Alaska Department of
NATURAL RESOURCES

Briefing Paper
CSHB 287(RLS)am
Commissioner's Office
April 2014

Purpose:

This bill grants legislative approval of an amendment of a royalty oil supply contract negotiated between the State of Alaska and Tesoro Refining & Marketing Company, LLC (Tesoro), the owner and operator of the Kenai Refinery.

This bill also facilitates continued operation of in-state refineries and incentivizes certain in-state oil refineries and hydrocarbon processing facilities. By creating a more favorable tax climate, we have the opportunity to expand an industry that provides jobs for Alaskans, adds value to Alaska's oil, and will help keep our resources in Alaska and available to Alaskans.

Tesoro Royalty Oil Contract:

The Department of Natural Resources (DNR) and Tesoro recently entered a one-year royalty oil supply contract in October 2013 to deliver up to 15,000 barrels per day of Alaska North Slope royalty oil beginning February 1, 2014. Legislative approval was not required for "the sale, exchange or other disposition of oil or gas ***for one year or less*** if the sale, exchange, or other disposition of oil or gas is entered into to relieve storage or market conditions."

Subsequent to the approval of the one-year contract, DNR and Tesoro agreed to an amendment to continue deliveries for one year beyond the State's current contractual obligation. Extending the October 2013 Agreement through January 31, 2016 and committing to royalty oil deliveries for more than one year triggered additional provisions of AS 38.05.183 and AS 38.06.055 that require a recommendation of the Alaska Oil and Gas Royalty Development Advisory Board (Royalty Board) and approval by the Alaska Legislature.

The Royalty Board reviewed the proposed amendment through a public hearing process and, in accordance with AS 38.06.050, issued a written recommendation on December 11, 2013, for legislative approval of the sale. Their resolution, along with the DNR commissioner's determination, is included in the Final Best Interest Finding and Determination for an Amendment of the "Agreement for the Sale of Royalty Oil between and among the State of Alaska and the Tesoro Refining & Marketing Company, LLC, a Delaware Limited Liability Company, October 25, 2013."

Refineries Incentives:

The price of feedstock is the largest single cost factor in the manufacture of distilled products for end-use. Changes in the marketplace have taken us from a time when Alaska North Slope (ANS) crude was traded at a discount to other crudes to where in the last 5 or 6 years, ANS now trades at a premium—making it more difficult for Alaska refineries to compete.

The provisions in the bill allow the DNR commissioner, upon approval of a request from the lessee, to value the royalty owed by the lessee to the state at the price the lessee receives for the oil it sells to an in-state refinery. Without this ability, the commissioner and the lessee must abide by the value terms of the lease based on the ‘higher of rule’. This will free the lessee from having to adjust royalty due to the state.

The bill also adds another new section to DOR’s corporate income tax statutes, creating a corporate income tax credit for in-state refineries or hydrocarbon processing facilities who incur “qualified infrastructure expenditures” during a tax year, and the credit is the lesser of 40% of qualified expenditures or $10 million. The credit created by the bill is refundable, and can only be applied against corporate income taxes for a period of 5 years to January 1, 2020.