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arctic slope
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THE ALASKA REFINING INDUSTRY
A PATH TO SUSTAINABILITY
February 2014

BACKGROUND

For nearly two years, ASRC and Petro Star have engaged in discussions with members of the Parnell Administration and the Alaska legislature concerning the growing number of issues faced by the Alaska refining industry. The recent announcement by Flint Hills that it is closing its North Pole refinery has generated discussion across the state that has focused on how best to preserve surviving Alaska refiners. Petro Star Inc., with small refineries at North Pole and in Valdez, is the only Alaska-owned refinery in the state, and Petro Star's owner, Arctic Slope Regional Corporation, is deeply interested in insuring that its doors remain open for business.

In past discussions we have stressed that the economic climate in the refining industry is suffocating in-state refiners. This continues to be true. Many of the concerns we will discuss in this whitepaper are not new; a few were created by Flint Hills' announcement. We have organized them solution-by-solution.

Flint Hills' drastic announcement underscores that the refining industry in Alaska is not healthy. Many of its ills can be directly traced to the high price Alaska refiners must pay for raw materials, a problem that is exacerbated for refiners along TAPS like Petro Star, which must pay enormous "TAPS Quality Bank" fees to re-inject their return oil into TAPS.

In 2013, the average combined costs of ANS crude oil and Quality Bank by themselves represented nearly ninety-five percent (95%) of the value of commercial jet fuel ***delivered*** to the Port of Anchorage.

The Quality Bank is discussed last in this whitepaper only because it is primarily federally regulated and the State has limited options to control it. We therefore are asking the Legislature and Parnell Administration to do what is possible, but always be mindful that until the Quality Bank is fixed, the refiners along TAPS will be profoundly disadvantaged.

IN-STATE REFINERS NEED CHEAPER CRUDE OIL

The refiners along TAPS have no choice but to buy ANS crude, and ANS currently is one of the highest-priced crude oils in the country. Indeed, ANS prices are so high that several refineries in the Pacific Northwest – including one owned by a North Slope

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producer – are investing in the infrastructure necessary to transport Bakken crude from North Dakota by rail to their refineries rather than purchase ANS and other waterborne crudes delivered by tankers.

The State has the power to directly address the problem of high ANS crude prices by selling royalty oil to in-state refiners at prices that would broadly serve the State and its residents by helping to preserve and foster local refining capacity.

SUPPORT PSI & GVEA COOPERATIVE EFFORTS

The Golden Valley Electric Association operates the pipeline that connects the Flint Hills and Petro Star refineries in North Pole to TAPS. This pipeline was significantly expanded to accommodate increased volumes of oil required by Flint Hills' predecessors, MAPCO and Williams, all while Petro Star increased its capacity only very modestly. Approximately 15% of GVEA's pipeline revenue came from Petro Star last year, and the rest came from Flint Hills. GVEA and Petro Star are working together to try to fashion a solution for this lost revenue, and very likely will be returning to the Legislature to seek support for a resolution that will allow both parties to continue to efficiently serve the Interior.

ASSIST PSI & ARR WITH TRANSPORTATION INFRASTRUCTURE

Petro Star and the Alaska Railway currently are in discussions to decide on what infrastructure improvements would be necessary to allow Petro Star to move fuel from its Valdez Refinery to the Interior and points north more efficiently than by truck. Flint Hills' announcement has added tremendous urgency to these discussions because closure of the Flint Hills refinery will both add to the need for more Petro Star product in the Interior and greatly diminish the Alaska Railroad's customer base—an effect with ramifications throughout Alaska. Petro Star and the Alaska Railroad are working together to decide how best to address these issues and will need help from the Legislature to implement whatever is the best solution.

REFINERS ALONG TAPS NEED RELIEF FROM THE TAPS QUALITY BANK.

The TAPS Quality Bank was designed to compensate for the impact of refinery return streams on the price of ANS crude, but it has grown to be the second highest cost to TAPS refiners—exceeded only by crude oil purchases. In 2013, Petro Star's Quality Bank expense exceeded ***all*** the operating costs at both its refineries, including labor and refinery fuel.

Petro Star has paid over $525 million in penalties over the last nine years, and nearly half that amount in the past three years alone: The Quality Bank is getting worse at the same time market conditions are getting worse for Alaska refiners and its effects are devastating. Over these past three years, most of the margin between Petro Star's crude oil price and the price it received for its refined products like commercial jet fuel was paid out in Quality Bank penalties.

In sum, the TAPS Quality Bank has been transformed from a mechanism to adjust for minor impacts to crude oil value into a huge profit center for Alaska's major oil producers and the state government (through its royalty oil and tax collections from major oil producers). Faced with the combination of exorbitant Quality Bank fees and high crude costs, Petro Star and ASRC have had to put on hold capital projects that would grow Petro Star's business in Alaska and benefit consumers statewide just when these are needed most.

For these reasons, we appeal to legislators to urge the Governor to strive for a fair settlement of the pending TAPS Quality Bank proceedings. Because the Quality Bank is primarily federally regulated, this is the principal way that the Legislature can help to solve the problems it presents.

Ideally, a settlement would restore Quality Bank penalties to more fair and sustainable levels. Relief from the same excessive Quality Bank fees that penalize the refiners would have the major additional benefit of encouraging the production of heavy oil on the North Slope, as the current Quality Bank penalizes heavy oil resources just as it does refinery return oil streams.

Critically, a more equitable Quality Bank would help to forestall further attrition of instate refining capacity and the negative consumer and economic impacts that would inevitably follow.

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