

**ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON ENERGY**

February 12, 2009
3:08 p.m.

MEMBERS PRESENT

Representative Bryce Edgmon, Co-Chair
Representative Charisse Millett, Co-Chair
Representative Nancy Dahlstrom
Representative Kyle Johansen
Representative Jay Ramras
Representative Pete Petersen
Representative Chris Tuck

MEMBERS ABSENT

All members present

OTHER MEMBERS PRESENT

REPRESENTATIVE LES GARA

COMMITTEE CALENDAR

Review of House Judiciary Report on retail gasoline prices in Alaska

PREVIOUS COMMITTEE ACTION

No previous action to record

WITNESS REGISTER

Ed Sniffen, Senior Assistant Attorney General
Commercial/Fair Business Section
Civil Division
Department of Law (DOL)
Anchorage, Alaska

POSITION STATEMENT: Presented the Attorney General's Report
2008 Alaska Gasoline Pricing Investigation.

JANE PIERSON, Chief of Staff
Representative Jay Ramras
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Answered questions on the House Judiciary Standing Committee Alaska Gasoline Pricing Report

ACTION NARRATIVE

[3:08:09 PM](#)

CO-CHAIR CHARISSE MILLETT called the House Special Committee on Energy meeting to order at 3:08 p.m. Representatives Dahlstrom, Ramras, Petersen, Millett, and Edgmon were present at the call to order. Representative Johansen and Tuck arrived as the meeting was in progress. Representative Gara was also in attendance.

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Review of House Judiciary Report on retail gasoline prices in Alaska

[Contains discussion of HB 68]

CO-CHAIR MILLETT announced that the only order of business would be a review of the House Judiciary Standing Committee Report on retail gasoline prices in Alaska.

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Ed Sniffen, Senior Assistant Attorney General, Commercial/Fair Business Section, Civil Division, Department of Law (DOL), summarized the conclusion of the Attorney General's Report 2008 Alaska Gasoline Pricing Investigation, and said that there was no evidence of illegal activity related to the pricing of gasoline. He described the investigative process of collecting information, looking at documents, and interviewing witnesses from the retail, distribution, and refinery businesses of the retail gasoline market. The collected information was then reviewed by a petroleum economist. Mr. Sniffen informed the committee that after careful consideration, the conclusion reached was that there are market reasons for the recent movement in the price of gas. The initial investigation began in August when the differential between the price of gas in Anchorage, compared to prices in the Lower 48, grew to \$1.06; the difference in gas prices between the Pacific Northwest and Alaska is historically about \$0.13 and questions were raised about the cause of this increase.

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MR. SNIFFEN stated that after looking at the information, the economist concluded that the record pace of the rise, and subsequent fall, of oil prices was unprecedented. The pricing volatility of crude oil pricing was coupled with Alaska's unique oligopoly market. He explained that an oligopoly is a concentrated market with a few competitors that account for all of the market share. Even when competitors do not collude, in this type of environment competitors' market strategies are well known to each other. These two factors can explain the price differentials to some extent, although oil companies may have taken advantage of this scenario and earned healthy profits. Mr. Sniffen advised that the Department of Law (DOL) could find no evidence of a violation of state law in documents or in testimony. He concluded that high prices are unfortunate and frustrating; however, the DOL was "satisfied that there was nothing illegal going on."

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REPRESENTATIVE PETERSEN asked whether "price-gouging" legislation that is now proposed before the Senate, if enacted, would have spurred an investigation by the attorney general into price fixing by refineries.

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MR. SNIFFEN opined oil refiners would have raised prices anyway; however, an investigation would have ensued when prices did not fall with those in the Lower 48 and the differential exceeded the statutory cap.

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REPRESENTATIVE JOHANSEN gave a point of order on the discussion of proposed bills.

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REPRESENTATIVE RAMRAS presented the House Judiciary Committee Report titled Alaska Gasoline Pricing Report, and explained that the report was tasked by the speaker of the house during the summer of 2008. Representative Ramras commended his staff members for their contributions and the DOL for its assistance in preparing the report. He noted that the report was prepared entirely "in-house" and his office is wholly responsible for its content and the process; nonetheless, all members of the House

Judiciary Standing Committee were offered the opportunity to attach addendums. Thus, addendums are attached by Representatives Gruenberg, Lynn, and Holmes. Also attached for reference is the Alaska Petroleum Products Pricing Investigation Closing Report prepared by the DOL and dated 11/21/2002.

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CO-CHAIR MILLETT asked for clarification on the timing of the Attorney General's report and that of the House Judiciary Standing Committee.

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REPRESENTATIVE RAMRAS explained that the governor charged the attorney general to look into possible illegal activity, and the speaker of the house charged the House Judiciary Standing Committee (HJUD) to make recommendations to the legislature for possible action. The reports contain similar data, although the intent of the judiciary committee was to consider price-gouging legislation; in fact, the legislation that has been proposed to the current legislature is referenced in the report. Representative Ramras confirmed that the HJUD committee reached the same conclusion as the attorney general. He opined government has three options: to regulate the market, through proposed price-gouging legislation; to subsidize the market, through a discount on the cost of royalty oil; and to incentivize the market. Representative Ramras then described the status of Alaska refineries and their product share.

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CO-CHAIR EDGMON asked whether there is vertical integration in Alaska, from the refinery level down to the retail [outlets.]

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REPRESENTATIVE RAMRAS suggested there is a "Gordian knot." He explained the State of Washington produces 10 times the volume of gasoline as Alaska; however, Alaska produces twice as much jet aviation fuel. The HJUD committee was interested in the fuel storage situation and the incentive of building large storage tanks in Anchorage. However, an unintended consequence of this incentive is to open up the market for large grocery chains that are in a position to fill the tanks with unbranded retail gas and put smaller independent dealers out of business. Representative Ramras said that the attorney general's report

concurr with the HJUD committee's concern that if the state provides a large tanker and storage in the urban and Railbelt market, the price of the stored gasoline over time may be higher than recent, smaller shipments.

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REPRESENTATIVE RAMRAS discussed the production of retail gasoline with Petro Star, Inc. (Petro Star), and its representative said that Alaska is a static market and its market share is two tenths of one percent of the national total. Furthermore, Alaska has a very "efficient market, with matched buyers and matched sellers," thus the refineries can charge whatever the market can bear. He relayed that Petro Star is not interested in entering the retail market even with inducements from the government because the market is static, the market is not growing, the market is well served, and there are too many regulatory hurdles to overcome. Representative Ramras returned to his description of the unusual period of time surrounding the fluctuating gas pricing. During this time, the Lower 48 marketplace suffered from demand destruction, conservation practices, recessionary economic conditions, and a surplus supply of refined gasoline. There is a spectrum of refineries across the nation, from complex refineries to simple refineries, as are found in Alaska. A complex refinery is more efficient but can not adjust its output. Alaska's simple refineries, like Tesoro Corporation (Tesoro) and Flint Hills Resources (Flint Hills) refineries in Alaska, can adjust their output according to the marketplace. He then explained that demand destruction is when consumers can not purchase a product because the price is too high. Conservation is an adjustment to how consumers use the product. A recessionary economic condition effects whether consumers purchase the product, and a surplus supply places too much of the product on the market.

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REPRESENTATIVE RAMRAS gave an example of this effect. He stressed that Alaska's simple refiners were able to respond to the market and were not forced to drop their prices "far below its break-even price." The result was that the refiners in Alaska had a great advantage over the consumers, whereas in the Lower 48, the consumers held the advantage. Representative Ramras said the comparison between the Alaska and Washington markets was completely inappropriate. Furthermore, refineries in the Lower 48 can easily sell to a multi-state market, putting lower prices within the reach of everyone connected by a

highway. This situation is not the same for Alaska, even for the folks who live in the shadow of a refinery.

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REPRESENTATIVE RAMRAS returned to the boundaries of the HJUD investigation and noted that concerns were raised about whether confidential and proprietary information should be revealed to committee members. As the task of the committee was to determine why the gasoline prices are still high and what solutions can be legislated, the committee turned to other variables in the Southcentral and Railbelt areas. He indicated that separate investigations should study the peculiarities surrounding the Southeast and Western Alaska retail gas markets.

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REPRESENTATIVE RAMRAS further explained that the HJUD committee continued its search for another significant variable in the Southcentral and Railbelt marketplace that could negatively impact the consumer, and concluded that it was the production of jet aviation fuel. He referred to page 46 of the HJUD report and read:

'Opportunity cost' is defined by Google as: 'The value of the next best choice that one gives up when making a decision.'

REPRESENTATIVE RAMRAS reminded the committee that Alaska refines twice the amount of aviation fuel as Washington. On a personal note, he said that he was not defending the refineries and described the effect of high gasoline prices on his business. He then reminded the gallery that the reason refineries exist in Alaska is for the production of jet aviation fuel, and not for the purpose of producing refined gasoline and diesel fuel for vehicles or home heating oil. He pointed out that the Stevens Anchorage International Airport is the fourth busiest cargo airport in the world due to its geographic location and competitively priced jet aviation fuel. Furthermore, the price of jet aviation fuel is set by the world market and the Anchorage airport must compete.

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REPRESENTATIVE RAMRAS called the committee's attention to the [bar chart] on page 4 of the HJUD report that indicated the average spread between Anchorage and Seattle retail gasoline

prices from 2002 to 2008. In March 2008, began a decoupling of the spread that led to the investigations by the attorney general and the HJUD committee. The HJUD committee theorized that the U. S. went into a recession at the end of 2007 and early in 2008, along with the rest of the world. Furthermore, the chart indicates that in April 2008, the disparity in pricing between Alaska and Seattle moved from \$0.20 to \$0.80. This happened because at the same time there was a glut in the refined gasoline market causing gas to be dumped in the Lower 48, jet aviation fuel was also being dumped onto the global market, lowering its market price. Representative Ramras acknowledged that the HJUD report was prepared without subpoenas and the investigation of proprietary information; however, the committee found that the Alaska refineries have two markets, the global jet aviation marketplace and the Railbelt. Furthermore, the two refineries, Tesoro and Flint Hills, must match the global price of aviation fuel in order to maintain the competitive position of the Anchorage airport. Representative Ramras emphasized the financial connections between the Anchorage airport and Fairbanks International Airport and the fiscal importance of the production of jet aviation fuel to both. In fact, the Fairbanks airport is subsidized by the Anchorage airport so that it can serve as a diversionary airport for Anchorage. He then gave an example of different profit margins for a variety of products.

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REPRESENTATIVE RAMRAS reiterated that the accepted conclusion of the HJUD report is that the refineries are laying off the losses from jet aviation fuel onto refined gasoline, low-sulfur diesel, and diesel consumers. Furthermore, seven infrastructure assets, for example, Eielson Air Force Base and Elmendorf Air Force Base, were identified as being uniquely dependent on jet aviation fuel. Representative Ramras remarked:

What if the refiners are laying off a disproportionate amount of their operating costs when they lose a dollar a gallon on jet aviation fuel, are they laying that cost off onto the consumer? Now, the legal term of art for that we just learned ... is called 'cross subsidization.' ... If we take testimony from the public that this will be one of the considerations that is greatly offensive to the public. ... that the consumers of Alaska could possibly be subsidizing the cost of jet aviation fuel for a global marketplace.

REPRESENTATIVE RAMRAS then explained that the HJUD committee considered the possible unintended consequences of enacting price regulations: The exit of the Alaska refiners leading to the loss of the two air force bases, the two refineries, the Alaska Railroad, the Stevens Anchorage International Airport, and the Fairbanks International Airport. These losses would represent about 10 percent of the state's gross domestic product and 10 percent of the state's work force. In addition, jet aviation fuel is a value-added product for Alaska, along with mining, fishing, oil, and gas. Representative Ramras opined these jobs and infrastructure assets are put at risk when the government tries to regulate the consumer side of the market and restricts the refiner's opportunity to lay off some of their costs. Although this theory is unpopular with the public the HJUD committee, in light of the attorney general's proof of no anti-trust [violation], no collusion, and no criminal activity, is trying to offer the reason why gasoline prices stay high.

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CO-CHAIR MILLETT asked Mr. Sniffen for his theory.

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MR. SNIFFEN said that he had no reason to dispute the factual basis of the conclusions of the HJUD committee. He opined that there is cross subsidization between jet aviation fuel and gasoline, even though the economist felt market factors weighed more heavily. He concluded that the pricing dynamics of Tesoro and Flint Hills must include consideration of all of their products. That said, he differed the question to the economist.

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CO-CHAIR EDGMON returned to page 32 of the HJUD report that discussed the Tesoro refinery and its 31 convenience stores and 58 branded stores. He asked:

So, in terms of the pricing dynamics from the refiner to the wholesaler to the retail outlet down to the consumer, what kind of market presence, the percentage basis, are the 29 outlets owned by Tesoro? ... Are we talking 50 percent, 20 percent? Do we know?

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MR. SNIFFEN assured the committee that his office looked at the numbers; however, this is proprietary information. He stated that there is vertical integration from the Tesoro refinery down to the company-owned stations. Mr. Sniffen explained that the branded stations are a little more independent and set their prices after paying the delivery price at their station (DTW). The Alaska Tesoro stations are not integrated in that they do not own the supply of oil; in Alaska, the level of integration starts at the refiner. Therefore, Tesoro has the advantage of setting the wholesale and retail price, in addition to its significant share of the Alaska market. The other major suppliers are Chevron U.S.A. Inc., Holiday Stationstores, Inc., and Shell Oil Company.

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CO-CHAIR EDGMON remarked:

You can't tell the committee the exact percentage of ownership of our retail outlets that the major refiner in the State of Alaska which produces 85 percent of the gasoline, that supplies basically 100 percent of the Railbelt, you can't tell us that percentage of the market in Anchorage, but it's a significant amount. And we know there is vertical integration, but we can't say that there's price-gouging, we can't say there's parallel pricing, we can't say if there's collusion, we can't say that there's monopoly activity because - can you finish that sentence for me?

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MR. SNIFFEN agreed that there is parallel pricing, but not necessarily due to illegal activity. Furthermore, there is competition in most of Alaska, with the exception of rural Alaska, where monopolistic practices exist, but are not necessarily illegal. This situation is troubling, but the DOL is limited by what can be done.

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CO-CHAIR EDGMON observed there are two different messages: the literal interpretation and the "gray area". He called attention to page 19 of the attorney general's report and read, "Tesoro owns or leases several tanker trucks to make these deliveries."

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REPRESENTATIVE PETERSEN disagreed that consumers are subsidizing jet fuel. His theory is that traditionally the aviation industry and airlines like to know in advance the cost of fuel; thus they contract in advance for 30 to 60 days to lock in prices and set airfares. Last year the airlines contracted a price with the refiners, but when the price of oil went up, the refiners sold jet fuel at a significant loss. That kept the wholesale price up until now. Representative Petersen noted that the graph on page 5 of the HJUD report indicates there is still a large differential between Alaska prices and the Lower 48; therefore the companies have to continue to keep prices high to "get back to profitability."

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MR. SNIFFEN, in response to Representative Petersen, acknowledged that may have been the case for some; however, airline contracts are keyed to market indices. He opined the refiners would not have been losing money because losses were tempered as prices moved with the market.

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REPRESENTATIVE PETERSEN observed that Alaska residents want to know why gasoline and diesel fuel prices are high; neither report gives a definite answer. He encouraged the committee to continue to look for satisfactory answers.

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REPRESENTATIVE RAMRAS read from Representative Lynn's addendum:

Trying to get definitive answers was difficult. The best we could do was to confirm a multiplicity of factors is involved. Many of the public explanations by the refinery representatives were a rehash of what we already knew or suspected. ... I have a problem with government imposed price controls, whether for gasoline or anything else. Typically price controls are counterproductive, result in many unintended consequences, and create more problems than they solve.

REPRESENTATIVE RAMRAS read from Representative Holmes' addendum:

First, the attorney general's office has been studying this issue in greater depth and its public report is expected in the very near future; this committee would benefit from seeing that report before finalizing our own. ... Second, the report comments on newly introduced legislation that has not yet been heard by any committee, let alone by this committee.

REPRESENTATIVE RAMRAS read from Representative Gruenberg's addendum:

... it was unfortunate that we do not have that department's thinking before publishing this committee's report. ... The laws of other states were not adequately discussed, there was insufficient review of other state [laws], such as those from Hawaii and North Carolina. ... [The report] offers no serious discussion on whether government should take a more active role in solving the problem. Finally the report paints a doomsday portrait should HB 68 pass before hearings have ever been scheduled on the bill. Ultimately, the report concludes that the legislature is powerless to do anything about the problem.

REPRESENTATIVE RAMRAS invited Mr. Sniffen to speak about the subpoena process used in the DOL investigation, and about Hawaii's experience with price regulation.

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CO-CHAIR MILLETT asked Mr. Sniffen whether his report discovered that any anti-trust laws were broken.

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MR. SNIFFEN said no. In response to Representative Ramras he described Hawaii's price regulation legislation. In 2005, the power to regulate the wholesale price of gasoline was granted to the Hawaii Public Utilities Commission. The legislation keyed the maximum price allowed the two Hawaii refiners to Gulf Coast and West Coast prices. After Hurricane Katrina, Gulf Coast prices were driven up, and the refiners immediately set their prices at the maximum allowable. He opined that the price cap creates a "safe harbor," that encourages manufacturers to price products at the cap. On the subject of subpoenas, Mr. Sniffen affirmed during his investigation subpoenas and civil investigative demands (CIDs) were issued for interviews and for

written information from the refineries, distributors, and retailers. Thousands of documents regarding pricing strategies and wholesale contracts were studied. He said that he was "comfortable that the conclusions we reached are absolutely accurate and correct." In response to Representative Edgmon's comment about price gouging, he advised that in Alaska law, the only thing illegal about pricing could be anti-trust behavior, or "unconscionable" pricing that violates the Alaska Consumer Protection Act. He concluded that gas prices are high because the market is at work and there is not much competition in Alaska; these conditions allow the gasoline wholesalers to price their products as they are unless there is evidence of collusion.

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REPRESENTATIVE JOHANSEN expressed his disappointment that the HJUD report did not include Southeast and Western Alaska in its investigation. He recalled two prior reports on gas pricing, one issued during the Knowles Administration, that also found nothing wrong. He said that he has faith in the work done by the DOL. Regarding price gouging he referred to page [11] of the attorney general's report and read:

Simply having a high price for gasoline is not price gouging in Alaska, even if those prices are in excess of prices in other parts of the country.

REPRESENTATIVE JOHANSEN understood the difficulty to consumers, especially those communities limited to bulk fuel supply by barge lines or air service. He described the situation in Ketchikan.

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MR. SNIFFEN, in response to Representative Ramras, confirmed that the attorney general's office holds broad subpoena power not subject to judicial approval. He said that he was not familiar with legislative subpoena power. In further response to Representative Ramras, he said that the report was produced by himself, as the primary and only attorney, with the help of an investigator and an economist with Econ One Research Inc. (Econ One). The contract with Econ One cost under \$150,000.

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REPRESENTATIVE RAMRAS pointed out that the HJUD committee did not have subpoena powers or CIDs, and had no investigator or support from an economist. He opined the HJUD committee produced a report in agreement with the attorney general and that also presented a hypothesis beyond the scope of previous reports. He asked Mr. Sniffen whether price gouging legislation would prevent high prices.

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MR. SNIFFEN acknowledged the difficulty of this question and cited the problem that arose in Hawaii. He opined there are potential risks, such as driving refiners out of business and forcing prices higher. In response to Representative Ramras, Mr. Sniffen provided his resume and title. Regarding price gouging regulation, he said that he held no authority to speak to the DOL position with regard to regulatory legislation.

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REPRESENTATIVE TUCK stated his appreciation for the HJUD committee report. He referred to the graph on page 5 and surmised the blue line representing average USA prices would have been lower had Alaska prices not been included.

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JANE PIERSON, Chief of Staff to Representative Jay Ramras, Alaska State Legislature, agreed.

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REPRESENTATIVE TUCK noted that gasoline prices in July and August could have been as high as \$7 per gallon and asked for an explanation.

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MS. PIERSON opined during this time there was a glut on market and this was also the time of highest use in Alaska. Furthermore, in Alaska change does not come as quickly as in the Lower 48.

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REPRESENTATIVE TUCK referred to a 2008 Reuters [news agency] report and read:

American based companies are shipping record amounts of gasoline and diesel fuel to other countries. A record of 1.6 billion barrels a day for the first four months of this year up to 33 percent from 1.2 [billion] barrels prior to that year.

REPRESENTATIVE TUCK observed that a shortage of oil causes prices to up, but there was no shortage. Referring to the chart on page 13 of the HJUD report, he asked whether petroleum products refined in Alaska are exported.

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MS. PIERSON advised that Alaska does not export gas; however, she was unsure about jet aviation fuel. In further response to Representative Tuck, she said that Alaska consumes all of the gas it refines.

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REPRESENTATIVE PETERSEN relayed in Hawaii the legislature regulated the price of gas, but not of diesel fuel. After Hurricane Katrina, gas prices came down due to the regulations, but the price of diesel fuel stayed high. He then asked about "cross subsidization" and how much is added to the price of gas to subsidize jet fuel.

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REPRESENTATIVE RAMRAS said he was not sure. He gave the example of Agrium Inc., and surmised the price of jet aviation was the same for all consumers. He did not offer the legal definition of the term "cross subsidization."

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REPRESENTATIVE PETERSEN asked whether the residents of the North Star Borough are subsidizing jet fuel by paying higher prices for home heating fuel.

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REPRESENTATIVE RAMRAS assured Representative Petersen that the residents of Fairbanks are subsidizing the economy of Anchorage because, if the HJUD committee theory is correct, they are paying higher prices to protect the supply of aviation fuel that

supports jobs in Anchorage. He strongly expressed his point of view supporting a free market over more government control.

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CO-CHAIR MILLETT asked Mr. Sniffen for historical data on how many previous reports have been issued by the attorney general on Alaska gasoline pricing.

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MR. SNIFFEN said that he was aware of one other that began in 1999. The investigation was slowed by debate over confidentiality and an interim report was issued in 2000 and the closing report was issued in 2002. These reports are available for the committee. Interestingly, in the 80's there was an investigation of gasoline prices that resulted in prosecutions of anti-trust violations in Anchorage. In response to Co-Chair Millett, he added that two or three independent gas station owners were involved, and the refineries were not.

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REPRESENTATIVE JOHANSEN corrected his previous statement, although the reports come to the same conclusion, he said.

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REPRESENTATIVE PETERSEN recalled that the price of gasoline went down as a result of the investigation.

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REPRESENTATIVE RAMRAS pointed out that gas prices came down after the HJUD committee investigation.

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REPRESENTATIVE TUCK assumed that Alaska is self sustaining as far as its source of gas. Furthermore, according to the HJUD committee report, it is not cost effective for another party to enter the market outside of the existing refineries. If this is so, there is no reason that Alaska prices would increase. He then turned to page 9, and paraphrased:

Pricing strategies and the refining/distribution costs
... have global and regional factors, ... which

include but are not limited to electricity costs, gas fuel cost, environmental regulations, equipment cost, maintenance cost, labor costs and the cost of additional capital investments that may be required by regulation changes.

REPRESENTATIVE TUCK understood the increase in energy and equipment costs and asked whether there have been changes in environmental regulations. If not, and Alaska is refining its own gas, there was no reason for the increase in prices.

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MS. PIERSON confirmed that there have been strict regulatory standards, especially regarding the production of low-sulfur diesel; in fact, Tesoro is the only facility in Alaska producing low-sulfur diesel.

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REPRESENTATIVE TUCK maintained his question.

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CO-CHAIR EDGMON stated his appreciation of both reports. He noted frustration over high prices in Alaska; however, no one is breaking the law and market forces prevail in Alaska and other states. He cautioned about the danger of crossing the line to unfair trade practices. Representative Edgmon concluded that there is a business relationship between major refineries and the outlets in Anchorage and questions remain for expert witnesses. He cited the situation in Western Alaska where residents are "paying incredibly high prices with no real understanding of what goes into ... the [overall] pricing structure."

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CO-CHAIR MILLETT thanked the presenters.

[4:59:30 PM](#)

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Energy meeting was adjourned at 4:59 p.m.