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March 23, 2022

Derek W. Nottingham
Director, Division of Oil and Gas
Alaska Department of Natural Resources
550 West 7th Avenue, Suite 1100
Anchorage, AK 99501
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Via Hand Delivery and Email

Re: Reply Comments to March 18, 2022 Oil Search (Alaska) LLC (“OSA”) Comments re Miscellaneous Land Use Application for Use of Kuparuk River Unit (“KRU”) Roads

Dear Director Nottingham:

ConocoPhillips Alaska, Inc. (“CPAI”) respectfully requests the opportunity to respond to comments filed by OSA on March 18, 2022.

CPAI has long supported the State’s interest in developing oil and gas resources on State lands. This is demonstrated by the long KRU history of voluntarily making KRU facilities available for third party use on commercially reasonable terms. In fact, the KRU owners currently share many KRU facilities, including roads, seawater capacity, gas infrastructure, oil and gas processing capacity, pad space, warehouse supplies, and other materials and services, on commercially reasonable terms that have been agreed with most units on the North Slope west of Prudhoe Bay Unit. CPAI has extended this courtesy to OSA by proposing reasonable commercial terms for long-term road use. OSA has now refused CPAI’s overtures to negotiate, revealing in its March 18 response that “a new road use agreement between the parties will not be forthcoming unless and until the State affirmatively acts to confirm its rights”¹

This tactic is consistent with OSA’s approach in the past. For three years, not only has CPAI allowed OSA to use KRU roads for free, in support of OSA’s exploration and pre-development activities, CPAI has also worked closely with OSA to develop potential options for OSA to use KRU seawater and KRU oil processing capacity to lower Pikka Unit capital costs and to potentially accelerate Pikka Unit development. Ultimately, as it is entirely within its rights to do as owner and operator of the Pikka Unit asset, OSA determined to construct its own standalone facilities.

Now, however, OSA insists that it is the commercial costs of KRU road use that are impeding the Pikka Unit project from progressing to a final investment decision (“FID”), and that free KRU road use is “necessary to allow the Pikka project to advance.”² OSA further claims that CPAI’s

¹ March 18, 2022 OSA comments at 2.

² *Id.*

commercial terms are “unprecedented” even though OSA proposed substantially equivalent road use terms to the Alaska Industrial and Export Development Authority (“AIDEA”) for OSA’s own long-term use of Pikka Unit project roads only two years ago.³

Although the KRU roads are the private property of the KRU owners, and what the KRU owners consider to be reasonable commercial terms for KRU road use is entirely within their discretion, CPAI believes it is important to correct OSA’s characterization of the CPAI commercial proposal, which seems aimed at engendering public pressure on DNR. To be clear, CPAI is not attempting to block the Pikka Unit development. Just the opposite: CPAI’s goal is to negotiate in good faith to reach commercial terms that fairly capture the unique nature of OSA’s planned use of the KRU roads.

1. CPAI’s proposal for long-term use of KRU roads is equivalent or lower than OSA’s proposal for long-term use of Pikka roads.

In 2020, OSA proposed that AIDEA “issue[] debt to purchase road(s) and bridge(s) from Pikka” for \$200 million.⁴ OSA now asserts that its offer to AIDEA offer was “not an attempt to purchase or sell the Pikka road”,⁵ but this statement is untrue.⁶ OSA’s own public documents show that OSA proposed that AIDEA “purchase road(s) and bridge(s) from Pikka” and charge OSA tolls for their use.⁷ Those tolls would have been, at minimum, \$1.4 million per road mile per year for long-term use of Pikka roads.⁸ CPAI has proposed that OSA pay the same amount per road mile for

³ The AIDEA proposal would have allowed OSA to recoup capital from the already constructed Pikka project roads, with OSA paying road use fees in return. For the KRU road use terms, OSA would be avoiding any capital outlay (no need to recoup) for additional Pikka project roads by paying road use fees.

⁴ Appendix 1 attached to this letter details the OSA offer to AIDEA to purchase Pikka roads, the terms OSA impliedly proposed for tolls that it would pay to AIDEA for long-term Pikka road use, and how those terms compare to CPAI’s February 25, 2022 proposal to OSA for long-term use of KRU roads.

⁵ March 18, 2022 OSA comments at 10.

⁶ See Appendix 1.

⁷ *Id.*

⁸ *Id.* The OSA proposal to AIDEA also included terms for “renewal/repurchase” at the end of the fee term. August 5, 2020 OSA presentation to AIDEA, at 11 (attached as Exhibit 4 to March 14, 2022 CPAI comments). The specific terms of the potential repurchase are not spelled out in the presentation, but if OSA reacquired ownership of the Pikka roads at the end of the fee term, it would thereby take over remediation and restoration obligations. Importantly, CPAI is not proposing that OSA assume any responsibility for remediation and restoration of KRU roads, which is a significant benefit to OSA.

long-term use of KRU roads.⁹

OSA's new claims must be rejected. It cannot be true, as OSA now claims, that CPAI's proposal is "unprecedented"¹⁰, when OSA made an equivalent proposal to AIDEA two years ago. It also is not credible that CPAI is attempting to create "a monopoly"¹¹ to harm OSA by offering OSA the same commercial terms OSA offered AIDEA. And clearly, OSA cannot credibly contend that privately built roads over KRU state oil and gas leases are part of the "land" owned by the State,¹² while only two years ago OSA tried to sell its own roads on state oil and gas leases¹³ to AIDEA for \$200 million.

OSA cannot have it both ways. Either the State owns roads built on oil and gas leases or the lessee owns them. If the State owns the roads that OSA tried to sell to AIDEA for \$200 million, then OSA has a Brooklyn Bridge problem. If OSA owns the roads that it tried to sell to AIDEA, then the KRU owners own their roads as well. Similarly, if it was lawful, reasonable, and fair for OSA to propose to pay AIDEA at least \$1.4 million per mile per year for long-term use of Pikka roads, then it is lawful, reasonable, and fair for CPAI to propose similar terms to OSA for long-term use of KRU roads.¹⁴

2. OSA's anticipated use of the KRU road system is unique, and, unlike other operators, OSA will not contribute capital for other KRU infrastructure.

In its March 18, 2022 comments, OSA contends that because KRU has not charged other operators similar road capital contribution fees in the past, that CPAI cannot propose that OSA pay such fees now.¹⁵ It is clear as a matter of law that owners of private property can charge or not charge any amount for use of their property, and if an owner chooses to charge one party

⁹ Adjusted downward to account for OSA's anticipated share of KRU road traffic – i.e., CPAI's proposal is \$1.4 million per mile per year * 20% OSA anticipated share of total use = approximately \$280 thousand per mile per year for OSA long-term use of KRU roads. Appendix 1 contains the details of calculations comparing OSA's 2020 proposal to AIDEA with CPAI's current proposal to OSA.

¹⁰ March 18, 2022 OSA comments at 8.

¹¹ *Id.* at 2.

¹² *Id.* at 3.

¹³ Some of the Pikka roads are located on state oil and gas leases owned by AIDEA, under easements granted by DNR. It is not clear from the OSA proposal whether OSA was proposing to also sell roads on AIDEA's leases.

¹⁴ Taking into account OSA's anticipated use of KRU roads, CPAI's proposal is actually much less than \$1.4 million per mile per year. See note 9 and Appendix 1.

¹⁵ See, e.g., March 18, 2022 OSA comments at 11: "CPAI does not point to any similar commercial road use agreement by and between the KRU owners and the owners of the Colville River Unit, Southern Miluveach Unit, Oooguruk Unit, Greater Moose's Tooth Unit, or Bear's Tooth Unit, despite that each of these units were developed using KRU roads and the operators of these units continue to use KRU roads to this day."

more than another, that is within the owner's rights. However, importantly, and, contrary to OSA's contentions, CPAI is not treating OSA inequitably.

OSA's anticipated use of the KRU road system will involve more and heavier use than any other non-KRU operator. Not only does OSA propose to use the KRU road system to traverse the KRU to reach the Pikka Unit leases and facilities on a daily basis, OSA proposes to use the KRU road system to transport sealift modules from Oliktok Point within the KRU, to build and operate a new seawater treatment plant within the KRU, to lay pipelines within KRU, to access gravel mine sites within KRU, to haul many tons of gravel to Oliktok Point and to the Pikka Unit, and for other construction-related and ongoing operational activities. No other non-KRU operator's use of KRU roads has been or is anticipated to be as extensive as OSA's anticipated use. OSA cites to the Willow project's anticipated use of KRU roads to take sealift modules from Oliktok Point to the Bear Tooth Unit, but notably, the Bear Tooth Unit operator does not propose to build or operate new facilities within KRU, to extract and haul gravel from mine sites within KRU to the Bear Tooth Unit, or to conduct other ongoing daily operations within the ongoing 24 hour daily operations of the KRU.

Further, anticipated levels of road use aside, other non-KRU operators who use KRU roads have made substantial commercial contributions to KRU, with each of the most significant users contributing tens of millions of dollars to improve and maintain KRU's gas, seawater, and road and pad infrastructure. This is in addition to regular fees collected under KRU processing, seawater supply, and gas infrastructure agreements, as well as ad hoc infrastructure use.

In contrast, OSA proposes in its MLUP Application to contribute nothing and to simply use KRU infrastructure for free, asserting that not even DNR could compel OSA to pay anything to the KRU owners to compensate them for OSA's anticipated use.¹⁶ Contrary to OSA's assertion, it is not CPAI's proposed commercial terms for road use that are unprecedented – OSA, itself, proposed substantially equivalent terms for use of Pikka roads – rather, it is OSA's attempt to contribute nothing to KRU and use KRU infrastructure on an ongoing basis at no cost that is without precedent.

3. CPAI is not blocking access.

As described above, CPAI has given OSA free use of KRU roads for three years and is offering OSA long-term KRU road use terms on commercially reasonable terms. Further, CPAI has never proposed that OSA build its own roads across KRU. OSA states that it would be difficult to environmentally permit construction of new roads across KRU.¹⁷ This is accurate. However, it is also true that the Pikka Unit benefits by its location adjacent to existing KRU infrastructure. KRU roads are not "access corridors" as that term is defined in the DNR North Slope Area Plan,¹⁸ but KRU roads do comprise extremely valuable infrastructure. Even though CPAI has never proposed that OSA build new roads across KRU, it is important to recognize the costs that OSA is saving by not having to construct its own road system. OSA built the Pikka Unit project roads

¹⁶ March 18, 2022 OSA comments, at 10: "[T]here is no legal basis upon which DOG could act to include in the MLUP any conditions or requirements related to compensation to CPAI or potential commercial agreements between CPAI and OSA."

¹⁷ *Id.* at 5-6.

¹⁸ See March 14, 2022 CPAI comments at 18-19.

for approximately \$17.4 million per mile (\$200 million for 11.5 miles of road). OSA is seeking to use 75.5 miles of KRU roads,¹⁹ an effective savings to OSA – based on OSA’s own costs to build the Pikka roads – of \$1.3 billion. It is appropriate to take that cost savings into account when weighing the reasonableness of OSA’s demand to use KRU roads for free.

4. OSA’s refusal to even consider an agreement with CPAI to use KRU roads is unreasonable and an impermissible attack on at least six DNR orders related to the Pikka Unit project.

On at least six prior occasions, DNR has made clear that OSA’s use of KRU infrastructure, including KRU roads, shall be through “agreement” with the KRU owners and that DNR “does not authorize” the use of those roads.²⁰ Conspicuously, though perhaps not surprisingly, OSA fails to address or even acknowledge DNR’s earlier decisions that speak specifically to the use of KRU roads. Instead, OSA ignores those prior decisions and effectively asks DNR to do the same.

Consistent with DNR’s prior rulings, CPAI has proposed a long-term commercial agreement to OSA for the use of the KRU roads throughout the life of the Pikka project, on commercially reasonable terms.

However, contrary to DNR’s rulings, OSA has made clear that it has not and will not negotiate with CPAI for the use of KRU roads.²¹ Instead OSA asks DNR to disregard its prior decisions and bestow upon OSA a financial windfall by issuing a MLUP that would theoretically provide OSA the use of KRU’s private roads free of charge. To do so would run afoul of DNR’s prior decisions requiring that such use would be subject to “agreement” with the KRU owners and would result in the KRU owners subsidizing OSA. DNR should deny OSA’s unprecedented request.²²

5. It is possible to reach agreement on commercially reasonable terms in time for OSA to make its final investment decision for Pikka.

As DNR is aware, OSA’s schedule for Pikka FID has recently changed,²³ which may allow more time for negotiations than OSA’s previous schedule. Further, although OSA contends that an

¹⁹ February 9, 2022 OSA Application, Appendix A, Maps (adding the miles on the map attached to the OSA application equals 75.53 miles of total KRU roads that OSA seeks permission to use).

²⁰ See CPAI March 14, 2022 comments at 8-9.

²¹ OSA March 18, 2022 comments at 2: “There is no legal basis for CPAI’s claims that it is entitled to charge for access across the KRU and, contrary to CPAI’s representations, a new road use agreement between the parties will not be forthcoming unless and until the State affirmatively acts to confirm its rights and deny CPAI a monopoly over access across the KRU.”

²² CPAI will not attempt to address all factual misstatements and legal gymnastics OSA employs in its March 18, 2022 comments, many of which are already addressed in our March 14, 2022 comment letter. However, a handful of new OSA inaccuracies are addressed in Appendix 2.

²³ “A guessing game”, Kay Cashman, *Petroleum News*, Week of February 20, 2022. Available at <https://www.petroleumnews.com/pntruncate/415017697.shtml>. See also “Santos mandates Moelis for Alaska sale, offers operating stake”, Anthony Macdonald, Sarah Thompson and Kanika

agreement “will not be forthcoming” – which is within OSA’s control, of course – the parties are not far apart on all terms. If OSA is willing to discuss reasonable capital contribution terms, as OSA was previously willing to discuss with AIDEA for long-term use of Pikka roads, CPAI is confident that resolution on other terms of the agreement could be relatively straightforward. In this regard, it has previously been suggested that DNR undertake a non-jurisdictional role in facilitating further discussions between OSA and CPAI. CPAI continues to support this approach and would be willing to meet with OSA and DNR.

6. CPAI continues to support the Pikka project and will continue to make KRU roads available for OSA use on commercially reasonable terms.

If DNR denies the requested “miscellaneous land use permit,” CPAI will continue to allow OSA use of KRU roads prior to Pikka FID, so long as OSA complies with the terms of the existing Ad Hoc Agreement. If DNR grants the requested permit, but stays its effectiveness until Pikka FID, then, without waiving any of its claims or rights, which CPAI would pursue by appeal and other remedies, CPAI will continue to allow OSA use of KRU roads prior to Pikka FID, so long as OSA complies with the terms of the existing Ad Hoc Agreement.²⁴

In either case, CPAI will leave open its February 25, 2022 proposal to OSA for post-FID long-term KRU road use, which, as discussed above, comprises commercially reasonable terms.

Thank you for your consideration of these additional comments.

Sincerely,



John F. Schell, Jr.

Sood, *Australian Financial Review*, February 24, 2022. Available at <https://www.afr.com/street-talk/santos-mandates-moelis-for-alaska-sale-offers-operating-stake-20220224-p59zbnk>.

²⁴ Although OSA is currently in material breach of Sections 2.2 and 12.8 of the Ad Hoc Agreement, CPAI will not terminate the Ad Hoc Agreement prior to Pikka FID, so long as OSA complies with the other terms of the Ad Hoc Agreement.

APPENDIX 1

OSA'S 2020 PROPOSAL TO AIDEA FOR PURCHASE AND SALE OF PIKKA ROADS & LONG-TERM ROAD USE AGREEMENT TOLLING TERMS

COMPARISON TO TERMS OFFERED TO OSA BY CPAI FOR KRU ROADS

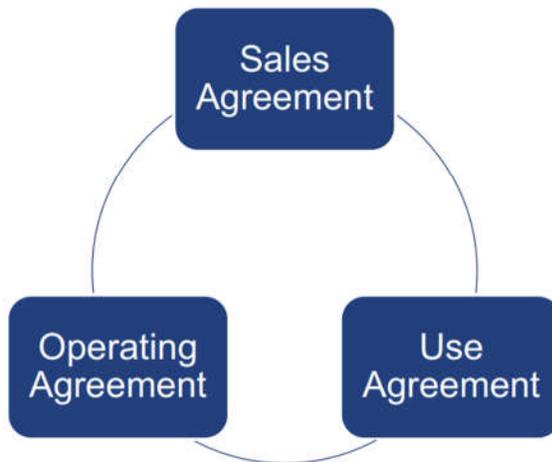
In 2020, OSA proposed that AIDEA “issue[] debt to purchase road(s) and bridge(s) from Pikka.”²⁵

DELONG MOUNTAIN TRANSPORTATION SYSTEM (DMTS) MODEL

Oil Search

CONTEMPLATED STRUCTURE

- » AIDEA issues debt to purchase road(s) and bridge(s) from Pikka
- » Pikka enters into a long-term use agreement with an associated fee
- » OSA provides maintenance services through operating agreement
 - Road to be operated as a non-public, industrial use road with access available to other commercial users and area residents



OSA indicated that the “valuation” of the road and bridge “asset” to be purchased by AIDEA was approximately \$200 million.²⁶

| | |
|------------------|---|
| Valuation | Confirm value of asset <ul style="list-style-type: none">• Pikka spent in excess of \$200 million in 2019/2020• Figure includes pads—which are unlikely to be part of the transaction |
|------------------|---|

OSA proposed that AIDEA issue bonds to fund the purchase:²⁷

| | |
|--------------------|---|
| Feasibility | Identify form(s) of financing available <ul style="list-style-type: none">• AIDEA to fund purchase - Revenue Bonds, AIDEA Bonds, Other• Pikka to pay fee for long term right of use |
|--------------------|---|

²⁵ August 5, 2020 OSA presentation to AIDEA, at 10 (Exhibit 4 to CPAI’s March 14, 2022 comments).

²⁶ *Id.* at 11.

²⁷ *Id.*

Now, two years later, directly contradicting its 2020 representations to AIDEA, in its March 18, 2022 comments, OSA states: “The referenced AIDEA transaction was a potential financing arrangement, *not an attempt to purchase or sell the Pikka road*. In fact, the materials submitted by CPAI reflect OSA’s view that *there was no property interest to sell . . .*”²⁸ OSA further asserts that roads across state oil and gas leases are part of the “land” owned by the State: “As a matter of plain language, a road may be considered ‘land’ (albeit land overlaid by gravel) versus a ‘structure.’”²⁹ And OSA asserts: “CPAI’s attempted use of the KRU roads to extract value from third-party leaseholders and as de facto toll roads exceeds the scope of the grant in the DL-1 leases.”³⁰

In 2020, with respect to Pikka roads also built across state oil and gas leases, in exchange for AIDEA “issue[ing] debt to *purchase road(s) and bridge(s) from Pikka*” for approximately \$200 million, OSA proposed that it would “enter[] a long term road use agreement with an associated fee.”³¹ OSA proposed to “model” the Pikka road sale and long-term road use fee arrangement on AIDEA’s Delong Mountain Transportation System (“DMTS”).³² The DMTS is a toll road.

According to information available on AIDEA’s website, AIDEA charges four tolls for use of the DMTS, under a 1997 agreement with the operator of the Red Dog zinc mine to which the 52-mile DMTS provides access.³³

The 1997 Agreement provides for four (4) tolls, or fee payments; namely:

1. Minimum Annual Assessment (MAA) which includes a Tonnage Sensitive adjustment;
2. Supplemental Minimum Annual Assessment (SMAA);
3. Contingent Tonnage Fee (CTF); and
4. Contingent Escalator for Zinc Price Increases (CEZ)

²⁸ March 18, 2022 OSA comments, at 10 (emphasis added).

²⁹ *Id.* at 3.

³⁰ *Id.* at 9.

³¹ August 5, 2020 OSA presentation to AIDEA, at 10 (emphasis added) (attached as Exhibit 4 to CPAI’s March 14 comments). See also “Redesigning Pikka”, Kay Cashman, *Petroleum News*, August 30, 2020, available at <https://www.petroleumnews.com/pntruncate/745913477.shtml>. “Oil Search would agree to maintain and operate the roads and bridges, which would be operated as *non-public*, industrial use with access available to other commercial users and area residents *for a fee, or toll*” (emphasis added).

³² August 5, 2020 OSA presentation to AIDEA, at 10. This OSA slide proposing the DMTS “model” is also pasted above in these reply comments.

³³ A comprehensive 2017 report regarding the DMTS commercial structure and terms (AIDEA DMTS Report) is available on AIDEA’s website at <https://www.aidea.org/Portals/0/PDF%20Files/2017Dec-DMTSFinalReport.pdf>. The above excerpt is from page 38 of the AIDEA DMTS Report.

According to AIDEA, the first of these tolls is approximately \$12 million per year; the second is approximately \$6 million per year.³⁴ The other two tolls do not appear to be significant, in part due to low zinc prices.³⁵ Total tolls for use of the 52-mile DMTS are, therefore, approximately \$18 million per year. According to AIDEA, this toll structure returns approximately 6.38% on AIDEA's \$267 million investment over 40 years.³⁶

It is not apparent from the public materials that OSA presented to AIDEA whether OSA proposed to replicate this investment structure exactly, or if AIDEA would have expected more favorable returns given the investment risk.³⁷

Indeed, if OSA had revealed to AIDEA in 2020 that OSA did not own the Pikka Unit project roads, that they were part of the "land" owned by the State, such that, in OSA's words, "*there was no property interest to sell*"³⁸ to AIDEA for \$200 million, AIDEA may have required an even higher return for what would have been, essentially, an unsecured \$200 million loan to OSA.³⁹ OSA's own reported target rate of return for investment in Alaska is at least 20%,⁴⁰ and it is reasonable to expect AIDEA would look for similar equity-level returns on a higher risk unsecured loan. These scenarios are shown in the following table:

³⁴ AIDEA DMTS Report at 40. The second toll relates to an expansion of the DMTS, reflecting that DMTS road users are responsible for additional capital expended by AIDEA.

³⁵ *Id.* at 41. Some of the revenues above the base toll amounts, which are collected by AIDEA based on tonnage use, are shared by AIDEA with the road operator for PILT payments, community investment, and other purposes. *Id.* at 39, 43.

³⁶ November 2012 AIDEA presentation http://dnr.alaska.gov/commis/priorities/Slides/Mark_Davis.pdf at 14. 6.38% apparently is a blend of 6.5% returned on the original portion of AIDEA's investment, and 6.33% returned on a subsequent DMTS expansion investment. See AIDEA DMTS Report at 40-41.

³⁷ For example, since 1997, when the DMTS agreement was entered into, AIDEA has made pension investments returning 7.38%. See AIDEA Financial Statements, June 30, 2021, at 57, available at https://www.aidea.org/Portals/0/Meeting%20Docs/2021BoardMeetings/120121/Alaska_Industrial_Development_2021_Financial_Statements_FINAL.pdf.

³⁸ March 18, 2022 OSA comments, at 10 (emphasis added).

³⁹ This assumes that the loan would have even been collectible. OSA now contends that the means of repayment that OSA proposed to AIDEA in 2020 – long-term road use fees or tolls – is unlawful.

⁴⁰ 2021 Oil Search investor presentation, available at https://www.oilsearch.com/_data/assets/pdf_file/0008/54926/OSH-2021-Half-Year-Presentation_24-Aug-21.pdf, at 22.

**TERMS FOR LONG-TERM USE OF
 11.5 MILE PIKKA ROAD SYSTEM
 REFLECTING DIFFERENT AIDEA
 RETURN EXPECTATIONS**

**BASED ON AIDEA ACQUISITION
 COST FOR PIKKA ROADS:
 \$200 MILLION
 FOR 11.5 MILES OF ROAD**

**ANNUAL FEE PER ROAD MILE
 (\$ Million / Mile)**

| | SOURCE | RATE OF RETURN | 20-YEAR TERM | 30-YEAR TERM | 40-YEAR TERM |
|--|---|---------------------------|-------------------------|-------------------------|-------------------------|
| Representative Breakeven Cost of Capital | AIDEA DMTS Investment = 6.38% ⁴¹ AIDEA Pension Investments = 7.38% ⁴² Federal Public Investments = 7% ⁴³ | 7.0% | \$1.64 million | \$1.40 million | \$1.30 million |
| Typical Oil Industry Discount Rate | 2020 Oil Search investor presentation, using 10% ⁴⁴ | 10.0% | \$2.04 million | \$1.84 million | \$1.78 million |
| Typical Industry Profit Threshold | 2021 Oil Search Investor Presentation (Alaska Oil... >20% internal rate of return (IRR)) ⁴⁵ | 20.0% | \$3.57 million | \$3.49 million | \$3.48 million |

As is shown in this table, if AIDEA required only a modest 7% return over 30 years (possible length of Pikka field life), the annual Pikka road use fee would have been \$1.4 million per mile, or \$16 million annually for OSA to use the 11.5 mile Pikka road system. If AIDEA required higher returns over a shorter twenty-year term, reflective of the risk associated with the proposed

⁴¹ See note 36.

⁴² See note 37.

⁴³ The federal Office of Management and Budget requires a 7% discount rate to be used for federal budget evaluations. See Discounting for Public Policy, January 2017, available at https://obamawhitehouse.archives.gov/sites/default/files/page/files/201701_cea_discounting_iss_ue_brief.pdf, referencing Circular A-94, available at <https://obamawhitehouse.archives.gov/sites/default/files/omb/assets/a94/a094.pdf>.

⁴⁴ It is common in the oil industry to use a 10% discount rate to compare capital investment opportunities. See, e.g., OSA 2020 investor presentation, available at https://www.oilsearch.com/_data/assets/pdf_file/0020/54281/01.-20210223_OSH_ASX_FY20_Results-and-Presentation_Final.pdf, at 5, 19, 20, 32.

⁴⁵ OSA's own reported target rate of return for investment in Alaska is at least 20%. 2021 Oil Search investor presentation, available at https://www.oilsearch.com/_data/assets/pdf_file/0008/54926/OSH-2021-Half-Year-Presentation_24-Aug-21.pdf, at 22.

investment, those fees would have been as high as \$3.6 million per mile per year, or \$41 million annually for OSA to use the 11.5 mile Pikka road system.

In comparison, for use of KRU roads,⁴⁶ CPAI has proposed approximately \$1.4 million per year per road mile, over a 20-year term, adjusted downward to reflect an estimated 20% OSA share of total KRU road traffic.⁴⁷ Accordingly, CPAI's proposal is slightly more favorable to OSA than the lowest of the potential road use fees that OSA would have paid to AIDEA for long-term use of Pikka roads, and much more favorable than the terms AIDEA might have required to account for the higher risk of the proposed investment.⁴⁸

⁴⁶ As noted in our March 14, 2022 comments, the KRU road system contains 10 bridges, while the OSA Pikka road system contains only one bridge and two pads. For a true apples-to-apples comparison, the above numbers would have to be adjusted to subtract the value of the two Pikka Unit project pads and to add the value of the additional KRU bridges OSA would seek to use.

⁴⁷ See February 25, 2022 CPAI proposal to OSA, shared previously with DNR. CPAI has proposed that OSA pay a \$95 million one-time total capital contribution for KRU road use for the life of the KRU and Pikka fields. CPAI offered that OSA could spread the \$95 million capital contribution over 20 years, if it wished, essentially removing any up-front capital obligation and reducing future capital payments to approximately \$10 million annually for use of approximately 36.4 miles of KRU roads, or approximately \$1.4 million per year per road mile, adjusted downward to reflect an estimated 20% OSA share of total KRU road traffic (36.4 miles * \$1.4 million per road mile * 20% estimated OSA share of total road traffic = approximately \$10 million).

⁴⁸ OSA has previously contended that KRU roads are not as valuable, because they are older and "fully depreciated." See, e.g., Exhibit 2 attached to CPAI's March 14, 2022 comments, and OSA's August 26, 2021 letter to DNR, at 3. Anticipating that OSA may raise that argument again, two points are important: (1) the KRU roads are not a utility asset, as OSA, itself, has agreed in Section 12.8 of the Ad Hoc KRU Road Use Agreement, so whether the KRU roads are depreciated is not relevant to commercial terms for their use; and (2) there is no reasonable contention that the KRU roads are of lesser quality than the Pikka Unit project roads built more recently, and, therefore, it is reasonable to expect that use of the two road systems would be priced similarly. A common example illustrates this fact. A city will include office space constructed at different times. An older building may sit next to a newer building. However, assuming the quality of the office space in the newer building is similar to the office space in the older building, one would reasonably assume that the rental cost of that office space also would be similar, even if the newer building is not fully depreciated on the books of its owner, and even if the older building is fully depreciated on the books of its owner. Depreciation simply has no relevance to determining market prices or rates in a non-utility context.

APPENDIX 2

RESPONSE TO CERTAIN OTHER OSA MISSTATEMENTS

A. OSA misreads KRU Agreement Section 3.7.

OSA contends that roads are not within the personal property described in Section 3.7 of the KRU Agreement, but rather should be considered “land” owned by the State.⁴⁹ OSA’s reasoning is noticeably unsupported and obviously flawed.⁵⁰

Section 3.7 recognizes as “personal property” “all lease and well equipment, materials, *and other facilities placed by any of the Working Interest Owners in the Unit Area.*”⁵¹ While not defined, “facilities” is referred to throughout the Unit Agreement as encompassing a laundry list of additions to the land—including buildings, pads, docks, causeways, airstrips, and *roads*—the key characteristic being the use or addition of these features by the KRU owners.⁵² These references are consistent with the common meaning of the word “facilities,” which generally implies something that is constructed or provided to serve a particular purpose or assist with a function.

Ignoring this common meaning, OSA argues that Section 3.7’s reference to “facilities” cannot include the KRU roads without creating a conflict with Section 14.4. OSA apparently believes that Section 14.4’s reference to the KRU owners abandoning the roads after the Agreement terminates indicates that DNR necessarily owns the roads *now*.⁵³ OSA is wrong. That Section 14.4 dictates what happens to the KRU roads *after* termination of the Unit Agreement says nothing about the KRU owners’ rights in those roads *before* termination; those rights are dictated by

⁴⁹ March 18, 2022 OSA comments at 2-3.

⁵⁰ OSA’s reading of KRU Agreement Section 3.7 also is at odds with the Commissioner’s recent statements, as quoted in a recent article: “[O]ne company had to pay to build the road in the first place . . . And fairly recognizing that property right can be complicated.” March 11, 2022, *Anchorage Daily News*, by Nathaniel Herz, “Alaska’s next big North Slope oil project is mired in a feud with ConocoPhillips, and reportedly for sale”, *available at* <https://www.adn.com/business-economy/energy/2022/03/11/alaskas-next-big-north-slope-oil-project-is-mired-in-a-feud-with-conocophillips-and-reportedly-for-sale/>.

⁵¹ Emphasis added. “Facility” as used in other state contexts includes roads. See AS 19.59.001(3), defining “controlled access facility” to be “a highway especially designed for through traffic”

⁵² See e.g., KRU Agreement Sections 5.1.1(4), 5.2.3(2).

⁵³ *Id.*

Section 3.7 in describing “facilities” as the “personal property” of the KRU owners. OSA’s non-sensical reading of KRU Agreement must be rejected.⁵⁴

B. OSA’S eminent domain arguments are flawed.

OSA fails to address CPAI’s argument, more fully described in CPAI’s March 14, 2022 comments, that the DNR has no eminent domain authority and the taking of the CPAI’s property interest by DNR and granting an interest to OSA is prohibited. Instead, OSA generally argues that the issuance of the MLUP would not result in a taking because CPAI only has a “contractual right to be free of ‘unnecessary or unreasonable interference’ with KRU operations.”⁵⁵ OSA’s characterization of CPAI’s rights is disingenuous and far too narrow, especially given the leases at issue expressly grant CPAI “an interest in real property in said land,”⁵⁶ and the Alaska Constitution broadly protects private property, including improvements, from government taking. OSA cannot reasonably argue that that issuance of a “miscellaneous land use permit” for use of KRU roads would not deprive CPAI of its economic interest in its property, given that OSA proposed to sell analogous property rights to AIDEA for \$200 million.

C. OSA’s citation of the expired 1999 Charter Agreement is misleading and inapt.

OSA cites to an agreement entered into by BP and CPAI (then ARCO Alaska, Inc.) in 1999 related to the BP-ARCO merger.⁵⁷ In that agreement, BP and CPAI agreed not to unreasonably withhold their voting support as facilities owners for allowing nearby satellites to have access to existing unit facilities on reasonable commercial terms.

That agreement has since expired. However, as described above, CPAI has proposed to give OSA access not only to KRU roads on commercially reasonable terms, but also access to KRU seawater and oil and gas processing on commercially reasonable terms that would have substantially decreased the capital costs of the Pikka project, which would have resulted in significant economic benefit to the Pikka owners.

⁵⁴ OSA’s interpretation of KRU Agreement Amendment 2 also should likely be rejected, although CPAI does not entirely understand what that interpretation is. OSA appears to assert that road use is not covered under Amendment 2 and draws from that the conclusion that the KRU owners may not charge for road use. March 18, 2022 OSA comments at 9-10. But Amendment 2 does not address whether the KRU owners may charge fees; it simply allows the KRU owners to make KRU facilities available for non-unit use. If KRU roads are not covered by Amendment 2, then third party use of KRU roads would not be covered, whether for compensation or without compensation to the KRU owners. CPAI does not believe that OSA intends to assert that the KRU Agreement does not allow any third-party use of KRU roads; accordingly, CPAI does not understand OSA’s interpretation of Amendment 2.

⁵⁵ March 18, 2022 OSA comments at 8.

⁵⁶ There can be no dispute that the KRU owners have a compensable property interest. See March 14, 2022 CPAI comments at 12-13.

⁵⁷ March 18, 2022 OSA comments at 4.

D. OSA's assertion that CPAI did not previously object to OSA's use of KRU roads is inaccurate and misleading.

OSA asserts that "CPAI did not raise any objections to OSA's use of KRU roads until April of 2020 when it became public that OSA would construct its own seawater treatment plant, rather than acquiring make-up water from CPAI's legacy facility."⁵⁸ First, it is important to note that CPAI has never objected to OSA's use of KRU roads, and CPAI does not object now to OSA's use of KRU roads, provided OSA has a commercial agreement with the KRU operator to do so.

Second, prior to April 2020, it was anticipated that OSA would purchase seawater from KRU, potentially utilize KRU oil and gas processing facilities, and contribute capital for facility upgrades necessary to accommodate the Pikka project. In the context of these discussions, it was anticipated that use of KRU roads would be an ancillary commercial term, much as it had been for other prior developments that utilized KRU facilities and contributed capital in connection with such use. In April 2020, OSA reversed course and elected to construct its own seawater treatment plant and oil and gas processing facilities. At that point, CPAI merely pointed out that OSA would need a commercial agreement for long-term use of KRU roads. At no point has CPAI objected to OSA's use of KRU roads under commercially reasonable terms.

E. OSA's interpretations of the Ad Hoc Agreement also must be rejected.

OSA argues that the March 2, 2018 KRU Ad Hoc Road Access and Use Agreement ("Ad Hoc Agreement"), executed by OSA's former president and CEO, which is still in effect, does not establish that the KRU roads are the private property of the KRU owners. OSA states: "the KRU Road Agreement carefully avoids describing the KRU roads as the 'private' or 'personal' property of the KRU working interest owners. Instead, the agreement describes the KRU roads as a 'road constructed by private parties for private purposes without any state or federal funding, and is intended for industrial traffic in a remote area[.]'"⁵⁹ Contrary to OSA's strained reading, it is not necessary for an agreement to say "private" more than twice in the same sentence for the meaning to be clear. Sections 2.2 and 12.8 also make clear that the KRU roads are the private property of the KRU owners.

OSA also maintains that it is not asserting a "right of use" to the KRU roads, in breach of Ad Hoc Agreement Section 2.2, because "OSA would not apply for a MLUP if it already had a "right of use" from the State to use KRU roads".⁶⁰ This statement ignores that the express and only basis for the OSA MLUP Application is to have DNR adjudicate an alleged OSA right of concurrent use in the KRU roads. If OSA were not asserting a right of concurrent use, there would be nothing to adjudicate. Thus, OSA's reading of Section 2.2 also must be rejected.

⁵⁸ *Id.* at 5.

⁵⁹ *Id.* at 8.

⁶⁰ *Id.* at 9.

F. OSA's assertion that CPAI has acted capriciously to create "uncertainty of access" is also without merit.

OSA asserts that CPAI has acted in a "capricious manner", which has caused "uncertainty of access" that only the requested OSA permit can resolve.⁶¹ In support of this statement, OSA offers as evidence the fact that CPAI could terminate the Ad Hoc Agreement but has so far not done so – in other words, CPAI's decision to continue to allow OSA to use KRU roads has somehow created uncertainty whether OSA can continue to use KRU roads. In reality, although the Ad Hoc Agreement has always been terminable in CPAI's (or OSA's) discretion, CPAI has done everything possible to accommodate OSA's use of the KRU road system, despite OSA's repeated refusals to comply with the commercial terms agreed to by its former president and CEO in 2018, which remain binding on OSA now.

⁶¹ *Id.*