

ALASKA LEGISLATURE COMMITTEE FILES 1903 1904 1905 1906 1907 1908

2752 HRES HB 320 (FILE 1) 2152

immediately preceding calendar month, in accordance 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 Payment. 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 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.

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-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 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 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, or on May 30, 1983, whichever is later. 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 provided above, and shall end January 1, 1995.

6.2 Termination of Existing Agreement. This Agreement as of the date it becomes effective as above provided shall terminate and supersede that certain "Agreement for the Sale and Purchase of Royalty

Oil" dated November 30, 1982, now effective between the parties; provided, however, (a) that no financial obligation of Purchaser to Seller arising out of such certain Agreement shall be affected by said termination, and (b) that the Letter of Credit furnished to Seller pursuant to Article XV of said Agreement shall to the extent of its principal amount apply to the Letter of Credit required by Article XV of this Agreement.

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 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 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.

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 of 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 Buyer'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 Article 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 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.

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 months notice, or to attempt to secure a waiver of any condition or requirements, 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.

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 365 successive days or more, 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 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

If to Purchaser:

NOTICES AND CORRESPONDENCE:

CHEVRON U.S.A. INC.
P. O. Box 9000
Concord, CA 94524

INVOICES AND REFUNDS ONLY:

CHEVRON U.S.A. INC.
P. O. Box W, Section 424
Concord, CA 94524

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 effect on the ability of Purchaser to perform an obligation under this Agreement other than the obligations to accept, dispose, and pay for Royalty Oil tendered under this Agreement.

ARTICLE XV

SECURITY

15. 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 \$100,000,000, or other banking institution acceptable to Seller in its sole discretion. The principal face amount of the letter of credit shall initially be \$23,000,000.00. 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 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 superseded by or inconsistent with 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 months immediately preceding the time at which he makes application for certification and is currently not eligible for unemployment benefits;

(2) "economically disadvantaged resident," defined as a resident whose total household income for the twelve 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 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 15.190.

16.5 Collective Bargaining Agreements. 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 Non-discrimination. 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 30 days immediately before the time that person's status is determined;

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

(C) has not established residency for voting purposes in the state;

(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 of 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.

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 Seller, at its option and on one year's notice, 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 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 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 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 unless there is clear and convincing evidence for a finding contrary to the Commissioner's findings.

DATED this 16 day of March, 1983.

SELLER:

THE STATE OF ALASKA

Esther C. Wamsick
Commissioner, Department of
Natural Resources

PURCHASER:

CHEVRON U.S.A. INC.

By: *R. F. Walsh*

R. F. Walsh, Vice President

Resolution 83-1

WHEREAS, the State of Alaska, through the Commissioner of the Alaska Department of Natural Resources, and the Tesoro Alaska Petroleum Company have entered into an "Agreement for the State and Purchase of Royalty Oil from the Cook Inlet Basin" dated the 22nd day of February 1983; and

WHEREAS, in accordance with AS 38.06.055(a) "... the Commissioner of Natural Resources may not enter into a sale, exchange, or other disposition of oil or gas or of the rights or waiver of the rights to receive future production of royalty oil or gas under AS 38.05.183 without the prior approval of the Legislature ..."; and

WHEREAS, according to AS 38.06.055(a), "... a sale, exchange, encumbrance, or other disposition of oil or gas or of the rights or waiver of the rights to receive future production of royalty oil or gas may not be made by the Commissioner of Natural Resources under AS 38.05.183 without prior review of the proposed sale, exchange, encumbrance or other disposition by the Board. A written recommendation of the Board on the proposed sale, exchange, encumbrance or other disposition of oil or gas or of the rights or waiver of the rights to receive future production of royalty oil or gas shall be submitted to the Legislature at the time a resolution approving the proposed sale, exchange, encumbrance, or other disposition is introduced in the Legislature"; and

WHEREAS, in accordance with AS 38.06.040(a), the Board shall

"(2) hold public hearings on proposed sales, exchanges, or other disposals of royalty oil or gas to determine whether the proposals comply with AS 38.06.070;

(3) examine proposed sales, exchanges or other disposal of, and recommend to the Legislature that it approve or disapprove a proposed sale, exchange or other disposal of

(A) the oil or gas that is obtained by the State as royalty under AS 38.05.132; or

(B) the rights to receive future oil or gas production under State leases"; and

WHEREAS, the Board did, on February 23, 1983 receive from the Commissioner of Natural Resources the above-mentioned agreement with Tesoro as well as a document entitled "Proposed Disposition of Royalty Oil, Tesoro Alaska Petroleum Company, Findings and Determinations Required for Disposals of Royalty Oil" dated February 22, 1983 and the Board did act and call public hearings, in accordance with the regulations outlined in 3 AAC 56, in Anchorage on March 22, 1983 and received public comment pertinent to this agreement; and

WHEREAS, in accordance with AS 38.06 and AS 33.05, the Commissioner of Natural Resources is required to submit to the Board, in writing, certain Findings or Determinations relating to the disposal of oil and gas royalty interests and the Board has received the required Findings and Determinations; and

WHEREAS, the board members had the opportunity to review the agreement, related Findings and Determinations and Public Testimony during the period February 28, 1983 until April 5, 1983; and

WHEREAS, the Board did, on April 5, 1983, meet to discuss the agreement, related Findings and Determinations, and Public Testimony to insure that this disposal is in accordance with the statutory purpose and criteria set forth in AS 38.06 as well as the Board's "Basic Principles and Policies" as outlined in the Board's development plan.

THEREFORE, the Board finds as follows:

1. that the Commissioner of Natural Resources has followed the board policies and applicable statutes and regulations relating to the disposal of oil and gas royalty interests.
2. that the sale of the royalty oil interests to Tesoro-Alaska Petroleum Company as per the agreement is in the best interest of the State because

- (a) the oil is to be refined or processed in the existing Tesoro refinery near Kenai, Alaska.
- (b) Tesoro-Alaska is an in-state refinery which supplies products to the Alaska market with supply benefits to state citizens.
- (c) the Commissioner of National Resources did issue a competitive solicitation for the disposition of Cook Inlet royalty oil. The Commissioner determined that other proposals received in response to this solicitation were not in the State's best interest.
- (d) the price the State will receive for this royalty interest appears to be substantially equivalent to or greater than the price the State would receive by taking this royalty in-value. However, the Board does not believe that the 10¢ per barrel cumulative capital investment for each barrel purchased is a significant factor.
- (e) Tesoro has received 100% of the Cook Inlet royalty oil since 1969 and the existing Nikiski refinery is only equipped to process crudes of similar quality. Therefore, if Tesoro does not have access to this royalty oil, they would need to acquire this or similar quality crude by exchange or direct purchase. Further, if Tesoro does not receive this royalty oil they would have the ability to increase purchases of Prudhoe Bay royalty crude by a like amount in accordance with the agreement entered into in 1981 with Tesoro for Prudhoe Bay royalty crude.
- (f) that Tesoro-Alaska is a highly qualified company which has been operating its refinery to produce products for the Alaska market for over 13 years.
- (g) that this agreement is consistent with the criteria outlined in AS 38.06.070.

AND THEREFORE BE IT RESOLVED THAT the Alaska Royalty Oil and Gas Development Advisory Board recommends to the Thirteenth Alaska Legislature that the "Agreement for the Sale and Purchase of Royalty Oil from the Cook Inlet Basin" between the State of Alaska and Tesoro-Alaska Petroleum Company, dated February 22, 1983 be APPROVED.

Board Member RICHARD LYON moved the adoption of the Resolution. Board Member Fred Bostrom seconded. The vote was as follows:

APPROVE

DISAPPROVE

R. Trumbull
John R. Rodewich
John
Fred Bostrom

STATE OF ALASKA

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

BILL SHEFFIELD, GOVERNOR

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

February 23, 1983

Mr. Don Wold
Executive Director
Alaska Royalty Oil and Gas
Development Advisory Board
620 E. 10th Avenue
Anchorage, AK 99501

Dear Mr. Wold:

I have enclosed, for the consideration of the Board, findings and a signed contract for the long-term disposition of Cook Inlet royalty oil to Tesoro Alaska Petroleum Company. The contract has been reviewed by the Attorney General's Office. Our intention is to submit a bill approving the contract to the Legislature 30 days after you have received these documents.

I have previously transmitted to you the enclosed findings in draft form, including my rejection of the offers of Union Oil and Chevron USA for the Cook Inlet royalty oil, and my intention to waive competitive bid under AS 38.05.183(c).

Thank you for your cooperation. I look forward to the Board's review of the enclosed materials, which are the result of the solicitation issued by the Department in 1982 as a result of discussions with the Board.

Please let me know if I may be of assistance in any way.

Sincerely,

Esther C. Wunnicke
for Esther C. Wunnicke
Commissioner

cc: Lennie Boston
Robert Maynard
Kay Brown

RECEIVED
FEB 28 1983

ALASKA ROYALTY
OIL & GAS BOARD

COOK INLET ROYALTY CRUDE

AGO 786646

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FEB 28 1983

ALASKA OIL & GAS BOARD
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 Cook Inlet 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:

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 projects 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 State currently receives royalty oil from four oil fields in the Cook Inlet basin. These fields have been in decline since the early 1970's; royalty production currently totals approximately 8,200 barrels per day (b/d), and is anticipated to decline to approximately 6,900 b/d/ in 1984 and 2,700 b/d by 1990. In February 1969, Commissioner of Natural Resources Thomas E. Kelley signed an eight-year contract with the Alaska Oil and Refining Company. The contract required the in-state processing of up to 15,000 b/d or royalty oil. Alaska Oil and Refining Company merged into the Tesoro Petroleum Company in July of that year, and constructed a refinery in Nikiski for the manufacture of gasoline, kerosene, and diesel from Cook Inlet crude.

In 1977, Tesoro requested a one-year contract extension, which was granted in March, 1978. In 1978, Tesoro requested a five-year extension, which was approved by the commissioner and legislature. The current termination date for the Tesoro contract is December, 1983.

In November, 1982, the Royalty Board recommended that the commissioner issue a competitive solicitation for the disposition of Cook Inlet royalty oil. Pursuant to that recommendation, a general notice of the prospective availability of Cook Inlet royalty oil was issued and published during that month. Union Oil, Chevron U.S.A. and Tesoro Alaska Petroleum Company (TAPC) each expressed an interest in obtaining the oil. For the reasons explained below, TAPC has been selected as the successful applicant for Cook Inlet royalty oil.

Union Oil Company of California

Union submitted a proposal for the purchase of the full volume of the State's Cook Inlet area royalty oil commencing January 1, 1984. The contract term which was proposed was for the period of five years and the price offered to be paid by Union for the royalty oil would have been Union's posted price. This proposal was nonresponsive to the State's needs since it did not offer (1) a price equal to an in-value price; (2) in-state refining or processing; or (3) a term of significant duration.

Chevron U.S.A.

Chevron U.S.A. also submitted a proposal for the entire volume of Cook Inlet royalty oil commencing January, 1984.

The term offered was six years but they were open for consideration to other periods. The price term was that which the State would have received if the State has taken the oil in-value and the additional consideration offered was to make available for sale in Alaska Chevron's historic level of aviation gasoline during the term of the Cook Inlet royalty oil contract. Chevron's promise of aviation gasoline is significantly less than the amount of products which would be produced from the amount of Cook Inlet oil products taken. Further, they made no promises regarding grades (e.g., guaranteed 80/87) nor would they agree to provide it if they do not make it in California. While the proposal represented an adequate term and the in-value price, the overriding consideration and benefits offered by Tesoro of in-state refining made it the overwhelming preference.

Tesoro Alaska Petroleum Company

Tesoro Alaska Petroleum Company (TAPC) submitted a proposal for the entire volume of Cook Inlet royalty oil commencing January, 1984. The term offered was eleven years and the price term was the weighted average price which the State would have received had it taken the oil in-value.

In addition, TAPC was willing to commit to manufacturing the Cook Inlet crude oil in their Nikiski refinery. The commissioner's expressed intention was to sell the Cook Inlet royalty oil to someone capable of processing the crude within the State. Tesoro met that goal as well as having the most realistic term, meeting the in-value price requirement, and offering an investment premium. TAPC agreed, in addition to the in-value price to be paid, to make cumulative capital investments in Alaska relative to their refining, marketing, transportation, or terminalling activities during the term of the contract equal to ten cents per barrel for each barrel of crude oil purchased under this contract. The expected contribution to employment, ancillary industries, and local tax bases (or, alternatively, to the State treasury) was a significant factor.

In addition, the sale of Cook Inlet oil to TAPC will not be a "net" sale of oil. In 1981, the state sold ANS oil to TAPC. The amount sold was 46,000 b/d minus the amount of Cook Inlet oil sold to TAPC. At present, the State sells about 37,000 b/d of ANS and 9,000 b/d of Cook Inlet oil to Tesoro. Therefore, if the State does not sell this oil to TAPC, it will have to increase its ANS delivery to TAPC. By selling Cook Inlet oil to TAPC, however, the State frees up an equal number of barrels of its ANS crude for other sales. In contrast, a sale to anyone besides TAPC will decrease available royalty oil to be sold.

Findings and Determinations

(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 the state's royalty share of Cook Inlet crude oil production 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 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. For that reason, 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 with respect to the proposed disposal to TAPC:

The cash value is the Producers' weighted average field price, plus a ten cent (10c) per barrel premium for capital investments. Therefore, as discussed above the cash value is equivalent to, and above, that 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 ensure the continued operation of the refinery with attendant employment and tax base benefits for the term of the contract. Crude oil products would be processed

in-state, insuring that industries dependent on those products would likely have adequate supplies.

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 the Cook Inlet 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 continued operation and expansion of the Nikiski refinery with attendant payroll and secondary benefits would have a positive and desirable effect on the citizens of the State.

The potential adverse social impacts, adverse governmental costs and responsibilities, adverse private impacts, and adverse environmental effects from consummating the proposal are negligible, if any, since the facility is already in existence. In fact, the effects of the proposed disposal upon existing commercial private enterprise and patterns of investments could only be beneficial because of the continued operation and expansion of Nikiski refinery and the continued supply of TAPC products to the State.

For the foregoing reason, 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
Esther C. Wunnicke, Commissioner
Department of Natural Resources

February 22, 1983
Date

STATE OF ALASKA
FISCAL NOTE

Revision Date _____, 1983

I. REQUEST

Bill/Resolution No.: HB 320
 Title: Approving Cook Inlet royalty oil agreement
 Sponsor: Governor
 Requestor: Governor

II. FISCAL DETAIL

Agency Affected: Natural Resources
 Program Category Affected: Mgmt. of Energy
 BRU, Program of Subprogram(s) Affected: Oil & Gas Mgmt.

EXPENDITURES/REVENUES: (Thousands of Dollars)

	FY 83	FY 84	FY 85	FY 86	FY 87	FY 88
OPERATING						
100 PERSONAL SERVICES						
200 TRAVEL						
300 CONTRACTUAL						
400 COMMODITIES						
500 EQUIPMENT						
600 LAND & STRUCTURES						
700 GRANTS, CLAIMS, ETC						
TOTAL OPERATING	0	0	0			
CAPITAL						
REVENUE						

FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER (Specify Source)						
	0	0	0			

POSITIONS:

FULL-TIME						
PART-TIME						
TEMPORARY						
	0	0	0			

III. SOURCE OF FUNDS TO OFFSET FISCAL IMPACT OF BILL:

IV. ANALYSIS: Attach a separate page for any Analysis

Prepared By: Mark Wittow *Mark Wittow* Phone: 465-2400
 Division: Commissioner's Office, DNR Date: 3/30/83
 Approved Commissioner: Maurice Loran Date: 3/30/83
 Department: Natural Resources

Distribution:

Original to Legislative Finance
 Copy to Office of Management and Budget (for Legislature introduced bills)
 Copy to Department (for Governor introduced bills)
 Copy to Sponsor

AGO 786653

HB 319

limit would allow the authority to operate for at least another year without the necessity for an additional adjustment to the statutory limit.

Sincerely,

/s/ Bill Sheffield

Bill Sheffield
Governor

HB 320

HOUSE BILL NO. 320 by the Rules Committee by request of the Governor, entitled:

"An Act relating to the sale of royalty oil by the State of Alaska to the Tesoro Alaska Petroleum Company; and providing for an effective date."

was read the first time and referred to the Joint Committee on Oil and Gas for review and comment, and the Resources Committee.

A zero fiscal note accompanied HB 320.

The Governor's transmittal letter dated March 31, 1983, follows:

Dear Mr. Speaker:

Under the authority of art. III, sec. 18, of the Alaska Constitution, I am transmitting a bill which provides for legislative approval of a royalty oil contract between the state and Tesoro Alaska Petroleum Company for the sale of Cook Inlet royalty oil.

This contract is described in the findings entitled "Proposed Disposition of Royalty Oil, Tesoro Alaska Petroleum Company" issued by the Department of Natural Resources on February 22, 1983. Copies of these findings have been made available to the legislature and the public for review.

HB 320

This contract is being submitted for legislative approval for two reasons. First, although this and the previous administration have consistently taken the position that the statutory requirement of legislative approval of royalty oil contracts is unconstitutional (AS 38.06.055), as a matter of comity I respect the legislature's desire to have a direct voice in major dispositions of royalty oil. Therefore, this contract contains provisions requiring approval by the legislature before it becomes effective. Second, this bill would ratify the agreement for the sale of oil. This ratification would cure any procedural defect that may have occurred in the process of entering into this contract.

Although we believe that all necessary steps have been taken, the statutes and regulations governing the disposal of royalty oil represent often conflicting desires and goals, both procedural and substantive. For example, even if statutorily requiring legislative approval were constitutional, the present statutes provide, on the one hand, that the legislature is to approve the contract by enacting legislation (AS 38.06.055), but, on the other hand, they also provide that a report of the Royalty Board "shall be submitted for legislative review at the time of [sic] resolution for legislative approval of a proposed disposition of royalty oil and gas is introduced in the legislature" (AS 38.06.070(c)). Since legislative approval is required anyway as a matter of contract, I believe it only prudent to present this contract for legislative approval and ratification at this time.

Sincerely,

/s/ Bill Sheffield

Bill Sheffield
Governor

HB 321

HOUSE BILL NO. 321 by the Rules Committee by request of the Governor, entitled:

RECEIVED
FEB 28 1983

AGREEMENT FOR THE SALE AND PURCHASE OF ALASKA ROYALTY
ROYALTY OIL FROM THE COOK INLET BASIN OIL & GAS BOARD

THIS AGREEMENT, entered into as of the 22nd day of
February, 1983, by and between THE STATE OF ALASKA
("Seller") and TESORO ALASKA PETROLEUM COMPANY ("Buyer").

ARTICLE I

DEFINITIONS

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

1.1 "Commissioner" means the Commissioner of 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 below-listed oil and gas leases
located within the State of Alaska:

ADL-17579, ADL-17586, ADL-17587, ADL-17594, ADL-17595,
ADL-17597, ADL-17602, ADL-18716, ADL-18729, ADL-18730,
ADL-18731, ADL-18742, ADL-18744, ADL-18746, ADL-18754,
ADL-18756, ADL-18758, ADL-18761, ADL-18772, ADL-18776,
ADL-18777, ADL-21068, and ADL-35431.

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 mean crude petroleum oil and other hydrocarbons, regardless of gravity which are produced and saved in liquid form at the well or its separator by ordinary production methods and this agreement does not cover natural gas or any liquified products separated from natural gas by other than conventional lease oil and gas separators.

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 "Capital Investment" means the expenditure of funds for an asset which benefits future periods or which would extend the useful life of an asset beyond the asset's original life. Capital Investment does not include normal maintenance or operating expenses.

ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity. Seller agrees to sell to Purchaser and Purchaser agrees to buy from Seller 100.00% of the Daily Royalty Oil from the "Leases" ("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.

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. That Purchase Price shall be determined by Seller based upon the reports submitted by the Lessees for production, severance, 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 Purchase Price will be the calculation of an amount per barrel equal to the per barrel volume weighted average of the in-value prices as reflected by information submitted by the Lessees for production, severance, or other tax purposes.

In the event that the tax reports no longer adequately reflect the amount that the State would have received from its lessees for the crude oil sold to purchaser hereunder, then at the request of either party, the parties shall meet to negotiate the revisal of the price term of this Agreement.

Any such request shall be made in writing and sent by registered mail, telegram, or telex, pursuant to Section 12 hereof.

The first meeting shall take place within fifteen (15) days from the receipt of said notice.

The parties shall have thirty (30) days from the receipt of said notice to reach an agreement over the alteration(s) to be made to the Agreement.

If the parties reach an accord within the time period of thirty (30) days, the alteration(s) which have been decided shall become effective on the first day of the month following the month during which the agreement has been reached.

If on expiration of the thirty (30) day period no agreement between the parties has been reached, then in such event either party shall have the option to terminate this Agreement, subject to the provisions of Article VIII.

Pending, or in the absence of, any agreement between the parties, the price to be in effect shall be the arithmetic average of the following postings for Cook Inlet Crude Oil: (1) Arco, (2) Union of California, (3) Chevron and (4) Mobil.

In settlement of litigation over various claims between and among the State, Purchaser and the eleven (11) companies holding lessee interests in twenty-three (23) specific oil and gas leases (listed below) issued by the State in the Cook Inlet Basin, the State, Purchaser and each of those Lessees agreed to various cash payments between and among themselves and to the establishment of certain "Platform-to-Shore Charges" and "C & D Allowances" under the terms of the settlement agreements, which were approved by the Court and made final in the Court's orders

dismissing the litigation. These "Platform-to-Shore Charges" and "C & D Allowances" arose solely under the explicit terms of the settlement agreements; and the full consideration for them was the settlement and compromise of the various claims being then litigated, upon the terms set forth in the settlement agreements. The State and Purchaser reaffirm the separate nature of these costs from this Agreement and from any other lease, contract or agreement of any kind (other than the settlement agreements); and the "Platform-to-Shore Charges" and "C & D Allowances" established by those settlement agreements shall, if applicable, be paid, without regard to any provision hereof and without effect on any price to be paid hereunder to the State by Purchaser. The leases to which the settlement agreements apply are:

ADL-17579, ADL-17586, ADL-17587, ADL-17594, ADL-17595,
ADL-17597, ADL-17602, ADL-18716, ADL-18729, ADL-18730,
ADL-18731, ADL-18742, ADL-18744, ADL-18746, ADL-18754,
ADL-18756, ADL-18758, ADL-18761, ADL-18772, ADL-18776,
ADL-18777, ADL-21068, and ADL-35431.

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 Capital Investment Premium. Purchaser agrees, in addition to any other consideration paid to Seller, to make cumulative capital investments in Alaska relative to Purchaser's refining, marketing, transportation or terminalling activities during the term of this Agreement equal to ten cents (\$.10) per barrel for each barrel of crude oil purchased under this Agreement. The Capital Investment Premium may be accumulated by Purchaser and expended either in parcels or in total at any time during the term of this Agreement. If at the expiration or termination of this Agreement the Purchaser has not made cumulative Capital Investments greater than, or equal to, the accrued Capital Investment Premiums to the date of expiration or termination, the amount of under investment will be paid directly to the Seller within one hundred twenty (120) days of such expiration or termination.

2.5 Points of Delivery. Delivery and receipt of all Royalty Oil purchased hereunder shall be at the point or points where such oil is delivered to the Seller by its Lessees, subject to all rights and obligations the State may have under any oil and gas lease subject hereto or other agreements hereafter made between the State and the Lessees; provided, however, nothing in this Section shall authorize any reduction in the price to be paid by Purchaser pursuant to Section 2.3 hereof, and no such other agreement hereafter made by the State and its Lessees shall diminish Purchaser's rights hereunder.

2.6 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.

2.7 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.

2.8 Transportation Arrangements. Purchaser shall make all necessary arrangements for transporting the oil sold under this Agreement from the Point of Delivery. 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.

2.9 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.

2.10 Date of First Delivery. On January 1, 1984, or seven months after statutory approval as set forth in Article VI, whichever is later, Seller will tender to Purchaser at the Point of Delivery the Quantity.

2.11 In-State Processing. Purchaser agrees that any and all of the Royalty Oil tendered under this Agreement shall be processed through Purchaser's refinery near Kenai, Alaska, or shall be exchanged for other crude oil which shall be processed at that refinery. "Process" means producing oil products in significant quantities, but which quantities may not be less than 40% 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 under 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 or exchanged 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 or the oil exchanged for 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. Purchaser agrees to use its best efforts to produce and market in Alaska an amount of crude oil products not less in volume than 40% 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. [

~~_____~~
~~_____~~
~~_____~~
~~_____~~
~~_____~~
] 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

Handwritten:
Kell
W/low

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.

2.14 Refinery Modification. In the event that the Purchaser modifies the Purchaser's refinery near Kenai, Alaska, to process one hundred percent (100%) Alaskan North Slope crude oil, the Purchaser will notify the Seller nine (9) months in advance of

the date when one hundred percent (100%) Alaskan North Slope crude oil could be processed in the refinery. Upon such notification, the Seller will have a one-time option to terminate the Agreement at the end of the nine (9) months notification period or continue the Agreement relieving the Purchaser, however, from the obligations imposed by Sections 2.11 and 2.12.

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 one hundred twenty (120) days thereafter, Purchaser will furnish to Seller, at Purchaser's sole cost and expense, complete financial statements, reflective of Purchaser's financial condition, 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 or the oil exchanged for the Royalty Oil. 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 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.

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 that 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 Petroleum Coke. 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
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 in the Cook Inlet Basin area of 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 point of delivery 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 accordance 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 Payment. 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 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.

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. The amount of all sums which are 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 seven (7) months after the above approval or January 1, 1984, whichever is later, 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 non-performance continues for more than thirty (30) days after Seller has notified the Purchaser of Purchaser's non-performance; 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.

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 Buyer'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 Article 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 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:

ARTICLE VIII

DISPOSITION OF OIL

8.1 Disposition of Oil Upon Default or Termination.

Purchaser acknowledges and agrees that under the Leases Seller's election to take Royalty Oil in kind may be revoked or reversed; and in certain instances, only upon the satisfaction of various conditions, including the giving of notice to return all or part of Seller's then current nominations. 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.

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 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, 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

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 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 fee amount of the letter of credit shall initially be Fourteen Million Dollars (\$14,000,000). 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 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 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 more 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 federal or state 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 (1) 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 twelve (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 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 non-residents when residents falling within one (1) 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.

16.5 Collective Bargaining Agreements. 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 Non-Discrimination. 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 non-resident of similar qualifications in employment covered by a collective bargaining agreement;

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

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

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

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;

(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.

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

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

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

of such 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. None of the above shall empower the Commissioner to determine the price of the crude oil, should such price become subject to renegotiation pursuant to Section 2.3.

DATED this 22 day of February, 1983.

SELLER: THE STATE OF ALASKA

Esther C. Whinnicke
Commissioner,
Department of Natural Resources

PURCHASER: TESORO ALASKA PETROLEUM COMPANY

By James F. Smith
James F. Smith,
President

W. H. W.
LAW



Tesoro Alaska Petroleum Company

March 15, 1983

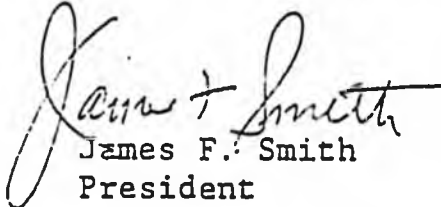
Ms. Esther C. Wunnicke,
Commissioner
State of Alaska
Department of Natural Resources
Pouch M
Juneau, Alaska 99811

Dear Commissioner Wunnicke:

Please find enclosed a fully executed original of the Letter Agreement between the State of Alaska and Tesoro Alaska Petroleum Company concerning third party control of Tesoro.

A copy of this letter has been retained for our records.

Yours very truly,


James F. Smith
President

JFS:pw

AGO 786697 +

STATE OF ALASKA

BILL SHEFFIELD, GOVERNOR

DEPARTMENT OF NATURAL RESOURCES

OFFICE OF THE COMMISSIONER

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

March 12, 1983

Mr. James F. Smith
President
Tesoro Alaska Petroleum
Company
8700 Tesoro Drive
San Antonio, Texas 78286

Dear Mr. Smith:

On March 12, 1983, the State of Alaska and Tesoro Alaska Petroleum Company ("Tesoro Alaska") entered into an Agreement for the Sale and Purchase of Royalty Oil (the "Agreement"). Article 7.5 of the Agreement provides that the State may elect to terminate the Agreement in the event that a "third party" obtains "control" (as such terms are defined therein) of Tesoro Alaska or its parent, Tesoro Petroleum Corporation ("Tesoro").

During the negotiations which led to the execution of the Agreement, you informed the State that, on January 26, 1983, two Charter Security Life Insurance Companies, subsidiaries of The Charter Company ("Charter"), had entered into a Purchase Agreement, a Stockholders Agreement, a Registration Rights Agreement and a Certificate of Designation Establishing A Series of \$2.20 Cumulative Convertible Preferred Stock (the "agreements") with Tesoro to purchase 2,875,000 shares of a new series of Cumulative Convertible Preferred Stock of Tesoro. Furthermore, those agreements contemplate that the Charter Security Life Insurance Companies or other companies affiliated with The Charter Company may purchase additional shares of Tesoro so that The Charter Company and companies affiliated with The Charter Company may own up to 30 percent of the voting interest in Tesoro. You also informed us that the Charter Security Life Insurance Companies will be entitled to up to three seats on Tesoro's Board of Directors, depending upon the size of Tesoro's Board.

AGO 786698

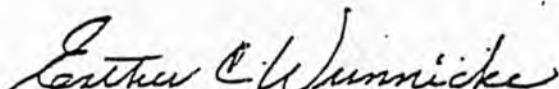
Mr. James F. Smith

-2-

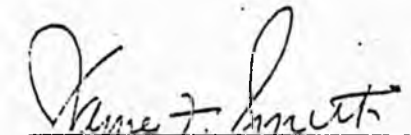
March 12, 1983

The purpose of this letter is to set forth the understanding and intent of the State and Tesoro Alaska with respect to the application of Article 7.5 of the Agreement to the contemplated relationship between Charter and Tesoro. If the arrangements described in the preceding paragraph are effected, it is the understanding and intent of the parties that Charter and/or its affiliates will not control Tesoro or Tesoro Alaska within the meaning of Article 7.5 of the Agreement. If, however, Charter and/or its affiliates materially increases its or their ability to direct or cause direction of the management and policies of Tesoro or Tesoro Alaska over that contemplated in the agreements, Article 7.5 will be applicable.

Sincerely,


Esther C. Wunnicke
Commissioner

ACCEPTED AND AGREED TO:



James F. Smith, President
Tesoro Alaska Petroleum Company

WFS
LAW

AGO 786699

CONTENTS OF FILE
ON
ROYALTY OIL CONTRACTS

- A) COPY OF REMARKS BY TESORO REPRESENTATIVE
- B) COPY OF REMARKS BY CHEVRON REPRESENTATIVE
- C) MEMO OF EXPLANATION ON CONTRACTS
- D) COPY OF LETTER OF AGREEMENT FROM TESORO
- E) COPY OF HB 320 WITH FISCAL NOTE AND GOVERNOR'S TRANSMITTAL LETTER
- F) COPY OF HB 370 WITH FISCAL NOTE AND GOVERNOR'S TRANSMITTAL LETTER
- G) COPY OF HB 371 WITH FISCAL NOTE AND GOVERNOR'S TRANSMITTAL LETTER
- H) COPY OF STOCKHOLDERS AGREEMENT BETWEEN CHARTER AND TESORO
- I) COPY OF CONTRACTS, WITH COMMISSIONER WUNNICKE'S COVER LETTER
- J) RESOLUTIONS FROM ROYALTY OIL BOARD

MEMORANDUM

State of Alaska

TO: Esther Wunnicke
Commissioner
Department of Natural Resources

DATE: May 5, 1983

FILE NO:

TELEPHONE NO: 465-3600

FROM: Norman C. Gorsuch
Attorney General

SUBJECT: Overview of royalty
oil contract terms

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

The state's royalty oil contracts are unique. Normally, oil sales contracts are for cash or equal amounts of oil, are for a relatively short term (three months to one year), and are very short documents (usually no more than three or four pages). In fact, large sales of oil are often accomplished merely by exchanging telex's, with industry custom filling in all non-expressed terms of the agreement. The flexibility of each company to respond to changes and conditions and the concern solely with price and quality of the oil sold allows these contracts to be generally sufficient. In addition, even the longer term contracts (up to five years) have clauses that allow either party to get out the contract, usually after each quarter, if they cannot continue to agree on the price of the oil sold.

The state's contracts, on the other hand, are unique in that not only are they long term (11 to 25 years), but also they have extensive and detailed provisions. The reason for the general difference is that the state is not in the oil market with the same goals as private companies. Nor does the state have a private company's flexibility.

Also, the state is much more risk adverse than the normal oil company. About 40 percent of total state revenues derive from the money the state gets for its royalty oil. Whereas a private company is often willing to "gamble" on making greater profit, the state interest is often more conservative.

Without taking "in-kind", the state would receive what the producers receive when they market their own oil. These companies, primarily Exxon, Sohio, and Arco, have large and expert marketing staffs and are generally able to approach or exceed the values the state could receive over the long term by a

similar marketing effort. Therefore, if the state decides to take its oil in kind it is making a decision that it can get greater consideration for its oil when it sells than the companies as a whole receive when they market their oil. Under certain circumstances this can occur, but it must occur either through unusual circumstances or through the offering of a benefit for the sale of royalty oil that the companies do not offer when they sell their oil in the normal commercial transaction.

In any event, the state is otherwise guaranteed a certain level of revenues from royalty oil when it leaves it with the producers. Taking the oil in kind not only puts an element of risk upon the state that the state should try to minimize, but also entails other problems that make the sale of the royalty oil a more complicated transaction. One of these considerations is that the state as a government has procedures for the sale of oil that bind its flexibility much more than that of a private oil company. For example, the constitution gives the legislature the power to set the terms and conditions of royalty oil sales. The legislature in the past has not given (and there are strong arguments why it should not give) complete discretion and flexibility to one state official in daily transactions for the sale of 40 percent of the state treasury. The delegation of that much control and authority in such a high risk area has been viewed by the legislature as too much of a gamble. Consequently, the statutes set forth a very detailed and, to a private company, cumbersome procedure before the state can commit any significant quantities of royalty oil.

Another practical problem is that it would be extremely difficult for the state to duplicate the marketing expertise of the individual oil companies. First, large staffs would have to be manned with experts in the area. It is doubtful that the state could be able to hire those expert traders on a state salary system. The only alternative would be to hire those experts by contract or to give them a percentage of the transaction.

Even so, the state also doesn't have the backup facilities or expertise in the other aspects of oil transportation and sale that the majors have acquired. The state does not have the ability to instantaneously take oil from or give oil back to the producers -- instead, the state must give six months notice before it can force the producers to either give the state oil or take oil back in case of a problem. Consequently, the state must be prepared to arrange for or invest

in tankers, storage facilities, or other backup systems that would be necessary to handle oil on any emergency basis.

Because of these and other considerations, the state has not attempted to enter the day to day oil marketing business in the same manner as the rest of the industry. Not only would it be difficult to consistently outperform the majors in that type of business transaction, but also there are practical and political barriers to the state attempting to run its royalty oil business in that manner.

Instead, the state has attempted to take advantage of unique conditions for the sale of oil or has attempted to offer a unique advantage to the purchaser of royalty oil that that purchaser could not receive in a normal commercial oil transaction. The occurrence of conditions for the short term sale of royalty oil for greater cash consideration are few and far between -- they usually depend upon holes in the market created by government regulation (e.g., government price controls and entitlements). And, those short term sales are only available for relatively small volumes (20 to 50 thousand barrels a day) of oil. Examples of the state taking advantage of unique conditions for a sale are the 1979 sale back to the producers of royalty oil for the ceiling price (which netted the state approximately three to four hundred million dollars) or the auction of state royalty oil in 1980, which ultimately netted the state approximately 60 to 70 million dollars (even with the various bankruptcies and some companies walking on the state contracts).

Otherwise, there is only one unique advantage the state can offer in the world oil market -- a long-term royalty oil contract. The state is the only place in the world where a purchaser can receive a long-term guaranteed supply of oil from a secure source of supply. That guarantee of a long-term supply has some, often unquantifiable, worth which the state can lever into additional consideration above the market value of the oil itself (since market value is determined by the relatively short-term sales of Prudhoe Bay oil).

In offering long-term contracts, however, the state entered into an area for which there was no real precedent. There were no form contracts or proven provisions for long-term oil contracts. As has been seen in the last decade in the oil markets, there are many unknown changes in world circumstances which will occur over the term of the contract. Thus the contract would have to anticipate possible problems and protect the state in the event that an unknown danger arose. Not knowing the exact nature of that unknown condition made the task much

more difficult. In addition, because of the relatively cumbersome procedures for disposing of royalty oil, the state has much less flexibility in amending a contract when problems arise in the future.

One example of this problem is the determination of a price for the oil over the long-term. The price of world oil has gyrated wildly just in the past six years. Negotiating a price term without the benefit of price reopeners over the long-term is a difficult task -- no outside referent (such as OPEC postings, product worth, etc.) has proved to be a reliable guide for the value of Prudhoe Bay oil from year to year. Thus in negotiating for the additional consideration for the long-term nature of the contract, the state must first identify the base consideration that it would otherwise have received for those years. In other words, whether or not the state wishes that additional consideration be in cash or in non-monetary benefits (e.g., in-state processing or in-state supply), a key term is the underlying base consideration representing the short-term value of royalty oil for any particular year. An additional, and extremely important consideration here is that the monetary income for the base price of the royalty oil is a large component of total state revenues. Thus the price term that must be picked should not carry with it the risk of the state receiving less for its oil than it would have if it never entered into a royalty contract at all.

The only price term which accomplishes these purposes is tying the base of the royalty oil to that which the state would have received from the producers if it had continued to take the oil in value rather than in kind. This term would rise and fall over time in proportion to the other sales of North Slope crude oil, and thus be in line with the short-term value of that royalty oil. At the same time it would leave the state in the exact same position as if it had never taken the oil in kind at all.

Therefore the base price for the royalty oil contracts is the "in-value" price term. If the state wishes to take the additional consideration for the long-term nature of the contract in cash, the state would ask for a premium above the in-value price (for example, the in-value price plus thirty cents). If the state wanted non-monetary consideration, it would simply ask for the in-value price and then provide for that non-monetary consideration in other parts of the contract (for example, requiring that the oil be processed in state).

As a general matter, the bulk of the royalty oil contract, and all of the terms of the contract which are unique to the state's sale of oil, revolve around the long-term nature of that contract. On the one hand are those terms which deal with the additional consideration be given to the state because of the long term nature of the contract.

On the other hand are those terms which protect the state from potential adverse consequences of entering into a long-term royalty oil contract. These derive not only from the unknowns which would arise from entering into a contract over a number of years, but also the problems that the state faces from its lack of flexibility if an emergency should arise.

These terms in effect shift the risk of unknown conditions or adverse consequences from the state to the purchaser. It must be emphasized that these terms also represent "consideration" to the state for entering into a long-term contract. As an example, if the benefit of a long-term contract to purchaser is equal to one dollar, terms protecting the state from adverse consequences over the long-term might be worth 40 cents of that dollar (like paying for insurance), leaving the additional consideration available for the cash portion of the price term to be only 60 cents. In other words, every time the state insists on being protected from adverse consequences, it reduces the state's ability to demand greater benefits for in-state benefits or cash from the purchaser.

And, as a matter of policy, the state has decided that if it is to make concessions in the negotiation process, it would make no concessions on those provisions which protect the state from adverse consequences. Consequently, the state, if necessary, would make some concessions in the area of guaranteeing the additional benefits, and make many more concessions on those relatively minor benefits that might be added to the contract. For example, the state would not budge from the stringent guarantees that would require the purchaser to pay the in-value price or guarantee its payment (e.g., a letter of credit for 60 days worth of oil which would require no documentation whatsoever to be submitted for instant payment except for the signature of the Attorney General and the Commissioner of Natural Resources). On the other hand, for in-state processing requirements the state was willing to give a little bit and make those provisions protections against abuse by the purchaser rather than absolute guarantees that certain goals would always be reached. In other words, the in-state processing and in-state supply provisions provide for minimum benchmarks that must be met, and rely upon market conditions in Alaska to

extract the greater benefits that may be realized. In the Tesoro ANS contract, for instance, the contract provides that all oil sold must be run through the plant, and at least 32% of that oil be converted to products marketed in Alaska. The proposed Tesoro plant, however, could produce a much higher percentage of product if Alaska demand required. The contract does not demand that higher percentage; rather, it relies on the market to realize that additional in-state use. It should be emphasized that these concessions were made in exchange for concessions by the purchaser to give the state protection against adverse consequences.

Specifically, there are four general types of provisions that the state has considered essential to protect its long-term interest. First, there are terms that insure that the state will be paid the amount that it would have received from the producers if it had not taken the royalty oil in kind, but instead had left the oil in value (the "in-value price). These include provisions that insure that in-value is the price paid, and assure the payment of that amount in case adverse circumstances arise. Provisions of the standard contract which implement these principles include Article 2.3 (price of royalty oil); Article 2.8 (absolute obligations); Article 5 (payments and accounting); Article 8.2 (inability to receive oil); Article 14 (sovereign power of the state); Article 12 (disposal of oil upon default or termination); Article 15 (security); Article 19 (amendment); and Article 23 (interpretations of terms and conditions).

Second, there are a group of terms which are designed to assure that the state is never in physical custody of the oil, or is otherwise left without someone to pick up the oil at Pump Station Number 1. First, such a situation might result in the state having to sell the oil at distressed prices without the hopes of ultimate recovery from a credit worthy party. Second, the state is simply not equipped, both legally and practically, to make instantaneous dispositions of oil on the spot market. Third, because of the limited storage capacity for oil at Valdez, it would not take very long for unlifted oil to back up at Valdez and potentially shut down the pipeline. Such an event would have disastrous consequences on all state revenues. In addition, this category of terms also provides that the state is never in physical custody of the oil: that the transfer of oil from the producers to the state and the state to its purchaser is an instantaneous transaction and that all risk passes to the purchaser at the time and point the state receives delivery of the oil. Thus these provisions provide that the purchaser must instantaneously accept delivery, that the state can force the

purchaser to take delivery under all imaginable circumstances, or that in an emergency the state can take the oil from a purchaser and sell to a third party without interference from the original purchaser (this is to prevent the purchaser from tying the disposition of oil during a disagreement). Examples of these provisions are Article 7 (default), Article 8 (disposition of oil upon default or termination), and Article 11 (force majeure).

A third category of provisions are those provisions that protect the state from the purchaser using an excuse or other legal argument to attempt to get out of their obligation to pick up the royalty oil and pay for it. Thus the state insisted on stringent conditions concerning default, force majeure, and provisions which would provide that the state would not warrant anything except that it had title to the oil. Examples of these provisions are Article 2.1 (quantity); Article 2.2 (quality); Article 2.4 through 2.6 (point and time of delivery, risk,); Article 4.1 (measurement); Article 18 (disclaimer of warranties); Article 7 (default or termination); Article 8 (disposition of oil); Article 2.8 (absolute obligation); Article 5.7 (late payment); and Article 5.3 (payment).

These provisions provide as close to complete protection as the state could reasonably devise by a contract. In addition, to cover the situation where the purchaser may argue that the contract might be ambiguous or vague when it attempted to be applied to some presently unforeseen event, the state insisted in Article 23 that such disagreements would first be resolved by the commissioner, and that the commissioner would make the initial determination of what the word, term, or application of that word, term or condition would be. In addition, the purchaser contracts to agree to accept that interpretation along as there is substantial evidence supporting the commissioner's findings, which is a standard of review similar to the limited review a court gives a finding of fact by a state agency when it is in its regulatory capacity. In addition, the state inserted some terms and conditions which would allow the state to monitor the purchaser's actions to see if there is any indication that the purchaser might be considering abandoning its obligations under the contract. Such provisions include Article 2.7 (transportation arrangements); Article 3.2 -- 3.3 (financial condition); and Article 22 (records).

In these areas the state insisted on extremely stringent conditions, and for the most part refused to consider any alteration even though it was recognized that these conditions would put burdens on the purchaser not matched any

where in the world under other oil contracts. These provisions were born from the experiences the state has undergone over the past seven years, including the present price dispute with the Alaska Oil Company, a previous bankruptcy of one of the state's purchasers (Energy Cooperative, Inc.), and the abandonment of the royalty oil contract by Alaska Petroleum Company. These terms were reviewed by outside counsel, who also suggested a number of the terms inserted in these contracts.

Although it is impossible to totally protect the state under all conceivable circumstances simply by a contract, there is little question that overall the state has the tightest oil contract in the world. Although this is a little like saying a person has the best sight in a room full of blind people (given the loose and flexible nature of almost all other oil contracts), it does provide a quantum level of increased protection for the state over any other oil contract known.

Like money spent for insurance, however, some premium must be paid by the insistence of the state upon such stringent conditions. Again, since the state was not willing to grant any concessions on terms it considered vital to protect it against risk, the state was not in a position to require as stringent provisions in the other terms of the contract dealing with the additional consideration. Thus in the in-state processing and in-state supply portions of the contract (the non-monetary consideration) the state was not able to insist upon stringent performance guarantees or other provisions which would require the purchaser to produce products in Alaska at a loss or break even point. Nor was the state in a position to insist upon levels of production or in-state processing which were above those reasonably required by Alaska market demand.

Instead, the in-state processing and supply provisions provided "sideboards" or minimum provisions that would protect the state against abuses by the purchaser from the intent of the contract. In other words, the state insisted that the oil be processed in an in-state refinery, that that refinery actually produce significant amounts of products, and that the purchaser otherwise exercise its best efforts to produce and market in Alaska some minimum quantity of oil products. The state left to the local demand the other economic decisions of the local refiner to increase production above that minimum quantity to either meet demand or increase market share.

Therefore, there are provisions in the contract which are designed to assure that to the extent the market in Alaska would support the economic processing and marketing of oil

products within the state, the oil sold to the purchaser would be processed and marketed in the state. Examples of these articles are Article 2.9 (date of first delivery -- in the Tesoro ANS contract); Article 2.10 (performance guarantee and reservation fee); Article 2.11 (in-state processing); Article 2.12 (best efforts); Article 3.5 (option to purchase resid). As a subsidiary matter, there are also provisions which are designed to assure that the purchaser is not asking or taking more oil than their in-state needs would require (and thus be actually used for some out of state benefit). Article 2.1 (quantity) and Article 2.10 (performance guarantee) are examples of those types of articles which are designed to assist in that goal.

Finally, the state negotiated for some additional benefits, but did not insist upon many guarantees of those benefits. These additional minor benefits could someday be very valuable, but were not considered the primary consideration for the long-term contract. Examples of these provisions are Article 3.4 (expansion); Article 3.6 (petroleum coke); and Article 16 (local hire).

RMM:jf

Cost of Oil to Western Alaska
Similar costs of gasoline