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TESTIMONY OF TARA SWEENEY and DOUG CHAPADOS

BEFORE THE
ALASKA LEGISLATURE
HOUSE FINANCE COMMITTEE
ON
H.B. 287

APRIL 09, 2014

Good evening Co-Chair Stoltze, Co-Chair Austerman and distinguished members of the Committee. I am Tara Sweeney, Senior Vice President of External Affairs for Arctic Slope Regional Corporation. Co-presenting with me this evening is Doug Chapados, president and CEO of Petro Star Inc. Thank you for the opportunity to speak before you today.

By way of background, Arctic Slope Regional Corporation ("ASRC") was established pursuant to the Alaska Native Claims Settlement Act of 1971 ("ANCSA"). Our corporate headquarters are located in Barrow, Alaska, and we have administrative and subsidiary offices across the state. We are owned by approximately 11,000 Iñupiat shareholders, many of whom live in the villages of Point Hope, Point Lay, Wainwright, Atqasuk, Barrow, Nuiqsut, Kaktovik, and Anaktuvuk Pass.

From very humble beginnings, ASRC has grown to become the largest locally-owned and operated business in Alaska. ASRC has five diverse lines of business, including the only Alaska-owned refining and fuel marketing operation in the state known as Petro Star. We have approximately 10,000 employees nationwide, and our family of companies has nearly half of our employees working across Alaska – in Barrow, Fairbanks, Anchorage, Kenai, Kodiak, Dutch Harbor, Valdez and across the North Slope oil fields. The remainder of our employees work in the lower 48.

SLIDE #2

Our presentation today will focus on the current shape of in-state refining in Alaska and why we support the Governor's proposal to stabilize the refining industry.

The recent announcement that Flint Hills Resources is shutting down its refinery in June has sent shock-waves throughout the state, but Flint Hills' economic problems are not unique. Alaska refineries that are dependent upon drawing ANS crude from TAPS are fighting to remain in business in this state. Leadership from this committee and the legislature is needed to help this vital industry to ensure that petroleum products Alaskans need are refined here in Alaska, from Alaska crude oil.

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SLIDE #3:
What this slide indicates is that ASRC is committed to Alaska. By the nature of our ownership, we intend to be in Alaska for the long-term. As you can see we have a presence across the state in employing all facets of Alaskan society from engineers to equipment operators, payroll technicians to attorneys, the five North Slope crafts, to lending officials.

In 2013 alone we invested over $36 million in Alaska infrastructure projects; provided over $2 million in charitable contributions and over $380 million in wages to Alaskans. These numbers are real, tangible and meaningful to the people the legislature is assembled to represent.

SLIDE #4:
ASRC was one of the original investors in Petro Star Inc., and ASRC's support has been crucial to making Petro Star a viable refiner in Alaska. Since 2007, ASRC has reinvested over $280 million in Petro Star's operations. This includes the ASRC Board of Directors' 2008 decision to invest over $150 million to build the facilities necessary for the Petro Star Valdez Refinery to produce EPA-mandated ultra-low sulfur diesel fuel (ULSD). This was, and remains, the single largest investment in ASRC's history and established Petro Star as one of only two instate refiners capable of producing that essential fuel. At this time I would like to turn it over to Doug Chapados.

SLIDE #5
Good evening Co-Chair Stoltze, Co-Chair Austerman, and members of the Committee.
I am Doug Chapados, president & CEO of Petro Star Inc. Petro Star is a wholly-owned subsidiary of Arctic Slope Regional Corporation. This slide provides the committee with additional background on our company. Petro Star is the only locally-owned refiner in the state of Alaska with two refineries; one located in North Pole and the other in Valdez.

We are one of two refiners in Alaska that provide ultra-low sulfur diesel to the Alaskan market, and we also produce and supply jet fuel, marine diesel and home heating oil.

Petro Star's North Pole and Valdez refineries were commissioned in 1985 and 1993, and have a combined crude processing capacity of 82,000 barrels per day – nearly equal to the capacity Flint Hills is now shutting down. Refined products from Petro Star's refineries can be found in consumer fuel tanks and equipment across the state. In addition to refining, much of Petro Star's production is sold through company owned marine terminals and heating oil distributorships located in Valdez, Kodiak, Unalaska, and the Interior.

Currently, 100% of the Alaska military jet fuel demand at JBER, Eielson AFB, Ft. Wainwright, and Coast Guard Air Station Kodiak is produced and delivered by Petro Star. In 2013 alone, Petro Star worked with 750 in state vendors, generated 282 million gallons in fuel sales, and provided products and services to over 14,000 customers.

Petro Star thus plays an important role throughout Alaska, especially within the communities in which it does business.

SLIDE #6

This slide provides additional detail about Petro Star's facilities in North Pole and Valdez.

SLIDES #7 & #8:

This slide represents the contribution Petro Star has made to the Alaska economy in 2013. While the numbers are aggregated to include our Anchorage operations, you can see the breakdown within the Interior, Valdez, Kodiak, and Unalaska. An important takeaway is that Petro Star, alone, has invested nearly $300 million in capital projects in the state over the last seven years.

These slides present a more detailed account of our business relationships, economic impact in various regions of the state and just how important refining is to Alaska.

SLIDE #9:

It is critical for this committee to understand that the challenges facing the in-state refining industry are not new. Two years ago ASRC and Petro Star approached the State of Alaska highlighting warning signs of a weak refining industry, and the discussions for a solution have been on-going.

In short there are two major challenges facing in-state refining. The first is the high cost of ANS crude. ANS is one of the most expensive in the United States despite being of lower quality than lighter, sweeter crude from fields like the Bakken in North Dakota-which currently sells at a large discount compared to ANS.

Several key takeaways are that the failure of any of the remaining in-state refineries would decrease competition within Alaska fuel markets, and remove most of the existing brakes on prices.

Failure of the Interior refineries would eliminate any local source of military jet fuel for Eielson AFB and of commercial jet fuel for the Fairbanks International Airport.

The second major challenge is the Quality Bank methodology, which is unique to refineries that draw crude oil from, and return oil to, TAPS.

The TAPS Quality Bank is regulated principally by the Federal Energy Regulatory Commission (FERC) and to a lesser extent by the Regulatory Commission of Alaska (RCA). In 2002, when the Quality Bank was litigated in a months-long proceeding, the FERC ultimately settled on a Quality Bank methodology that made the TAPS refiners pay shippers more than any party requested at the hearing and the RCA concurred. This led directly to the excessive Quality Bank penalties that are imposed on the TAPS refiners today.

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.

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.

<u>SLIDE #10:</u>
This slide represents the Governor's proposal, as we understand it to date.

ROYALTY OIL:
This provision provides a benefit to in-state refiners because it expands the potential pool of available ANS crude.

It allows producers to sell their crude in-state without penalty. This is important because in the proposed form it encourages producers to have their RIV price assessed at a value equal to sales to in-state refiners versus at the higher rate they or others might receive if they chose to market their crude out of state.

IN-STATE REFINERY TAX CREDIT:
This provision is equitable because it is done on a per refinery basis, and aims to mitigate the high price of ANS crude.

As stated, 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 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.

INFRASTRUCTURE CREDIT:
This provision spurs reinvestment into the industry by in-state refiners with a reasonable cap. If refiners make significant infrastructure investments they are responsible for at least 90% of the total project cost.

<u>CONCLUSION</u>

ASRC has deep roots in Alaska. By the nature of our mission and structure, we will continue to be an economic driver in this state and a strong advocate for fair and meaningful business development policy. As stated earlier, we have grown from very humble beginnings into Alaska's largest locally-owned company and an employer of choice for thousands of Alaskans.

We make disciplined business decisions focused on our mission. The investments we have made were based on Alaska's future potential, not because they qualified for State subsidies, tax credits or financing. Rather they were grounded in ASRC's commitment to this State and its residents.

While we will continue to operate in Alaska with the long-term on the horizon, uncertainties surrounding the continued viability of refining in Alaska makes us question whether we should employ our assets elsewhere.

The stark economic realities that face the Alaska refining industry have required ASRC to suspend major new capital investments in refining and fuel distribution. ASRC has been compelled to put on hold a significant multi-million dollar capital project that is necessary for the long-term health of both our refineries. This particular project would have benefitted Alaskans in South Central and the Interior, as well as organizations like the Alaska Railroad.

We fully support the Governor's amendment because it remedies one of the outstanding threats to in-state refiners. Please know that neither Petro Star nor ASRC are looking for an exit strategy. We are seeking the stability that is necessary to justify long-term investment and maintain a viable refining industry in Alaska.

Quyanaqpak. Thank you.