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Alaska pump prices remain slow to drop

• Based on stock trading information, questions arise on whether Tesoro refinery uses Alaska to recoup losses elsewhere

By Naomi Klouda
Homer Tribune
November 19, 2008

Alaska consumers may be offsetting refinery profit losses in the Lower 48, providing one possible reason for why state gasoline prices remain high, according to discussions before the House Judiciary Committee.

Hearings by the committee, led by Rep. Jay Ramras, R-Fairbanks, continue Friday in Anchorage. The group seeks to gather as much information as possible about how fuel pricing works in Alaska. A partner investigation by the Alaska Attorney General Office, led by Assistant Senior Attorney General Ed Sniffen, also is involved in the task of finding answers on why Alaska fuel prices remain the highest in the nation.

One possible reason can be found in the recent troubled performance of Tesoro, the company that dominates the gasoline market in Alaska and has six refineries Outside, where prices are lower, according to information compiled by economist Dermot Cole of Fairbanks.

"A year ago, Tesoro stock was valued in the \$60 range. Today it is in the \$10 range. At one point last month, the stock was below \$8," Dermot wrote in a column published in the Fairbanks Daily News Miner. Since Tesoro stock is traded on the stock market, some financial information is available, such as its recent profit reports for the third quarter that do not separate out its Alaska operations from refineries in Anacortes, Wash. Tesoro has other refineries in Mandan, N.D., Salt Lake City, Los Angeles, Martinez, Calif., and Kapolei, Hawaii.

The refining companies had record results before the steep climb in oil prices, but 2008 has been a bad year. It has been particularly tough on companies like Tesoro that don't explore or produce oil, Cole said. "That's a question the committee is looking at: Is Tesoro's Alaska operations used to offset losses elsewhere?" said Ramras aide Jane Pierson.

There also isn't a correlation between how close a community is to a refinery and low fuel prices, Sniffen told the group at its last hearing in Anchorage in late October. People might believe that with transportation costs thrown into the retail costs equation, those closest to the refineries would pay the least.

"The problem is more complex than that," Sniffen said. "It is not true in Alaska nor is it accurate in California. The mega refineries have scales of operations that dwarf what we have up here in Alaska. It is more complex than just being close to a refinery."

Rep Mike Hawker, also on the committee, said based on the documentation so far, it is clear that there is a problem with retail prices in Alaska.

"We look across the country and Alaska was on parity with North Dakota," he said. "We spiked the same and now North Dakota is \$1 different. We continue to see the disconnect ... the regulatory thing is coming if they don't do something."

Regulatory solutions?

Hawker proposed possible solutions for "predatory pricing" and legislative action or regulation through the Regulatory Commission of Alaska, which must approve electricity and natural gas hikes before companies are allowed to impose them.



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Gas was \$5 a gallon in June at a small gas station along the Richardson highway



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"The unintended consequences would be there. Under a regulatory price control, structure is cost-plus-profit. Mr. Sniffen," he asked of the attorney general, "do you agree that the high prices we saw in Alaska would not have been as high if we were under a regulatory end?"

Sniffen responded that it depends on what type of legislation is developed.

"You would not see the lows or the highs (in prices), but the averages would be higher than they are over the long-run," he said.

Each stage in the attorney general's investigation is looking at different segments of the gasoline cost flow chart, Sniffen has said.

The price of crude on the world market dictates what price refineries pay for the oil they purchase to refine into gasoline, diesel, heating oil, propane and jet fuel. But how much does the refinery charge for its product to the next stage down - a wholesaler who then passes costs along at the pump?

That information is protected as proprietary or confidential trade information. In Alaska the two main refineries are owned by Tesoro Alaska and Flint Hills. Tesoro's refineries at North Pole process most of the oil sold in Alaska.

"We are looking at more than just the refineries," Sniffen told the committee. "We have Chevron and some other companies that are involved. We are looking at why the crude and retail prices are so different here and why they are not reacting now to the markets, which right now are falling and prices are falling around the country. The reason prices don't change is generally more than a market issue, and that is what we are looking at - the red flags that are going up." In a normal market, prices come down because of the competition. They come down because the price of a commodity decreases. "But the prices are not coming down," he said.

No laws are broken when companies charge what they want, Sniffen added. "You might as well ask, 'why aren't they charging \$10 a gallon?'"

How prices trickle down

As part of her energy relief package, Gov. Sarah Palin rescinded the 8 cents per gallon state tax on fuel. The committee discussed the ways in which that was intended to impact the pump price of oil.

"As soon as the bill became law, the price went down 8 cents. I'm not sure if we will ever know if it was passed on to the people, but it seemed like it was," Sniffen said. "One of the things we can look at is that in places like (Kenai and Homer) there are borough and city sales taxes up to 6 (and 7.5) percent and that makes up for some differences and economics of volume make some difference. The 8 cents is not showing up on the ledger anymore."

Tesoro Alaska's external affairs manager, Kip Knudson, said it's not true that the company is using its Alaska sales to offset losses elsewhere.

"There are a lot of factors that determine the price of fuel," he said.

"We spend a lot of time with the attorney general, giving him lots of proprietary data. When he is done talking to the refineries in this state, it will be seen as a false summary. When we're done manufacturing, gasoline, we sell into a market."

Tesoro reported its third-quarter earnings rose five-fold because of higher profit margins. "It doesn't reveal what the profit margins are in Alaska, compared to the other regions where it operates," analyst Cole said. "The Tesoro refinery in Kenai represents more than 10 percent of the company's refining capacity," among other refineries in Anacortes, Wash., as well as in Mandan, N.D., Salt Lake City, Los Angeles, Martinez, Calif., and Kapolei, Hawaii.

"The company does not report its Alaska results independently. It lists combined figures for the Anacortes refinery and the Kenai refinery," Cole wrote.

Tesoro's Knudson said an easy math equation is to divide the price of crude per barrel with the number of gallons per barrel - 42 - to figure out profit margins. If today's price of crude is \$55 per barrel, divided by 42 would place price per gallon at about \$1.25. Add sales tax to that and subtract it from the pump price. That will give an idea of profit margins for recovering costs.

HomeRun Oil of Homer owner Shelly Erickson said it simply isn't true that retailers are making more than pennies per gallon of gas. At least, HomeRun Oil isn't, she said. The company uses its own trucks to transport directly from the Kenai refinery.

"The cost we pay depends on where they are pricing it off at that point. In Alaska, we are tied at West Coast prices," Erickson said.

"We have to pay whatever price the refinery is charging."

The price added onto a gallon of fuel mandated by local and borough sales taxes will keep Homer prices higher than other places, Erickson said. "This is one of the huge things. When you add 22.5 cents onto

\$3 in fuel, that will keep Homer prices higher," she said.
When all is calculated, there isn't much left for a profit for a small
locally owned company, Erickson added.

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