to the citizens of Alaska is the best interest determination described in 11 AAC 03.010(d). 11 AAC 03.060(b). In making that determination I must consider the criteria described in AS 38.05.183(e), state which of those criteria apply to the proposed disposition, and discuss the weight given to the applicable criteria in determining the maximum benefit to the State. The criteria described in AS 38.05.183(e) are:

1. the cash value offered;

2. the projected effects of the sale, exchange, or other disposal on the economy of the State;

3. the projected benefits of refining or processing the oil and gas in the State;

4. the ability of the prospective buyer to provide refined projects or by-products for distribution and sale in the State with price or supply benefits to the citizens of the State;

5. the criteria described in AS 38.06.070(a).

The criteria described in AS 38.06.070(a) are:

1. the revenue needs and projected fiscal conditions of the State;

2. the existence and extent of present and projected local and regional needs for oil and gas products and by-products, the effect of state or federal commodity allocation requirements which might be applicable to those products and by-products, and the priorities among competing needs;

3. The desirability of localized capital investment, increased payroll, secondary development, and other possible effects on the sale, exchange, or other disposition of oil and gas or both;

4. the projected social impacts of the transaction;

5. the projected additional costs and responsibilities which could be imposed upon the State and affected political subdivisions by development related to the transaction;

6. the existence of specific local or regional labor or consumption markets which should be met by the transaction;

7. the projected positive and negative environmental effects related to the transaction;

8. the projected effects of the proposed transaction upon existing private commercial enterprise and patterns of investments.

In addition, AS 38.06 and 3 AAC 56 govern the actions of the Alaska Royalty Oil and Gas Development Advisory Board and require, among other things, that they hold public hearings on proposed disposals of royalty oil to determine compliance with AS 38.

Background and Chronology

The Commissioner of Natural Resources issued a solicitation for the sale of royalty oil in February, 1981, which was amended in July, 1981. The solicitation invited proposals from companies interested in purchasing royalty oil, but stressed that preference would be given to proposals for the processing of royalty oil in-state or the supply in-state of products from royalty oil processed elsewhere, as required by statute.

Twenty-seven companies responded to the solicitation. The Commissioner conducted negotiations with each proponent, and subsequently narrowed consideration to those companies whose proposals appeared most meritorious. Chevron USA was one of the finalists.

Chevron USA is one of the largest West Coast refiners and marketers of petroleum products, with a total refining capacity of 870,000 b/d. Chevron owns a small and now antiquated refinery in Nikiski, Alaska, with a capacity of 18,000 b/d, as part of its West Coast refining network. It is also the largest supplier of petroleum products in Alaska, which products are refined both in Nikiski and at Chevron's California refineries. Chevron owns productive leases in both Cook Inlet and at Prudhoe Bay. Currently, Chevron trades its Cook Inlet production to Tesoro Alaska Petroleum to be run in Tesoro's Nikiski refinery. All 12,000 b/d of Chevron's North Slope production is being used in Chevron's Nikiski refinery.

Chevron USA submitted a proposal in response to the solicitation requesting a long term contract for the sale of 45,000 b/d of royalty oil. Of the 45,000 b/d, 18,000 b/d represented an amount equal to the full refinery charge for the Nikiski refinery, 7,000 b/d was for a possible expansion of the Nikiski refinery, and the remaining 20,000 b/d would be refined in California and returned to Alaska in the form of petroleum products. The State was not considering the dedication of royalty oil to a mere tentative expansion; consequently, 7,000 b/d was excised from the proposal and negotiations centered on a volume of 38,000 b/d for a term of 12 years.

Negotiations between the State and Chevron USA continued until the deadline for submitting completed contracts to the legislature for approval/disapproval was reached. At that point, in return for a 12 year contract for 38,000 b/d, Chevron was willing to (1) use its best efforts to market specified petroleum products from its Nikiski refinery, (2) use its best efforts to supply historic levels of specified petroleum products produced from the 20,000 b/d processed in California, (3) supply Alaska needs first in the event of products shortage to the extent permitted by Federal law,

(4) continue to supply any local market in which Chevron is or becomes the sole supplier, (5) investigate a possible expansion of the Nikiski refinery and facilities in Western Alaska, and (6) provide the State with an option to purchase up to 400,000 tons annually of petroleum coke. Among other features, Chevron requested the right to terminate the contract on one year's notice.

The State came to the following conclusions with respect to Chevron's offer:

a. Much of what Chevron was proposing appeared to be in Chevron's interest anyway, and likely to be done by Chevron regardless of whether it received a royalty oil contract from the State.

b. Chevron could not offer petroleum coke to the State until 1986, which was not soon enough to satisfy the State's purposes in obtaining such an option.

c. The consideration being offered by Chevron, especially with respect to the 20,000 b/d to be exported from Alaska, was not sufficient to offset the potential losses which the State could experience from displacement and market downtrends created by a State sale. 1/

As a result, the State and Chevron USA were unable to come to an agreement for a long term contract at the time the deadline for submission of proposals to the 1982 legislature was reached. Negotiations were, therefore, suspended with the proviso that further discussions would be conducted subsequent to the legislative session to determine whether common ground could be identified. In the event it were possible for Chevron USA and the State to reach agreement, a contact would be drafted by the Commissioner and presented to the next Governor for action at the Governor's discretion. 2/

Several meetings were held after the legislative session between the State and Chevron regarding a possible long term contract. While some additional consideration was identified, it was not deemed sufficient by the State to justify a long term agreement.

In conjunction with a discussion held in the fall of 1982, however, Chevron notified the State that it expected its refining system would be short of crude oil in the immediate future. Therefore, while Chevron remained interested in a long term contract, their preference was now for a one year agreement with delivery as soon as possible. Chevron's initial request was for 100,000 b/d, later scaled back to 38,000 b/d and finally to 18,000 b/d. Chevron stated that

without additional crude supplies, the closure of the inefficient Nikiski refinery might be imminent.

At the time of Chevron's request, it was generally known that Chevron's principal supplier on the West Coast was Sohio, through an exchange agreement that had been in force for some time. Trade journals placed the volume of ANS received by Chevron from Sohio as high as 300,000 b/d, and stated that Chevron (through its parent Standard of California, an Aramco partner) returned Arabian Oil to Sohio for its refineries in the eastern US. At the time Chevron altered its request to the State from a long term to a short term contract and stated that they were crude short, articles began appearing in the press that the exchange agreement was being renegotiated with a substantial possibility that no agreement would be reached. Were this to happen, the State assumed that Chevron would replace some or all of the ANS formerly received from Sohio with foreign crude, thereby reducing the amount of higher-netback West Coast ANS placements. Consequently, the State did not want to become in any way a factor in the bargaining between Chevron and Sohio over continuation of their exchange agreement.

In discussing a possible short term agreement with Chevron, the State set forth the following elements as its position:

a. The State may not sell royalty oil on a short term (less than one year) basis except for a price premium or to relieve a market situation. The State notified Chevron that it would not consider a short term sale absent a price which would plainly return more to the State than if it made no sale, or a demonstration by Chevron that failure to make the sale would make closure of the Nikiski refinery imminent and likely.

b. The State would consider only a volume of 18,000 b/d (representing the full refinery charge for Nikiski) for in-state processing. The State would consider a greater volume only if the premium were so high it would be irresponsible for the State to ignore it.

c. Even if Chevron could demonstrate that closure of the Nikiski refinery was imminent and likely absent a sale of royalty oil, a premium equalizer over and above the Producers' Weighted Average Field Price would be required to obviate any losses from displacement and to avoid creating a market downtrend by serving as an acquisition bargain in contrast to Chevron's existing suppliers. Further, the State could not view as consideration the benefits which would accrue through a long term contract in which the relationship between the company and the State were maximized.

d. Chevron would be required to run the royalty oil through the Nikiski refinery and to produce specified levels of stated petroleum products on a best efforts standard. Further, Chevron would be required to use its best efforts to produce historic levels of asphalt and to produce additional amounts if demand so required. 3/

e. The State would not attempt to blend a short term contract into a long term contract, with the latter being approved by the legislature; only a short term contract would be considered.

f. A public hearing in Kenai would be required at which Chevron aired its reasons for needing royalty oil in order to keep the refinery open. Other parties would be permitted to testify. A sufficient justification for selling royalty oil short term would have to be placed on the public record by Chevron, both as a legal prerequisite and to avoid any appearance that a contract was being concluded behind closed doors in the final days of the Administration.

At the public hearing in Nikiski, Chevron presented written and oral testimony regarding its refining needs and the fact that it is presently crude short. 4/ This was later supplemented with additional written testimony. Chevron has stated for the record that, without additional crude oil in the form of State royalty oil, Chevron would have to seriously consider closing the Nikiski refinery as it is the least efficient member of its refining system (see attached letter). 5/ They have characterized a decision on closure of the refinery as imminent and likely to be adverse to its continued operation.

Chevron also agreed to the conditions set forth by the State (summarized on the previous page), including a price consisting of the Producers' Weighted Average Field Price, adjusted for the outcome of the present litigation, plus $.94 per barrel.

In February 1983, Chevron again approached the State with a proposal for a long-term contract for 38,000 b/d, to see if the new Administration would treat their proposal differently from the previous one. Because market conditions on the West Coast have not changed from the fall, the concerns cited above are still applicable. However, in the interest of keeping Chevron's Nikiski refinery operational for as long as possible, the State was willing to consider a long-term contract for volumes to be run at the Nikiski refinery. Those volumes will be sold at the in-value price, plus a .$30 premium.

The long-term contract, if approved by the legislature and governor, will supercede the one-year contract negotiated by the previous commissioner.

For general information on previous dispositions of Alaska royalty oil, and the marketing factors to be considered, I have also relied upon the <u>Review of Alaska Royalty Oil</u>, dated January 1, 1983, and prepared by former deputy commissioner Geoffrey Haynes, and hereby adopt the body of that report as part of these findings. That report also contains an analysis of all of the standard terms of the contract, which I hereby cite as an alternative to a discussion of them in this document.

<u>Findings and Determinations</u>

(1) I find and determine that the taking of royalty oil in-kind and the disposal of that royalty oil to Chevron for processing in-state is in furtherance of the intent of AS 38.05.182-183 and AS 38.06, and is in the best interest of the State for the following reasons:

a. The volume is limited to 18,000 b/d which will be run at Nikiski. Therefore, the entirety of the sale is for in-state processing, which is entitled to the highest preference under governing statutes.

b. Without the supply of royalty oil to Chevron, there is a substantial possibility that the refinery at Nikiski would be closed. There are numerous reasons (not limited to the availability of crude oil) which might cause Chevron to consider closing the facility, not the least of which is the decline in demand for petroleum products. However, Chevron has stated that they will keep the facility open for at least an additional year given a royalty oil contract for the amount of the Nikiski refinery charge. The combination of the adverse economic effects of closing Nikiski on the surrounding region together with the immediate absence thereafter of in-state capability for asphalt production at a time of high demand renders such a sale in the public interest. 6/

c. The price equalizer of $.30 over the Producers' Weighted Average Field Price will likely offset the adverse effects of displacement, and avoid creating any significant downward trend in the market through an acquisition bargain for Chevron. While it is impossible to forecast the spread in the two-tier price structure over the period of the contract, the amount of the equalizer is likely to cover a reasonable differential. Therefore, the equalizer is expected to leave the State in the same position financially as if no sale had been made, and avoids placing the State in

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a position of inadvertently affecting any negotiations between Chevron and its other suppliers.

d. Public sentiment expressed at the hearing in Kenai and in other settings supports the sale of royalty oil to Chevron for the purpose of keeping the Nikiski refinery open.

(2) I find and determine that the findings required by AS 38.05.182 and 11 AAC 03.010(c) relating to taking in-value and to relief of storage conditions are not applicable to this proposed disposal.

(3) I find and determine that the findings required by AS 38.05.183(d) and 11 AAC 03. 010(e) relating to the export of royalty oil from the State are not applicable to this proposed disposal.

(4) I have determined in accordance with AS 38.05. 183 (a) that the best interest of the State does not require competitive bidding. The best interest of the State is served by requiring several contractual provisions designed to protect the State from factors which lay outside the realm of the competitive bid process. These include provisions designed to preclude the placing of royalty oil in a market which could have the effect of lowering the State's in-value price. Other concerns which lie beyond the pale of the competitive bid process include the security arrangements to insure payments to the State, provisions designed to forestall any possible responsibility or liability on the part of the State for handling royalty oil at Pump Station One, and provisions unique to the circumstances of each purchaser.

I find and determine that, in order to realize the objectives intended by AS 38.05.182-183 respecting instate processing and supply, disposal strictly by competitive bid with the award determined entirely upon the cash value offered is not in the best interest of the State. Rather, it is in the best interest of the State to dispose of royalty oil for a minimum of the in-value price to purchasers who offer the maximum benefits to the State under contracts which protect the interests of the State, recognizing the objectives intended by AS 38.05.182-183.

(5) With respect to the criteria set forth in AS 38.05.183(e), I make the following findings and determinations with respect to the proposed disposal to Chevron USA:

The cash value is the Producers' Weighted Average Field Price, plus .$30 per barrel. Therefore, as discussed above the cash value is equivalent to, and possibly

above, what the State would receive if it did not enter into this agreement.

A disposal to Chevron will have a favorable effect on the economy of the State because it will ensure the continued operation of the refinery with attendant employment and tax base benefits for the term of the contract. Crude oil products (including asphalt), would be processed in-state, insuring that industries dependent on those products would likely have adequate supplies. Moreover, continuation of existing processing and supply would maintain competition to the benefit of products consumers.

The benefits of the continued operation of the Nikiski refinery include the aforementioned employment, tax base, and security of supply benefits, and there would therefore be direct favorable results of processing 18,000 b/d in-state. Secondary industries partially or wholly connected with Chevron's refining operation would also continue to benefit from that relationship.

Chevron is the largest supplier of petroleum products in Alaska, and has demonstrated for over 90 years their ability to provide refined products or by-products for distribution and sale in the State. Continued operation of the Nikiski refinery promotes competition in the petroleum products market in Alaska and therefore benefits the citizens of the State.

(6) With respect to the criteria set forth in AS 38.06.070(a), I make the following findings and determinations with respect to the proposed disposal to Chevron USA:

Regarding the effect of the disposal on the revenue needs and projected fiscal conditions of the State, the matter is covered above.

The supply needs of crude oil products in various localities and regions are generally best met by Chevron, which has the most extensive marketing structure in the State of any refiner/supplier. Commodity allocation requirements are not applicable to this disposal.

The continued operation of the Nikiski refinery with attendant payroll and secondary benefits would have a positive and desirable effect on the citizens of the State. Although this disposal will not result in new capital investment or development, it will enable existing investment and development to continue to be utilized.

The projected social impacts of a disposition to Chevron are anticipated to be favorable. The benefits presently received from the operation of the Nikiski refinery plus the supply of products through Chevron's distribution system would continue. Should the refinery close, the social impact would be negative.

Since most of the essential provisions of the proposed disposal to Chevron relate to operation of its existing facilities and systems the additional costs and responsibilities which could be imposed upon the State and affected subdivisions are likely to be minimal.

While local labor markets are primarily confined to the Nikiski area, regional consumption markets could be directly and favorably affected by the Chevron disposal.

Environmental effects from consummating the proposal are negligible, if any, since the facility is already in existence.

The effects of the proposed disposal upon existing commercial private enterprise and patterns of investments could only be enhanced because of the continued operation of the Nikiski refinery and the continued supply of Chevron's full range of products to the State.

For the foregoing reasons, I find and determine that the proposed Chevron disposal is in the best interest of the State and maximizes benefits to the State.

Esther C. Wunnicke — March 16, 1983

Esther C. Wunnicke, Commissioner — Date
Department of Natural Resources

Corrected for typographical errors April 15, 1983
Esther C. Wunnicke

FOOTNOTES:

1. The price term for sales of royalty oil is founded on the average destination sales price (or internal transfer price) received by the Producers for all sales of Alaska North Slope (ANS) crude oil, netted back (i.e., with transportation and pipeline tariff charges subtracted) to Pump Station No. 1, the point of sale; this is referred to as the Producers' Weighted Average Field Price. Because ANS crude oil is marketed both on the West Coast and the Gulf Coast of the United States, the Weighted Average Field Price is necessarily a mixture of sales prices for both markets. Traditionally, the average netback price for West Coast sales has been higher than for Gulf Coast sales (as

explained on pp. 101 of the Commissioner's February 26, 1982 Findings). This differential netback is often called the two-tier price structure; the State believes this structure is a valid indication of the value of ANS in the respective markets and will persist in the future.

The two-tier price structure creates two potential adverse financial consequences to the State for a royalty oil sale to a West Coast destination. First, since the Producers' Weighted Average Field Price is used to calculate severance tax and royalty payments due the State, a State royalty sale to a West Coast destination may replace a higher netback West Coast producer sale in the calculation on pp. 116 of the Commissioner's February 26, 1982 Findings). The State estimated that the effect of displacement in a sale to Chevron would be in the neighborhood of $2,000,000 to $5,000,000 annually.

Second, if the State's mixed-market Producers' Weighted Average Field Price were substantially below the West Coast Commercial Price for ANS crude oil, large volume sales by the State on the West Coast could create a downward trend on the price of ANS generally with some major adverse effects on royalty and severance tax payments to the State. As explained in the Commissioner's Findings (pp. 99), this apparently happened once previously when approximately 159,000 b/d of the State's royalty oil was on the market short term from several of the State's purchasers. The potential losses to the State from creating a downtrend in the market can be in the tens of millions of dollars annually.

While economic and other benefits can generally be identified to offset potential losses with respect to instate processing, the same is not necessarily true regarding royalty oil processed elsewhere and simply brought back in the form of refined products. As a result, while the State offered Chevron a 12 year contract for 18,000 b/d (which Chevron declined), it did not believe that the consideration offered by Chevron for the remaining 20,000 b/d justified a sale. In addition to a lack of sufficient benefits to offset the consequences of displacement and market downtrends for the exported barrels, it was noted that a West Coast refiner such as Chevron may realize substantial savings in its crude oil acquisition costs if it purchases royalty oil from the State. This is because the Producers' Weighted Average Field Price used by the State (mixed Gulf Coast/West Coast price) will be lower than the West Coast commercial price charged by North Slope producers selling ANS on the West Coast to Chevron and others. The amount of savings would vary depending on the continuation of the two-tier price structure and the degree of difference between the Gulf Coast and West Coast netbacks. For 38,000 b/d over 12 years, however, the amount of reduced

acquisition costs could be as much as $200,000,000. The State did not believe that the consideration offered by Chevron was in proportion to these potential savings.

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2. This same provision was made for Suneel Alaska and for Provident Energy, for which agreement was unable to be reached in time for the legislative session. Both companies subsequently withdrew their proposals.

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3. The Department of Transportation and Public Facilities indicated the possibility of an asphalt shortage for the 1983 season which could slow the State's capital construction program. In addition, the State's other supplier of asphalt appears ready to terminate operations.

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4. Sohio correctly pointed out that a sale of royalty oil by the State in substitution for one of the producers would not result in a net increase in ANS crude oil on the West Coast.

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5. Chevron declined an 18,000 b/d contract at the Weighted Average for 12 years on the grounds that an obligation to keep Nikiski open for that period is not worth it unless Chevron gains additional oil for its California facilities. Therefore, we have concluded that Chevron will be unwilling to commit to keeping Nikiski open over the long term absent a royalty contract from the State for a volume including California barrels as well as Nikiski barrels.

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6. This unique combination of circumstances cannot be assumed to repeat itself at any time Chevron considers closing this facility.

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AGREEMENT FOR THE SALE AND
PURCHASE OF ROYALTY OIL

THIS AGREEMENT entered into as of the 16th day of March, 1983, by and between the STATE OF ALASKA ("Seller") and CHEVRON U.S.A. INC., a California corporation ("Purchaser),

ARTICLE I
DEFINITIONS

As used in this Agreement, the following terms shall have the following meanings:

1.1 "Commissioner" means the Commissioner of the Alaska Department of Natural Resources.

1.2 "Day" means a period of twenty-four (24) consecutive hours beginning at 12:01 a.m., Alaska Standard Time.

1.3 "Leases" means the oil and gas leases which are subject to the terms of the Unit Agreement.

1.4 "Lessee" means any person owning a working interest in any of the Leases.

1.5 "Month" means the period beginning at 12:01 a.m., Alaska Standard Time, on the first day of the calendar month and ending at the same time on the first day of the next succeeding calendar month.

1.6 "Oil" or "crude oil" shall have the same meaning as the word "oil" under the Unit Agreement.

1.7 "Point of Delivery" shall have the meaning set out in Article 2.4.

1.8 "Royalty Oil" means the oil which the Seller may take in-kind amount as its royalty under the Leases whether or not Seller has elected to take or is taking that royalty in in-kind.

1.9 "Daily Royalty Oil" means the quantity of Royalty Oil produced by the Lessees each day.

1.10 "Unit Agreement" means the Prudhoe Bay Unit Agreement effective April 1, 1977, by and between Seller and the Lessees, as it may be amended from time to time.

ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity. Seller agrees to sell to Purchaser and Purchaser agrees to buy from Seller that amount of oil equal to 9.600% of the Daily Royalty Oil ("Maximum Quantity"). Upon at least nine (9) months written notice to Seller, Purchaser may increase or decrease the amount of Daily Royalty Oil to be tendered by Seller at the point of Delivery, provided that the amount tendered by Seller under this Agreement shall not exceed the Maximum Quantity. It is understood and agreed that the volume of Daily Royalty Oil available to Seller will vary and may be interrupted from time to time, and depends upon a variety of factors, including the rate of production from the Leases. Seller disclaims and Purchaser waives any representation, covenant or warranty, express or implied, as to the specific quantity or the total or daily, monthly, average, or aggregate volume of Royalty Oil to be sold or tendered under this Agreement. Seller warrants that it has good title to the oil tendered under this Agreement. Seller shall hold the Purchaser harmless from all liens, encumbrances and valid adverse claims that may affect the Royalty Oil at the time the Royalty Oil is tendered to the Purchaser.

If Purchaser has not taken the Maximum Quantity of oil within five (5) years after the effective date of this Agreement, Seller, at its option, may permanently decrease the Maximum Quantity to the greatest percentage of Daily Royalty Oil tendered by Seller within that five-year period or, (2) the maximum amount of oil that can be processed at Purchaser's refinery, located at Nikiski, Alaska. Purchaser may permanently decrease the Maximum Quantity or terminate this Agreement upon nine (9) months written notice to Seller.

If Seller underlifts or stores Royalty Oil at Prudhoe Bay, or if Seller recovers underlifted or stored Royalty Oil, the quantity of Royalty Oil tendered under this Agreement shall be calculated as if no Royalty Oil was underlifted or stored or recovered.

2.2 Quality. The Royalty Oil sold shall be the same quality as the oil delivered by the Lessees to the Seller at the Point of Delivery. It is understood and agreed that the quality of the Royalty Oil sold may vary from time to time. Seller disclaims, and Purchaser waives, any guarantee, representation, or warranty, either

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expressed or implied, of the merchantability, fitness for use, or suitability for any particular use or purpose, or otherwise, of any of the oil delivered under this Agreement or as to any specific, average or overall quality or characteristic of Royalty Oil to be sold or tendered under this Agreement.

2.3 Price of the Royalty Oil. The price for the oil tendered under this Agreement shall be equal to the amount that Seller would have received from its Lessees for the Royalty Oil tendered if that royalty had been payable in money (taken in value) rather than taken in kind, plus a premium of $0.30 per barrel, plus the Field Cost Allowance incurred by that oil as determined under the Prudhoe Bay Royalty Settlement Agreement (dated April 1, 1980 for reference purposes only), which was entered as part of a final judgment dated August 13, 1980 in State of Alaska, et al. v. Amerada Hess Corp., et al., (Superior Court for the State of Alaska, First Judicial District at Juneau) ("Amerada Hess") ("Settlement Agreement") ("Purchase Price"). The Purchase Price shall be determined by Seller based upon the reports submitted by the Lessees for royalty purposes or, when those reports are unavailable, incomplete, or inaccurate, upon information submitted by the Lessees for production tax or other tax purposes, as may be adjusted from time to time as provided in this Agreement. Buyer will only be entitled to review or request material or information which is not confidential under state law or regulation.

The method, basis and amount of royalty due Seller when it takes its royalty in value from the Leases is presently the subject of litigation in Amerada Hess. One of the issues involved is the proper method to be used by the Lessees in calculating the state's royalty when that royalty is payable in money (in value). Until there is a resolution of that dispute through judicial resolution or settlement, the Purchase Price will be based upon the calculation of an amount per barrel equal to the per barrel volume weighted average of the in-value prices reported by the Lessees to Seller for royalty purposes or, when the royalty reports are unavailable, incomplete, or inaccurate, upon information submitted by the Lessees for production tax or other tax purposes, plus the Field Cost Allowance as determined under the Settlement Agreement. Upon resolution of each of the various issues

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that are or will be involved in Amerada Hess, adjustments will be made to previous payments in accordance with each resolution. If additional amounts are owed by Purchaser to Seller, interest on those amounts will be paid at a variable interest rate which is the higher of: (1) the prime rate as may be announced from time to time by The Bank of America, San Francisco, California plus three per cent (3%); or (2) the rate of return as is realized from time to time in the investment of the State of Alaska's general fund. Amounts owed from Seller to Purchaser shall be repaid at the rate set out in Article 5.6.

If any applicable law of the United States of America or any rule or regulation promulgated by a federal agency will, in the judgment of Seller, operate to prohibit or prevent Seller from receiving the full amount due under the above provisions, Buyer's obligation to pay the amount of the Purchase Price in excess of the amount permitted will be suspended or adjusted to the minimum extent required for Seller to comply with that law, rule or regulation.

2.4 Point and Time of Delivery. Simultaneous with receipt of its Royalty Oil from its Lessees, Seller shall tender the oil to Purchaser at the point at which Seller receives the Royalty Oil from its Lessees. That point as presently agreed to by Seller and its Lessees in Article 2.3 of the Settlement Agreement is the custody transfer meters into the Trans Alaska Pipeline System at Prudhoe Bay.

2.5 Passage of Title and Risk of Loss. Title and risk of loss to the Royalty Oil sold under this Agreement shall pass from Seller to Purchaser for all purposes when Seller tenders the oil at the Point of Delivery.

2.6 Purchaser's Responsibility. Purchaser shall be responsible for the oil after passage of title. Purchaser will indemnify and hold Seller harmless from and against any and all claims, costs, damages (including reasonably foreseeable consequential damages), expenses or causes of action as a result of any loss, injury, or damage incurred by any party as a result of any transaction or event which relates to the crude oil after title has passed to Purchaser.

2.7 Transportation Arrangements. Purchaser shall make all necessary arrangements for transporting the oil sold under this Agreement from the Point of Delivery, including satisfaction of line fill obligations and storage tank bottom requirements of the Trans Alaska Pipeline System, if any. If and as requested by the Seller, and at the time or times requested by Seller, Purchaser shall submit specific information concerning the arrangement it has made for transportation of the Royalty Oil sold under this Agreement through and away from the Trans Alaska Pipeline System and for the resale or other disposal of the Royalty Oil. Such information may include the specific tenders of oil made to the Trans Alaska Pipeline System and identification of tankers which will transport the Royalty Oil. In addition, Purchaser will provide Seller, if and as requested by Seller, with satisfactory evidence or reasonable assurance of the existence and continuing validity of adequate arrangements for the transportation or disposal of the Royalty Oil subject to this Agreement. Failure to provide information, evidence or assurances requested will, at Seller's election by notice to Purchaser, be a material default under this Agreement.

2.8 Absolute Obligations. The obligations of Purchaser to accept, pay for, and arrange for the transportation of the Royalty Oil tendered or sold under this Agreement are absolute and will not be excused or discharged by the operation of any disability of Purchaser, event of force majeure, impracticability of performance, change in conditions, or any other reason or cause.

2.9 Date of First Delivery. On May 30, 1983, or on the date of statutory approval as set forth in Article VI, whichever is later, Seller will initiate tenders of the Royalty Oil to Purchaser at the Point of Delivery the Maximum Quantity unless Purchaser, under the provisions of Article 2.1, decreases the amount of Royalty Oil to be tendered.

2.10 Performance Guaranty and Reservation Fee. If Purchaser does not take the Maximum Quantity on the Date of First Delivery, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to 1.25% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the actual quantity

tendered to and accepted by Purchaser ("Actual Quantity") for each day Purchaser does not take the Maximum Quantity on and after the Date of First Delivery. The payment of this fee shall end on the day that Purchaser accepts delivery of the Maximum Quantity. When Purchaser accepts the Maximum Quantity, all of the amounts paid under this Article 2.10 will be allowed to be credited against future payments for oil tendered under this Agreement except for an amount to be retained by Seller equal to .75% of the Purchase Price per barrel per day on the difference between the Maximum Quantity and the Actual Quantity for each day Purchaser did not take the Maximum Quantity on and after the Date of First Delivery. If Purchaser should thereafter decrease the amount of Royalty Oil to be tendered under this Agreement, Purchaser shall pay to Seller, in addition to the Purchase Price, an amount equal to .75% of the Purchase Price per barrel per day after the date that the decrease in the amount of Royalty Oil to be tendered by Seller takes effect on the difference between the Maximum Quantity and the Actual Quantity.

2.11 In-state Processing. Purchaser agrees that 100% of the Royalty Oil tendered under this Agreement shall be processed through Purchaser's refinery near Nikiski, Alaska, or shall be exchanged for other crude oil which shall be processed at that refinery. "Process" means producing oil products from the crude oil in significant quantities, but which quantities may be less than 34.44% of the volume of Royalty Oil tendered under this Agreement. "Exchange" means: (1) direct trades of equal volumes of crude oil; (2) trades of crude oil involving either cash or volume adjustments, or both, provided that those adjustments relate solely to quality or location differences; (3) sequential transactions in which Purchaser receives back crude oil from a party other than the party which receives the Royalty Oil in a trade from Purchaser; or (4) matching purchases and sales of crude oil. The terms under which Purchaser receives crude oil in any exchange shall not differ in any significant term from the terms under which Purchaser delivered Royalty Oil except for terms which adjust for differences in quality and location. Purchaser agrees that any trade or exchange shall not reduce the price to be paid to Seller and that trades or exchanges shall be at no cost or expense to Seller.

Purchaser's obligation to process Royalty Oil in-state may only be suspended or excused under (1) the provisions of Articles VIII and XI, or (2) during refinery maintenance or asphalt production.

Seller may, at its option, waive the in-state processing requirement in whole or in part, if Seller is satisfied that Purchaser is using its best efforts to process the Royalty Oil tendered under this Agreement at Purchaser's refinery and that the waiver would not be contrary to the underlying intent of the other provisions of this Agreement.

2.12 Best Efforts. (1) Purchaser agrees to use its "best efforts" to produce and market in Alaska an amount of crude oil products from its refinery near Nikiski, Alaska not less in volume than 34.44% of the Royalty Oil tendered under this Agreement. Said crude oil products shall be comprised of at least jet kerosene, heating fuel, diesel, and asphalt. (2) In addition, Purchaser agrees to use its "best efforts" to sell to the Defense Fuels Supply Center JP-4 military jet fuel produced at said refinery. "Crude oil products" does not include residual fuel oil exported from Alaska unless the Commissioner, in his sole discretion, otherwise agrees, but does include bunker fuel loaded in Alaska. During periods of refinery maintenance or asphalt production where some or all of the Royalty Oil or exchanged oil is not being processed in-state (as described in Paragraph 2.11), the amount of crude oil products required under this paragraph which are not produced from the Nikiski refinery shall be produced from Purchaser's California refining facilities and made available. On or before the 20th day after the end of each month of the term of this Agreement, the Purchaser shall provide to the Seller an affidavit certified by the Purchaser stating the quantity of crude oil products produced and marketed in the State of Alaska from in-state processing of the Daily Royalty Oil tendered under this Agreement.

A determination of "best efforts" under this Article shall include consideration of Purchaser's capabilities and the surrounding business circumstances. Purchaser's obligation to use its best

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efforts include reasonable, diligent, and good faith efforts, but shall not require Purchaser to produce and market crude oil products in Alaska at a loss. "Best efforts" would, however, require Purchaser to produce and market products in Alaska even though Purchaser could make a greater profit by another disposition of the Royalty Oil or the products refined from that oil.

2.13 Future Dispositions of Royalty Oil. Seller recognizes that AS 38.05.183, which governs disposition of Royalty Oil by the State of Alaska, establishes a statutory preference for dispositions proposing (1) in-state processing of Royalty Oil and (2) in-state supply of products generated from processing of Royalty Oil, in that order. Seller represents that, in conjunction with future dispositions of Royalty Oil, Purchaser will be afforded the consideration contemplated by AS 38.05.183.

ARTICLE III

REPRESENTATION AND OBLIGATIONS OF PURCHASER

Purchaser warrants, represents and agrees:

3.1 Good Standing and Due Authorization. Purchaser is, and at all times during the operation of this Agreement shall remain, a corporation qualified to do business in, and in good standing with, the State of Alaska. Purchaser has all necessary corporate power to enter into this Agreement and to perform its covenants and obligations under this Agreement. All necessary corporate action has been taken to authorize Purchaser's entering into this Agreement and performing its covenants and obligations under this Agreement.

3.2 Financial Condition. The financial information submitted to Seller is complete and correct and fairly presents Purchaser's financial condition at the time the information was submitted to Seller. The financial information was prepared in accordance with generally accepted accounting principles consistently applied. Since the date the information was submitted, the condition, business and properties of Purchaser have not been materially adversely affected in any way. Purchaser agrees to inform Seller immediately if during the

term of this Agreement there is any material adverse change in the condition, business, or properties of Purchaser which would have an appreciable adverse effect on Purchaser's performance under this Agreement. Purchaser, in addition, will immediately inform Seller of any significant change in ownership of either the Purchaser or any of its affiliates or parent company, and of any change in Purchaser's operations or agreements which would appreciably affect Purchaser's performance under this Agreement.

3.3 Financial Statements. As soon as possible after the end of each fiscal year of Purchaser, and in any event within 120 days thereafter, Purchaser will furnish to Seller, at purchaser's sole cost and expense, a report or a complete copy of a report in a form to be prescribed from time to time by Seller which will include Purchaser's balance sheet as of the close of the fiscal year and the income statement for that year prepared in each case in accordance with generally accepted accounting principles consistently applied by certified public accountants of recognized standing. For purposes of complying with this Article, Purchaser may submit, and Seller will accept, the annual report and supplement thereto of the Standard Oil Company of California.

3.4 Expansion/Modification. Purchaser agrees, for so long as Purchaser, in its sole judgement, determines that an expansion or modification of its in-state refining capacity is potentially viable for Purchaser, to conduct feasibility studies concerning the expansion or modification of its in-state refining capacity, including analysis of the various options for producing refined products and by-products, including petroleum coke. Purchaser shall report to Seller annually on the status of such studies.

3.5 Option to Purchase Resid. Subject to Purchaser's existing contracts, Purchaser grants to Seller an option to purchase all, or any quantity, of the residual oil ("resid") produced or refined from oil sold hereunder or the oil exchanged for the Royalty Oil refined at Purchaser's Nikiski, Alaska refinery. Seller shall exercise this option by giving Purchaser written notice nine (9) months in advance of purchase by Seller. The notice shall specify the quantity Seller will purchase. Thereafter Seller may increase, decrease, or terminate the quantity of resid by giving written notice

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nine (9) months in advance, and Seller may again subject to Purchaser's existing contracts, commence purchases after having terminated such purchase by giving written notice nine (9) months in advance of Seller's purchase. Provided, however, that Seller shall take the resid for a period of at least nine (9) months unless the Royalty Oil is run in Purchaser's refinery for a period of less than nine (9) months. In that case, Seller shall be obligated to purchase resid only for that shorter period of time.

This option shall remain in effect for the term of this Agreement. Failure to exercise this option for any period of time shall not affect Seller's right to exercise the option at a later time. This option, in whole or in part and for any term, shall be freely assignable by Seller and such assignment shall release Seller from all obligations to receive or pay for the resid sold under this option; provided, however, that Purchaser shall have the right to demand of an assignee of Seller reasonable security for the resid sold to that assignee. If authorized in an assignment by Seller, an assignee shall have the further right freely to assign that option, however, that assignment shall not release the assignee (or any subsequent assignee) of any responsibilities or liabilities to Purchaser unless agreed to by Purchaser in writing. Purchaser's obligations to supply resid, as set forth in this Article, following exercise of the purchase option by Seller, shall be freely assignable by Purchaser, in whole or in part and for any term; provided, however, that any such assignment shall not relieve purchaser of its obligations hereunder.

Seller shall pay the same price for resid as the highest price the Purchaser is offered for the same product from any other bona fide buyer of the resid. In the event Purchaser has no similar offer to buy from a bona fide buyer, the price shall be Purchaser's posted price for a like grade of resid in effect on date of loading at its Nikiski, Alaska refinery, provided, however, that at no time shall the price be more than the cost of the Royalty Oil purchased hereunder plus actual transportation cost to Nikiski, Alaska. Purchaser shall have the right to supply a comparable or better quality of resid from any source, domestic or foreign, so long as the laid-in cost of the

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resid at Seller's intended destination does not exceed the laid-in cost based upon Seller purchasing the resid at Nikiski, Alaska.

3.6 Petroleum Coke. Purchaser agrees that if it modifies or expands its refinery at Nikiski, Alaska so that the refinery is able to produce and handle petroleum coke, Purchaser will at that time enter into good faith negotiations with Seller for an option to purchase that petroleum coke.

ARTICLE IV

MEASUREMENTS AND TESTS

4.1 Measurement Standards and Procedures. The quantity and quality of the crude oil sold under this Agreement shall be determined at the Point of Delivery. Procedures and methods for measuring and metering the oil sold under this Agreement shall be in accordance with the practices then in effect at Prudhoe Bay, Alaska.

ARTICLE V

PAYMENTS AND ACCOUNTING

5.1 Billing. Seller will send to Purchaser, on or before the tenth (10th) business day of each month after delivery of Royalty Oil, an invoice statement of account of all Royalty Oil estimated to have been measured at the custody transfer meter into the Trans Alaska Pipeline System and tendered to Purchaser under this Agreement during the immediately preceding month according to the best information available to Seller, the estimated price or prices applicable to those deliveries, and the total amount due ("initial billing"). The estimates will be made by Seller according to the best information reasonably available to Seller. Seller may render its initial billing to Purchaser based in part upon information reported by the Lessees to Seller and information published by the U. S. government. Seller shall thereafter adjust its initial billing under this Article as soon as more accurate information concerning the quantity and price or prices of Royalty Oil delivered each month is available. Seller, however, shall not be required to adjust the initial billing prior to the sending of the next month's invoice statement of account.

5.2 Initial Adjustment. After the monthly invoice under Article 5.1, the subsequent monthly invoice will also state Seller's initial adjustments to be made, if any, to the invoice rendered in the

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