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# Amerada Hess Royalty Oil Dispute and Settlement

## **FY 06 Capital Projects Financing**

The Administration proposes to use the earnings from the Amerada Hess settlement to pay the debt service on bonds to be issued by Alaska Housing Finance Corporation. The estimated \$30 million in annual interest earnings from the settlement is expected to support a \$343 million bond package. The proposal is to use these bond proceeds to fund capital projects that range from road construction to deferred maintenance to a new University science building.

In addition to the legislation necessary to authorize sale of the bonds, other legislation will be introduced to create the “Legacy Capital Fund” into which the earnings of the Amerada Hess principal will be transferred and accumulate until they are appropriated.

The following is background regarding the Amerada Hess settlement.

## **Settlement’s History**

The fight with North Slope oil producers started in 1977, almost as soon as oil began to flow through the Trans-Alaska pipeline. That year the state filed a lawsuit accusing oil companies of undervaluing their oil and gas and thus denying the state the full value of its 12.5% royalty share. In 1989, the state filed claims against 15 companies for \$902 million. The dispute became known as the Amerada Hess case, named after the first company listed alphabetically in the lawsuit.<sup>1</sup>

Royalty oil is the state’s ownership share of the crude coming out of the ground. The state takes its royalty share in two ways: in-kind, which is sold to Railbelt refineries and a Fairbanks electrical utility; and in value, which is sold back to the producers and priced at the wellhead net of transportation costs. The problem came in figuring out how to value the royalty oil. The state claimed that the companies used “bookkeeping fictions and intracorporate transactions” to under value the oil at market and overstate transportation costs, which combined to artificially lower

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<sup>1</sup> The Amerada Hess company was actually a very minor player in the case and settled out of court with the state in 1989 for \$319,000.

the wellhead value.<sup>2</sup> The production at issue occurred between 1977 and 1986 from the Kuparuk River and Prudhoe Bay oilfields.

The case became the longest running legal battle between the state and North Slope producers, lasting 18 years. One issue that came up early in the course of the litigation was that since 25% of royalty payments are dedicated to the Permanent Fund, earnings from settlement payments would eventually trickle into annual dividends paid out to Alaska residents. This issue was first raised in 1987 when three oil company defendants filed a lawsuit in federal district court to enjoin the Amerada Hess case from proceeding to trial in any court in Alaska. They claimed they could not receive a fair trial in Alaska because every judge and juror had a financial interest in the outcome of the case by reason of their respective annual Permanent Fund Dividends, which would be increased by any earnings derived from damages awarded to the state in Amerada Hess.<sup>3</sup>

In June 1988, the federal district court dismissed the action, ruling that the due process issue must be addressed in the state court before being asserted in the federal court. The companies appealed. In 1989, the Ninth Circuit Court of Appeals encouraged the parties to seek a legislative solution. Governor Cowper immediately introduced corrective legislation. This was ultimately passed into law (Ch 38, SLA 1989) in May 1989. Codified as AS 43.23.045 (b) Dividend Fund, it provided that:

*income earned on money awarded after trial in State v. Amerada Hess, et al, 1JU-77-847 Civ. (Superior Court, First Judicial District) shall be treated in the same manner as the Alaska permanent fund except that it is not available for distribution to the (dividend) fund, and shall be annually deposited into the principal of the Alaska permanent fund.*

Independently, in April of the same year the Ninth Circuit affirmed the district court's disposition, requiring the oil companies to raise the issue of disqualification in state Superior Court. The companies sought review by the U.S. Supreme Court but their petition was denied.

In October 1990, the companies filed a motion to disqualify the Alaska courts. In March 1991, Judge Carpeneti ruled that AS 43.23.045(b) removes most, but not all, of the sources of revenue flowing to the

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<sup>2</sup> "State Settles Oil Fight - \$100 Million Ends 18-Year Battle," Ralph Thomas, *Anchorage Daily News*, April 7, 1995.

<sup>3</sup> Transmittal from Governor Hickel for SB 213, March 18, 1991.

Permanent Fund dividend that created the bias. He also found that the statute failed to prevent additional monies from going to the dividend fund as a result of the so-called Amerada Hess price adjustment clauses in royalty-in-kind (RIK) contracts. He agreed with claims by the oil companies that if the state prevailed, it would result in a \$300 million judgement against refineries and the Fairbanks utility for in-kind purchases. Part of any judgement then would flow to the Permanent Fund and increase Permanent Fund Dividends (by \$81 over the next 15 years).

According to Judge Carpeneti, this failure to deal with RIK recoveries would require the Alaska court to disqualify itself. The result was another piece of legislation introduced by Governor Hickel in March of 1991 that became part of a more comprehensive rewrite of Permanent Fund statutes (19 Ch 134 SLA 1992) that included repealing AS 43.23.045(b) above. A new section was added to AS 37.13.145 Disposition of Income statute:

*(d) Notwithstanding (b) of this section, income earned on money awarded in or received as a result of State v. Amerada Hess et al, 1JU-77-847 Civ. (Superior Court, First Judicial District), including settlement, summary judgement, or adjustment to a royalty-in-kind contract that is tied to the outcome of this case, or interest earned on the money, or on the earnings of the money shall be treated in the same manner as other income of the Alaska permanent fund, except that it is not available to the dividend fund, and shall be annually deposited to the principal of the Alaska permanent fund.*

One final note on the legal history: 19 Ch. 134 SLA 1992 contained a conditional repealer stating that if the Alaska Supreme Court made a final determination that “no judge or juror is disqualified from serving as a judge or juror solely because the judge or juror may qualify to receive a permanent fund dividend,” subsection (d) would be repealed, i.e., earnings on the Amerada Hess principal would be added into the annual dividend calculation.

Eventually, almost all of the state’s claims were settled out of court. The final piece fell into place in 1995, when the state settled an assortment of gas royalty claims against three companies—BP, Exxon, and Mobil—for the last \$100 million of about \$1 billion in total settlements. Altogether the state spent nearly \$100 million in building its legal case. Over the course of the litigation, the share of settlements deposited into the Permanent Fund totaled \$194.1 million. Realized earnings on the Amerada Hess settlement money since the first deposit in FY 92 have added another \$230.3 million to the settlement principal, which totaled \$424.4 million at the end of FY 04.

**Amerada Hess as a subset of the Permanent Fund Principal**

The Amerada Hess portion of Permanent Fund principal is tracked separately in accounting records solely because its earnings cannot be included in the dividend calculation as previously discussed. Otherwise it is invested and managed exactly like the rest of the Permanent Fund. Realized earnings are deposited into the principal of the Permanent Fund, with the amount of realized earnings for inflation proofing accounted for separately. The inflation proofing piece is primarily informational to show how much the Amerada Hess earnings contributes to overall inflation proofing of the Amerada Hess portion of principal of the Permanent Fund.

## Amerada Hess Settlement

	Principal			Realized Earnings (over inflation)			Inflation-proofing			Total Settlement Principal
	<u>Beginning</u>	<u>Contributions</u>	<u>Ending</u>	<u>Beginning</u>	<u>Additions</u>	<u>Ending</u>	<u>Beginning</u>	<u>Additions</u>	<u>Ending</u>	
FY 1992	Inception	82,099,000	<b>82,099,000</b>	0	0	<b>0</b>	0	2,005,000	<b>2,005,000</b>	<b>84,104,000</b>
FY 1993		82,099,000	<b>98,510,000</b>	0	4,641,000	<b>4,641,000</b>	2,005,000	4,541,000	<b>6,546,000</b>	<b>109,697,000</b>
FY 1994		98,510,000	<b>111,723,000</b>	4,641,000	5,620,000	<b>10,261,000</b>	6,546,000	3,615,000	<b>10,161,000</b>	<b>132,145,000</b>
FY 1995		111,723,000	<b>173,440,000</b>	10,261,000	6,145,000	<b>16,406,000</b>	10,161,000	5,060,000	<b>15,221,000</b>	<b>205,067,000</b>
FY 1996		173,440,000	<b>176,300,000</b>	16,406,000	18,441,000	<b>34,847,000</b>	15,221,000	5,864,000	<b>21,085,000</b>	<b>232,232,000</b>
FY 1997		176,300,000	<b>184,147,000</b>	34,847,000	21,377,000	<b>56,224,000</b>	21,085,000	7,058,000	<b>28,143,000</b>	<b>268,514,000</b>
FY 1998		184,147,000	<b>208,769,000</b>	56,224,000	31,254,000	<b>87,478,000</b>	28,143,000	6,853,000	<b>34,996,000</b>	<b>331,243,000</b>
FY 1999		208,769,000	<b>208,769,000</b>	87,478,000	36,086,000	<b>123,564,000</b>	34,996,000	5,102,000	<b>40,098,000</b>	<b>372,431,000</b>
FY 2000		208,769,000	<b>215,655,000</b>	123,564,000	30,331,000	<b>153,895,000</b>	40,098,000	8,307,000	<b>48,405,000</b>	<b>417,955,000</b>
FY 2001		215,655,000	<b>229,242,000</b>	153,895,000	7,687,000	<b>161,582,000</b>	48,405,000	14,543,000	<b>62,948,000</b>	<b>453,772,000</b>
FY 2002		229,242,000	<b>194,083,000</b>	161,582,000	<b>(23,384,000)</b>	<b>138,198,000</b>	62,948,000	<b>(5,154,000)</b>	<b>62,112,000</b>	<b>394,393,000</b>
FY 2002		194,083,000	<b>194,083,000</b>	138,198,000	0	<b>138,198,000</b>	62,112,000	4,318,000	<b>62,112,000</b>	<b>394,393,000</b>
FY 2003		194,083,000	<b>194,083,000</b>	138,198,000	0	<b>138,198,000</b>	62,112,000	6,160,000	<b>68,272,000</b>	<b>400,553,000</b>
FY 2004		194,083,000	<b>194,083,000</b>	138,198,000	14,713,000	<b>152,911,000</b>	68,272,000	9,133,000	<b>77,405,000</b>	<b>424,399,000</b>
	<b>Total</b>	<b>194,083,000</b>		<b>Total</b>	<b>152,911,000</b>		<b>Total</b>	<b>77,405,000</b>		

Note: FY2002 reductions are the result of an audit correction of an over deposit of settlement principal and related earnings.

# Legacy Capital Fund's Ability to Support Capital Projects

## ASSUMPTIONS

Realized Return on AMHES	7.00%
Realized Return on LCF	7.00%
<b>Cumulative Capital Project Amount</b>	<b>\$343,000,000</b>

Year	Fiscal Year Project Amount *	Cumulative Balance in Legacy Capital Fund	Fiscal Year Debt Payments	Year Realized Return Posted 6/30	Net increase (Decrease) for Fiscal Year	LCF coverage on Debt Service	Year Cumulative Balance in
2004							
2005		0	0	29,707,930	29,707,930		29,707,930
2006	100,000,000	29,707,930	0	29,707,930	31,787,485		61,495,415
2007	110,000,000	61,495,415	8,730,000	29,707,930	24,671,509	7.0	86,166,924
2008	75,000,000	86,166,924	18,333,000	29,707,930	16,123,305	4.7	102,290,229
2009	58,000,000	102,290,229	24,918,000	29,707,930	10,205,986	4.1	112,496,215
2010		112,496,215	30,010,400	29,707,930	5,471,537	3.7	117,967,752
2011		117,967,752	30,010,400	29,707,930	5,854,545	3.9	123,822,297
2012		123,822,297	30,010,400	29,707,930	6,264,363	4.1	130,086,659
2013		130,086,659	30,010,400	29,707,930	6,702,868	4.3	136,789,527
2014		136,789,527	30,010,400	29,707,930	7,172,069	4.6	143,961,596
2015		143,961,596	30,010,400	29,707,930	7,674,114	4.8	151,635,710
2016		151,635,710	30,010,400	29,707,930	8,211,302	5.1	159,847,012
2017		159,847,012	30,010,400	29,707,930	8,786,093	5.3	168,633,105
2018		168,633,105	30,010,400	29,707,930	9,401,119	5.6	178,034,224
2019		178,034,224	30,010,400	29,707,930	10,059,198	5.9	188,093,422
2020		188,093,422	30,010,400	29,707,930	10,763,342	6.3	198,856,763
2021		198,856,763	30,010,400	29,707,930	11,516,775	6.6	210,373,539
2022		210,373,539	30,010,400	29,707,930	12,322,950	7.0	222,696,488
2023		222,696,488	30,010,400	29,707,930	13,185,556	7.4	235,882,044
2024		235,882,044	30,010,400	29,707,930	14,108,545	7.9	249,990,590
2025		249,990,590	30,010,400	29,707,930	15,096,143	8.3	265,086,733
2026		265,086,733	30,010,400	29,707,930	16,152,873	8.8	281,239,606
2027		281,239,606	21,280,400	29,707,930	26,624,674	13.2	307,864,281
2028		307,864,281	11,677,400	29,707,930	38,763,612	26.4	346,627,892
2029		346,627,892	5,092,400	29,707,930	48,523,014	68.1	395,150,907

\* 20 year term 5.06 and 6.06 TIC