THE STATE of ALASKA
GOVERNOR BILL WALKER

Department of Natural Resources
COMMISSIONER'S OFFICE
550 W.7th Avenue, Suite 1400
Anchorage, AK 99501
Main: 907.269.8431
Fax: 907.269.8918

March 15, 2017

The Honorable Representative David Guttenberg
State Capitol Room 501
Juneau AK, 99801

Dear Representative Guttenberg:

Thank you for your questions during the House Finance committee hearing on March 13, 2017 regarding Senate Bill 30. This legislation would ratify the contract negotiated between DNR and Petro Star Inc. (Petro Star) for Petro Star to purchase the state's royalty oil for four years. Below are responses to the questions you raised during the committee hearing.

1. **Does the State of Alaska have standing in Federal Energy Regulatory Commission (FERC) Quality Bank disputes?**

   The State of Alaska has standing in Quality Bank disputes so long as it can trace an injury to an action by the Quality Bank. In the particular case you referenced (challenge to valuation of residual component of barrel of oil after refining), the United States Court of Appeals for the District of Columbia Circuit held that the State of Alaska did not have standing to make a *particular argument* we argued in support of Petro Star's appeal. The Court held the State of Alaska did not have standing because the state was not challenging a particular Quality Bank methodology or rate, but rather the state was challenging the way in which the FERC decided the underlying decision.

2. **What is the impact of FERC tariff protests or challenges to the Royalty in Kind (RIK) price?**

   The proposed contract with Petro Star has a retroactivity provision that at any time within eight years after an invoice is sent more accurate information is obtained (i.e., FERC tariff adjustments), then the state and Petro Star agree to adjust the payments accordingly. *See* Section 3.3 of contract, pgs. 15-16. So, if FERC orders a retroactive TAPS tariff adjustment within eight years of an invoice under this RIK contract, the invoice will be adjusted to reflect the correct tariff, and thus RIK price.

3. **Are pipelines upstream from TAPS Pump Station 1 included in the transportation deductions, and if so, are these regulated tariffs?**

   Yes, the "feeder" pipeline tariffs upstream from Pump Station 1 are transportation deductions that are included in the netback formula when determining the Royalty in Kind (RIK) or Royalty in Value (RIV) price. The Regulatory Commission of Alaska (RCA) and FERC regulate the tariffs on these upstream pipelines. Attached for your review is an example of a recently-approved RCA tariff filing for the upstream pipelines.

4. **How are marine transportation deductions calculated?**

   Since the RIK oil will be taken from leases that are affected by the various royalty settlement agreements (RSAs), the marine transportation deduction for the RIK-RIV price comparison follows the definitions in the RSAs. The marine transportation deduction is the sum of three elements: the marine fuel expense, the marine capital expense, and the marine operating expense. If a lessee does not own the tankers (directly or indirectly through a subsidiary), the marine transportation deduction will reflect the expense in leasing or chartering those tankers from a third party.

   The portion of Alaska North Slope (ANS) oil taken in value (RIV) from leases that are not subject to a RSA can be divided into two groups: oil sold in state versus oil sold outside the state. For the in-state RIV sales, there is no marine transportation deduction, but rather a location differential. For RIV sold out of state, the lessees with the ability to transport ANS oil out of state, like Exxon, ConocoPhillips, BP, and Chevron, will use a value for the marine transportation deduction similar to the RSAs, discussed above.

5. **Can you show how the Quality Bank adjustments are equivalent in RIV and under this contract?**

   The quality bank adjustments for RIV and RIK are not equivalent. The difference stems from the different methodologies that are prescribed by the various RSAs that affect the valuation of the ANS oil (when taken as RIV) from which the State will be taking its RIK. The difference in the RIK-RIV price comparison is negligible (an average of $0.07 per barrel in 2015 in favor of the RIK barrel). For a detailed reference on the Quality Bank calculation for RIK, see Appendix 2 of the Petro Star contract.

Thank you for your support of Senate Bill 30. Please let DNR know if we can provide additional information for your consideration.

Thank you,

Andrew T. Mack
Commissioner
Department of Natural Resources

cc: House Finance Committee Members