

ALASKA LEGISLATURE COMMITTEE FILES 1991-1992 8672
7654 SENATE RESOURCES

of the first month after the applicable notice period expires.

It is understood and agreed that the volume of Daily Royalty Oil available to the State 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. The State disclaims and Petro Star JV waives any representation, covenant or warranty, expressed 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. The State warrants that it has good title to the Oil tendered under this Agreement.

If the State underlifts or stores Royalty Oil at Kuparuk River Unit, or if the State recovers underlifted or stored Royalty Oil, the quantity of Oil tendered under this Agreement shall be calculated as if no Royalty Oil was underlifted or stored or recovered.

2.2 Quality. The Oil sold shall be the same quality as the Royalty Oil delivered by the Lessees to the State at the Point of Delivery. It is understood and agreed that the quality of the Oil sold may vary from time to time. The State disclaims, and Petro Star JV 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 Oil to be sold or tendered under this

Agreement. Petro Star JV expressly waives any claim that any liquid hydrocarbons made available to the State by the Lessees, including such substances as crude oil, condensate, natural gas liquids, or return oil from the Kuparuk River Unit Crude Oil Topping Plant, that may be blended with crude by the Lessees before the Point of Delivery and tendered as a common stream by the Lessees to the State as Royalty Oil are not Oil, for purposes of this Agreement.

2.3 Price of the Royalty Oil. The price each Month for Oil purchased under this Agreement shall be the average Royalty Value (weighted by production volume) for that Month of all Oil delivered from the Kuparuk River Unit production for which the Royalty Value is determined by the Royalty Settlement Agreements plus field costs. See examples attached as Exhibits A and B.

Field costs are those costs as defined in the Field Cost Agreement. If a field cost different from that in the existing Field Cost Agreement is established through future written agreement, or settlement or final resolution of any litigation, then that new field cost shall apply to the portion of the liquid hydrocarbons deemed not to be covered by the now existing Field Cost Agreement. In the interim, Petro Star JV agrees to pay the State the field costs claimed by the Lessees for any Royalty Oil taken by Petro Star JV. Any future field cost adjustments shall bear interest as provided in Section 5.6.

If any applicable law of the United States of America or any rule or regulation promulgated by a federal agency will,

in the judgment of the State, operate to prohibit or prevent the State from receiving the full amount due under the above provision, Petro Star JV'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 the State to comply with that law, rule or regulation.

2.4 Purchase Price Reopener. The State and Petro Star JV shall have the right to reopen this Agreement as to purchase price only. At any time after Petro Star JV receives Oil for two years from the Date of First Delivery (as defined in Section 2.11), the State or Petro Star JV may exercise the right to reopen by giving the other party one Month prior written notice. Upon issuance and receipt of a notice to reopen, Petro Star JV and the State will promptly commence good faith negotiations in an attempt to establish a new purchase price. If a new purchase price is not agreed to by Petro Star JV and the State within three Months after giving the notice to reopen, either Petro Star JV or the State may terminate this Agreement upon nine Months written notice to the other. The purchase price for Oil tendered during any period pending termination shall be determined in accordance with the price term in effect immediately before giving the notice of intent to reopen. If a new purchase-price provision is agreed to by Petro Star JV and the State, the new purchase-price provision shall become effective for Oil tendered in the Month following the written Agreement on the new purchase-price provision. Not less than two years after the conclusion of

the purchase-price reopener process described above, either Petro Star JV or the State again may reopen this Agreement, as to purchase price only, by giving notice of intent to exercise the right to reopen. At that time, the purchase-price reopener process described above may again be followed and every two years thereafter.

2.5 No Third-Party Intervention. Petro Star JV shall not voluntarily intervene or otherwise participate in any way regarding litigation, styled State of Alaska v. Exxon, et.al., Case No. 1-JU-77-847, ("ANS Royalty Litigation"), any future Royalty Settlement Agreements, or any reopeners or other discussions under or pertaining to Royalty Settlement Agreements. Any judgment resulting from the ANS Royalty Litigation, any future Royalty Settlement Agreements, or any reopener under any Royalty Settlement Agreement shall be conclusively binding upon Petro Star JV whether or not Petro Star JV agrees with or consents to the terms of any such judgment, settlement, or reopener. Furthermore, Petro Star JV has no independent right to invoke any of the provisions of any Royalty Settlement Agreement. If the Royalty Value is modified in the future as a result of a modification of any Royalty Settlement Agreement, a corresponding retroactive modification will be made to the price term of this Agreement and interest will apply to the modification, whether resulting in an overpayment or underpayment, as set forth in Section 5.6. Petro Star JV agrees to be conclusively bound by any such modification agreed to by

the State and BP or ARCO.

2.6 Point and Time of Delivery. Simultaneously with receipt of its Royalty Oil from its Lessees, the State shall tender the Oil to Petro Star JV at the point at which the State receives the Royalty Oil from its Lessees. That point as presently agreed to by the State and its Lessees in Section 2.3 of the Field Cost Agreement is the Central Production Facility Meter into the Kuparuk Pipeline.

2.7 Passage of Title and Risk of Loss. Title and risk of loss to the Oil sold under this Agreement shall pass from the State to Petro Star JV for all purposes when the State tenders the Oil at the Point of Delivery.

2.8 Petro Star JV's Responsibility. Petro Star JV shall be responsible for the Oil after passage of title. Petro Star JV will indemnify and hold the State harmless from and against any and all claims, costs, damages (including reasonably foreseeable consequential damages), expenses, or causes of action arising from or in connection with any transaction or event which relates to the Oil after title has passed to Petro Star JV.

2.9 Transportation Arrangements. Petro Star JV shall make all necessary arrangements for transporting the Oil sold under this Agreement from the Point of Delivery, including satisfaction of line fill obligations and storage tank bottom requirements of the Kuparuk Pipeline and of TAPS, if any. If requested by the State, Petro Star JV shall submit specific information concerning its arrangement for transportation of the

Oil sold under this Agreement through and away from the Kuparuk Pipeline and the TAPS and for the resale or other disposal of the Oil. Such information may include the specific tenders of Oil made to the Kuparuk Pipeline and TAPS and identification of tankers, if any, which will transport the Oil. In addition, Petro Star JV will provide the State, if requested by the State, with satisfactory evidence or reasonable assurance of the existence and continuing validity of adequate arrangements for the transportation or disposal of the Oil subject to this Agreement. Failure to provide information, evidence, or assurances requested will, at the State's election by notice to Petro Star JV, be a material default under this Agreement.

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

2.11 Date of First Delivery. The date of First Delivery will be the first Day of the first Month that is the later of (i) seven Months after the Effective Date or (ii) seven Months after Petro Star JV certifies that within seven Months the refinery will be ready to accept and process Oil. If requested by Petro Star JV, the State, in its sole discretion, may set an earlier date of First Delivery.

2.12 Performance Guaranty and Reservation Fee. If at any time, Petro Star JV does not take the Maximum Quantity, Petro Star JV shall pay to the State, in addition to the purchase price on the actual quantity taken, an amount equal to .75% of the purchase price per barrel per Day on the difference between the Maximum Quantity and the actual quantity tendered to and accepted by Petro Star JV for each Day Petro Star JV does not take the Maximum Quantity.

2.13 In-state Processing. Petro Star JV agrees that not less than 80% of the Royalty Oil sold under this Agreement, averaged on a quarterly basis, shall be processed through Petro Star JV's refinery near Valdez, Alaska, except as provided below. "Process" means producing refined petroleum products from the Oil in quantities not less than 20% of the volume of Royalty Oil run through Petro Star JV's refinery pursuant to this Agreement.

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

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

ARTICLE III

REPRESENTATION AND OBLIGATIONS OF PETRO STAR JV

Petro Star JV warrants, represents, and agrees:

3.1 Good Standing and Due Authorization. Petro Star Valdez, Inc., Alaska Refining Inc., Arctic Slope Regional Corporation, and Harbor Enterprises, Inc. are and at all times during the operation of this Agreement shall remain, corporations organized and existing under and by virtue of the laws of the United States or of any state, territory or the District of Columbia, and qualified to do business in, and in good standing with, the State of Alaska. Petro Star Valdez, Inc., Alaska Refining Inc., Arctic Slope Regional Corporation, and Harbor Enterprises, Inc. each have all necessary corporate power to enter into this Agreement and to perform the covenants and obligations under this Agreement. All necessary corporate action has been taken to authorize Petro Star Valdez, Inc., Alaska Refining Inc., Arctic Slope Regional Corporation, and Harbor Enterprises, Inc. entering into this Agreement and performing its covenants and obligations under this Agreement.

Petro Star Valdez Refinery Joint Venture is, and at all times during the operation of the Agreement, shall remain a joint venture consisting of Petro Star Valdez, Inc., Alaska Refining Inc., and Harbor Enterprises, Inc. Petro Star Valdez Refinery Joint Venture is organized and exists under and by virtue of the laws of the State of Alaska, and is qualified to do business in, and in good standing with, the State of Alaska. Petro Star

Valdez Refinery Joint Venture is authorized by and on behalf of Petro Star Valdez, Inc., Alaska Refining Inc., and Harbor Enterprises, Inc., to enter into this Agreement and to perform its covenants and obligations under this Agreement. All necessary acts have been taken to authorize Petro Star Valdez Refinery's entering into this Agreement and performing its covenants and obligations under this Agreement.

3.2 Financial Condition. The financial information submitted to the State is complete and correct and fairly presents Petro Star JV's financial condition at the time the information was submitted to the State. 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 Petro Star JV have not been materially adversely affected in any way. Petro Star JV agrees to inform the State immediately if there is any material adverse change in its condition, business, or properties which may have an appreciable adverse effect on its ability to perform under this Agreement. Petro Star JV, in addition, will immediately inform the State of any significant change in ownership of Petro Star JV, affiliates, parent company, and of any change in Petro Star JV's operations or Agreements, which may appreciably affect Petro Star JV's performance under this Agreement.

3.3 Financial Statements. As soon as possible after the end of each fiscal year of Petro Star JV, and in any event

within one hundred twenty Days thereafter, Petro Star JV will furnish to the State, at Petro Star JV's sole cost and expense, a report or a complete copy of a report in a form to be prescribed from time to time by the State which will include each of Petro Star JV's balance sheet as of the close of the fiscal year and the income statement for that year, prepared in each case in accordance with generally accepted accounting principles consistently applied by certified public accountants of recognized standing. For purposes of complying with this article in the first year of this Agreement, Petro Star JV may submit, and the State will accept, the annual report of the corporate parties to this agreement filed with the United States Securities and Exchange Commission pursuant to Sec. 13 or 15(d) of the Security Exchange Act of 1934.

ARTICLE IV

MEASUREMENTS AND TESTS

The quantity and quality of Oil sold under this Agreement shall be determined at the Point of Delivery. Procedures and methods for measuring and metering the Oil sold under this Agreement shall be in accordance with the practices then in effect at Kuparuk River Unit, Alaska, between the Lessees and the operators of Kuparuk Pipeline.

ARTICLE V

PAYMENTS AND ACCOUNTING

5.1 Billing. The State will send to Petro Star JV, on or before the tenth business Day of each Month after delivery of Oil, an invoice statement of account of all Oil estimated to have been measured at the Central Production Facility Meter into the Kuparuk Pipeline and tendered to Petro Star JV under this Agreement during the immediately preceding Month according to the best information available to the State, the estimated purchase prices applicable to those deliveries, and the total amount due ("Initial Billing"). The estimates will be made by the State according to the best information reasonably available to the State. The State may render its Initial Billing to Petro Star JV based in part upon information reported by the Lessees to the State, information published by the U.S. Government, and information published in Platt's Oilgram Price Report or any other publicly available report. The State shall thereafter adjust its Initial Billing under this Article as soon as more accurate information concerning the quantity and purchase price of Oil delivered each Month is available. The State, however, shall not be required to adjust the Initial Billing before the sending of the next Month's invoice statement of account.

5.2 Initial Adjustment. After the Initial Billing under Section 5.1, the next Monthly invoice will also state the State's initial adjustments to be made, if any, to the invoice rendered in the immediately preceding Month, in accordance with

any additional or more accurate information which may have become available to the State. Whether or not initial adjustments are made, however, subsequent adjustments may be made under Section 5.5.

5.3 Payment. Petro Star JV will make payment of each amount billed under this Article within ten Days after receipt of the invoice statement of account. Payment shall be made without any deduction, set off, or withholding, by wire transfer of immediately available funds to the State's account at the following address:

State Street Bank & Trust Company
Boston, Massachusetts
ABA #011000028
For credit to the State of Alaska
General Investment Fund, AY01
Account #00657189
Attn: Kim Chan, Public Funds

Payment may be made in such other manner or to such other address as the State 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 the State may bill, and that Petro Star JV will pay, amounts that are based upon confidential information held or received by the State. If confidential information is used as the basis for a billing, then upon request, the State will furnish Petro Star JV with the certified statement of the Commissioner that the amounts billed

are correct based upon the best information available to the State. If a dispute concerning a bill arises, Petro Star JV agrees to pay the full amount billed by the State, except for obvious clerical mistakes, pending final resolution of the dispute.

5.4 Payment to Lessee. Petro Star JV, at the request of the State in the invoice statement of account or otherwise in writing, shall pay all or any portion designated by the State 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 the State. The payment will be made within the time limit specified in Section 5.3. The State 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 Section 5.3.

5.5 Subsequent Adjustments. Petro Star JV acknowledges that after the Initial Billing and initial adjustment, more accurate information concerning the quantity of or purchase price for Royalty Oil tendered may become available to the State. If any such information should later become available to the State, it shall promptly furnish a corrected invoice statement of account to Petro Star JV and the State will adjust the amount billed; and Petro Star JV will pay, or the State will credit or refund the amount of those adjustments. If

the State should render a corrected invoice to Petro Star JV, any amount to be credited or refunded from the State to Petro Star JV or paid from Petro Star JV to the State will be refunded or paid within thirty Days after the date of the corrected invoice. The provisions of this Section 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 later determined to be due as an adjustment, shall bear interest from the date accrued until paid in full at the rate as provided in AS 38.05.135(d) or as may later be amended. Currently, that interest rate in a calendar quarter is at the rate of five percentage points above the annual rate charged member banks for advances by the 12th Federal Reserve District as of the first Day of that calendar quarter, or at the annual rate of 11 percent, whichever is greater, compounded quarterly as of the last Day of that quarter. The term "date accrued" means the date of the receipt of the "Initial Billing plus ten Days." Interest shall apply to both adjustments for overpayments and underpayments.

5.7 Late Payment Penalty. If Petro Star JV fails to make a full payment within ten business Days 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 actual payment, Petro Star JV will pay an amount equal to five percent of the amount owed. The late payment penalty is due at the time of the next Month's payment.

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

ARTICLE VI

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 December 31, 1993, or if Petro Star JV does not certify that it will within seven Months be ready and able to accept and process the Oil as required by Section 2.11 before December 31, 1993. Subject to the other provisions contained in this Agreement, State's obligation to sell and Petro Star JV's obligation to buy Royalty Oil shall begin as provided above, and shall end December 31, 2003. As used in this Article, "enactment of legislation" is as defined in AS 01.10.070(f)(4).

ARTICLE VII

DEFAULT OR TERMINATION

7.1 Default. If any one or more of the following events ("Events of Default") occur, then at the State's sole option, the State 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) At any time, Petro Star JV (a) repudiates any of its covenants or obligations under this Agreement, or (b) fails, within five Days, after written request from the State to provide the State with written affirmation of this Agreement and of Petro Star JV's intention to perform under this Agreement (together with evidence or assurances of transportation arrangements pursuant to Section 2.9 reasonably satisfactory to the State); or
- (ii) Petro Star JV does not pay in full any sum owed under this Agreement at the time when payment is due; or
- (iii) Petro Star JV fails to observe or perform any of its other covenants and obligations under Article II; or
- (iv) Petro Star JV does not perform any act required or contemplated under this Agreement

and: (a) the nonperformance cannot be cured;
(b) the nonperformance continues for more than thirty Days after the State has notified Petro Star JV of Petro Star JV's nonperformance; or (c) Petro Star JV had failed to perform the same or any other act required or contemplated under this Agreement during the immediately preceding twelve Month period; or

- (v) There is a material adverse change in Petro Star JV's condition, business, or property which may appreciably affect its ability to perform any of their obligations under this Agreement and Petro Star JV is unable or unwilling to give the State adequate assurance of continued performance either within five Days of a request for such an assurance or within such other shorter time period as the State may request under the circumstances; or
- (vi) Any representation or warranty made by Petro Star JV in this Agreement was materially false or incorrect when made.
- (vii) Petro Star JV's failure or inability for any reason (including reasons beyond Petro Star JV's control) to maintain the Security

described in Article XV, notwithstanding Petro Star JV's continuing willingness and ability to perform its other obligations and covenants under the Agreement.

7.2 Failure to Pay Debts. If Petro Star JV becomes unable to pay any of its debts when due, or should otherwise become insolvent (without regard to how that insolvency may be evidenced), Petro Star JV will immediately give notice of that fact to the State. Whether that notice is given, if Petro Star JV becomes unable to pay any of its debts when due or should otherwise become insolvent, the State's obligation to tender and sell Oil under this Agreement will automatically and immediately terminate without any requirement of notice or other action by the State; however, Petro Star JV will nevertheless be and remain liable for payment and performance of all its obligations and covenants under this Agreement with respect to Oil actually tendered by the State to and after any such termination. Within thirty Days after receipt of Petro Star JV's notice or, if no notice is given, after the State otherwise becomes aware (as determined in the State's sole discretion) of Petro Star JV's insolvency, the State will have the right, upon written notice to Petro Star JV, to reinstate all of the State's and Petro Star JV's obligations under this Agreement retroactively to the date of termination.

7.3 State's Remedies. If any Event of Default occurs or if the State's obligation to tender and sell Oil under this

Agreement is terminated or suspended, all Petro Star JV's obligations accrued but not otherwise due and payable under this Agreement will immediately be due and payable in full. In addition, Petro Star JV will indemnify and hold the State harmless from and against all other liability, damages (including reasonably foreseeable consequential damages), costs, losses and expenses (including reasonable attorney's fees and disbursements) incurred by the State and arising out of the Event of Default, termination, or suspension. The State 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.

Additionally, in its sole discretion, the State, upon occurrence of any Event of Default: (1) may dispose to third parties Royalty Oil to be tendered and sold under this Agreement and (2) may release Petro Star JV from the in-state processing obligations set forth in Article 2.13 until the Event of Default no longer exists or the obligation of Petro Star JV to take Oil under this Agreement expires. If the State disposes Oil to third parties, or if Petro Star JV is released from Article 2.13, whether or not this Agreement is terminated, Petro Star JV will nevertheless remain liable for the difference between the purchase price for that Oil under this Agreement and the price received by the State by disposition, including all of the expenses (including reasonable attorneys' fees and costs), and

losses incurred by the State arising out of the Event of Default or disposition.

7.4 Petro Star JV's Exclusive Remedies. Upon any breach of, or default in performance of any of the State's covenants or obligations under this Agreement, Petro Star JV agrees that its remedies will not include a temporary restraining order or preliminary injunction preventing the State from taking any action with regard to the Royalty Oil which is the subject of this Agreement.

ARTICLE VIII

DISPOSITION OF OIL

8.1 Disposition of Oil Upon Default or Termination. Petro Star JV recognizes that the State may be required to give six Months notice under the Unit Agreement (or ninety Days if the amount increased or decreased is less than ten percent of the then current nominations) to increase or decrease the amount of Daily Royalty Oil to be taken in-kind. Petro Star JV agrees that the State's election to invoke its rights to return to taking its Royalty Oil in-value on less than six Month's prior notice, or to attempt to secure a waiver of any condition or requirement, is at the State's sole discretion. Notwithstanding termination of this Agreement for any reason, Petro Star JV shall continue to take and purchase the State's Royalty Oil in the amount and for the price set forth in this Agreement for up to six Months following termination if the State, in its sole discretion, so requires.

8.2 Inability to Receive Oil. If for any reason Petro Star JV is unable or refuses to accept or receive any Oil tendered under this Agreement, Petro Star JV shall nevertheless be and remain responsible for the disposal of that Oil and for paying the State for the Oil as though it had been received and accepted by Petro Star JV unless the State, in its sole discretion, elects to waive this requirement. In order to secure the obligations of Petro Star JV under Section 8.2 and Section 2.10, Petro Star JV shall, if the State requests, assign to the State all right, title and interest of Petro Star JV under any nominations, Leases, Agreements, contracts, charter parties and other arrangements for the transportation of the Oil sold under this Agreement through and away from the Kuparuk Pipeline and the Trans Alaska Pipeline System; provided, that the State shall not have any liability or obligations under any such nominations, Leases, Agreements, contracts, charter parties or other arrangements unless, and to the extent that, the State shall actually exercise its rights to succeed to Petro Star JV's interest under them and shall obtain the benefits of them.

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

ARTICLE IX

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

If any provision or clause of this Agreement or application of this Agreement 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 Petro Star JV's obligations to pay for Oil tendered and to accept and

dispose of Royalty Oil, neither party shall be liable for any failure to perform when the failure is caused in whole or in substantial part, by force majeure. The term "force majeure" 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 Petro Star JV is excused or suspended by a force majeure for three hundred sixty-five successive Days or more, the State will have the right to terminate this Agreement. Before the State exercises its right to terminate, the State and Petro Star JV shall in good faith negotiate to restore the benefits and obligations that existed under this Agreement before the occurrence of the force majeure condition.

11.2 Responsibility. If a party believes that force majeure has occurred, the party shall immediately notify the other party of its claim of force majeure. If force majeure

occurs, that occurrence shall, so far as possible, be remedied with reasonable diligence. Except for Petro Star JV's obligations to pay for Oil tendered and to accept and dispose of Oil, the disabled party's obligations to perform that are affected by the force majeure shall be suspended from the time that notification occurs until the disability should have been remedied with reasonable diligence, and for no longer. But, the settlement of strikes, lockouts, or industrial disputes or disturbances will be entirely within the sole discretion of the party having the difficulty.

ARTICLE XII

NOTICES

12.1 Method. All notices, requests, demands or statements shall be in writing, and may be delivered personally, telecopied, or sent by registered or certified United States mail, postage prepaid, with a return receipt requested, to the party to be notified. Notice deposited in the mail in this manner shall be effective upon the expiration of seven 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 shall be as follows:

If to the State: State of Alaska
 Commissioner of Natural Resources
 400 Willoughby Avenue
 Juneau, AK 99801

and

Commissioner of Revenue
P.O. Box S
Juneau, AK 99811-0400

and

Director, Division of Oil and Gas
P.O. Box 107034
Anchorage, AK 99510-0734

If to Petro Star JV: Attn: Stephen T. Lewis
Petro Star Valdez Refinery Joint Venture
P.O. Box 61030
Fairbanks, Alaska 99706
Telecopy Number: (907) 474-0503

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

ARTICLE XIII

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 of the State of Alaska.

ARTICLE XIV

SOVEREIGN POWER OF THE STATE

This Agreement shall not be interpreted as a limit on the State of Alaska's exercise of any of its sovereign or regulatory powers, whether conferred by constitution, statute or regulation, including, but not limited to, its regulatory power over the Leases. Its exercise of any sovereign or regulatory power will not operate or be deemed to enlarge any rights of

Petro Star JV or to limit or impair any obligations or liability of Petro Star JV under this Agreement.

ARTICLE XV

SECURITY

One hundred ninety Days before the Date of First Delivery, Petro Star JV shall cause to be issued and delivered to the State an irrevocable stand-by letter of credit, with an effective date no later than the Date of First Delivery, issued for the benefit of the State by a state or national banking institution of the United States ("Issuer"), which is insured by 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 the State in its sole discretion. The principal face amount of such letter of credit shall be a sum estimated by the Commissioner to be equal to the aggregate purchase price for the approximate total amount of Oil to be tendered by the State to Petro Star JV during the first ninety Days following the Date of First Delivery. The letter of credit shall be 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 Petro Star JV is liable to

the State for a sum equal to the amount of such draft, and that sum is due and payable in full and has not been timely paid. The letter of credit must be renewed ninety Days before its expiration so that a letter of credit is continuously valid for ninety Days after the date of the last delivery of Royalty Oil. If a replacement letter of credit, in a form satisfactory to the Commissioner in his sole discretion, is not received ninety Days before the expiration of the existing letter of credit, then Petro Star JV shall be deemed to have materially breached this Agreement, there shall have occurred an event of default under Article 7.1, and all obligations of Petro Star JV accrued, but not otherwise due and payable under this Agreement, will immediately become due and payable in full.

If the State has reasonable grounds for asserting any claims against Petro Star JV 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, Petro Star JV shall upon the State's request (whether or not Petro Star JV may deny, reject or otherwise resist such claims) cause the principal face amount to be increased by an amount equal to the excess. Petro Star JV shall also automatically increase the principal face amount, without request from the State, whenever the face amount is less than the expected purchase price of ninety Days of Oil tenders, to an amount equal to the expected purchase price of ninety Days of Oil tenders. Petro Star JV may decrease the principal face amount upon approval of the State, if the face

amount is more than the expected purchase price of ninety Days of Oil tenders to an amount equal to the expected purchase price of ninety Days of Oil tenders.

The letter of credit must allow drafts to be drawn and presented to the Issuer up to and including the 90th Day after the last delivery of Royalty Oil to Petro Star JV under this Agreement. The Commissioner may accept such other or additional security as he, in his sole discretion, considers adequate to protect the State.

ARTICLE XVI

PREFERENTIAL HIRING AND NON-DISCRIMINATION

Petro Star JV agrees to employ Alaska residents and Alaska companies to the extent they are available, willing and qualified for all work performed in Alaska in connection with the Agreement. "Alaska resident" means an individual who has resided in Alaska for one year at the time of employment and "Alaska companies" means companies incorporated in Alaska or whose principal place of business is in Alaska.

If this provision is determined to be unconstitutional, then Petro Star JV agrees to employ Alaska residents and Alaska companies to the extent such preferential hiring is determined to be constitutional.

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 Petro Star JV hereby irrevocably submits to the jurisdiction of that court in any such action or proceeding.

ARTICLE XVIII

WARRANTIES

The purchase and sale of Royalty Oil is subject only to the warranties of the State expressly set forth in this Agreement and the State disclaims and Petro Star JV waives all other warranties, express or implied in law, whatsoever.

ARTICLE XIX

AMENDMENT

This Agreement may be supplemented, amended, or modified only by written instrument duly executed by the parties. Any amendment which appreciably reduces the

consideration received by the State requires prior approval of the Legislature of the State of Alaska.

ARTICLE XX

SUCCESSORS AND ASSIGNS

No assignment, pledge, or encumbrance of this Agreement shall be made by either party without the written consent of the other party. The Commissioner or his designee may grant or deny such consent in his sole discretion. 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 assignees.

ARTICLE XXI

HEADINGS

Headings used in this Agreement are for convenience only and shall not affect its construction.

ARTICLE XXII

RECORDS

22.1 Preservation of Records. Petro Star JV 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 no less than six years from the date of transaction or last adjustment relating to the

transaction. Petro Star JV 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 Petro Star JV nor the State shall be required to retain any records for more than six years unless retention of such records is specifically required by applicable law or regulation, or this Agreement. Petro Star JV shall either maintain its records within the State of Alaska or make such records available to the State at Petro Star JV's principal office in the State of Alaska within thirty Days after written request by the State.

22.2 Inspection of Records of Parties. Petro Star JV and the State 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 Petro Star JV's or the State'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. The State shall not be required to disclose any information, data, or records which are required to be held confidential by state or federal law or regulation. If the information obtained by the State may be held confidential under state or federal law or regulation, Petro Star JV may request that information be held confidential by the State and the State will keep this information confidential.

ARTICLE XXIII

INTERPRETATION OF TERMS AND CONDITIONS

In the event that there is a disagreement about the meaning or application of a word, term, or condition in this Agreement, Petro Star JV will present the arguments supporting its view in writing to the Commissioner for his consideration. The Commissioner will subsequently issue a finding on the meaning or application of the disputed word, term, or condition, setting forth the basis for his conclusions. Petro Star JV agrees to accept findings by the Commissioner under this Article are supported by substantial evidence.

ARTICLE XXIV

COUNTERPARTS

This Agreement may be executed in multiple counterparts, it not being necessary for all parties to sign the same counterpart. Each counterpart shall be deemed to be an original and all of which taken together shall be one and the same instrument.

SIGNATURES

the State:

THE STATE OF ALASKA

Harold C. Skene

Commissioner
Department of Natural Resources

Date: 3/4/92

Petro Star Valdez Refinery
Joint Venture

By: _____

Date: _____

Petro Star Valdez, Inc.

By: _____

Date: _____

Alaska Refining, Inc.

By: _____

Date: _____

Arctic Slope Regional Corp.

By: _____

Date: _____

Harbor Enterprises, Inc.

By: _____

Date: _____

SIGNATURES

the State:

THE STATE OF ALASKA

Commissioner
Department of Natural Resources

Date: _____

Petro Star Valdez Refinery
Joint Venture

By: *Stephen T. Linn*
Chairman of the Management Committee

Date: *3/5/92*

Petro Star Valdez, Inc.

By: *Stephen T. Linn*
President

Date: *3/5/92*

Alaska Refining, Inc.

By: _____

Date: _____

Arctic Slope Regional Corp.

By: *David Adams*
D Adams

Date: *3/5/92*

Harbor Enterprises, Inc.

By: _____

Date: _____

SIGNATURES

the State:

THE STATE OF ALASKA

Commissioner
Department of Natural Resources

Date: _____

Petro Star Valdez Refinery
Joint Venture

By: _____

Date: _____

Petro Star Valdez, Inc.

By: _____

Date: _____

Alaska Refining, Inc.

By: _____

Date: _____

Arctic Slope Regional Corp.

By: _____

Date: _____

Harbor Enterprises, Inc.

By: *[Signature]*

SRIP MARKETING
Date: Nov 5, 1992

ACKNOWLEDGMENT

STATE of Alaska)
) ss.
Third Judicial District)

THIS IS TO CERTIFY that on the 4th day of March, 1992, before me, appeared Harold C. Heinze, the Commissioner, Department of Natural Resources, State of Alaska; that Harold C. Heinze executed that document under legal authority and with knowledge of its contents; and that this act was performed freely and voluntarily upon the premises and for the purposes state in the document.

Witness my hand and official seal the day and year in this Agreement first above written.

Shirley Haines
Notary Public in and for Alaska
My commission expires: 7/10/94

State of Alaska)
) ss.
Third Judicial District)

THIS IS TO CERTIFY that on the 5th day of March, 1992, before me appeared Stephen T. Lewis, the person who has been lawfully authorized as the Chairman of the Comm. of Petco Star Udder 2 Refinery JV to execute this document; that Stephen T. Lewis executed that document under legal authority and with knowledge of its contents; and that this act was performed freely and voluntarily upon the premises and for the purposes stated in the document.

Witness my hand and official seal the day and year in this Agreement first above written.

Carol Boque
Notary Public in and for Alaska

My commission expires: 10-3-94

State of Alaska)
) ss.
Third Judicial District)

THIS IS TO CERTIFY that on the 5th day of March 1992, before appeared Stephen T. Lewis, the person who has been lawfully authorized as the President of Petro Star Valdez, Inc. to execute this document; that Stephen T. Lewis executed that document under legal authority and with knowledge of its contents; and that this act was performed freely and voluntarily upon the premises and for the purposes stated in the document.

Witness my hand and official seal this day and year in this Agreement first above written.

Carol Boagre

Notary Public in and for Alaska

My commission expires: 10.3.94

State of Alaska)
) ss.
Third Judicial District)

THIS IS TO CERTIFY that on the 5th day of March 1992, before appeared Neil Berg, the person who has been lawfully authorized as the Chairman of Alaska Refining Inc to execute this document; that Neil Berg executed that document under legal authority and with knowledge of its contents; and that this act was performed freely and voluntarily upon the premises and for the purposes stated in the document.

Witness my hand and official seal this day and year in this Agreement first above written.

Dolores A. Keenan
Notary Public in and for Alaska

My commission expires: 4-18-94

State of Alaska)
) ss.
Third Judicial District)

THIS IS TO CERTIFY that on the 5 day of March 1992, before me appeared Jacob Adams, the person who has been lawfully authorized as the President of Arctic Slope Reg'l Corp. to execute this document; that Jacob Adams executed that document under legal authority and with knowledge of its contents; and that this act was performed freely and voluntarily upon the premises and for the purposes stated in the document.

Witness my hand and official seal the day and year in this Agreement first above written.

Caval Borne
Notary Public in and for Alaska

My commission expires: 10-3-94

State of Alaska)
)
Third Judicial District) ss.

THIS IS TO CERTIFY that on the 5th day of March, 1992, before me appeared James S. Burns, the person who has been lawfully authorized as the Senior V.P. of Hardac Ent. to execute this document; that James S. Burns executed that document under legal authority and with knowledge of its contents; and that this act was performed freely and voluntarily upon the premises and for purposes stated in the document.

Witness my hand and official seal the day and year in this Agreement first above written.

James S. Wainwright
Notary Public in and for Alaska

My commission expires: 7/29/94

EXHIBIT A. INTEREST CALCULATION EXAMPLE

Numbers in this exhibit are illustrative. They do not represent accurate values that may have existed in the past or are forecasted for any time in the future. Companies A and B represent the illustrative Kuparuk netback values for ARCO and BP. Consistent with Section 2.3, the average monthly Kuparuk Netback of other lessees are not included in the price calculation.

Mechanics of the calculations include:

1. The annual interest rate specified in legislation is converted to a daily rate for calculations.
2. Credits are applied to the next monthly payment. Payment for an underpayment is due within 10 days of the time the bill is received, and interest on underpayments stops accruing when payment is received.

Example 1. Initial Billing

Assumptions

1. Month is February
2. Royalty Oil delivered to Petro Star JV in January = 800,000 bbls
3. Bill Received by Petro Star JV on February 10th; Payment due to State on February 20th.

Offtake for Calculating Price to Petro Star JV:

<u>Lessee</u>	<u>Monthly Reported Offtake</u>	<u>Average Monthly Kuparuk Netback plus Field Costs</u>
Company A (Arco or BP)	3,000,000 bbls	\$10.5000/bbl
Company B (other of ARCO or BP)	4,500,000 bbls	\$10.7575/bbl
Total for Calculating Price:	7,500,000 bbls	Weighted Average: \$10.6545/bbl

Notes and Calculations

There are other lessees in the Kuparuk Unit, but their offtake is not used for calculating the price to Petro Star JV.

$$\begin{aligned} \text{Volume-weighted average price under Section 2.3 of the Agreement} &= \\ &= \frac{(\$10.5000/\text{bbl} \times 3,000,000 \text{ bbls}) + (\$10.7575/\text{bbl} \times 4,500,000 \text{ bbls})}{7,500,000 \text{ bbls}} = \$10.6545/\text{bbl} \end{aligned}$$

Billing

If billing received Feb. 10th; payment due Feb. 20th = 800,000 bbls x \$10.6545/bbl = \$8,523,600.00

Example 2. Initial Adjustment

Assumptions

1. Month is March.
2. Royalty Oil delivered to Petro Star JV during January = 800,000 bbls
3. Annual interest rate charged member banks for advances by 12th Federal Reserve District as of January 1 rate assumed to be 5%. Annual interest rate for contract = 11%
4. Petro Star receives notice of credit as of March 3rd.

Revised Offtake for Calculating January Price to Petro Star JV:

<u>Lessee</u>	<i>Revised Monthly Reported Offtake</i>	<i>Revised Average Monthly Kuparuk Netback plus Field Costs</i>
Company A (Arco or BP)	<u>3,200,000 bbls</u>	<u>\$10.5000/bbl</u>
Company B (other of ARCO or BP)	<u>4,500,000 bbls</u>	<u>\$10.7500/bbl</u>
Total for Calculating Price:	7,700,000 bbls	Weighted Average: \$10.6461/bbl

Notes and Calculations

Volume-weighted average price under Section 2.3 of the Agreement =

$$= \frac{(\$10.5000/\text{bbl} \times 3,200,000 \text{ bbls}) + (\$10.7500/\text{bbl} \times 4,500,000 \text{ bbls})}{7,700,000 \text{ bbls}} = \$10.6461/\text{bbl}$$

Billing

Revised January bill = 800,000 bbls x \$10.6461/bbl =	\$8,516,880.00
<u>Amount paid =</u>	<u>\$8,523,600.00</u>
Overpayment for January =	(\$6,720.00)

Difference between date when Petro Star notified of credit (March 3rd) and original due date (February 20th) = 12 days

Interest due = \$6,720.00 x (11%/366)*12 =	(\$24.24)
Credit due Petro Star for next month's billing =	(\$6,744.24)

Example 3. Subsequent Adjustment

This adjustment is assumed to occur after true-up of BP expenses, a reopener for one of the Royalty Settlement Agreements, or for some other reason. It is assumed to occur in June 5th.

Assumptions

1. Month is June.
2. Royalty Oil delivered to Petro Star JV during January = 800,000 bbls
3. Annual interest rate charged member banks for advances by 12th Federal Reserve District as of January 1 assumed to be 5%; as of April 1, 7%. Annual interest rate for contract = 11% for first quarter; 12% for second quarter
4. Petro Star JV receives notice of underpayment on June 5th.

Revised Offtake for Calculating January Price to Petro Star JV:

<u>Lessee</u>	<i>Revised</i> Monthly Reported <u>Offtake</u>	<i>Revised</i> Average Monthly Kuparuk Netback plus Field Costs
Company A (Arco or BP)	3,200,000 bbls	<u>\$10.6005/bbl</u>
Company B (other of ARCO or BP)	<u>4,500,000 bbls</u>	<u>\$10.7500/bbl</u>
Total for Calculating Price:	7,700,000 bbls	Weighted Average: \$10.6879/bbl

Notes and Calculations

Volume-weighted average price under Section 2.3 of the Agreement =

$$= \frac{(\$10.6005/\text{bbl} \times 3,200,000 \text{ bbls}) + (\$10.7500/\text{bbl} \times 4,500,000 \text{ bbls})}{7,700,000 \text{ bbls}} = \$10.6879/\text{bbl}$$

Billing

Revised January bill = 800,000 bbls x \$10.6879/bbl =	\$8,550,320.00
<u>Amount paid =</u>	<u>\$8,516,880.00</u>
Underpayment for January =	\$ 33,440.00

Days of interest in first quarter (Feb. 20th through March 31st) = 40

Days of interest in second quarter (April 1 through June 5th) = 66

Interest for first quarter = \$33,440.00 x (11%/366) x 40 = \$402.01

Interest for second quarter = (\$33,440.00 + \$402.01) x (12%/366) x 66 = \$732.32

Payment from Petro Star due state within 10 days of receiving bill = \$34,574.33

EXHIBIT B. CALCULATION OF PRICE

This exhibit shows the mechanics of the price calculation and data sources. Average Royalty Value and production volumes for BP and ARCO are taken from the Royalty Reports filed by those lessees.

Royalty Value (before field costs deduction) is taken from Column H of these reports; Royalty Volume is taken from Column C. An example calculation using the information from November 1991, from the attached reports is shown below.

The format of these reports may change from time to time. However, the information will remain available.

(1)	(2)	(3)	(4)
<u>Lessee</u>	Production Volume (Column C)	Royalty Value Before field costs (Column H)	Production times Value [Col 2] x [Col 3]
	<u>Barrels</u>	<u>\$/barrel</u>	<u>Dollars</u>
ARCO	4,904,813.86	\$11.360	\$55,718,685.4496
BP	<u>3,835,974.69</u>	\$10.1400	<u>\$38,896,783.3566</u>
	Total: 8,740,788.55		Total: \$94,615,468.8062

$$\text{Monthly Price} = \frac{\text{Total of Column (4)}}{\text{Total of Column (2)}}$$

$$\text{Monthly Price} = \frac{\$94,615,468.8062}{8,740,788.55 \text{ barrels}}$$

$$\text{Monthly Price} = \$10.82/\text{barrel}$$

COMPANY NAME ARCO ALASKA, INC. A Subsidiary
 of Atlantic Richfield Company
 ADDRESS P. O. Box 100360
 CITY, STATE, ZIP Anchorage, Alaska 99510

REPORT FOR MONTH OF November 1991
 REVISION NUMBER
 DATE OF REVISION

(a)	(b)	(c)	(d)	(e)	(g)	(h)	(i)	(j)											
Gross unit or Lease Production (Bbls) or (MCF)	Working Interest Ownership %	(a) x (b) (Bbls) or (MCF)	Royalty Rate (%)	(c) x (d) (Bbls) or (MCF)	Royalty In-Kind (Bbls) or (MCF)	Royalty In-Value (e) - (f) (Bbls) or (MCF)	Royalty Value \$ per Bbl or MCF	Field Costs per Bbl or MCF	(h) - (i) Reported Royalty per Bbl or MCF	(g) x (j) Royalty In-Value Dollars									
CRUDE	51.74%	CRUDE NPSL	12.50030%	11,867.07	2,410.44	9,456.63	\$11.36000	\$0.000	\$11.360	\$107,427.33									
9,456,439		94,934.29									12.50030%	4,797,630.04	599,718.15	121,814.75	477,903.40	\$11.36000	\$0.418	\$10.942	\$5,229,218.98
CRUDE NON-NPSL		237.69									12.50030%	12,011.84	1,501.52	0.00	29.71	\$11.36000	\$0.000	\$11.360	\$337.52
KRUTP NPSL		0.00									12.50030%	0.00	0.00	0.00	1,501.52	\$11.36000	\$0.418	\$10.942	\$16,429.59
KRUTP NON-NPSL		0.00									12.50030%	0.00	0.00	0.00	0.00	\$0.000	\$0.000	\$0.000	\$0.00
NGL'S	NGL'S ARE INCLUDED ON THIS REPORT FOR CONVENIENCE ONLY.																		
NON-NPSL	0.00	12.50030%	0.00	0.00	0.00	0.00	\$0.000	\$0.000	\$0.000	\$0.00									
NPSL	0.00	12.50030%	0.00	0.00	0.00	0.00	\$0.000	\$0.000	\$0.000	\$0.00									
(1) TOTALS		4,904,813.86	12.50030%	613,116.45	124,225.19	488,891.26	\$11.360	\$0.410	\$10.950	\$5,353,413.42									

* WEIGHTED AVERAGE VALUE

I declare that I have examined this report, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

SIGNED Devery L. Prince
 Title: Analysis Accountant TYPED NAME Devery L. Prince

(3) KRUTP \$3,667.75
 (4) Less Field Costs for RIK (\$50,918.57)
 Lease/Plant Split Costs for RIK \$0.00
 (5) Revisions (attach amended returns) See Below (\$594.13)
 NPSL
 (6) Amount Due \$5,305,568.48
 (3) through (5)

PHONE NO: 265-6045

DATE 19-Dec-91

GAS ROYALTY: ATTACH FORM 10-422

OIL ROYALTY: ATTACH FORM 10-405

OIL AND/OR

GAS ROYALTY: VERIFICATION OF WIRE TRANSFER AMOUNTS OR A COPY OF THE CHECK MADE IN PAYMENT OF ITEM (5) MUST BE ATTACHED.

AMENDMENTS: Mail With Applicable Attachments To:

State of Alaska
 Department of Natural Resources
 Division of Oil and Gas
 Royalty Accounting Section
 P. O. Box 7034
 Anchorage, Alaska 99510-7034

 (\$594.13)

STATE OF ALASKA
DEPT. OF NATURAL RESOURCES
DIVISION OF OIL AND GAS
ROYALTY ACCOUNTING SECTION
P.O. BOX 187834
ANCHORAGE, AK 99518-7034

AMENDMENT: 00
ROYALTY PAYER: BP EXPLORATION (ALASKA)
P.O. BOX 194612
ANCHORAGE, AK 99519-4612

FIELD, POOL OR LEASE: KUPARUK RIVER UNIT
PRODUCTION MONTH: NOVEMBER 1991
FILING DATE: 12/31/91
PAGE: 1 OF 2

	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)
PROD TYPE	GROSS UNIT OR LEASE PRODUCTION (BBL)	WORKING INTEREST OWNERSHIP (%)	(A) X (B) (BBL)	ROYALTY RATE	(C) X (D) (BBL)	ROYALTY IN-KIND (BBL)	(E) - (F) ROYALTY IN-VALUE (BBL)	ROYALTY VALUE \$/BBL	FIELD COSTS \$/BBL	(H-I) RPTD ROYALTY \$/BBL	(G) X (J) ROYALTY IN-VALUE DOLLARS
OILCM	9,427,069.08	40.5145000	3,819,655.99	012.500	477,456.75	96,981.01	388,475.74	010.1400	0.4100	009.7220	3,698,985.14
OILTPT	28,570.23	57.1240664	16,320.70	012.500	2,040.09		2,040.09	010.1400	0.4100	009.7220	19,833.75
(1) TOTALS			3,835,976.69		479,496.84	96,981.01	382,515.83				(2) 3,710,810.09
(3) TOPPING PLANT											4,886.62
(4) LESS FIELDS COSTS RIK-OIL PROCESSING FEES RIK-NOLS											-40,538.06
(5) REVISIONS (ATTACH AMENDED RETURNS OR RECONCILIATION)											00.00
(6) AMOUNT DUE (0)											3,885,187.45

I DECLARE THAT I HAVE EXAMINED THIS REPORT, INCLUDING ACCOMPANYING SCHEDULES AND STATEMENTS, AND TO THE BEST OF MY KNOWLEDGE AND BELIEF IT IS TRUE, CORRECT, AND COMPLETE.

SIGNED: *[Signature]*

TITLE: Manager, Commercial Function

DATE: 12/31/91

OIL ROYALTY: ATTACH FORM 10-485

VERIFICATION OF WIRE TRANSFER AMOUNTS OR A COPY OF THE CHECK MADE IN PAYMENT OF ITEM (6) MUST BE ATTACHED. MAIL APPLICABLE ATTACHMENTS TO DEPARTMENT OF NATURAL RESOURCES AT ABOVE ADDRESS.

RECEIVED
DEC 31 1991
DIV. OF OIL & GAS
ROYALTY ACCOUNTING

STATE OF ALASKA

DEPT. OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

WALTER J. HICKEL, GOVERNOR

P.O. BOX 107034
ANCHORAGE, ALASKA 99510-7034
PHONE: (907) 762-2553

March 11, 1992

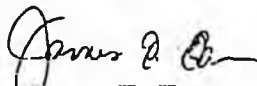
Dear Alaskan:

The State of Alaska proposes to sell 30,000 barrels per day of the state's royalty oil to the Petro Star Valdez Refinery Joint Venture. A draft of the contract and the preliminary finding was distributed for a month-long public comment period in late January. The proposed sale was discussed at a meeting of the Alaska Royalty Oil and Gas Development Advisory Board on February 6, 1992. Public comments were solicited through letters to a 450-person mailing list, and through display advertisements in five newspapers in Juneau, Anchorage, Fairbanks, and Valdez. Only three comments were received from the public.

After considering the comments received from the public, agencies, and the Royalty Board, the department prepared the Final Contract, and Final Finding and Determination for the proposed sale. The sale will not take effect unless approved by the legislature. A bill approving the sale is expected to be introduced into both houses of the legislature this week.

The proposed royalty sale is summarized on the back of this page. If you would like a copy of the contract, or the Commissioner's Final Finding and Determination, please contact Bob Loeffler of my staff at 762-2578. Thank you for your interest.

Sincerely,


James E. Eason
Director

Summary of Proposed Royalty In-kind Sale Petro Star Valdez Refinery Joint Venture

March 11, 1992

THE REFINERY

- A 30,000 barrel per day refinery to be built on private land in Valdez.
- The refinery is expected to produce approximately 110 million gallons per year (¼ of the purchased oil volume). These products are expected to include:
 - at least 20 million gallons per year of jet fuel for Mark Air;
 - approximately 10 million gallons per year of heating fuel and marine diesel, available in Valdez for Prince William Sound consumers; and
 - the balance will be marine diesel sold to Petro Marine Services, a marine fuel distributor servicing south central Alaska. Most of this fuel will be sold in Seward, Kodiak, and Dutch Harbor.
- \$30 million capital investment; \$25 million in Alaska. 16-20 permanent jobs with an annual payroll of approximately \$1.7 million. Approximately \$400,000 per year in property taxes.
- Construction could start as early as this spring; operation, as early as next winter.

SALE OF IN-KIND ROYALTY OIL

- 30,000 barrels per day from the Kuparuk River Unit (approximately 80% of Kuparuk's Royalty Oil).
- 10-year contract beginning seven months after the legislature approves the sale, or when the refinery is ready to process the oil (whichever is later).
- Price would be the weighted-average per-barrel value paid to the state by ARCO and BP. These two companies own approximately 95% of production from the Kuparuk field.

WHO IS PETRO STAR VALDEZ REFINERY JOINT VENTURE? A joint venture of three Alaskan Companies:

- Petro Star Inc, a subsidiary of the Arctic Slope Regional Corporation;
- Alaska Refinery, a wholly owned subsidiary of Neil Bergt Trust; and
- Harbor Enterprises which operates Petro Star Marine Services.

WHAT HAPPENS NEXT? A bill approving the proposed contract is expected to be introduced into both houses of the Alaska legislature during this week (March 9-13). Hearings and public testimony will be scheduled by the legislative committees.

WHERE TO GO FOR MORE INFORMATION? For more information or copies of the proposed contract or preliminary finding, please contact Bob Loeffler at Box 107034; 3601 "C" Street, Suite 1380; Anchorage, Alaska 99510. Telephone: (907) 762-2578. Fax: (907) 562-3852.

STATE OF ALASKA

DEPT. OF NATURAL RESOURCES

DIVISION OF OIL AND GAS

WALTER J. HICKEL, GOVERNOR

P.O. BOX 107034
ANCHORAGE, ALASKA 99510-7034
PHONE: (907) 762-2553

January 27, 1992

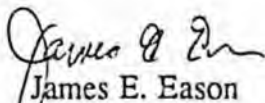
Dear Alaskan:

The State of Alaska proposes to sell 30,000 barrels per day of the state's royalty oil to Petro Star Valdez Refinery Joint Venture. The joint venture will process the oil in a refinery proposed for Valdez. Enclosed is a copy of the Preliminary Finding and Determination, and the proposed contract. The Alaska Royalty Oil and Gas Advisory Board will be discussing the proposed sale at a meeting on February 6, 1992 at 3601 "C" Street (Frontier Building), Suite 1100; Anchorage, Alaska. The public is invited to attend. Also scheduled for the meeting is a preliminary discussion of long-term gas sales.

These findings are preliminary; final conclusions have not been reached. Comments received from the public and from the Alaska Royalty Oil and Gas Advisory Board will be used to determine whether the proposed contract is in the state's best interest, and if so, whether changes are needed. If the commissioner determines that the proposed sale is in the state's best interests, the contract with the final finding and determination will be forwarded to the legislature. The sale will not take effect unless approved by the legislature; nor will oil be delivered to the joint venture before the refinery is ready to process the oil.

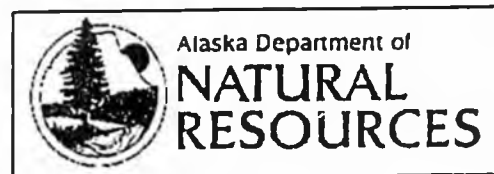
Comments must be received by February 24, 1992 and should be addressed to James E. Eason, Director; Box 107034; Anchorage, AK 99510. If you have any questions, please contact Bob Loeffler of my staff at 762-2578. Thank you for your interest.

Sincerely,


James E. Eason
Director

Enclosures

**Preliminary Finding and Determination
To Sell Royalty Oil
to
Petro Star Valdez Refinery Joint Venture**



**Division of Oil and Gas
3601 "C" Street; Suite 1380
Box 107034
Anchorage, Alaska 99510-7034**

January 23, 1992

Preliminary Finding and Determination To Sell Royalty Oil to Petro Star Valdez Refinery Joint Venture

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Summary

The Commissioner of the Department of Natural Resources, on behalf of the state, proposes a long-term sale of 30,000 barrels per day of the state's royalty oil to Petro Star Valdez Refinery Joint Venture ("Petro Star JV"). Petro Star JV proposes to build and operate a refinery in Valdez. This document provides the preliminary finding and recommendation required under AS 38.05.183 for the proposed sale.

The public is invited to comment on the proposed sale. Comments must be received in writing by **February 24, 1992** at the address below:

Jim Eason, Director
Division of Oil and Gas
3601 C Street; Suite 1380
Box 107034
Anchorage, Alaska 99510-7034

The Alaska Royalty Oil and Gas Advisory Board will be discussing the proposed sale at a meeting scheduled for **February 6, 1992** at 3601 "C" Street (Frontier Building), Suite 1100; Anchorage, Alaska. The public is invited to attend.

These findings are preliminary; final conclusions have not been reached. Comments received from the public and from the Alaska Royalty Oil and Gas Advisory Board will be used to determine whether the proposed contract is in the state's best interest, and if so, whether changes are needed in the proposed contract. If the commissioner determines that the proposed sale is in the state's best interests, the contract with the final finding and determination will be forwarded to the legislature. The sale will not take effect unless approved by the legislature; nor will oil be delivered to Petro Star JV before the refinery is ready to process the oil.

Background

The State of Alaska receives as royalty 12-1/2% of the oil and gas sold from the Kuparuk River oil field. The state may take its royalty either in-kind or in-value. When the state takes its royalty share of oil production in-kind, it takes ownership of the oil, and the commissioner acting on behalf of the state, disposes of the oil through either competitive or non-competitive sales. When royalties are taken in money (in-value), the state's lessees that produce the oil also market the state's share of production, and they are obligated to pay the state the value of its royalty share. The commissioner administers the state's oil and gas lands and royalty program.

In mid-1991, Petro Star JV contacted the Department of Natural Resources with a request to purchase a portion of the state's royalty production. In response to that request and after negotiation with the company, the department proposes to execute the contract which accompanies this preliminary finding.

Petro Star JV is a joint venture of three Alaskan companies: Petro Star Valdez, Inc., a subsidiary of the Arctic Slope Regional Corporation; Alaska Refinery, wholly-owned subsidiary of Neil Bergt Trust; and Harbor Enterprises. The joint venture proposes to build a facility to refine 30,000 barrels per day of north slope crude oil into jet fuel, marine diesel, and heating fuel. The refinery will be constructed on private land purchased by Petro Star JV. The land is located adjacent to Dayville Road east of the Trans Alaska Pipeline terminal in Valdez.

The refinery expects to produce approximately 110 million gallons per year of the products listed in Table 1. One hundred and ten million gallons per year is equal to 7,200 barrels per day, or approximately one-quarter of the amount being delivered. The remaining three-fourths will be returned to the Trans-Alaska Pipeline System and sold by Petro Star JV.

Table 1. Expected Refinery Products

<u>Product</u>	<u>Approximate Volume</u>
Jet A	105,00 gallons per day
Heating Fuel #1	20,000 gallons per day
Marine Diesel (summer weight)	130,000 gallons per day
Marine Diesel (winter weight)	45,000 gallons per day

Total (approximate)	300 thousand gallons per day (110 million gallons per year)

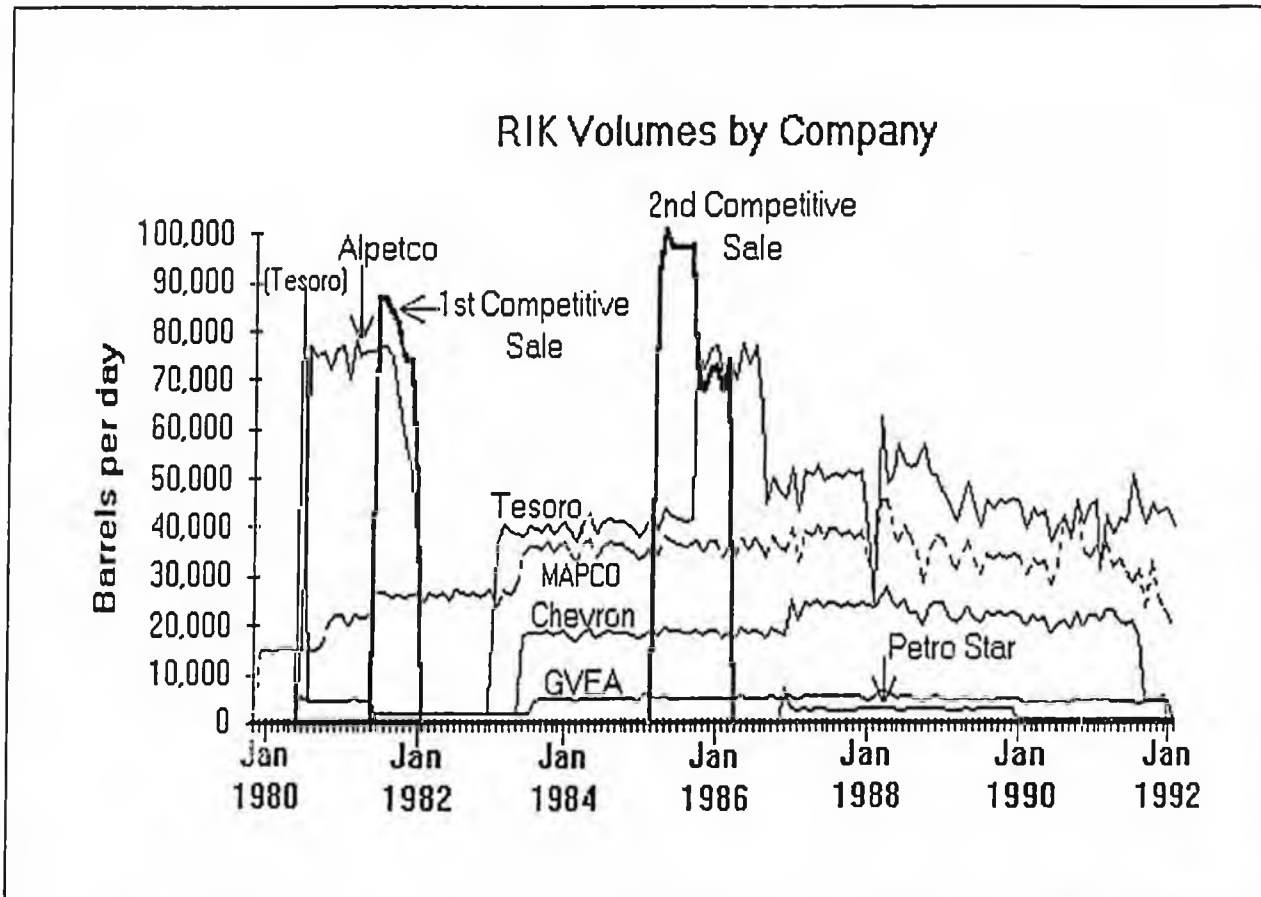
The product mix outlined in Table 1 is expected to change after the refinery begins operation and the demand becomes clear. Petro Star JV has executed two sales contracts for its products. The joint venture will sell jet fuel to MarkAir Inc., an Alaska-based airline. It will sell 20 - 40 million gallons per year of jet fuel, depending on the outcome of the airline's current expansion. Approximately 10 million gallons per year of heating and marine diesel fuels will be available locally in Valdez for Prince William Sound communities. The balance of the products will be sold to Petro Marine Services, a subsidiary of Harbor Enterprises and a marine fuel distributor servicing southcentral Alaska. Petro Marine Services is expected to use most of the purchased fuel in Seward, Kodiak, and Dutch Harbor.

Petro Star JV has purchased private land for the facility, has received a conditional use permit from the City of Valdez, and has initiated the required air quality permitting process. Construction may begin as early as April 1992, and the refinery may be ready to begin operation as early as October 1992.

This finding and best interest determination *does not* decide whether construction and operation of the proposed refinery is in the best interests of the state. The refinery is a private facility built on private land. The refinery is not dependent on this proposed royalty oil sale. The proposed refinery, like others operating in the state, has the option of purchasing north slope crude oil directly from the north slope producers. While the proposed royalty oil sale may help the financial viability of the refinery by providing a long-term source of crude oil at a competitive price, the decision on whether to construct the proposed refinery is rightly made by the private

owners, and not by the state. This best interest determination decides whether the proposed royalty oil sale is in the state's best interest.

Summary of Previous North Slope Royalty Oil Sales

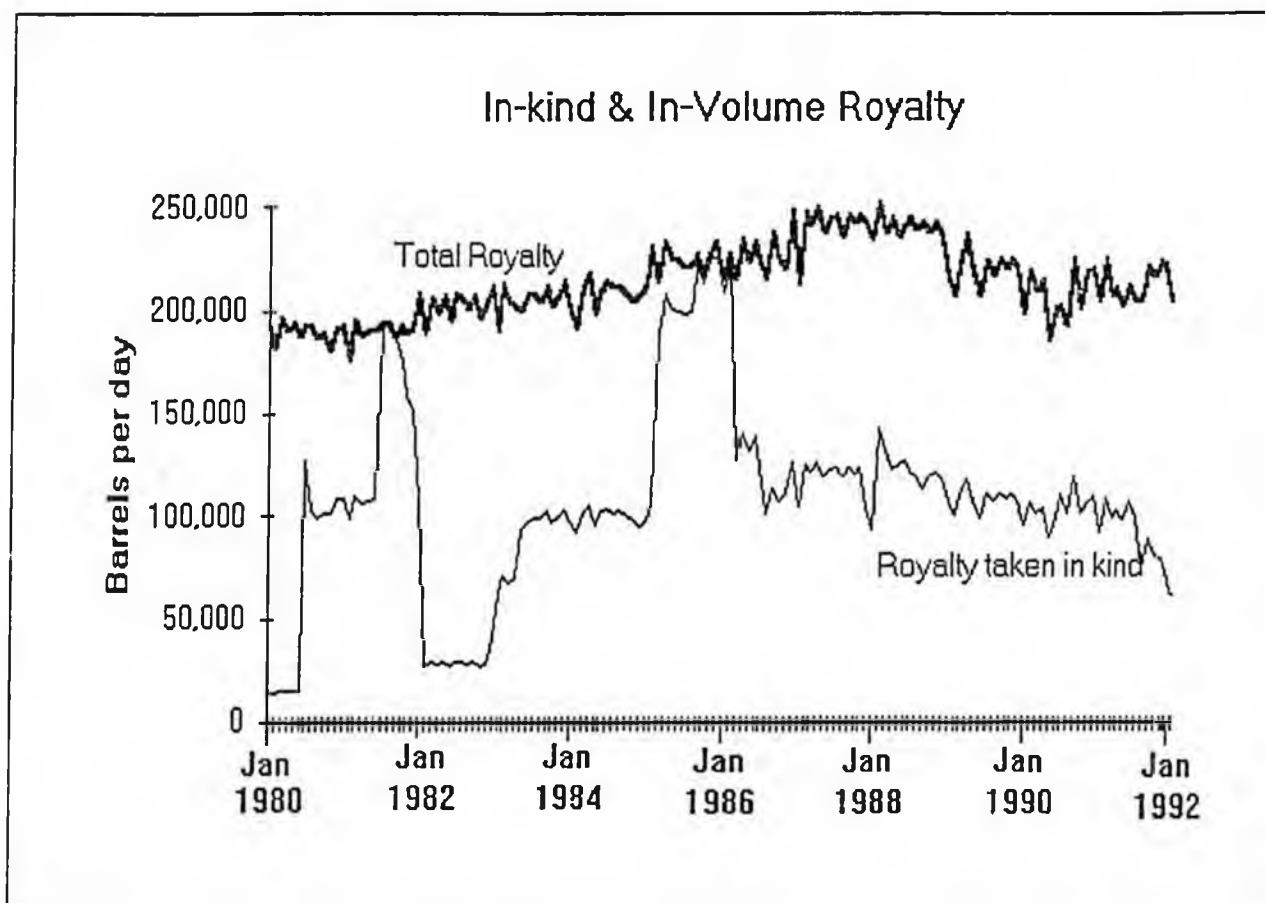


Volumes. Beginning in November 1979 and continuing to the present, the state has delivered royalty-in-kind north slope crude oil to fourteen companies in sixteen negotiated contracts, two competitive sales, and one quasi-competitive sale. Through September 1991, the state had delivered 475 million barrels or approximately 50% of its north slope royalty oil in these sales.

Figure 1 shows the amount of royalty oil sold to each company since the north slope production began. The graph shows that the amount of oil sold to each company has varied over the years, but that Tesoro and MAPCO have been the state's two most consistent customers. Most crude purchased by Tesoro is refined at its facility in Nikiski (capacity 80,000 barrels per day). Chevron's in-state refining was at its 18,000 barrel-per-day plant in Kenai, which ceased production in June 1991. The MAPCO and GVEA purchases are refined at the MAPCO refinery in North Pole (capacity 113,000 barrels per day). The Petro Star purchase is refined at its 7,000 barrel-per-day plant in North Pole. (Capacity figures are taken from *Historical and Projected Oil and Gas Consumption, June 1991* published by DNR, Division of Oil and Gas.)

The competitive and quasi-competitive sales were purchased by a mixture of companies. Some of the crude purchased in these sales was refined at the in-state refiners, some was exported from Alaska. The Alpetco purchases were also exported.

Figure 2 shows the total amount of royalty oil due the state, and the amount of that oil taken in-kind and sold by the state. The volumes of royalty sales have remained approximately constant since 1986 until the recent decline.



Price. Since the first royalty oil sale, the state's policy has been that it would not necessarily maximize revenues from royalty in-kind sales, but that it would not receive less for the people's royalty when taken in-kind and sold than the state would otherwise have received had it left the oil with the lessees and taken its royalty in-value. Consistent with this policy, each of the state's previous non-competitive royalty contracts have had a similar conceptual price: the value that the state would have received if it had left the oil in-value (plus field costs, and in some cases plus a premium). However, the value that the state receives for its in-value royalty has been in litigation as part of the ANS Royalty Litigation (1-JU-77-847 Civil, Superior Court for the State

of Alaska, First Judicial District at Juneau)¹. Thus, the price term for former royalty in-kind contracts have included interim pricing formulae to be used until the final monthly values are known, and a mechanism for retroactive adjustment of the interim price based on the outcome of the litigation. The price term for every former negotiated state royalty-in-kind contract has had essentially this form. The substantive differences have been in the interim payment method, and sometimes the addition of a premium.

During the last two years, seven companies representing approximately 80% of north slope oil production have settled their ANS Royalty Litigation obligations with the state. Two of these companies, ARCO and BP, own leases in the Kuparuk River Unit. These two companies represent 94.5% of production from the Kuparuk River Unit. These settlements provide an agreed-upon valuation method that did not exist when any of the previous royalty oil contracts were signed. As a result, the price term in the proposed contract to Petro Star JV differs from previous royalty in-kind contracts. This contract relies upon the agreed-upon valuation methods in the ARCO and BP settlements to establish a contract price. It will not require a retroactive adjustment or an interim pricing method except for possible field costs.

Competitive and quasi-competitive contracts have been priced differently. The department felt that strong bidder aversion to retroactive ANS Royalty Litigation adjustments would depress bids, and the competitive sales have required bidders to offer premiums over a base price without retroactive ANS Royalty Litigation adjustments.

Recent Development - Canceled Contracts. In the first half of 1991, the state's in-kind deliveries of north slope crude averaged approximately half of the state's total royalties, or approximately 103,000 barrels per day. The state delivered north slope crude to five companies under six contracts. Recently, however, the state's purchasers have canceled four of the six contracts. By March 1992, in-kind deliveries of north slope crude are expected to decline to less than 60,000 barrels per day (less than 30% of north slope production). Table 2 shows the average volume delivered from January through June 1991 to each company. It also shows the last delivery date for the four canceled contracts.

¹ This case was originally titled State of Alaska, et al v. Amerada Hess Corp., et al and has been frequently been referred to as the Amerada Hess litigation.

Table 2. Current Royalty Contracts

<u>Company</u>	<u>Average Deliver Volume</u> (barrels per day) <u>January -- June, 1991</u>	<u>Date of Last Delivery</u>
GVEA ¹	4,730	January 31, 1992
Chevron ²	22,148	December 31, 1991
Petro Star ³	1,104	December 31, 1991
MAPCO	34,283	Continuing
Tesoro	40,567	Continuing

¹ GVEA will continue to pay the state its 30¢ per barrel premium through June 30, 1992.

² Chevron had two contracts. The last delivery under the larger contract occurred August 31, 1991.

³ Petro Star will continue to pay its 35¢ per barrel premium through February 29, 1992.

As a result of the cancellations, the state is taking less of its oil in-kind than it has at any time since early 1983. Beginning in February 1992, the state will be taking less than 29% of its royalty in-kind. Except for Chevron which shut down its Kenai refinery last June, the companies are still refining north slope oil, but they are buying less oil from the state. While the crude supplier(s) for each company is confidential (and not known by the department), it appears that the companies are now purchasing more of their oil directly from north slope producers.

Summary of Proposed Contract Terms

1. **Price.** The state will receive a total price per barrel that is the sum of two components: netback value and field cost.
 - (a) *Netback Component.* The netback component is the volume-weighted-average netback value at the delivery point (the inlet of the Kuparuk Pipeline) of royalty barrels produced by ARCO and BP from the Kuparuk River Unit. These two lessees have settled their ANS Royalty Litigation obligation with the state, and together they produce 94.5% of the oil from Kuparuk. Production volumes of companies for which the state is still in litigation under ANS Royalty Litigation will not be included in the volume-weighted average netback.
 - (b) *Field Cost Component.* Per barrel Kuparuk River field costs as described in the agreement that is Appendix I to the December 1981 Kuparuk River Unit Agreement.
2. **Point of Delivery.** The state will deliver the oil to Petro Star JV at the time and place when it receives its royalty oil from its lessees. At present, that is the custody transfer meters into the Kuparuk Pipeline at the Kuparuk Central Production Facility.
3. **Purchase-price Reopener.** At any time after two years following the date oil is first

delivered under the contract, the state or Petro Star JV may reopen the contract to begin negotiations to establish a new purchase price. If, after negotiating, the state and Petro Star JV do not reach agreement, either party may cancel the contract, subject to notice requirements. If agreement is reached, either party may re-open after a further two years.

4. **Quantity and Source.** The contract allows Petro Star JV to purchase a maximum quantity of 30,000 barrels per day expressed as a percentage of daily royalty oil from the Kuparuk River Unit. Because the maximum quantity is expressed as a percentage of the Kuparuk River Unit production, it will decline as production from the Kuparuk River Unit declines. Petro Star JV may elect to purchase less oil, subject to notice requirements (required by the Kuparuk River Unit Agreement). Petro Star JV may make a permanent decrease in the maximum quantity (subject to notice requirements) before the first delivery of oil, and at one time after that date. Petro Star may also elect to purchase less than the maximum quantity, but it must pay a per-barrel reservation fee on each barrel less than the maximum quantity that it elects not to purchase. The per-barrel reservation fee is 0.75% of the full purchase price.
5. **Term.** Delivery of the oil will begin first day of the first month that is the later of:
1) seven months after the contract is approved by the Legislature and the Governor, or
2) seven months after Petro Star Valdez Refinery certifies that within seven months it will be ready to accept oil. The contract terminates on December 31, 2003. The contract is expected to be approved during the 1992 legislative session, and the first oil delivery is expected to occur at the end of 1992 or the beginning of 1993. Thus, the contact term is expected to be approximately 10 years.
6. **In-state Processing.** Petro Star JV agrees to process at least 80% of the royalty oil delivered under this contract at the proposed refinery in Valdez. The state may waive this requirement if it is satisfied that Petro Star JV is using its best efforts to process the royalty oil and that the waiver would not be contrary to the underlying intent of other provisions of the contract.
7. **Security.** Beginning 190 days before oil is first delivered, Petro Star JV will provide an irrevocable letter of credit equal to the Commissioner's estimate of the value of 90-days delivery of oil. The term of the letter of credit must be renewed 90-days before it expires (so that the letter of credit is continuously valid for 90-days beyond any date oil is delivered). In addition, Arctic Slope Regional Corporation, an Alaskan Native corporation with significant in-state assets, is a signatory to the contract.

Discussion of Specific Contract Provisions

This section of the finding explains differences between this and typical provisions in recent royalty-in-kind contracts. The most recent contract was signed in December 1985. That was a two-company sale from the state to Petro Star, Inc. and Chevron (differences due to the unique

two-company sale of that contact are not discussed). The most recent one-company contract, the GVEA-3 contract, was signed in October 1985.

Price: No Retro Active ANS Royalty Litigation price readjustment; no escrow. Previous non-competitive contracts have been designed to net the state no less than the value it would have received had it left the oil with the lessees and taken its royalty in value. (Sometimes with the addition of a premium). However, implementing this design has had a practical problem. Until the recent settlements, the state and the north slope lessees have not agreed on how to compute the lessees' royalty in-value liability, and there has been no accepted methodology to compute a dollars-and-cents price-per-barrel for a royalty in-kind sale. Thus, every negotiated contract has included provisions for retroactive price adjustments based on the outcome of the ANS Royalty Litigation.

The requirement for ANS Royalty Litigation retroactive price adjustments provided significant problems both for the purchaser and for the state. It meant the purchaser is buying oil (and must price its refined oil) based on an alternative purchase price for the crude that may not be known for years. The state is only now nearing completion of its first ANS Royalty Litigation adjustment for royalty-in-kind oil though the first oil was delivered in 1979.

The amount of the price readjustment and the potentially long time lag may result in a large liability. The state's first ANS Royalty Litigation rebilling will total significantly more than \$100 million to five companies. The large rebillings also provide problems for the state. The delay in providing a final bill means that disputes over the final bill may not be identified until long after the oil is delivered. It may be difficult for some companies to pay a potentially large amount long after the refined products have been sold. And at least one in-kind purchaser, Alpetco, has gone bankrupt.

To avoid these problems, the 1985 Petro Star contract required the company to escrow \$1.12 per barrel of royalty oil purchased as a deposit against its ultimate ANS Royalty Litigation liability. Although Petro Star's ultimate liability has not been determined, Petro Star has assured the department it will pay its retroactive ANS Royalty Litigation obligation.

As mentioned previously, based on recent settlements of ANS Royalty Litigation price litigation with seven companies, there is now an agreed-upon price method for 94.5% of the state's royalty production from Kuparuk River. Agreed-to methods for valuing the vast majority of the state's in-value production from the Kuparuk River Unit now exists.

The proposed contract requires Petro Star JV to pay the volume-weighted average netback value for those Kuparuk lessees that have settled: ARCO and BP. As 94.5% of Kuparuk's production is accounted for by the ARCO and BP ANS Royalty Litigation settlements, there is no need for a retroactive price adjustment based on royalty settlement for the remaining production. The value of the 94.5% should be an adequate proxy for the remaining 5.5%.

By establishing a firm value based on agreed-to methodologies, there is no need for an escrow,

and no need for retroactive ANS Royalty Litigation adjustments. Petro Star JV has a firm purchase price on which to price its refined oil, and the state is certain of being paid the final value.

Price Premium. Many of the previous royalty-in-kind contracts have included a premium above the average netback value for in-value royalty oil. This premium was intended to compensate the state for the so-called "displacement effect" and "competitive effect."

The "displacement effect" theorizes that in-kind sales by the state replace west-coast sales by the lessees. For example, once the sale is in place, a west-coast refiner in California or Washington may no longer purchase crude to make jet fuel to sell in Alaska. While the amount of west-coast sales (including Alaska) would remain the same, some of these sales would be state in-kind sales and less would be made by the lessees. If this occurs, the lessees' average monthly netback value would reflect a lower proportion of west-coast sales and a higher proportion of gulf-coast sales. The effect is diminished by the fact that the state's royalty share is only one-eighth of the lessees' production. Therefore, only one-eighth of the displacement effect is borne by the state. The displacement effect was much larger a few years ago when half of Alaska's crude oil was transported to the U.S. gulf.

In 1985, almost half of the state's royalty in-value oil was sold to refiners in the US Gulf (including the Virgin Islands). That amount has been decreasing. Between May and August of this year, it had decreased to 11%, and according to the Department of Revenue's Spring 1991 Revenue Forecast, it will continue to decrease until 1996, when the last gulf sale is projected to occur.

The "competitive effect" is more difficult to explain than the "displacement effect." At the risk of oversimplification, one can maintain that the actual market price on the west coast is above the competitive market-price due to the decision of producers, primarily BP, to transport oil to the gulf coast that might be sold on the west coast, but at a lower price. If the state were to sell significant oil in competitive sales, it might undermine the market power of the producers and lower the market price.

This effect was a larger concern during 1985 and 1986 than it has been after that time because of the large negotiated and competitive in-kind sales that were then occurring. Between May 1985 and April 1986, the state sold approximately 90% of its royalty oil in-kind, up to an average of approximately 210,000 barrels per day during January 1986. There was some concern that this amount of state sales would affect the west-coast market power of the lessees.

The proposed sale to Petro Star JV will not generate this effect. Thirty thousand barrels per day is less than 2% of the north slope production and will not affect operation of the west-coast oil markets.

The small and decreasing proportion of gulf sales, and the small volume proposed to be sold to Petro Star JV mean that the proposed contract will not noticeably displace the lessees' west-coast

sales nor generate competitive effects on the west-coast oil markets. For these reasons, and to encourage the jobs, income, tax, and consumption benefits from in-state refining, the proposed contract does not include a premium.

Purchase-price Reopener. The two-year purchase-price reopener is a standard component of most in-kind royalty contracts. Day-to-day fluctuations in the netback value are built into the state's royalty oil settlements and are a part of the contract price to Petro Star JV. The reopener provides additional flexibility to respond to unforeseen changes.

Field Cost. Previous royalty-in-kind contracts do not specify a separate field cost for Natural Gas Liquids (NGLs). While the field cost for crude oil was established in a 1980 field cost agreement (that was made part of the Kuparuk River Unit Agreement), the NGL field cost is still in dispute with the lessees of the Kuparuk River and Prudhoe Bay Units.

NGLs are approximately 3% of the total oil volume produced from the north slope. Some lessees recognize NGLs as part of the crude oil stream and report the agreed-upon crude-oil field cost. Others report a separate field cost for NGLs. That cost varies considerably by lessee and by field -- up to \$13.60 per barrel from one Prudhoe Bay lessee. The state recognizes NGL field costs to be the same as those in the field cost agreement (approximately 42¢ per barrel for Kuparuk River oil).

Between April 1985 and March 1988, lessees from Kuparuk River oil field sold NGLs with the remainder of Kuparuk's crude oil stream. The field cost for those NGLs is still in dispute. Since March 1988, the lessees have re-injected all NGLs as part of Kuparuk's enhanced oil recovery program. At present, Kuparuk lessees do not take a field cost deduction for NGLs, and disputed NGL field costs are not a problem for the proposed contract. However, NGLs may be sold from the field in the future, and the proposed contract provides a method for resolving the problem, should it occur.

The contract requires that if NGLs are sold from the Kuparuk River Unit, Petro Star JV will pay the full producer-reported field cost for NGLs (or for any other field cost in dispute). It also requires a retroactive adjustment for over- or underpayment after a final, field cost has been determined. Specifically, the contract provides that if a field cost different from the existing field cost agreement is established, the state will rebill (or provide a credit) for field costs not covered by the existing agreement. This provision was added to ensure that Petro Star JV would pay the state's liability for the full NGL field costs if the Kuparuk River lessees begin selling NGLs, and if NGLs are determined to have a different field cost than that of the remaining crude.

Quality. The 1985 contracts did not distinguish between crude oil, condensate, or natural gas liquids. In the proposed contract, Petro Star JV waives any claim that either condensate or NGLs blended with the crude by the lessees and tendered to the state as royalty oil is not oil for the purpose of the contract. If NGLs are once again sold from the Kuparuk River Unit, this waiver will protect the state against a future claim that Petro Star JV did not receive its full volume of crude oil or more oil than it contracted for by asserting that condensate or NGLs are not crude

oil under the contract.

Best Efforts. In its 1985 contract, Petro Star agreed to use its "best efforts" to market its refined products in Alaska. It agreed to its "best efforts" to market a volume of at least 23% of the royalty oil sold under the contract.

This "best efforts" provision is not included in the draft contract. The contract requires that 80% of the royalty oil be processed at the proposed Valdez refinery; it no longer requires "best efforts" in-state marketing of the product.

The provision is omitted because assessing "best efforts" is difficult if not impossible to enforce. In addition, given the incentives to market refined product in Alaska, the history of in-state refiners marketing in Alaska, and contractual provisions of the joint-venture owners of the refinery to market the refined product to MarkAir and to Petro Marine Services, the "best efforts" requirement is unnecessary.

Late Payment Penalty. The 1985 Petro Star contract required a monthly 1% penalty fee to all late royalty payments except for those caused by unintentional clerical errors. This contract changes the fee to 5% per month to be more in line with current practices.

Interest. This contract uses a different interest rate for under- and over-payments than previous contracts. It uses the rate that the legislature established during its last session. Chapter 23 SLA 91 establishes the interest rate to be "five percentage points above the annual rate charged member banks for advances by the 12th Federal Reserve District as of the first day of that calendar quarter, compounded quarterly as of the last day of that quarter." It is important to recognize that if Petro Star JV overpays, the state will have to credit back the amount of the overpayment plus interest to Petro Star JV, just as Petro Star JV will have to pay the amount of any underpayment plus interest to the state.

Security. The proposed contract requires an irrevocable letter of credit equal to 90 days' worth of oil deliveries. The letter of credit is intended to protect the state from any inability of Petro Star JV to pay its bills to the state or to take delivery of the oil. The 90-day requirement has been a feature of all royalty oil disposals since the competitive sale of December 11, 1984 with two exceptions. The Prudhoe Bay royalty oil offered in that competitive sale included a "put call" option which enabled the letter of credit requirement of that oil to be reduced to 60 days (see The Findings and Determination to Conduct a Competitive Sale of Prudhoe Bay and Kuparuk River Royalty Oil, of October 17, 1984). In addition, in the 1985 Petro Star-Chevron sale, Chevron agreed to a "backup" arrangement to accept delivery of any volume of royalty oil upon which Petro Star might default. That "backup" agreement allowed Petro Star's letter of credit requirement to be reduced to 60 days.

The 90-day requirement provides protection for the state. Understanding the risk, however, requires an understanding of the "denomination" process.

The Kuparuk River Unit Agreement and the recent ANS Royalty Litigation settlements effectively give the state the ability to "denominate" most of its oil (change its take of royalty oil from in-kind to in-value) with specified notice to the producers. In the Kuparuk River Unit, there is what amounts to a 90-day notice requirement for 95% of production, and a six-month notice requirement for the remaining 5%. Thus, if the state were notified that Petro Star JV was unable to meet its obligations under the contract -- either that the joint venture was unable to process the oil or unable to pay for it -- the state would have to dispose of the equivalent of 93½-days worth of in-kind deliveries before it could return to taking its royalty in-value. (The 93½ days equals 95% of in-kind deliveries with 90-days notice plus 5% with a six month notice.)

In the unlikely event that Petro Star JV were to become bankrupt, the state may not receive notice until it fails to receive timely payment. By that time, the joint venture may have received approximately 70 days worth of oil:

- 30 days for the production month
- + 10 days for billing (the state bills 10 days after the end of each month)
- + 7 days to for Petro Star to receive the bill
- + 10 days for payment (payment is required 10 days day after the bill is received)
- + 13 days for decision (a decision to declare the contract in default and denominate the oil would undoubtedly take some time)

70 days of oil

The letter of credit would have to make the state whole for non-payment for 70-days worth of oil, and to make up the discount in selling additional 93½-days worth of oil that would be the state's responsibility before the state's royalty reverted to in-value production. The 90-day letter of credit would make up the difference to the state as long as the state received 80% of its royalty-in-value revenue for the 93½-days of in-kind oil it was forced to sell. That is, neglecting fluctuations in oil prices, the value of a 90-day letter of credit is approximately equal to the value of 70-days in-kind deliveries plus 80% of the value of 93½-days of in-kind oil.

In the two cases where the state was forced to dispose of in-kind production because of bankruptcy, it sold the oil to ARCO and Sohio for only a slight discount from the full price. These experiences and knowledge of the oil markets indicate that the state would be able to sell as an "emergency sale" three months of production at more than 80% of the in-value revenue.

In addition to the 90-day letter of credit, additional security is provided by the fact that Arctic Slope Regional Corporation is a signatory to the contract. Arctic Slope Regional Corporation is a regional Native Corporation representing the north slope. The corporation is and will remain an Alaska corporation with significant assets in Alaska. The corporation's assets provide security for the state in case of bankruptcy by Petro Star JV, and if retroactive billings exceed the value of the 90-day letter of credit or if billings occur after the last delivery of oil. The corporation's commitment to the contract along with the 90-day letter of credit should provide adequate protection for the state.

Local Hire. Like the state's other long-term royalty oil contracts with in-state refiners, the proposed contract contains a provision concerning local hire. The preferential hiring clause states in part that Petro Star JV "agrees to employ Alaska residents and Alaska companies to the extent they are available, willing and qualified for all work performed in Alaska in connection with the Agreement." An "Alaska resident" is defined as an "individual who has resided in the state for one year at the time of employment." If this provision is determined to be unconstitutional, then, Petro Star JV agrees to employ Alaskan residents and Alaska companies to the extent such preferential hiring is determined to be constitutional.

In-state Benefit Analysis

The primary bases for this long-term negotiated sale are: 1) to receive a fair market value for royalty oil; and 2) to encourage in-state processing of royalty oil and the attendant benefits (primarily jobs, taxes, competition between refined product suppliers that may lead to lower product prices for consumers.)

Construction and Operation Benefits. Even without this contract, the Petro Star Valdez Refinery may build and operate the refinery with crude oil purchased from the north slope lessees rather than from the state. Therefore, most or all of the benefits of constructing and operating the refinery cannot be ascribed to the proposed contract. It is possible, however, that this proposed royalty oil contract may increase the financial viability of the refinery. If so, an unknown portion of these benefits should be ascribed to the contract.

The direct benefits from refinery construction and operation occur through payroll, property taxes, state corporate taxes, and profits if held in-state. All of the joint venture profits are expected to be held in state. These cash infusions are multiplied as they are spent and recycled throughout the economy. However, actual project specific multiplier effects can only be ascertained by extensive surveys or actual development.

Table 3. Direct Construction and Operation Benefits
(thousand dollars; figures are approximate)

<u>Construction Benefits</u>		<u>Operation Benefits</u>	
Capital Investment	\$30,000	Payroll	\$1,700 (16-20 jobs)
Capital Investment in Alaska	\$25,000	Property Taxes	\$ 400
		Profits	Unknown
		State Income Tax	Unknown

		Known Total	\$2,100

Table 3 provides some measures of in-state benefits for the Petro Star JV. The table shows estimates of potential direct benefits from operation and construction of the refinery. The direct operation-benefits to the state are approximately \$2.1 million dollars per year plus whatever

benefits exist from in-state profits and state income taxes and from multiplier effects. The facility will also provide approximately 100 construction jobs and 16-20 permanent jobs once the refinery begins operation. In addition, it will pay approximately \$400,000 in taxes to the City of Valdez. (The jobs and taxes do not include any created by downstream employment such as additional dock workers.)

The addition of another in-state refinery might have the effect of decreasing a small proportion of production at an existing refinery -- either the existing Tesoro facility at Nikiski (capacity of 80,000 barrels per day), or at MAPCO facility at North Pole (capacity of 113,000 barrels per day). If this decrease occurs, then the tables may overstate the operation benefits of the refinery.

All of the products that Petro Star Valdez Refinery expects to produce are also produced in-state by other refiners. The current in-state refining output does not provide all of Alaska's needs for these products. A portion of Alaska's supply of these fuels are imported from outside the state, and that proportion appears to be larger than the expected output of the refinery. While pricing and supply patterns may change in the state, there appears to be in-state demand to accommodate the proposed production from Valdez without provoking idle refining capacity elsewhere in Alaska.

According to the Army Corps of Engineers publication "Waterborne Commerce of the United States, 1989" (the most recent year published), approximately 52 million gallons of jet fuel and 60 million gallons of kerosene was imported into Anchorage from outside the region. It appears that the amount of jet fuel imported by Alaskans is in excess of the amount that the Valdez refinery will produce. Similar figures are not easily available for marine diesel, but it is expected that the proposed refinery output will not displace all marine diesel imports into Alaska.

Consumption Benefits. Consumers may benefit from the proposed sale through lower product prices. Oil products refined in Alaska may be priced lower than those imported from outside the state. In addition, an increase in competition resulting from the addition of another refinery may result in lower product prices. If either of these situations occur, consumers will benefit through lower prices. There is certainly no reason to believe that construction or operation of the refinery could have the effect of increasing overall consumer prices.

The proposed Petro Star JV has sales agreement to sell most of its Jet Fuel to MarkAir Inc., and most of the remaining product to Petro Marine Services. MarkAir Inc., is an airline company based and operated in Alaska. Presumably, MarkAir will purchase the fuel for less than its current cost. The extent to which the lower prices result in lower airline fares is unknown.

Petro Marine Services, is a fuel distributor which markets its products throughout coastal southcentral Alaska, though mostly in Kodiak, Dutch Harbor, and Seward. Presumably, it has signed the purchase agreement to decrease costs, though the extent, if any, to which consumer fuel prices will be lowered in those communities is unknown.

Environmental Impacts. The impacts of the royalty sale itself are expected to be minimal. The

impacts of constructing and operating the refinery may be somewhat greater. Previous analysis indicated that the economic benefits of constructing and operating the refinery cannot be ascribed to the state's royalty sale. The same is true of the environmental impacts.

The Petro Star JV has received a conditional use permit from the City of Valdez. The City of Valdez is the appropriate authority to consider whether such a facility is compatible with the land use requirements of the city. Approval by the City of Valdez indicates that the conversion of the vacant land to a refinery will cause no unacceptable land-use impacts. Similarly, the refinery has begun the process to apply for an air quality permit from the Department of Environmental Conservation. Air quality impacts are best considered by the Department of Environmental Conservation in that process. Operation of the refinery requires compliance with the applicable permits. That compliance will be evidence of acceptable environmental impacts.

Social Impacts. The refinery will pay property taxes to the City of Valdez, and its employees will use city services. The tax base in the City of Valdez is decreasing approximately \$90 million per year (as depreciation lowers the assessed value of the Trans Alaska Pipeline System). This decrease has severe impacts on the city's tax receipts. This year's property tax rate is expected to increase by three mills to make up for the smaller tax base. The \$30-million refinery is expected to pay approximately \$400,000 in property taxes. It will be a welcome addition to the city's tax base.

The additional employment may also affect services in the City of Valdez. The Community Development Director for the City of Valdez reports that while vacancy rates in Valdez are currently low, there is a ample supply of vacant land suitable for residential housing. In addition, he reports that the addition of children to the Valdez school system brought by new employment is unlikely to overtax the school system; in any case it will not cause any unacceptable social impacts.

Preliminary Findings and Determinations

Competitive Bidding is Waived. I have determined in accordance with AS 38.05.183(a) and 11 AAC 03.030 that the best interest of the state does not require competitive bidding, and that competition does not exist for state in-kind royalty oil. During the last few years, the state has been delivering royalty oil to in-state refiners under six contracts. Four of the six contracts have been canceled over the last few months. Contracts were canceled by Chevron (two contracts), GVEA, and Petro Star. Once all of the deliveries under the canceled contracts cease, the state will be taking less than 30% of its royalty oil as in-kind deliveries. This is the lowest percentage of royalty oil taken in-kind since February 1983. The only in-state refiners who are being supplied with royalty oil are MAPCO and Tesoro, both of which purchase additional fuel from north slope producers. As the state has more royalty oil available than it has purchasers, a competitive bid would not result in a higher value to the state. The state retains enough royalty oil to be able to sell to future in-state purchasers should they become interested.

The Sale is in the Best Interest of the State. Under AS 38.05.183(e), a non-competitive sale, exchange, or other disposal of royalty oil or gas taken in-kind by the state may be awarded by the commissioner to the prospective buyer whose proposal offers maximum benefits to the citizens of the state.

In accordance with AS 38.05.183(a),(c), and (e), and 11 AAC 03.010(b) and (d), I find that taking royalty oil in-kind and selling that oil to Petro Star Valdez Refinery Joint Venture ("Petro Star JV") for use at the proposed refinery in Valdez is in the best interests of the state and that it will maximize benefits to state citizens. According to AS 38.05.183(e) and AS 38.06.070(a), before making a non-competitive sale of state royalty oil, the commissioner must consider the criteria listed in AS 38.05.183(e) and AS 38.06.070(a) and listed in the appendix to this finding.

1. The state is now highly dependent on oil revenues and will continue to depend on oil revenues in the future. The price term of the sale protects the state's interest by ensuring that revenues from this sale will equal the in-value alternative.
2. Petro Star JV will make an initial investment of approximately \$25 million dollars within Alaska. The direct annual benefits to local payroll and to the purchase of local goods and services is more than \$2.1 million. While the proposed sale may increase the financial viability of the refinery, the extent to which these benefits can be ascribed to the proposed contract is unknown.
3. The existence of the refinery may increase competition in fuel sales in the state and may provide for lower consumer product prices. A one cent decrease in the price of each gallon of refined product that could be made from 1,000 barrels per day translates to an annual consumer saving of approximately \$153,000. The two companies that will purchase most of the refinery's products are MarkAir Inc., and Petro Marine Services will almost certainly benefit from lower prices.

4. The proposed refinery would add 16-20 permanent, new jobs in the City of Valdez, and pay property taxes of approximately \$400,000 per year to the city. The addition of new employment and a larger tax base for Valdez are expected to be welcome benefits to that city's declining property tax revenues and outweigh whatever additional social costs and responsibilities, if any, that they impose. As with construction and operation benefits, however, the extent to which these benefits can be ascribed to the proposed sale contract is unknown.
5. Any environmental effects will result from construction and operation of the refinery, not from the proposed royalty sale. The sale itself has little or no environmental effects. The major permanent construction and operation impacts are the land-use and air-quality impacts. The fact that the refinery has received a conditional use permit from the City of Valdez and is consistent with that city's coastal zone plan shows that the land-use impacts are acceptable. Similarly, the proposed refinery will not operate without receiving an air quality permit from DEC. Those impacts are best considered by the Department of Environmental Conservation during that process.
6. To the extent that the sale helps provide a long-term crude oil supply to the proposed Petro Star JV, the sale will help provide new in-state investments. It will provide increased competition for existing in-state refineries.

Criteria Weights. According to 11 AAC 03.060(b), "In considering the criteria described in AS 38.05.183(e), the commissioner will state which criteria apply to the proposed disposition, and discuss the weight given to the applicable criteria in determining the maximum benefit to the state..."

In making this finding, the department first determined that the state would not lower the total royalty oil revenue due the state by making a disposal to Petro Star JV. The department next looked at whether the disposal would increase the amount of in-state refining and has the potential to lower product prices. Finally, the department examined the criteria to determine that the sale would not create any unacceptable environmental or social impacts.

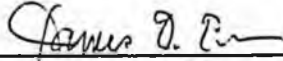
Contract Prices Are Acceptable. Under 11 AAC 03.091(b), I find that in establishing the price of this royalty oil contract, the department has obtained a price that is equal to the volume-weighted average of settled royalty netback value applicable to the oil that is being sold, plus field costs incurred by the royalty share. The 94.5% of Kuparuk production that is based on settled claims with the state under ANS Royalty Litigation provide the agreed-upon values and methodology for the in-kind sale of Kuparuk River oil. A price based on the volume-weighted average netback of that production is an acceptable benchmark for final value due the state. Therefore, I find there is no need for a retroactive adjustment upon resolution of further ANS Royalty Litigation claims.

Conclusion. Under the terms of the proposed contract, the state would receive a market price for the royalty oil, while fostering in-state processing, potentially lowering product prices, and

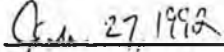
providing attendant benefits. The satisfactory price terms, coupled with the associated direct and secondary benefits for Alaska citizens, supports the decision to waive competitive bidding.

The foregoing facts and analysis support a preliminary finding that this disposal is in the best interest of the state and that it maximizes the benefits to Alaska citizens.

Invitation to Comment. These are preliminary findings; final conclusions have not yet been reached. The public is invited to comment on the proposed sale. The commissioner will consider comments received by **February 24, 1992** in making a final decision on the proposal. Comments should be mailed to the James E. Eason, Director, Division of Oil and Gas at Box 107034; 3601 "C" Street, Suite 1380; Anchorage, Alaska 99510.



James E. Eason, Director
for Harold C. Heinze
Commissioner



Date

AS 38.05.183(e) and AS 38.06.070(a)

AS 38.05.183(e) When a sale, exchange or other disposal of oil or gas taken in kind by the state as its royalty share, or a sale, exchange or other disposal in whole or in part of a right to receive future royalty oil or gas, under a state lease under this chapter is made other than by competitive bid, the sale, exchange or other disposal shall be awarded by the commissioner to the prospective buyer whose proposal offers the maximum benefits to citizens of the state. The commissioner shall consider:

- (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 or 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; and
- (5) the criteria listed in AS 38.06.070(a).

AS 38.06.070. Criteria. (a) In the exercise of its powers under AS 38.06.040(a) and 38.06.050 the board shall consider

- (1) the revenue needs and projected fiscal condition of the state;
- (2) the existence and extent of present and projected local and regional needs for oil and gas products and by-products, the effect of state of 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 of 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 on the state and affected political subdivisions by development related to the transaction;
- (6) the existence of specific local or regional labor or consumption markets or both which should be met by the transaction;
- (7) the projected positive and negative environmental effects related to the transaction; and
- (8) the projected effects of the proposed transaction upon existing private commercial enterprise and patterns of investments.

DRAFT FOR PUBLIC REVIEW

AGREEMENT FOR THE SALE AND PURCHASE

OF

STATE ROYALTY OIL

to

PETRO STAR VALDEZ REFINERY JOINT VENTURE
PETRO STAR VALDEZ, INC.
ARCTIC SLOPE REGIONAL CORPORATION
HARBOR ENTERPRISES, INC.
ALASKA REFINING, INC.

THE STATE OF ALASKA
Department of Natural Resources

January 23, 1992

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AGREEMENT FOR THE SALE AND
PURCHASE OF ROYALTY OIL

THIS AGREEMENT is entered into as of _____
_____by and between the State Of Alaska ("the State") and Petro
Star Valdez Refinery Joint Venture, Petro Star Valdez, Inc.,
Alaska Refining, Inc., Arctic Slope Regional Corporation, and
Harbor Enterprises, Inc. (collectively hereinafter referred to as
"Petro Star JV").

ARTICLE I

DEFINITIONS

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

1.1 "Commissioner" means the Commissioner of the
Alaska Department of Natural Resources or his designee.

1.2 "Daily Royalty Oil" means the quantity of Royalty
Oil available from the Lessees of the Kuparuk River Unit each
day.

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

1.4 "Effective Date" shall have the meaning set out in
Article VI.

1.5 "Field Cost Agreement" means the Agreement for
Settlement of Cleaning, Dehydration and Transportation Charges
Applicable to Royalty Oil Taken from the Kuparuk River Unit,

effective as of December 13, 1981, and attached to the Kuparuk River Unit Agreement of December 1, 1981 as Appendix I.

1.6 "Leases" means the Oil and Gas Leases which are subject to the terms of the Kuparuk River Unit Agreement.

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

1.8 "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.

1.9 "Oil" shall have the same meaning as the word "Oil" under the Leases and the Kuparuk River Unit Agreement, except where inconsistent with Section 2.2 of this Agreement, in which case Section 2.2 shall control.

1.10 "Point of Delivery" shall have the meaning set out in Section 2.5.

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

1.12 "Royalty Settlement Agreement" means the written royalty settlement agreements between the State and BP Exploration (Alaska) Inc. ("BP") dated December 31, 1991, and the State and Atlantic Richfield Company and Arco Alaska, Inc., ("ARCO") dated September 12, 1990.

1.13 "Royalty Value" means, with respect to each

Royalty Settlement Agreement, the royalty value calculated in accordance with BP's and Arco's Royalty Settlement Agreement for Kuparuk River Oil.

1.14 "TAPS" means the Trans Alaska Pipeline System.

1.15 "Unit Agreement" means the Kuparuk River Unit Agreement effective December 1, 1981, by and between the Lessees, as amended from time to time.

ARTICLE II

SALE OF ROYALTY OIL

2.1 Quantity. The State agrees to sell to Petro Star JV and Petro Star JV agrees to buy from the State that amount of Oil equal to 76.17% (Note: This figure to be adjusted to equal 30,000 barrels per day) of the Daily Royalty Oil ("Maximum Quantity"). Petro Star JV may permanently decrease the Maximum Quantity only twice: (1) once by giving the State written notice seven months before the date of first delivery and (2) once thereafter by giving the State nine months written notice.

Petro Star JV may at any time decrease or increase the amount of Oil to be tendered but not the Maximum Quantity except as provided above. To increase or decrease the amount of oil to be tendered, Petro Star JV must give the State at least nine months written notice. If, however, the increase or decrease is less than ten percent of the then current nomination, Petro Star JV must give at least one hundred Days written notice.

It is understood and agreed that the volume of Daily Royalty Oil available to the State 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. The State disclaims and Petro Star JV waives any representation, covenant or warranty, expressed 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. The State warrants that it has good title to the Oil tendered under this Agreement.

If the State underlifts or stores Royalty Oil at Kuparuk River Unit, or if the State recovers underlifted or stored Royalty Oil, the quantity of Oil tendered under this Agreement shall be calculated as if no Royalty Oil was underlifted or stored or recovered.

2.2 Quality. The Oil sold shall be the same quality as the Royalty Oil delivered by the Lessees to the State at the Point of Delivery. It is understood and agreed that the quality of the Oil sold may vary from time to time. The State disclaims, and Petro Star JV 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 Oil to be sold or tendered under this Agreement. Petro Star JV expressly waives any claim that any

liquid hydrocarbons made available to the State by the Lessees, including such substances as crude oil, condensate, natural gas liquids, or return oil from the Kuparuk River Unit Crude Oil Topping Plant, that may be blended with crude by the Lessees before the Point of Delivery and tendered as a common stream by the Lessees to the State as Royalty Oil are not Oil, for purposes of this Agreement.

2.3 Price of the Royalty Oil. The price each Month for Oil purchased under this Agreement shall be the average Royalty Value (weighted by production volume) for that Month of all Oil delivered from the Kuparuk River Unit production for which the Royalty Value is determined by the Royalty Settlement Agreements plus field costs. See examples attached as Exhibits A and B.

Field costs are those costs as defined in the Field Cost Agreement. If a field cost different from that in the existing Field Cost Agreement is established through future written agreement, or settlement or final resolution of any litigation, then that new field cost shall apply to the portion of the liquid hydrocarbons deemed not to be covered by the now existing Field Cost Agreement. In the interim, Petro Star JV agrees to pay the State the field costs claimed by the Lessees for any Royalty Oil taken by Petro Star JV. Any future field cost adjustments shall bear interest as provided in Section 5.6.

If any applicable law of the United States of America or any rule or regulation promulgated by a federal agency will, in the judgment of the State, operate to prohibit or prevent the

State from receiving the full amount due under the above provision, Petro Star JV'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 the State to comply with that law, rule or regulation.

2.4 Purchase Price Reopener. The State and Petro Star JV shall have the right to reopen this Agreement as to purchase price only. At any time after Petro Star JV receives Oil for two years from the Date of First Delivery (as defined in Section 2.11), the State or Petro Star JV may exercise the right to reopen by giving the other party one Month prior written notice. Upon issuance and receipt of a notice to reopen, Petro Star JV and the State will promptly commence good faith negotiations in an attempt to establish a new purchase price. If a new purchase price is not agreed to by Petro Star JV and the State within three Months after giving the notice to reopen, either Petro Star JV or the State may terminate this Agreement upon nine Months written notice to the other. The purchase price for Oil tendered during any period pending termination shall be determined in accordance with the price term in effect immediately before giving the notice of intent to reopen. If a new purchase-price provision is agreed to by Petro Star JV and the State, the new purchase-price provision shall become effective for Oil tendered in the Month following the written Agreement on the new purchase-price provision. Not less than two years after the conclusion of the purchase-price reopener process described above, either Petro

Star JV or the State again may reopen this Agreement, as to purchase price only, by giving notice of intent to exercise the right to reopen. At that time, the purchase-price reopener process described above may again be followed and every two years thereafter.

2.5 No Third-Party Intervention. Petro Star JV shall not voluntarily intervene or otherwise participate in any way regarding litigation, styled State of Alaska v. Exxon, et.al., Case No. 1-JU-77-847, ("ANS Royalty Litigation"), any future Royalty Settlement Agreements, or any reopeners or other discussions under or pertaining to Royalty Settlement Agreements. Any judgment resulting from the ANS Royalty Litigation, any future Royalty Settlement Agreements, or any reopener under any Royalty Settlement Agreement shall be conclusively binding upon Petro Star JV whether or not Petro Star JV agrees with or consents to the terms of any such judgment, settlement, or reopener. Furthermore, Petro Star JV has no independent right to invoke any of the provisions of any Royalty Settlement Agreement. If the Royalty Value is modified in the future as a result of a modification of any Royalty Settlement Agreement, a corresponding retroactive modification will be made to the price term of this Agreement and interest will apply to the modification, whether resulting in an overpayment or underpayment, as set forth in Section 5.6. Petro Star JV agrees to be conclusively bound by any such modification agreed to by the State and BP or ARCO.

2.6 Point and Time of Delivery. Simultaneously with receipt of its Royalty Oil from its Lessees, the State shall tender the Oil to Petro Star JV at the point at which the State receives the Royalty Oil from its Lessees. That point as presently agreed to by the State and its Lessees in Section 2.3 of the Field Cost Agreement is the Central Production Facility Meter into the Kuparuk Pipeline.

2.7 Passage of Title and Risk of Loss. Title and risk of loss to the Oil sold under this Agreement shall pass from the State to Petro Star JV for all purposes when the State tenders the Oil at the Point of Delivery.

2.8 Petro Star JV's Responsibility. Petro Star JV shall be responsible for the Oil after passage of title. Petro Star JV will indemnify and hold the State harmless from and against any and all claims, costs, damages (including reasonably foreseeable consequential damages), expenses, or causes of action arising from or in connection with any transaction or event which relates to the Oil after title has passed to Petro Star JV.

2.9 Transportation Arrangements. Petro Star JV shall make all necessary arrangements for transporting the Oil sold under this Agreement from the Point of Delivery, including satisfaction of line fill obligations and storage tank bottom requirements of the Kuparuk Pipeline and of TAPS, if any. If requested by the State, Petro Star JV shall submit specific information concerning its arrangement for transportation of the Oil sold under this Agreement through and away from the Kuparuk