

**ALASKA STATE LEGISLATURE
HOUSE LABOR AND COMMERCE STANDING COMMITTEE**

March 25, 2009

3:24 p.m.

MEMBERS PRESENT

Representative Kurt Olson, Chair
Representative Mark Neuman, Vice Chair
Representative Mike Chenault
Representative John Coghill
Representative Bob Lynn
Representative Robert L. "Bob" Buch

MEMBERS ABSENT

Representative Lindsey Holmes

COMMITTEE CALENDAR

HOUSE BILL NO. 68

"An Act making sales of and offers to sell certain energy resources by a refiner at prices that are exorbitant or excessive an unlawful act or practice under the Alaska Unfair Trade Practices and Consumer Protection Act."

- HEARD AND HELD

PREVIOUS COMMITTEE ACTION

BILL: HB 68

SHORT TITLE: PRICE GOUGING INVOLVING ENERGY RESOURCES

SPONSOR(S): REPRESENTATIVE(S) PETERSEN, GARA, TUCK, GRUENBERG, KAWASAKI

01/20/09	(H)	PREFILE RELEASED 1/16/09
01/20/09	(H)	READ THE FIRST TIME - REFERRALS
01/20/09	(H)	L&C, JUD, FIN
02/04/09	(H)	L&C AT 3:15 PM BARNES 124
03/25/09	(H)	L&C AT 3:15 PM BARNES 124

WITNESS REGISTER

REPRESENTATIVE PETE PETERSEN
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Testified as a joint prime sponsor of HB 68.

DAVID DUNSMORE, Staff
Representative Pete Petersen
Alaska State Legislature
Juneau, Alaska

POSITION STATEMENT: Testified and answered questions during the discussion of HB 68.

BOB WEINSTEIN, Mayor
City of Ketchikan
Ketchikan, Alaska

POSITION STATEMENT: Testified during the discussion of HB 68.

CAROLINE POWELL, Owner
Mallotts General Store, Inc.
Yakutat, Alaska

POSITION STATEMENT: Testified during the discussion of HB 68.

LYNN WESTFALL, Senior Vice-President, External Affairs and Chief Economist
Tesoro Petroleum Corporation (Tesoro)
San Antonio, Texas

POSITION STATEMENT: Testified and answered questions during the discussion of HB 68.

KIP KNUDSON, Manager
External Affairs
Tesoro Alaska Company
Anchorage, Alaska

POSITION STATEMENT: Testified and answered questions during the discussion of HB 68.

JEFF COOK, Director
External Affairs
Flint Hills Resources Alaska (Flint Hills)
North Pole, Alaska

POSITION STATEMENT: Testified and answered during the discussion of HB 68.

PATRICK GAMBLE, President; CEO
Alaska Railroad Corporation (ARRC)
Anchorage, Alaska

POSITION STATEMENT: Testified during the discussion of HB 68.

ACTION NARRATIVE

[3:24:35 PM](#)

CHAIR KURT OLSON called the House Labor and Commerce Standing Committee meeting to order at 3:24 p.m. Representatives Buch, Chenault, Lynn, and Olson were present at the call to order. Representative Coghill arrived as the meeting was in progress.

HB 68-PRICE GOUGING INVOLVING ENERGY RESOURCES

3:24:57 PM

CHAIR OLSON announced the only order of business would be HOUSE BILL NO. 68, "An Act making sales of and offers to sell certain energy resources by a refiner at prices that are exorbitant or excessive an unlawful act or practice under the Alaska Unfair Trade Practices and Consumer Protection Act."

3:25:03 PM

REPRESENTATIVE PETE PETERSEN, Alaska State Legislature, stated he introduced the bill because so many of his constituents complained about high gasoline prices. While the Attorney General's office investigated the matter, he related that it is yet unresolved. He opined fuel costs have had a devastating effect on individuals, businesses, and communities. This bill would restrict a refiner from selling or offering to sell fuel at exorbitant or excessive costs. The bill would consider such practices as an unfair trade practice and would establish strict penalties as a deterrent. Additionally, the bill would shift the burden of proof from the seller to the refiner. He emphasized the biggest misconception is that the bill sets prices, but it does not.

REPRESENTATIVE PETERSEN pointed out that the ten percent threshold in the bill creates a triggering mechanism. Prices would still be legal above the ten percent so long as the refiners could prove the product price was not an exorbitant profit. Under current statutes, the attorney general must determine that collusion or price fixing exists in order to prosecute. This bill would provide the attorney general with an additional tool. Historically, Alaska's gas prices have been close to West Coast prices. However, last year Alaska's gas prices were dramatically higher than any place in the country. He opined the disparity exists today. Last year, the legislature suspended the state's gas tax. Still, Alaska's gas prices remain higher than any place in the Lower 48. He referred to a handout in members' packets labeled "Dist. by Rep. Petersen" from AAA and API.org sources that lists gasoline

prices by state without state gasoline taxes included in the price, listing Alaska's price as the highest per gallon price at \$2.52 per gallon. He pointed out that states without any oil industry have lower gasoline prices than Alaska. Yet, Alaska is one of the major oil producers in the U.S.

REPRESENTATIVE PETERSEN explained that high fuel prices affect the prices of most goods due to the shipping costs. He opined that is one reason Anchorage had a 4.6 percent inflation rate last year. Rising fuel costs are especially hard on small businesses since rising fuel costs increase their expenses while decreasing customer demand. Some businesses have expressed concern that high fuel costs will cause them to scale back or even close. Separate investigations by the attorney general's office, Legislative Research, and the House Judiciary Standing Committee have all shown high prices are the result of abnormally high margins charged by Alaska's two oil refineries. He called attention to a graph on page 12 of the Legislative Research report Number 09.053 dated December 18, 2008. He interpreted that the graph clearly shows that even as crude oil prices fell, the margins charged by the refiners increased disproportionately to margins charged by Lower 48 refiners. He explained that currently HB 68 would only apply to refineries. However, after hearing from Alaska residents from all parts of the state, he suggested the committee consider adopting an amendment to include wholesale distributors and retailers to those affected by the bill.

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REPRESENTATIVE PETERSEN stated he has heard from many rural Alaskans expressing concern about the impacts of high fuel prices since often the community has one fuel source so competition does not affect their fuel costs. He opined that high prices continue to hurt Alaskans and Alaskan businesses. Since fuel prices typically rise during the summer, he expressed concern that prices could continue to rise. He said, "Under the Alaska Constitution, we as legislators have a duty to ensure that Alaska's resources are used to the maximum benefit of the Alaskan people." He offered his belief that charging higher prices for Alaska's petroleum products than in the Lower 48, meets the "maximum benefit" test. He urged the committee to act quickly adopt the amendment, and move HB 68 to the next committee of referral so Alaska's businesses and families do not need to wait another year for lower fuel prices.

[3:30:46 PM](#)

DAVID DUNSMORE, Staff, Representative Pete Petersen, Alaska State Legislature offered to provide answers to issues and arguments that have been raised about the bill since its introduction. He explained that some people have a philosophical objection to government intervention in commerce. However, this bill would add to the list of 55 items that the state has deemed as unfair trade practices. He related that Hawaii had a law to address pricing, but its mechanism was substantially different than the one in HB 68. He elaborated that Hawaii had a commission similar to the Regulatory Commission of Alaska (RCA) that capped fuel prices. This bill prohibits exorbitant prices and establishes an objective threshold, with a burden of proof shifted to the seller to demonstrate the prices are justified by their expenses. Since some discussion has arisen with respect to the Hawaii law, a handout in members' packets titled Hawaii Fuels Study shows the effect of the Hawaii law on gas prices. He explained that the Hawaii law only regulated gasoline prices but not diesel prices. He described the handout briefly and indicated the study had the unfortunate timing of being implemented immediately after Hurricane Katrina so the prices were uncharacteristically high.

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MR. DUNSMORE explained that pink and blue lines on the graph represent prices in Honolulu and statewide prices in Hawaii, which are not regulated by legislation. Additionally, Hawaii did not experience reductions in diesel fuel that they did with gasoline. He emphasized that this bill is fundamentally different than the Hawaii bill. The Hawaii committee set prices while HB 68 would establish that it would be an unfair trade practice to charge excessive or exorbitant prices. The bill would use a threshold rather than a cap on pricing. Thus, the burden of proof will shift to the sellers.

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MR. DUNSMORE mentioned that Washington State was selected for comparison since Alaska and Washington have traditionally been linked commercially. Additionally, he pointed out Washington does have a competitive refinery market and Alaska does not. He opined the idea was to select a place in the Pacific Northwest. He mentioned that some people suggested prices will simply decline with the price of crude oil, but thus far that has not been the case. He recalled the earlier handout of retail prices by state, not including state gasoline taxes. He opined that

Alaska is radically higher than any state in the U.S. at \$2.52. He added that most of the crude oil is Alaska North Slope (ANS) crude oil or Cook Inlet crude oil. He highlighted that the bill is designed to protect consumers from excessive gas prices and is not intended to criticize Alaskan refiners. He also mentioned Alaskan for profit corporations have a fiduciary duty to make the profits that they can within the bounds of the law. He stated the point of HB 68 is to establish boundaries such that excessive or exorbitant prices are prohibited.

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REPRESENTATIVE LYNN asked whether that would be price fixing if the refiners are required to set the price within certain limits.

MR. DUNSMORE answered that the language prohibits excessive or exorbitant prices. He stated subsection (c) sets out it is prima facie evidence that a price is exorbitant or excessive if the price exceeds by more than 10 percent the average wholesale price of comparable energy resource charged by refiners in the state of Washington. Thus, the bill does not set price or a cap, but an objective threshold. This subsection also allows a refiner to rebut the presumption by proving evidence that the amount charged by the refiner was justified by reasonable costs incurred by the refiner.

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REPRESENTATIVE LYNN asked how the bill defines excessive or exorbitant pricing.

MR. DUNSMORE offered his belief that the term was taken from an Idaho consumer protection law. He related that it is a legal term.

REPRESENTATIVE LYNN asked for the basis of determining excessive.

MR. DUNSMORE related his understanding that excessive would be decided by a court of law. However, the bill sponsor specifically did not want to set prices since markets can fluctuate. However, consumers should have reasonable protection from excessive charges.

REPRESENTATIVE LYNN stated that he still does not understand the definition of exorbitant.

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REPRESENTATIVE PETERSEN stated that setting the limit at ten percent above Washington's pricing was chosen since it has been the traditional price differential between Alaska and Washington. He mentioned that rarely have prices fluctuated from the ten percent difference until recently. This bill sets up a trigger mechanism. Thus, any prices at the fuel pump that are set at more than ten percent of the consumer price index in Washington would be considered exorbitant prices.

REPRESENTATIVE LYNN related his understanding that gasoline prices above ten percent would be considered exorbitant.

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CHAIR OLSON referred to the Legislative Research Report 09 187 dated March 12, 2009. He advised members that he asked the agency for a comparison of prices between Anchorage and Seattle. He stated that transportation costs are roughly 11 percent of household expenditures. He opined that food is 12.5 percent of the monthly expenditures and utilities are about 10 percent. He further opined that all three items are related 10 percent higher than in Anchorage. He inquired as to whether the other items such as utilities and grocery costs should also be included.

REPRESENTATIVE PETERSEN related that he did not look at traditional prices for utilities, groceries, or housing.

CHAIR OLSON offered his belief that food prices in Alaska are still significantly higher than in Washington.

MR. DUNSMORE offered one difference is Alaska's Constitution contains a provision that obligates it to use its resources to the maximum benefit of Alaskans. Thus, other consumer goods listed would not be affected by the constitutional provision. Additionally, many of the items listed originate in Lower 48, while much of the gasoline is refined in Alaska. He mentioned that gasoline, heating oil, and diesel is known economically as demand in Alaska because when fuel prices increase people have few choices of items to eliminate. People are still going to need to heat their homes and while they can lower the thermostat, but to a large extent will need to absorb the additional fuel costs.

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REPRESENTATIVE CHENAULT asked whether a chart shows the crude oil prices for the timeframe of the chart.

MR. DUNSMORE offered to provide the chart.

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CHAIR OLSON, in response to Representative Chenault, stated that 29 percent refers to household income. He referred to page 2, titled "Table 1: Cost of Living Index Comparison, Anchorage and Seattle, 2008". He stated that compared to the national average, housing in Anchorage is set at 137.2 percent and Seattle is set at 152.0 percent. Thus, housing is 14 or 15 percent less expensive in Anchorage than in Seattle. Groceries are 142.7 percent in Anchorage and 117.3 percent in Seattle.

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REPRESENTATIVE CHENAULT related that the Tesoro refinery is in his district. He stated he takes the comments seriously. He related that Alaska imports foreign crude oil to the Tesoro facility. He recalled that about 30 percent of the crude oil at the refinery was foreign crude oil. He stated that all the oil products for Flint Hills Resources originate from ANS crude oil. However, some fuel sources for regions such as Southeast Alaska originate in Washington for SE Alaska. He offered his belief that he could be mistaken. He also believed that some fuel is barged from Washington to other areas in rural Alaska. He suggested that the refineries could provide more details.

[3:47:00 PM](#)

REPRESENTATIVE COGHILL agreed that this is a legitimate question. He offered that two refineries are in his district and they provide 15 percent of the gasoline for Alaska. He explained if the refineries did not also sell jet fuel to the airports that gasoline for home heating would be higher. He explained that in order to obtain economies of scale the refinery needs the "flow through." He inquired as to whether the sponsor considered the option "turning off the refinery and importing oil." He surmised that if the crude oil destined for jet fuel was not refined in Alaska the price would be costly. Additionally, he expressed concern that jet fuel might not be available in Alaska if the refineries were not operational. He

inquired as to whether the sponsor considered the current subsidy to home fuel and gasoline prices.

3:48:59 PM

REPRESENTATIVE PETERSEN recalled the House Judiciary Standing Committee report discussed jet fuel at length. He related his understanding that a large percentage of fuel produced by the refineries is jet fuel. He said that based on his business experience that it would be an unusual business model to sell the majority of the product at a very low margin and try to make up for low costs by increasing the price on the products that the business sells that are a lesser volume. He opined that traditionally this is not the way businesses are managed. He related that his goal is not to shut down the state's refineries, but to determine why prices have gone up and have not gone down in comparison to crude oil prices. He stated that traditionally the lines on the graph would move in conjunction with one another. Last year gas prices at the pump and the price of crude oil seemed to be disconnected, with a larger gap between them than normal. He acknowledged the situation could be unique. He reiterated that he would like to know the reason for the significant gap.

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REPRESENTATIVE COGHILL related that he has the same question. He recalled the business model in the gasoline report, noting that sometimes stores such as Safeway sell gas at a loss to attract people to the store to buy groceries. Thus, he confirmed the business model can sometimes work that way. He related his understanding that the fuel commodity is sold to two different markets. He related he is more sympathetic to the pricing than some people since he compares the cost to what it would cost to ship the fuel to Alaska. He commented that since the Tesoro Refinery produces 85 percent of the gasoline, the Interior may feel "chaffed". He pointed out that the Interior is using costly fuel from the Trans-Alaska Pipeline System (TAPS) to refine their fuel. Thus, the two refineries have a different price model than refineries that have the opportunity to use natural gas in the refinery process. He stated he would not be surprised with the whole market dynamic of using more gas demand than diesel. He pointed out that in Interior Alaska the refineries strive to make just the right amount of gasoline to keep the contracts viable. He suggested that the lag tracks the price per barrel of oil from the TAPS line and the lag for contracts and subsequent products. He remarked that fuel prices

declined, but perhaps not as fast as he would have liked. He explained his own observations convinced him that price-gouging was not the case. He inquired as to whether 10 percent is the right number to set. He further inquired as to whether the number should be increased to allow for legitimate market lag. He suggested he would rather increase the index to provide more assurance. He opined that 10 percent is too close to the market price to be considered exorbitant.

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REPRESENTATIVE BUCH related his understanding that jet fuel is priced globally. He asked for clarification since the price is established in a global market.

REPRESENTATIVE PETERSEN recalled that jet fuel prices were being kept low in order to help prevent it from being shipped in from the Lower 48. He opined that shipping costs for a barge load of jet fuel would add 10 to 20 cents to the fuel cost. He said he is trying to understand why jet fuel pricing works the way it does in Alaska since Alaska is isolated. He highlighted that Alaska has substantial demand from companies such as Fed-Ex. He related his understanding that normally high demand causes the price to increase. He recalled that the Interior refineries produce 60 percent of the jet fuel with small profit margins. He opined that passing the cost to consumers on other products such as gasoline does not make sense. He recalled that grocery stores offer incentives to customers who buy gasoline, but their primary product is not gasoline. Thus, the discount is small compared to the overall grocery products the stores will sell.

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REPRESENTATIVE NEUMAN referred to the proposed Section 2, to "Sales of certain energy resources by Alaska refiners." He recalled that substantial amounts of fuel purchased in Southeast Alaska and rural Alaska is from Washington and is not refined in Alaska. He inquired as to how the mechanism would work to determine "price-gouging."

REPRESENTATIVE PETERSEN recalled that the House Special Committee on Energy discussed this when the committee held an overview on the Regulatory Commission of Alaska. He related that he did not include the RCA in the bill since the Department of Law conducted an investigation on fuel costs. However, he also recalled the RCA mentioned that it was within its purview to look at fuel prices and monopolistic prices in rural and

Western Alaska. He suggested that he could ask the RCA to review.

3:59:03 PM

REPRESENTATIVE NEUMAN related his understanding that RCA regulates utility companies not gasoline producers or refiners. He inquired as to the structure that would be used to consider transportation costs when gasoline is refined in Seattle and shipped to rural Alaska. He further inquired as to who would decide the profit-making scale.

4:00:13 PM

REPRESENTATIVE PETERSEN stated that he requested an amendment to the bill to include distributors. He recalled testimony during a trip to Western Alaska that indicated prices were higher than reasonable, even when they factored in transportation costs. He offered that one company will provide fuel to an area, creating monopolistic situations in rural Alaska. He emphasized that residents feel the price is exorbitant, which is why he is willing to consider amending the bill to include distributors.

4:01:22 PM

REPRESENTATIVE NEUMAN stated he still is interested in understanding the type of system or structure that would be set up to review the costs.

REPRESENTATIVE PETERSEN responded that the triggering mechanism is 10 percent above the Washington index. He recalled Representative Coghill mentioned that 10 percent might be too low and had suggested setting it at 15 percent. He offered to examine the percentage. However, he offered his belief that some triggering mechanism should be in place to cause an investigation to take place. Otherwise, he opined that prices could spin out of control.

4:03:02 PM

REPRESENTATIVE NEUMAN maintained his interest in knowing what structure would be in place to determine price gouging. He related his understanding that to consider prices between Seattle and various points in Alaska would lead to multiple mechanisms. He stated that he did not see a structured mechanism in place to do so. He asked if it would be left up to the courts to decide.

REPRESENTATIVE PETERSEN answered that the attorney general's office would investigate any complaints. However, he opined that for some parts of the state, the RCA would be more appropriate due to monopolistic conditions in rural Alaska. He offered his belief that in those instances, the company could be considered a utility.

[4:04:20 PM](#)

CHAIR OLSON mentioned that Ed Sniffen, Department of Law, normally handles these issues, but had a pressing engagement in Washington DC. He offered to try to have him available for questions at the next hearing.

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REPRESENTATIVE LYNN recalled that the attorney general's office investigated this matter.

REPRESENTATIVE PETERSEN reiterated that the attorney general's office performed an investigation to determine whether there was collusion. He explained collusion such as if companies got together and made a coordinated plan. He opined that it is difficult to prove collusion.

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REPRESENTATIVE LYNN asked what would cause a price to be exorbitant or unusual.

MR. DUNSMORE explained the attorney general's report concluded that nothing illegal transpired under current law since a law prohibiting exorbitant prices did not exist. However, the attorney general's report concluded that Alaska does not have a competitive refinery market, but an oligopoly, which is where several large firms control the market. Without a competitive market to regulate prices, such as the Washington state market, this bill would prohibit excessive prices that could arise due to a non-competitive market. Ordinarily, competition causes a downward pressure on prices. Furthermore, for most goods in Alaska competitive pressure exists, but not for refined petroleum products in Alaska

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MR. DUNSMORE, in response to Representative Lynn, stated that the attorney general's office investigated fuel costs under current Alaska law. The attorney general would not have reviewed price gouging since it is not currently considered as an illegal activity.

REPRESENTATIVE COGHILL reiterated the attorney general's office advised the House Judiciary Standing Committee that Alaska does not have a price-gouging law. Thus, collusion was only issue the attorney general could investigate. However, the attorney general's report indicated a price gouging law is usually event driven, such as by Hurricane Katrina. He related his understanding that this bill attempts to even costs out by considering the lack of competition in Alaska as though it were an event. Therefore, Alaska needs to index costs to another state such as Washington to provide reasonable costs. He said he was not sure if he agreed with this but offered his summary of the intent of HB 68.

[4:09:08 PM](#)

REPRESENTATIVE LYNN pointed out that nothing in the bill addresses specific events or a catastrophe.

REPRESENTATIVE BUCH asked who initiated the attorney general's investigation that led to the report.

REPRESENTATIVE CHENAULT recalled the governor had requested the investigation.

[4:10:09 PM](#)

REPRESENTATIVE PETERSEN stated that many consumers believe the fuel prices represent a catastrophe, especially in many parts of Alaska. Furthermore, fuel costs are a problem from the consumer's point of view. He indicated that he introduced the bill to address legitimate complaints from Alaskans who are entitled to some measure of protection. He reiterated that the threshold is set at 10 percent, but the committee could consider another percentage.

[4:11:37 PM](#)

BOB WEINSTEIN, Mayor, City of Ketchikan, stated that he would speak in support of the concept of the bill. He related that a considerable number of people expressed concern last November and December about what appeared to be an unusually high

disparity between gasoline and fuel oil prices in Ketchikan as compared to prices in the Lower 48. He opined that the issue was the topic of angry letters to the newspaper and media, as well as to legislators. Finally, the concern became so great that people picketed and protested the high prices. He explained that prices dropped "at the pump" by \$1 to \$1.40 per gallon. He offered his belief that the causes of possible exorbitant pricing may be different in Ketchikan than in other parts of Alaska, the concerns are similar. He further opined that HB 68 would do at least two things. First, it would give the attorney general a new tool to protect Alaska consumers in the event a refiner does charge excessive prices. Second, the very fact that the tool exists might in and of itself deter a refiner from selling energy resources at excessive or exorbitant prices.

4:14:00 PM

MR. WEINSTEIN, in response to Representative Chenault, stated that the fuel in Ketchikan is barged in from Seattle.

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CAROLINE POWELL, Owner, Mallotts General Store, Inc. stated that she and her husband have been the owners/operators of a store in Yakutat for over 40 years. She explained that their electric bill has generally been about \$4,000 per month, but swelled to \$17,000 one month due to high fuel surcharges. She highlighted the average increase in the surcharge alone is \$200 per day, or \$6,000 per month, or \$72,000 per year. She said:

We won't be able to survive at these rates. The community has no purchasing dollars left after paying fuel surcharges on their power bills, plus the high cost of home heating fuel. The surcharge on a residential electric bill of \$270 is \$400, making it over \$600 total. One hundred gallons of home heating fuel cost over \$500.

MS. POWELL opined that if Mallotts General Store has to close, the effects on Yakutat would evolve into greater losses, including losses to their employees and families, to customers, and reductions of sales taxes to the City and Borough of Yakutat. She explained some ramifications such as that the local fishing fleets would not be able to fish. She pointed out that gas cost \$5 per gallon. She recalled that recently a halibut boat delivered his catch, but after the skipper paid

fuel bill he said he would not be returning. She opined that others would also not return. She highlighted that Delta Western Bulk Fuel (Delta Western) is the only distributor. It bought fuel in Yakutat when prices were the highest. She offered that there is not any competition. She described a scenario in which a distributor sells \$2 fuel at 10 percent profit would receive \$.20 profit. If it sells \$5 fuel at the same profit, the distributor would make \$.50 or \$.30 more. Delta Western is the only fuel company so it has a monopoly. She offered her belief that the state has an obligation to protect consumers from monopolies. She recalled that the mayor advised the distributor informing them that the Yakutat Power Company could bring in cheaper fuel from Seattle. The response was that it would take the community longer to buy up the higher cost fuel if Yakutat Power Company does not help purchase the fuel. She also recalled that the Yakutat Power Company did bring in fuel from Seattle several times. However, this week the barge was cancelled due to weather. Thus, Yakutat Power Company is forced to purchase fuel from Delta Western again. Furthermore, Delta Western increased the cost to Yakutat Power Company by \$.30 per gallon advising the company it is no longer on its preferred customer list or entitled to the utility rate. Therefore, electric rates will rise, she stated. She said, "Yakutat needs some relief. And I thank you for the opportunity to speak."

[4:17:44 PM](#)

REPRESENTATIVE BUCH thanked Ms. Powell for her testimony. He inquired as to the source of the fuel under normal circumstances.

MS. POWELL stated she was not certain. She opined that the fuel costs are lower when the fuel is barged in on Alaska Marine Lines from Washington. She said, "Delta Western has basically said they won't be dealing with anyone who does this."

[4:18:55 PM](#)

LYNN WESTFALL, Senior Vice-President, External Affairs and Chief Economist, Tesoro Petroleum Corporation (Tesoro), introduced himself.

KIP KNUDSON, Manager, External Affairs, Tesoro Alaska Company, introduced himself to members.

MR. WESTFALL stated that Tesoro is an independent refiner, which means it does not own any crude oil. Tesoro purchases its product on the free market from third parties. He also stated that Tesoro does not necessarily make its profit from high gas prices. He said, "We make profit on the difference in price between gasoline and the other products we sell and the price we have to pay for crude oil." Last year when the headlines were filled with news about the large profits being made in the oil companies: those were from profits being made by crude producers. Last year was one of the worst years for profitability in history for the refining business. And the outlook for the refining business as a whole is continuing to deteriorate. Last year, gasoline demand in the United States declined by 3.5 percent, which was its second worse decline since 1965. Jet fuel demand is down over 10 percent, a larger decline than we saw in the aftermath of the 9/11 incident. U.S. refineries are only running at about 80 percent capacity versus a historical average in the 90s. But overseas refineries continue to be built. Last month, one of the largest refineries in the world started up in India. That refinery alone can provide enough gasoline to fill 40 percent of the U.S.'s requirements for imports. The Chinese are building between 4 and 5 refineries per year, some of which will be dedicated for the export market. Many refineries are in the planning stage in the Middle East. He opined the final word that can be said on the state of the industry can be had simply by looking at Tesoro's stock price. A little over a year ago, the stock at Tesoro was about \$60 a share, about a month and a half ago it went down to \$6, and it has only recovered to about \$15.

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MR. WESTFALL opined the industry is not healthy or earning high profits. However, he pointed out that refining is the industry he has chosen and will continue to be in so long as the industry knows the risks it operates within. He explained that with its system of seven refineries, the Nikiski refinery is core to their operations. He highlighted that it the only refinery in the state to invest in technologies to produce ultra low sulphur diesel fuel. He offered the investment was approximately \$65 million. He related that to be certain the product "had a home" and all markets were served, Tesoro entered into a unique marketing arrangement with Flint Hills Resources to purchase a large portion of its product to sell to their customers. He mentioned another significant capital project of similar size will be to remove benzene content in gasoline. However, Tesoro could face a new risk, which is the bill before members today.

MR. WESTFALL stated HB 68 attempts to stop a perceived practice of price gouging by instituting a cap on the price of gasoline and other petroleum products. Not only do these requirements not work where they have been tried, but they have an opposite effect. He highlighted a scenario in which price controls were established in the 70s in Texas, with long gas lines, and even or odd filling days, depending on the license plate number. He opined every study conducted during the 1970s time frame concluded that the shortage was caused by price controls and not by the oil embargo. He explained that Hawaii attempted to institute price caps on gasoline. Shortly after the price caps were instituted, a hurricane in the Gulf Coast made the Gulf Coast gasoline prices go from the lowest in the world to being one of the highest. However, since Hawaii placed a cap on prices gasoline prices could not increase enough to compete for limited volumes of gasoline that was available. The result was that "gasoline left the state of Hawaii." He said:

So you can control the price, but if you do it at a level that can't compete with the rest of the world, we have an obligation for our corporation to send it to another market. The Hawaii regulation is now in abeyance and as you know is not being enforced. Price caps don't work because you can't outguess or forecast the market. It is a world market for crude. It's a world market for petroleum products. And a piece of legislation can't compete with a daily decision making process of millions of consumers world wide. And just as price caps don't work; neither do vague terms like exorbitant or excessive.

I think one of the basis tenets of our legal system is that we have to have enough clarity in our laws that someone knows ahead of time that a contemplated action is illegal so he can change his behavior before breaking the law. Having government officials tell us after the fact that our actions were illegal because the law is vague is a very great risk to ask us to bear.

In conclusion, I need to say the Tesoro Corporation has and would like to continue investing their assets in the State of Alaska. But since we have limited capital, and we have to choose the best places to use that resource, we have to consider business risks. And the bill before you today would add a new risk to

our decision-making process. Thank you very much for your time. And I expect I'll get a question or two.

4:25:47 PM

CHAIR OLSON asked if this bill had been enacted a year ago, whether Tesoro would be in business at the current time.

MR. WESTFALL answered yes. He stated he did not mean to imply that there would be an immediate effect to the bill. However, the effect will be in Tesoro's long-term investment decisions. He explained that had the bill been in effect at the time Tesoro decided to invest the \$65 million to make ultra-low sulphur diesel fuel; it would have been a factor. He acknowledged that he cannot go back in history and re-make the decision. However, he offered his belief that it would have been a factor.

CHAIR OLSON inquired as to the current source of Tesoro's oil.

MR. WESTFALL related that generally about 50 percent is Alaska North Slope (ANS) crude oil and 25 percent is Cook Inlet crude oil, and the remaining 25 percent is purchased worldwide. He also mentioned that Tesoro buys all of Cook Inlet's crude oil. In response to CHAIR OLSON, Mr. Westfall reiterated that 25 percent is Cook Inlet crude oil.

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REPRESENTATIVE COGHILL related his understanding that Tesoro buys refined fuel at market price. Thus, Tesoro has a good idea about its fixed cost, but not the cost of the crude for refining, what the market will bear, and how regulators will affect them. He inquired as to whether instead of considering price gouging by the refinery, if the legislature should be examining upstream since those prices would affect the refiners, consumers, and everyone. He further inquired as to whether that has been considered.

MR. WESTFALL recalled that in the initial stages of the Hawaii law, the government considered retail instead of wholesale, but decided that would hurt smaller businessmen. Thus, Hawaii targeted retail prices. He said:

I think overall, it has the same chilling affect. Eventually each chain in the supply chain has to make a reasonable profit. If you try to limit any chain, you're going to damage that part, be it the wholesale

chain, the retail chain, or the refining chain. So I don't think by moving the point of enforcement significantly changes what the impact of the bill would have been or would be.

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REPRESENTATIVE COGHILL stated the problem is when someone is taking advantage of a "run up" some companies make the most profit. He opined that one of the things the Congress was attempting to do was to level out the profits of those oil producers with huge windfall profits. He recalled the Congress brought major producers before it to ask questions. He further recalled that Hurricane Katrina spurred the investigation. He related his understanding since price gouging is usually event driven that seemed like a reasonable starting point. Based on Mr. Westfall's testimony, the fixed costs would be plant management, hardware, cost of fuel used during the refining process. Thus, the crude oil purchase price is the issue, he opined. He asked if the committee is "barking up the wrong tree" or is the market so complex that an index point cannot be found.

MR. WESTFALL said:

The answer to your question, I believe, is that I would love to tell you we are a cost plus business, where you can take the cost of "crude" add in our funding manager's salary, adding 10 percent and that is or should be the price of gasoline. Unfortunately, the crude oil market has its own supply and demand factors worldwide. For instance, it certainly wasn't U.S. demand that drove the price up to \$140 per barrel. That was Chinese demand. Gasoline has its own supply and demand characteristics, either at the international level or even down to the store across the street level. And they move in different directions. So there really is no tie between, at "this crude price" gasoline should be at "this price." So, as I say, they're really different, but both are global supply and demand factors that you have to account for. And you can't, I can't tell you today, I'm certainly not smart enough, what the relationship between any two markets should be tomorrow. People have talked about Pacific Northwest, looking back in history. I don't know what that relationship will be next year. Washington state is out of compliance with

federal ozone standards and they're going to have to come up with a compliance plan and part of that plan may be instituting California grade gasoline, which is a whole different animal when it comes to gasoline. If they do that you can take your historical charts and throw them away. The relationship will change. But I guess my point is, "I don't know next year what any of those relations are going to be." And to assume a cap or regulate it is something that I don't have the brains to tell you what it ought to be.

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REPRESENTATIVE COGHILL stated that it would be helpful to know how many other refineries Tesoro competes with that service the Washington market. He also asked how the Tesoro refinery decides the cost of diesel and gasoline based the varying volumes of diesel and gasoline.

MR. WESTFALL answered, with respect to overall competition in refining, that Tesoro has refineries in Alaska, Hawaii, two in northern California. He recalled 13 refineries in CA, four in Washington, two in Hawaii, and those in Alaska. He pointed out that when a company has a refinery in one location, it can compete with many others. For example, there is a pipeline that joins Salt Lake City to Eastern Washington State. Thus, part of the supply originates in Utah. A pipeline from El Paso, Texas connects to Arizona, and one from Arizona to California, which connects those two markets. He related it is difficult to draw a supply corridor that is narrow. Furthermore, once product is placed in a tank, as is done in Alaska, the product can be shipped anywhere in the world. He opined that he just described the competition just in the Pacific Northwest area.

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REPRESENTATIVE COGHILL related that he is interested in the market dynamic in order to be able to gauge excessive or exorbitant prices. He also indicated he would like to determine how similar the market is in Washington in order to assess the 10 percent index. He mentioned that the "price at the pump" is what is viewed, but the distribution system and consumption rates would likely be different.

MR. WESTFALL offered his belief that every market is a unique market. Certainly, Alaska is smaller and is geographically diverse. He opined that he could not find another market

similar to Alaska except Hawaii. However, Hawaii has its own characteristics such that it does not have any crude oil or natural gas.

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CHAIR OLSON related his understanding that Tesoro is buying 25 percent of its crude oil for Alaska on the spot market. He asked how far out purchases are made.

MR. WESTFALL answered that it would depend. He stated that in South America it ranges from 30 to 45 days, but in the Middle East it can be up to 90 days. In further response to Chair Olson, Mr. Westfall stated the crude oil that is arriving in Alaska today was purchased at some other price.

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REPRESENTATIVE BUCH asked for the market of Nikiski plan products.

MR. WESTFALL related that approximately 60 percent of its gasoline is sent to other refiners. He related that the molecules purchased at Alaska's gas stations originated at Tesoro's refinery. Additionally, besides its own brand, Tesoro sells to wholesalers with their own brand, and to the independent gasoline stations. He stated that diesel goes to another refiner, Flint Hills Resources Alaska, and to wholesale and bulk fuel facilities. He further stated that jet fuel is destined to the airport. Furthermore, he mentioned about 30 percent of Tesoro's product is heavy oil, which is exported at a loss. He offered to provide more detail to the committee.

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MR. WESTFALL, in response to Representative Buch, stated that it does not export Tesoro's products to other parts of the world. He clarified that the "bottom of the barrel" is destined to Far East markets.

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JEFF COOK, Director, External Affairs, Flint Hills Resources Alaska (Flint Hills), expressed his concern with HB 68. He opined that HB 68 would adversely affect the Flint Hills refinery, harm consumers, and have long term negative effects for Alaskans. He provided the Flint Hills refinery's history.

He stated that Flint Hills is not in the crude oil production business nor does it have retail gasoline stations. All of its products are sold on wholesale market. Flint Hills produces less than one-fifth of the gasoline used in Alaska and only one-third of the heating fuel used in the Fairbanks area. Its 175 employees are proud of their contributions to Alaska. He pointed out that Flint Hills recently won awards and recognition and is an efficient and safe refinery. Flint Hills Resources has more than 60 years experience in the refining business. It has owned and operated the North Pole refinery since 2004. The company also owns and operates refineries in Minnesota and Texas. He explained that the North Pole refinery began operating in 1977, shortly after the Trans-Alaska Pipeline System was completed. The facility has undergone modifications but its basic configuration has remained unchanged. The refinery is a topping plant, which means it lacks the sophisticated processing capability to refine all the incoming crude oil into finished products.

MR. COOK indicated that the North Pole plant receives 180,000 to 220,000 barrels of crude oil per day, heats the crude oil to distill it into a few products for resale, and the rest of the stream is returned to TAPS, and Flint Hills pays an adjustment or penalty to do so. As a result, Flint Hills currently retains about 40,000 barrels per day of saleable product, the majority of which is jet fuel. Additionally, Flint Hills retains a quantity of fuel as an energy source for its refinery operations since it does not have access to natural gas. He opined that many topping plants were in operation in 1977, but most have closed due to environmental emissions regulations and increasingly stringent federal requirements on the types of fuels produced. He offered his belief that the North Pole refinery has kept pace with new environmental regulations but the changes in the types of fuels produced has impacted the amount of gasoline and diesel fuel that Flint Hills can produce. Federal mandates to lower sulphur content in the last few years have substantially diminished its ability to produce the fuels. Although it produces some gasoline and off-road diesel, it now purchases gas and diesel to meet the full needs of its customers. He further opined that is the reason that supplies are tight and profit margins are very small.

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MR. COOK pointed out that Flint Hills is working with the Department of Natural Resources (DNR) to develop a better understanding of its operations and the circumstances that

threatens its long-term viability in the state. Even though the refinery has been recently profitable, that is not currently the case. He related that Flint Hills is facing substantial uncertainty and is in the process of exploring its options. Thus, HB 68 poses a serious threat to future of the refinery, particularly since the bill does not establish a definition of exorbitant or excessive prices, yet subjects refineries to penalties that are 10 times the amount of the economic benefit from unlawful sales or \$50 million, whichever is greater. This bill would have an adverse affect on Alaskan consumers and businesses. He offered his belief that the bill would be so oppressive to its business, that Flint Hills would be forced to cease refining and distributing fuel in the state due to the uncertainty of pricing and the burdensome penalties. No one questions consumers can and should seek the lowest cost fuels. However, government intervention creates far more harm than good, he opined. He highlighted that producers react to price controls or cap legislation in a number of ways and none are good for consumers. He emphasized that a producer could shut down facilities or it may only produce the product when the price makes a sale profitable. Additionally, price controls affect investment decisions. If the control price is not sufficient to generate an acceptable rate of return, the investment will not occur. Competing producers observing the market will only enter if they believe they can earn money under the control price.

MR. COOK stressed that all of this leads to shortages. A lower price is not of any use to a consumer if the fuel is not available. He offered his belief that trying to outguess the market by setting a price cap that is thought to be adequate to address these problems is a dangerous game and one that Flint Hills will not engage in. He highlighted that none of us can forecast the future with any degree of accuracy and the consequences of being wrong will result in a shortage of fuel in Alaska. He acknowledged the sponsor's intentions are good, but he implored the committee to not to advance HB 68. He stressed that the bill could shut down the Flint Hills facility, but could do greater harm to Alaskans. He related his understanding that high fuel costs are burdensome for many Alaskan families. North Pole workers pay the same prices for their gasoline and heating fuels. However, price control legislation will harm consumers by causing shortages. The Flint Hills refinery is facing serious challenges with the demand for jet fuel down significantly in Alaska, particularly at the Anchorage International Airport. He highlighted that Federal Express is

transferring 68 pilots from Anchorage. He respectfully requested the committee not move HB 68 from committee.

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REPRESENTATIVE BUCH recalled an article from the parent company, Koch Industries, Inc. He recalled reading that when oil prices are high the company could not "make any money" but when the price was low it could not earn profits. He stated he was initially confused. He inquired as to whether some margin exists or certain price ranges that allows the company is more profitable.

MR. COOK cautioned that he is not an economist. He stressed that he is restricted from making some comments in a public setting. However, he related that when prices were high the company was challenged since it takes crude oil, refines it into energy source to run the refinery, and did pay three times the average cost of other refineries to process crude oil. He stated that besides crude oil, the cost of energy is the second highest cost the company incurs. He offered his belief that he could not specifically answer the question due to his lack of knowledge and the legal constraints.

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PATRICK GAMBLE, President and CEO, Alaska Railroad Corporation (ARRC), stated that since 2004 he has held a close association with Flint Hills in his role as the president of the ARRC. He explained that the ARRC transports Flint Hill's products to the airport. He further explained that he has currently been more involved with DNR and Flint Hills to examine all options to keep the refinery open. He opined that this involvement has enabled him to assess the impacts if the refinery was not there. He emphasized that part of the process is to collectively work with Flint Hills and DNR to build a value chain for the state to determine what is in the best interests of Alaska with respect to the refining portion of the royalty oil, which belongs to all Alaskans. He stressed that building that value chain is different for the state than it is for a private corporation such as Flint Hills. He asked to comment on "the other side of the coin". He indicated that he has a clearer picture of the consequences of not having the Flint Hills refinery. He opined that it is simply a business case, reviewing one value chain and comparing it to another, and presenting to the legislature the factual data in terms of the viability of the Flint Hills refinery. However, "the other side of that coin" is the fallout

of that process. He stated that not having a refinery in Interior Alaska would affect all Alaskans. The ARRC depends on Flint Hills as its dominant customer, and a long list of ARRC customers along the Railbelt in turn depend on the ARRC, such as ports and companies extending as far as the North Slope in terms of providing support for producers, gold mines, and the military. He highlighted that ARRC is part of the strategic defense transportation system and is a defense connector line that is ready to transport the military within Alaska. He also mentioned several large projects are underway that could be affected, such as the Fairbanks Bypass, the Northern Line Extension and the Matanuska-Susitna extension. He opined that the viability of the ARRC is important to all these customers and projects since it allows all these customers to look to the railroad as a tool for economic development.

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MR. GAMBLE said "I am thoroughly convinced that HB 68 would be almost tantamount to a heart shot in terms of the opportunity to continue a reasonable dialogue with Flint Hills, with the opportunity for a reasonable outcome, and the ability to look at several reasonable options that would keep the refinery open." He offered his belief the impact of HB 68 would be so egregious as to render some options as not worthwhile. He further emphasized his concern due to the impact on ARRC. He explained the ARRC estimates 600 jobs including the Flint Hills refinery, the ARRC, and others that the University of Alaska ISER study indicated would also be affected. He opined that 500 indirect jobs would also be at stake. He offered his belief that without the ARRC revenue, the business would also be affected. He stressed that besides payroll, capital is also pumped into the economy. Thus, when considering the value chain to Alaska, all of these items must also be considered. He concluded that he wanted to provide this perspective to the committee.

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CHAIR OLSON announced that HB 68 would be held over for further consideration.

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ADJOURNMENT

There being no further business before the committee, the House Labor and Commerce Standing Committee meeting was adjourned at 4:55 p.m.