ALASKA STATE LEGISLATURE
HOUSE SPECIAL COMMITTEE ON ENERGY
March 12, 2009
3:06 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

COMMITTEE CALENDAR

Overview: Fuel Pricing in Rural Alaska

PREVIOUS COMMITTEE ACTION

No previous action to report

WITNESS REGISTER

ED SNIFFEN, Senior Assistant Attorney General
Commercial/Fair Business Section
Civil Division
Department of Law
Anchorage, Alaska
POSITION STATEMENT: Advised the witnesses.

MEERA KOHLER, President and CEO
Alaska Village Electric Cooperative (AVEC)
Anchorage, Alaska
POSITION STATEMENT: Testified during the hearing on fuel pricing in rural Alaska.

KIRK PAYNE, Chief Operating Officer
Northstar Utilities Group
Anchorage, Alaska
POSITION STATEMENT: Testified during the hearing on fuel pricing in rural Alaska.

ELAINE BROWN, General Manager
NorthStar Gas
Anchorage, Alaska
POSITION STATEMENT: Testified during the hearing on fuel pricing in rural Alaska.

CRAIG TORNGA, General Manager
Oil Industry Services
Crowley Marine in Alaska
Anchorage, Alaska
POSITION STATEMENT: Testified during the hearing on fuel pricing in rural Alaska.

JUSTIN CHARON, Independent Consultant
Anchorage, Alaska
POSITION STATEMENT: Testified during the hearing on fuel pricing in rural Alaska.

SMOKEY NORTON, Director of Marketing
Petro Marine Services
Anchorage, Alaska
POSITION STATEMENT: Testified during the hearing on fuel pricing in rural Alaska.

ACTION NARRATIVE

3:06:14 PM

CO-CHAIR BRYCE EDGMON called the House Special Committee on Energy meeting to order at 3:06 p.m. Representatives Dahlstrom, Ramras, Johansen, Petersen, Millett, and Edgmon were present at the call to order. Representative Tuck arrived as the meeting was in progress.

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OVERVIEW: FUEL PRICING IN RURAL ALASKA

CO-CHAIR EDGMON announced that the only order of business would be an overview on fuel pricing in rural Alaska. He then invited Mr. Sniffen, representing the Department of Law (DOL), to advise the witnesses on the scope of their testimony.

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ED SNIFFEN, Senior Assistant Attorney General, Commercial/Fair Business Section, Civil Division, Department of Law, reminded participants to be cautious in their discussion of competitively sensitive pricing information.

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MEERA KOHLER, President and CEO, Alaska Village Electric Cooperative (AVEC), informed the committee that AVEC is a non-profit electric utility serving 53 villages, primarily in Western and Northwestern Alaska. The population served is about 22,000 residents, thus AVEC represents about 45 percent of the villages in Alaska. The Alaska Village Electric Cooperative has 48 power plants and tank farms in the villages. Last year it purchased about 5.5 million gallons of fuel in bulk that, unfortunately, was purchased at or above $4.00 per gallon during the peak of the high oil prices. The average landed price was $4.70 per gallon resulting in an increase to the cost of electricity in the villages. The average fuel surcharge for electricity ranged from 37 cents to 58 cents per kilowatt hour. On the other hand, villages with wind generation paid the lowest charge of 25 cents per kilowatt hour. She continued to explain fuel is purchased for a three-year period, with two additional one-year periods that are elective to add to the contract. Ms. Kohler said AVEC has just ended a five-year contract that was exclusive to a single supplier serving Western Alaska. She stated at the conclusion of the bidding process for this year, the cost for the transportation of fuel for the next period had gone up dramatically. She opined this change is not surprising because, for the previous five years, the cost was "locked in" with a small consumer price index (CPI) increase. Ms. Kohler surmised the supplier absorbed this increase in the past. The cooperative hoped for additional competition during the bidding process this year; unfortunately, the bulk of its purchases will go to same single transportation agent again. Even at the current price, the cost of fuel in the villages will be from $2.50 to $3 per gallon unless there is a dramatic oil price increase. Ms. Kohler said the economy is starting to recover and she expects the price of oil to be $100 per barrel again within two years. She expressed her understanding that the cost of transporting fuel is high; however, she encouraged the state to discuss methods to bring in more competition. Ms. Kohler concluded that the reality of rural Alaska is "what small quantities of fuel we use."

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REPRESENTATIVE RAMRAS recalled the committee's visit to small communities, and regional hub communities, in rural Alaska. He asked for the range of kilowatt production from the smallest to the largest communities. In addition, he asked for the age and condition of the transmission grids for these communities.

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MS. KOHLER assured the committee AVEC enjoys "extremely good line loss numbers." In fact, the average line loss of the distribution system is about 4.5 percent. This amount is competitive with any large utility in the country. In addition, AVEC achieved an average kilowatt hour sales per gallon of fuel last year of 12.92. The smallest system is in Anvik, a town of 100 people, and the largest is Hooper Bay, a town that has about 1,100 people; however, the range of efficiency is comparable and the amount of kilowatt hours per gallon is about the same. Ms. Kohler noted that AVEC worked with the manufacturers of the generation engines to achieve efficiency. Although AVEC can not achieve what Nome did because of the size of its generators, it can get about 13.5 kilowatt hours per gallon of fuel, which is about what Dillingham gets. She asked the committee not to compare AVEC with a "stand alone" village because [AVEC] is able to maintain high levels of efficiency longer than is possible for a village. Regarding transmission system losses, she indicated that AVEC built lines to connect Tununak and Nightmute to the wind generators at Toksook Bay, resulting in a reduction of the fuel surcharge component to 25 cents per hour; however, wind can never provide more than 40 percent of a community's power.

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MS. KOHLER informed the committee AVEC recently energized wind systems in Savoonga and Hooper Bay, and will soon have wind systems in Gambell and Chevak. Gambell and Savoonga are "class seven wind regimes, which is the very best." The cooperative's goal is to reduce diesel consumption by 25 percent in ten years, "but it's going to take a lot of wind generators."

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REPRESENTATIVE PETERSEN asked whether AVEC was in the process of installing more wind generators paid for by grants from the renewable energy fund.

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MS. KOHLER said yes. New systems are going in at Savoonga and Chevak and all have been funded primarily by the Denali Commission and the rural utility service (RUS). The cooperative received $10 million in grants through the renewable energy appropriation that will add one turbine to Toksook Bay, provide a complete new system in Quinhagak and Mekoryuk, provide a modest system in Ambler, and fund hydroelectric feasibility [studies] in two places.

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CO-CHAIR EDGMON called the focus of the meeting back to fuel pricing. He asked for a description of the different circumstances of fuel pricing in communities.

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MS. KOHLER stated the delivered cost of fuel to AVEC has historically been less than that of other entities. The primary reasons are that AVEC is a credit-worthy customer; orders a large amount of fuel early in the spring, and allows the transporter to deliver at its convenience. On the other hand, with deliveries to a local business or city there may be issues about the timeliness of the order and the ability to pay. Furthermore, the local retailer adds its cost of delivery. She advised AVEC business plans for the tank farms it builds in rural Alaska for the Denali Commission, reveal it is necessary to add 35 cents to $1 per gallon for delivery costs. However, Ms. Kohler stated the fuel prices in the villages reported from the Department of Commerce, Community, & Economic Development (DCCED), Division of Community and Regional Affairs (DCRA) "don't necessarily relate to that, and I don't know what the difference is ... "

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REPRESENTATIVE DAHLSTROM asked how the amount of fuel purchased, and the way it is stored, determines pricing and rates.

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MS. KOHLER explained AVEC strives to have 14 months worth of fuel stored at each location. Purchasing all of the needed fuel at one time saves the additional cost of later deliveries and scheduling problems. Her organization plans to have enough fuel to last until spring with one month leeway. The costs of storage are about 6 to 7 cents per gallon and are absorbed by the cooperative. She noted at this time of year, AVEC is often contacted by other organizations who wish to buy or borrow excess fuel, although that is not something it does. However, AVEC does work closely with schools and most school districts are allowed to "piggy-back on our fuel contract." During negotiations for the fuel contract this year, AVEC asked for three-year bids with two one-year extensions; however, a proposer was reluctant to quote for more than one year due to the problems with the Flint Hills refinery. The cooperative decided to go ahead on a one-year contract with its primary supplier in the hope that next year it will have better prices, especially for transportation. Regarding the electric rates, Ms. Kohler explained the cooperative buys fuel for 53 villages and is required to get approval from the Regulatory Commission of Alaska (RCA) on its fuel cost charge. The RCA approves the fuel cost charge and sets the power cost equalization (PCE) level at the same time. For example, last year the PCE level of $1 per kilowatt hour went into effect on the first of October, and AVEC submitted for its approval sometime in October or November. Therefore, the AVEC fuel charge will not change soon, and last year's high cost of fuel will be seen in the electric bills through next October.

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CO-CHAIR EDGMON observed this is a tough winter for Bush Alaska. He asked what may happen to consumers if high prices return for another two or three years.

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MS. KOHLER recalled last year there was not a higher rate of delinquency; however, this last winter consumers have "started to reach their breaking point because their cash resources were not enough to cover their energy costs and their other cash needs." She opined similar costs in the coming winter "will be the straw that breaks backs."

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REPRESENTATIVE RAMRAS asked how many average kilowatts are consumed by the cooperative's customers as opposed to the rates in more urban areas.

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MS. KOHLER answered village residents' actual average monthly use is 390 kilowatt hours. In the Northwest and Nenana region use is higher because of sewage pumps and piped water systems. The average use in Anchorage and Fairbanks is 700 kilowatt hours per month.

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REPRESENTATIVE RAMRAS asked whether the volume of kilowatt use increased in the communities with wind generation that brought the price down to 25 cents per kilowatt hour.
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MS. KOHLER said no, because PCE adjusted the difference and there was no reduction in price to residents, although businesses benefitted.

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CO-CHAIR MILLETT asked whether AVEC felt the impact of the permanent fund dividend (PFD) and state resource rebate payments to residents.

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MS. KOHLER said yes. The cooperative was overwhelmed with payments; in fact, some residents left a large credit on their accounts. In further response to Co-chair Millett, she said payments at the time of the PFD are always high.

3:33:45 PM

KIRK PAYNE, Chief Operating Officer, Northstar Utilities Group, informed the committee that the companies operating under the umbrella of Northstar Utilities Group in Alaska are Delta Western and Inlet Petroleum. He addressed the questions that were previously submitted to him by the committee. The first question was: Can you list out some of the components of fuel pricing that could explain disparities in the cost of fuel from one village to another? Mr. Payne said the first component of fuel pricing was commodity cost, which can vary from day to day and from region to region, and is dictated by supply and demand. The next cost to consider was operating expense that is the cost of operating transportation equipment, labor, fuel, disposables, and inspection services. The third consideration was logistic inefficiency caused by the direct delivery of fuel that requires the fuel to be transported by more than one piece of equipment to various terminals scheduled around weather, tides, product availability, and dock space. The fourth consideration was the cost to carry the product for a long time as it voyages from Seattle; in fact, it may be sixty days or, if a port becomes iced in, eight months to final delivery. The fifth consideration was operating risk due to the cost of non-performance of contracts and deliveries made under difficult conditions such as low water, extreme tides, wind, weather, and waves. Mr. Payne said there are also compliance costs, as the industry is a much regulated industry at the federal and state level, and Northstar intends to be 100 percent compliant. The seventh [component] was supply risk as the fuel is procured in advance, "but there's a lot of water between a lift and a delivery," he said. Although his company arranges for the pick up of the product at the refinery, it may not be there, or the dock may not be available. The next consideration was credit risk. Obviously, he said, his company must be sure it will be paid for its product. Next was the environmental risk of operating in some of the most pristine country in the world. Mr. Payne pointed out that petroleum products are very volatile and there is handling and breathing loss each time the product is transferred. The next component was the terminal through-put fees assessed each time the product is handled before final distribution. Next, he noted the cost of general insurance and specific coverage regarding pollution and cargo. Mr. Payne said the company must also consider the equipment capital costs for marine assets that are only utilized during Alaska's short season. Also, on the horizon is the new [Oil Pollution Act of 1990 (OPA 90)] requirement for doubled hulled barges; to date, there is only one line-haul barge in service in Alaska. Furthermore, he advised that the lighterage fleet is old and, although exempt from OPA 90, requires re-investment. Finally, there are local sales taxes levied by municipalities on fuel on a percentage basis, pipeline fees, through-put fees, and moorage fees.

MR. PAYNE addressed the second question that was: In any of the components you listed - could you talk about instances where your company may have had wide variations in costs from one trip to the next? He responded that commodity cost has a very big impact on that question; in fact, the volatility [of the price] was high last year, combined with uncertainties in weather for each voyage. Question three was: Do you see anything cities, villages, or utilities could be doing process-wise to lower the ultimate price consumers are paying? Mr. Payne suggested planning ahead can lower the cost of the delivery of fuel. Some communities and users do not order until the last moment and, from a transportation logistics perspective, that makes [deliveries] even more inefficient and expensive. Question four was: Any factors that can help us learn about pricing of fuel products in areas of Alaska off the road system? He opined that the components listed in the first question "tells the story of what the issues are." Question five was: What can you tell us about infrastructure advantages such as tank storage, distributor relationships or other factors that might have direct effects on retail price at the community level? He explained that larger orders are not always the most cost effective as in the case of an order of 150,000 gallons of fuel to be delivered by a vessel with 100,000 gallons of space. Mr. Payne reiterated that pre-planning would make a difference in this example. Question six was: Are there any regulations or restrictions that you can identify that play a role in the overall cost of your products? He predicted that line-haul equipment compliance with OPA 90 will be a big issue, in addition to changes in coastwise tugboat regulations that will "impact the whole fleet." Furthermore, the Department of Transportation & Public Facilities (DOTPF) has a rule change coming that will affect truck sales and increase the cost of fuel. Question seven was: Where do you purchase the fuel? If outside, why isn't the fuel purchased in Alaska? Mr. Payne said his company buys fuel inside and outside of Alaska depending either on the logistics or the price.

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REPRESENTATIVE DAHLSTROM asked for the average age of Northstar's equipment.

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MR. PAYNE said Northstar has two lighterage barges, one of which is under repair and after will be "a new piece of equipment." However, the average barge in the lighterage fleet was built in 1960.

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REPRESENTATIVE DAHLSTROM asked how Northstar plans for equipment expenses; for example, are incurred costs "figured into next year's pricing."

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MR. PAYNE advised for a business to remain viable, there must be reinvestment in the business; however, the business must have a profit to reinvest.

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REPRESENTATIVE RAMRAS asked whether a major capital investment in a village will "factor into pricing" for that village.

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MR. PAYNE pointed out terminals owned and operated by Northstar must be sustainable. He said, "There is no good answer, in this venue, to say this is how much we would spend on this terminal [and] this on this one. Long term, the business has to be viable."

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REPRESENTATIVE RAMRAS restated the question.

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MR. PAYNE further explained each terminal needs to make the money to support its improvements. Northstar's business plan looks at reinvestment over 30 to 50 years.

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REPRESENTATIVE RAMRAS described a situation in which the average cost of fuel is $5. Would the expenditure of $1 million for capital improvements cause an increase to $6 or $7 in the cost of fuel specifically for that village? He said the committee was told there was a $1 variation in the price of fuel between communities only 10 miles apart.

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MR. PAYNE advised the income stream for each of those facilities over the previous ten years should already have been "built-in." Northstar makes a continual reinvestment over long-term.

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REPRESENTATIVE RAMRAS asked how $5 million in costs would be amortized for a community.

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MR. PAYNE said the costs are amortized according to U.S. generally accepted accounting principles (GAAP).

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REPRESENTATIVE RAMRAS remarked:

> GAAP in relation to the government, or GAAP in relation to the communities that you serve, that is the question I'm trying to ...

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MR. PAYNE said, "GAAP related to maintaining investment grade."

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REPRESENTATIVE RAMRAS asked "What kind of a return on investment do you strive for?"

MR. PAYNE declined to answer. In further response to a request from Representative Ramras, Mr. Payne declined to provide the committee with copies of his notes.

3:51:43 PM

ELAINE BROWN, General Manager, NorthStar Gas, informed the committee NorthStar Gas is a Native-owned petroleum distributor within Western Alaska. NorthStar delivers fuel on a three-year contract with two one-year extensions and is currently at the end of its present contract. The company brokers all of the fuel delivered to the Yukon-Kuskokwim coast and is planning to expand into the Norton Sound-NANA region, and the Dillingham region. NorthStar was established in 1998 and delivers fuel village by village. It also assists villages with financing and deliveries. Ms. Brown addressed question one and said her company determined there are three components to fuel pricing in rural communities: the market from which the fuel is purchased; the transportation costs by gallon to each community; and the costs of overhead and maintenance that can be fixed, such as the size of the tank farm and insurance, or variable, such as the age of the tank farm and the number of employees operating the tank farm. She then gave an example of five villages on the Yukon River that pay a fixed price for fuel but have differing costs for overhead, maintenance, and profit margin, resulting in a difference in fuel cost of between $.5 and $1.50.

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CO-CHAIR EDGMON asked whether NorthStar was the one fuel cooperative in Alaska.

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MS. BROWN said no, Norton Sound also has a fuel cooperative. She then addressed question two and reiterated her example of the NorthStar Gas contract for transportation that remained the same for each community. However, for a community that did not participate with a company that had a contract, its delivery price was open to fair market value. This is one reason fuel prices can vary between villages. She addressed question three and suggested the price of fuel would decrease if communities would band together, become credit-worthy, and purchase all of their fuel from one entity. Ms. Brown stressed credit worthiness is a major factor and her organization helps get loans approved; in fact, loan applications are time-consuming and a delay in loan approval also may delay a fuel order. In addition, early loan approval could allow for one delivery of fuel, which would be a huge savings on transportation. Also, if each community would combine its tank farms there would be a savings in overhead. She addressed question four and said factors for regions off the road system are: overhead, maintenance, transportation, and the market. She addressed question five and said Northstar Gas does not own tank farms but negotiates on behalf of rural communities. Negotiating for all of the region would lower prices on transportation. She addressed question six and suggested Alaska Energy Authority (AEA) loan applications should be streamlined. Regarding question seven, she said NorthStar Gas does not own fuel.

4:00:18 PM

REPRESENTATIVE DAHLSTROM asked whether residents travel to a neighboring village to buy fuel at a lower price.

MS. BROWN said yes. She gave an example of three villages within one or two miles of each other where the residents fill fifty-gallon drums to save money.

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REPRESENTATIVE DAHLSTROM asked whether residents were aware that the higher-priced fuel "would still be there."

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MS. BROWN pointed out people drive out of their way to buy cheaper fuel in Anchorage.

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REPRESENTATIVE DAHLSTROM asked why the village government would set a higher price and discourage local business.

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MS. BROWN said she can not speak for the village board of directors; however, each community must consider operating expenses and its profit margin.

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REPRESENTATIVE DAHLSTROM asked whether this would happen if the distance between communities was great.

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MS. BROWN suggested this would still happen if relatives were visiting or if a village ran out of fuel.

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REPRESENTATIVE PETERSEN referred to Ms. Brown's observations on the loan process and asked for her suggestions.

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MS. BROWN suggested expansion of the AEA loan approval from one year to three or five years would streamline the process. The loans could also be set up similarly to an open line of credit; this would be helpful in that the annual waiver would not have to be signed during fishing season when officials are at fish camp. Furthermore, if AEA administrators would begin the loan approval process after receipt of a facsimile copy of the application, there would be a time savings. She also suggested the loan could be approved on the basis of the applicant's payment history, but subject to the final payment from the previous year.

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REPRESENTATIVE RAMRAS spoke about the possibility of a Pacific NorthWest Economic Region (PNWER) summit between small rural Canadian communities and like communities in Alaska to discuss problem solving in remote regions. He then disclosed his personal experience was that last summer, the gross profit margin on fuel in Fairbanks was 20 cents per gallon. He asked for Ms. Brown to estimate the gross profit for the entities in her area.

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MS. BROWN said the gross profit is unique to each community. Although she was unsure of the basis upon which the profit margin is set, she estimated profits run from 5 percent to 40 percent. Ms. Brown listed four villages with a disparity in overhead costs and how they calculated their profit margin. She said there are efforts to encourage "everybody, [to] at least [use] one formula, but that changes community by community."

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REPRESENTATIVE RAMRAS asked whether the Department of Commerce, Community, & Economic Development (DCCED) was present in the villages to work on energy problems with individual communities that do not have the support of large utilities.

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MS. BROWN said her cooperative is in close contact with the DCCED office in Bethel when there is an issue. The Denali Commission also provides some operations training once a year.

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REPRESENTATIVE RAMRAS recommended the committee ask AEA what is being done to provide uniform training to communities. He pointed out that some rural communities are very well organized and managed, and others are struggling to hang on through this difficult winter. To encourage problem solving he re-stated the idea of a summit with similar Canadian communities and further discussion with the AEA on analyst availability and training.

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MS. BROWN expressed her support for both ideas, and especially for a loan education program through AEA.

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CO-CHAIR EDGMON noted that officials of AEA and DCCED are listening to the testimony and further discussion of this topic could be continued on another occasion.

4:17:27 PM

CRAIG TORNGA, General Manager, Oil Industry Services, Crowley Marine in Alaska, gave a brief PowerPoint presentation. Mr. Tornga informed the committee Crowley Marine has 21 fuel storage facilities in Alaska with a capacity of 30 million gallons of storage. In every community, Crowley employs 100 percent local hire for good jobs with long-term employment and good benefits. His company has a large fleet of shallow draft vessels in Western Alaska for coastal and river use, and a slide showed two new vessels under construction. He displayed a slide of a vessel making a difficult fuel delivery from the beach and said most deliveries are made without the benefit of a dock. The next slide showed a delivery in Hooper Bay by a very long red hose strung out to reach the "header." The next slide showed the shallow channel to Newtok with the barge stuck on the bottom. The next slide was of Prince of Wales Island with the barge and a float hose operation exposed to the ocean surf. The next slide displayed a delivery at Little Diomede with a rocky coast and no dock. He explained two weeks can be spent at some of these locations, such as Gambell, waiting for acceptable weather to make a delivery.

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MR. TORNGA then displayed a slide of the Chevak lower tank farm with small tanks that must be filled individually. He stressed "time is cost" and each delivery takes a lot of time, especially with a line-haul vessel that has a deep draft requiring the transfer of the fuel to a lighterage vessel. The next slide showed the fuel storage tank at Newtok that can not be completely filled because it has a bullet hole. He pointed out this situation creates a liability for his company when the owners of the tank farms do not take responsibility. The slide at Nightmute showed the barge on the beach, waiting for the tide, and a red hose at the upper tank farm that only has a two-inch diameter.

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MR. TORNGA, in response to Representative Tuck, explained sometimes there is not a header within reach of the hose and the barge pumps directly to a tanker truck; this situation, as in Twin Hills, takes a lot of waiting time when 100,000 gallons of fuel is loaded into 5,000 gallon tanker trucks. The final slide displayed Platts Index of Market Price Comparison that indicated the swings in fuel prices last summer. Mr. Tornga addressed question one and said product cost is the first reason for the variation in cost from one village to the next. Next is the cost of local municipalities fees and taxes; for example, Hooper Bay has a 5 percent city sales tax and Chevak does not. Other variables are transportation and logistics, the difficulty of delivery, lighterage operations, and the cost of float hose operations. He opined the components that may be improved are customer operations; for example, the lack of adequate storage that makes two deliveries necessary, the lack of trained personnel on the delivery site, the credit limits of customers and payment cycles, and limited volume. Mr. Tornga addressed question two and said the biggest component to wide variations in cost is product cost. Lesser components are the weather conditions, beach erosion, and volume. He addressed question three and suggested the consolidation of storage and distribution has the potential to make a difference, especially in a village of 500 residents that has three separate tank farms. The Denali Commission is funding a new tank farm "package" but they are given for a single purpose, are not consolidated, and do not lower the operations cost to the user. In addition, professional and trained management of operations will lower the cost for receipt of the delivery, and securing early bookings will result in lowering the total cost. He addressed question four and said local taxes make a big difference from village to village. Also, delivery logistics, regulatory requirements from the U.S. Coast Guard, spill plans, Environmental Protection Agency (EPA) rules, and state and federal insurance requirements vary from village to village. He addressed question five and re-stated the importance of centralizing the tank farms and improving the economies of scale. He addressed question six and listed the requirements of the Coast Guard, Occupational Safety and Health Administration (OSHA), the ADC spill plans, and Certificates of Financial Responsibility to transport fuel over water as some of the regulations Crowley Marine must meet. Furthermore, there will soon be cost increases to meet the new EPA regulations set by the Oil Pollution Act of 1990 (OPA 90). His company's fleet of single hull line-haul barges will have to be replaced by 2015; in fact, four new barges will be required at a cost of $20 million each. In addition, by 2010 new EPA regulations will require different handling of ultra low-sulfur diesel in Alaska. He addressed question seven and said his company purchases the majority of its fuel in Alaska, some on the West Coast, and about 12 million gallons from foreign sources.

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REPRESENTATIVE JOHANSEN encouraged Mr. Tornga to look in Alaska for facilities with the capability to manufacture fuel barges.

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MR. TORNGA said Crowley Marine sends barges to Ketchikan for repair.

There was a brief reference to the Ocean Ranger program.

REPRESENTATIVE JOHANSEN asked whether Crowley Marine is in contact with the Department of Environmental Conservation (DEC) to improve the tank farms and the delivery situation in the villages.

4:40:12 PM

MR. TORNGA said his contact with DEC is usually regarding Crowley Marine tank farms. In further response, he said his crew is not allowed to fill the community tank farms that do not have headers because, "those are risks we can't take."

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REPRESENTATIVE RAMRAS asked whether Crowley is liked and trusted by the communities it serves.

4:41:06 PM

MR. TORNGA remarked:

> You're the guy at the end of the hose with the high price, so they always look at you like you're the reason for the high price. Now I will say in the last

couple of years that has changed dramatically ... they now realize this is a global issue.

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REPRESENTATIVE RAMRAS likened companies like Crowley to a "de facto" utility because they are the only provider for space heat and electric generation in these small communities. He pointed out that the RCA regulates utilities in Fairbanks at a 12 percent rate of return. He asked whether Crowley exceeded this rate or fell below that level.

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MR. TORNGA deferred the question to Mr. Sniffen.

4:43:19 PM

REPRESENTATIVE RAMRAS clarified that he asked about the rate of return, not the percentage of pricing.

MR. TORNGA opined this question "crosses the line" to proprietary information.

REPRESENTATIVE RAMRAS opined his question does not belie proprietary information, thus is not an anti-trust issue. This is a reasonable question that could be answered, and communities are interested in the answer. He said, "We heard a lot of public testimony, with all due respect, to precisely that end ... only two weeks ago."

4:44:36 PM

JUSTIN CHARON, Independent Consultant, informed the committee he was an independent consultant but his testimony was not for the benefit of a client. Previously, he was a 50 percent owner of a fuel company in Anchorage, and prior to that he was the vice president of Yukon Fuel. His experience in the industry, from 1998 through 2005, was studying the costs of fuel distribution in Western Alaska. Mr. Charon summarized three reasons for the price differences between villages: timing of the inventory; the actual delivery cost; and big pricing differences between the independent owners. He pointed out the vast majority of tank farms in Western Alaska are owned by third party bulk fuel owners with a variety of compliance levels and capital.

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REPRESENTATIVE RAMRAS asked what can be done to bring uniformity to all of the different communities so they are all based on the most successful model.

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MR. CHARON recalled the Denali Commission, through Rural Alaska Fuel Services, Inc. (Rafs), came up with a model on what a responsibly run tank farm should look like; however, this help "may not get you to the prices you want." For example, he compared Hooper Bay, that has a better infrastructure and higher fuel prices, with Chevik, that has lower prices and a deteriorating tank farm. He opined bringing all of the villages to compliance "[is] the right answer, but not necessarily the cheapest answer." In fact, it would eliminate the village to village discrepancies, but may mean a higher price.

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REPRESENTATIVE RAMRAS asked whether there is gouging going on in some communities that are served by a single supplier.

4:49:10 PM

MR. CHARON said it is very unlikely that there is gouging going on in a wide-spread basis. He re-stated that each community has its own independent fuel provider; however, most of those providers are the city or a Native corporation. As far as the big companies - the fuel distributors - he said, "I'm very confident there is no gouging going on there, I've studied that in depth, many times." Mr. Charon explained when the prices get too high, Delta [Western] and Crowley [Marine] will aggressively compete with each other and reinvest in equipment. There are barriers to entering this market, but the barriers are not insurmountable. In fact, there is a new company called Ruby Marine on the Yukon River. Furthermore, if there were gouging, other investors would come into the market "and level things out." He acknowledged the Western Alaska market is expensive to come into because it is capital intensive and fixed-cost intensive.

4:50:53 PM

REPRESENTATIVE RAMRAS asked whether the rate of return exceeds the rate of return enjoyed by utilities regulated by the RCA.

MR. CHARON said he did not know the profits of Crowley and Delta; however, at Yukon Fuel, the "after tax return would have been something we would have looked forward to." He remarked:

> The typical RCA return isn't a pre-tax return, it's a post-tax return, and that post-tax return was a number that was attractive to us. We many times joked we would be better off that way."

MR. CHARON then gave the example of Bethel, where $50 million worth of steel in the tank farm, in addition to the value of the fuel, is a total capital investment of $80 million. It is very hard to make a return on that investment, even though the gross profit may be very attractive. Prior to the sale of Yukon Fuel to Crowley, prospective investors were asking for returns in excess of 25 percent; in fact, venture capitalists will not get into this market because the returns are so low.

4:52:49 PM

CO-CHAIR EDGMON asked for Mr. Charon's suggestions regarding the consolidation of facilities in order to maximize efficiencies and generate economies of scale.

4:53:34 PM

MR. CHARON agreed with Ms. Brown and Mr. Tornga in that tank farms are very heavy in fixed cost and the consolidation of tank farms would be very efficient. For example, a 600,000 gallon facility would cost about $.50 per gallon to run, whereas a 200,000 facility would cost about $1.25 to run. This is also true of regionalization in that fuel companies can focus on fewer delivery sites. In addition, increasing capacity of the tank farms will reduce the number of deliveries and generate a cost savings as well.

4:54:36 PM

CO-CHAIR EDGMON asked whether there were sources for price data other than the Division of Community & Regional Affairs, DCCED.

4:54:48 PM

MR. CHARON said no. However, customers keep businesses informed about competitor's prices.

4:55:10 PM

REPRESENTATIVE PETERSEN asked:

> If there was regulation by the RCA in rural Alaska, it's your opinion that the prices would actually be higher now then what they actually are?

4:55:32 PM

MR. CHARON answered, "more than likely, yes."

4:55:53 PM

REPRESENTATIVE RAMRAS asked where relief could come from for the residents of the villages.

4:56:08 PM

MR. CHARON encouraged the committee to try [to help], although there no easy answers. He predicted $150 per barrel oil prices will return someday and everyone should prepare for that. Mr. Charon re-stated the expense of doing business in the region and the need to address credit issues in order to prevent last minute orders. Theoretically, if everyone had a tank farm big enough to hold one year's worth of fuel, and all orders were in by May 1, the fuel companies would respond by minimizing repeat trips and planning deliveries by the map and the equipment needed. He also encouraged continued support of the AEA Bulk Fuel Revolving Loan Fund and suggested the department could provide management and pricing assistance to the borrowers.

4:58:13 PM

SMOKEY NORTON, Director of Marketing, Petro Marine Services, informed the committee Petro Marine Services is not in business in Western Alaska but has marine market facilities in Southeast and coastal Southcentral. He referred to the previous testimony and said, "Most of the ground has been plowed." However, he pointed out a tremendous challenge for his company was that the cost component of the fuel was "least controllable." Petro Marine worked to manage terminal and labor cost, and to invest well, but to stay in business, it must pass on the purchase cost. An equal challenge will be to use the large inventories of high priced fuel after the prices begin to fall. Mr. Norton assured the committee "screaming customers are the last thing that you want." He also predicted that the cost of doing business will increase with the expense of the new double-hulled barges. On the subject of reducing expenses for Western Alaska, he suggested conservation practices would be effective "household to household."

5:01:53 PM

REPRESENTATIVE PETERSEN asked whether Petro Marine's business was all in Southeast Alaska.

5:02:41 PM

MR. NORTON stated his company serves many very small communities and all of the cities of Southeast, and most of Southcentral, including Cook Inlet, Kodiak, Valdez, and Cordova. In further response to Representative Petersen, he said Petro Marine purchases most of its fuel for Southcentral in Nikiski and the fuel for Southeast in the [Pacific] Northwest. Recently there have been some supply problems. Again responding to Representative Petersen he said the supply problems happen with both the Alaska and the West Coast refineries. Furthermore, the distributors do not have the flexibility to try to save money by "timing" the purchase of fuel.

5:05:09 PM

REPRESENTATIVE PETERSEN asked whether refinery prices are lower on the West Coast than in Alaska.

5:05:35 PM

MR. NORTON said yes.

5:06:13 PM

ADJOURNMENT

There being no further business before the committee, the House Special Committee on Energy meeting was adjourned at 5:06 p.m.