

HOUSE FINANCE COMMITTEE  
April 9, 2014  
6:06 p.m.

6:06:08 PM

CALL TO ORDER

Co-Chair Stoltze called the House Finance Committee meeting to order at 6:06 p.m.

MEMBERS PRESENT

Representative Alan Austerman, Co-Chair  
Representative Bill Stoltze, Co-Chair  
Representative Mia Costello  
Representative Bryce Edgmon  
Representative Les Gara  
Representative David Guttenberg  
Representative Lindsey Holmes  
Representative Cathy Munoz  
Representative Steve Thompson  
Representative Tammie Wilson

MEMBERS ABSENT

Representative Mark Neuman, Vice-Chair

ALSO PRESENT

Joe Balash, Commissioner Designee, Department of Natural Resources; Doug Chapados, CEO and President, Petro Star Inc.; James Tangaro, Vice President, Kenai Refinery, Tesoro; Representative Mike Chennault.

PRESENT VIA TELECONFERENCE

Tara Sweeney, Vice President, External Affairs, Arctic Slope Regional Corporation.

SUMMARY

HB 287 APPROVE TESORO ROYALTY OIL SALE

HB 287 was HEARD and HELD in committee for further consideration.

6:06:35 PM

Co-Chair Stoltze discussed the agenda.

#hb287

HOUSE BILL NO. 287

"An Act approving and ratifying the sale of royalty oil by the State of Alaska to Tesoro Corporation and Tesoro Refining and Marketing Company LLC; and providing for an effective date."

6:07:12 PM

JOE BALASH, COMMISSIONER DESIGNEE, DEPARTMENT OF NATURAL RESOURCES, discussed that HB 287 had been introduced by the governor to approve the sale of royalty oil to Tesoro (one of the instate refineries). He spoke to an amendment that he hoped would be offered by members.

Co-Chair Stoltze noted that the amendment had been proposed by Representatives Thompson and Wilson.

Commissioner Balash discussed that the sales contract with one of the state's six instate refineries highlighted the value the facilities provided to the state's economy.

Co-Chair Stoltze asked for verification that the amendment had been provided to the public. [His staff Daniel George nodded in verification.]

Commissioner Balash continued to discuss the legislation. He stressed the importance of a healthy instate refining industry and ensuring that Alaskans had energy security. Of the state's six refineries, four made products for consumer markets and provided more than 900 jobs in Valdez, North Pole, Nikiski, and in other communities. He stated that keeping the refineries open was good business for the state. He remarked that unfortunately it appeared the state would lose one [Flint Hills Refinery]. He relayed that the operation of refineries in Alaska was good for the state's business and its national security; having a ready source of jet fuel was critical for the state's military strategic infrastructure at various locations throughout the state. He emphasized that if the state wanted a shot at basing F-35s in Alaska it needed to have a secure source of jet fuel

available. He communicated that due to a variety of factors the refineries' margins were severely diminishing. The largest problem related to the jet fuel market. He detailed that the Ted Stevens International Airport in Anchorage operated as one of the busiest air cargo hubs in North America. As a result a large demand was created for the supply of refined product; it provided additional scale for the operations that made the manufacture of gasoline, diesel, home heating fuel, and marine fuels more cost effective and efficient. He stated that without the air cargo business the costs for refinery products used in Alaska would increase. The biggest challenge the refineries faced in competing for the jet fuel market related to pricing. He elaborated that the feed stock into refineries was priced on a basis that was tied to the ANS West Coast deliveries; in the last ten years there had been a dramatic change in the pricing structure. He expounded that ten years earlier ANS had been priced at a \$2.00 discount to West Texas Intermediate (WTI); however, currently ANS traded roughly at a \$10 premium to WTI. He explained that the "bizarre phenomenon" in the market place was driven in many ways by oil production the mid-continental U.S.

[6:13:31 PM](#)

Commissioner Balash anticipated that in the long run things would even out and a narrowing of pricing would occur. In the meantime the cost disadvantage was impairing the state's oil refineries from competing in the jet fuel market. The department had heard from Interior refineries (particularly in North Pole) about challenges they faced since the pricing change had occurred and due to federal actions on pipeline tariffs and other. Beginning in 2012 the state had been in discussions with the refinery ownership. He relayed that the state had negotiated a new contract for the sale of its royalty to Flint Hills in the prior year; the contract had made a significant move on price for the sales. Additionally, the state had been in an ongoing conversation with Petro Star (the entity did not purchase royalty oil) related the effect of Quality Bank issues and other cost pressures that were eliminating margins. Representatives from Petro Star would share their concerns with the committee. The department had hoped that the problem would correct itself through normal market forces; however, the announcement in February that Flint Hills was closing its North Slope facility had changed the conversation. Since the Flint Hills announcement a subset

of the governor's cabinet had begun meeting regularly on the issues as a whole. He spoke to a small pipeline between the Trans-Alaska Pipeline System (TAPS) and North Pole refineries that was owned by the Golden Valley Electric Association. He explained that a pair of pipelines ran to and from TAPS connecting crude to the two North Pole refineries. The revenue requirement on the two pipelines was \$4.5 million in 2013; the cost was split 85 percent to 15 percent between Flint Hills and Petro Star respectively. The consequence of the impending Flint Hills closure was that the full cost would be borne solely by Petro Star. Due to concerns about the potential cost increase to Petro Star the department had reached out to the entity to determine whether it had plans to close. Petro Star had relayed that it did not intend to close at present, but that the possibility was real if something did not change. The department had considered various options including selling the state's royalty at a discount to mirror pricing like WTI; it had also considered a discount for select sales. However, after conversing with the Department of Law the department had been convinced that federal U.S. Constitutional questions around the Interstate Commerce Act and equal protection clauses could require the state to sell or value all of its royalty at the discounted price. He reasoned that at the current 85,000 barrels of production per day the price tag could be measured in the \$100 to \$200 million range. Therefore, the department was not willing to consider the option.

[6:19:34 PM](#)

Commissioner Balash relayed that the consequences of the closure of additional refineries and the potential effect of military basing decisions by the U.S. Department of Defense and the continued viability of the Eielson Air Force Base were being taken seriously by the administration. He elaborated that aside from the valuation issues the scenario put the state in the position of picking winners and losers; the state had a limited supply of royalty to go around and production would need to come from some of the private producers as well. The administration had worked to create a package of provisions to determine a defined value that would not be fungible that could be provided for a finite period of time. The package would also offer incentives to make additional investments in the facilities to increase efficiency, profit, and ability to compete for the jet fuel market and

the manufacture of other products used in Alaska. He provided highlights on the proposal. First, the package included a royalty valuation provision similar to the one used for the sale of Cook Inlet natural gas to utilities. Second, it included an investment incentive for capital investments in the refinery infrastructure. Third, it included a credit that was modeled in part on the small producer credit for the oil and gas production tax system. He detailed that the two tax provisions would be available for the upcoming five years; the credits would also include specific limitations to ensure that the state was providing a value that could be used to ensure that refineries continued to operate and provide economic benefits, jobs, and energy security in Alaska.

[6:22:57 PM](#)

Co-Chair Stoltze pointed to the amendment.

Representative Wilson MOVED to ADOPT Amendment 1 (28-GH2862\A.3, Nauman, 4/9/14)(copy on file).

Co-Chair Stoltze OBJECTED for discussion.

Representative Wilson explained the amendment. Section 2 included a \$15 million tax credit for any refinery in the state selling to a third-party (it did not apply to refineries on the North Slope producing and using their own oil). She detailed that a company could receive the money in cash if it was not able to take the entire \$15 million in a tax credit. She relayed that some of the funds could come from an oil and gas tax credit fund that currently held \$90 million. Section 3 included a tax credit in the amount of \$50 million; no single entity would take over \$5 million of the credit. She noted that Section 3 would not include North Slope refineries unless they decided to sell to a third party at some point in the future. Section 1 allowed a company to sell barrels for a discount. She explained that if a company had 8,000 barrels to sell the discount would be required to apply to all 8,000 barrels. The provision would enable companies to sell extra oil to another market. She asked for verification that her understanding of Section 1 was accurate.

Co-Chair Stoltze noted that the royalty contract was inalterable by the legislature and that it was unusual to add ancillary language to a royalty contract. He observed

that the provision in Amendment 1 was a departure from the norm. He could not recall another time that a royalty contract had a substantive amendment.

[6:26:14 PM](#)

Commissioner Balash agreed. He detailed that historically royalty contracts had been approved as standalone measures; however, the state constitution allowed for a measure to include multiple features provided that they were all on the same subject.

Co-Chair Stoltze understood. He suspected the actions resulted from the urgency of the situation. Commissioner Balash agreed. He spoke to the need to take action that would stabilize the industry and give confidence to decision makers in Washington, D.C.

Representative Wilson added that the amendment included a five-year sunset. She had asked what would change in five years. She had been told that upgrades to increase efficiencies would occur. She believed the primary issue was the difference between ANS West Coast and WTI pricing. She hoped pricing would even out. She observed that there were some strange dynamics occurring that would hopefully dissipate in the upcoming five years.

Representative Thompson pointed to Section 3, page 5, line 19 of the amendment. He referred to language specifying that a qualified infrastructure expenditure was an expenditure directly attributable to the in-state purchase. He asked if the language was referring to the Flint Hills Refinery or to equipment upgrades that would increase efficiency.

Co-Chair Stoltze asked for clarification about the reference to Flint Hills.

Representative Thompson wondered if the credit would be available to a company wanting to purchase the Flint Hills Refinery. Commissioner Balash replied in the negative. The language did not pertain to the purchase of refineries. Rather, it was in reference to the tangible personal property referred to on page 5, line 20 of the amendment.

[6:29:26 PM](#)

Representative Guttenberg asked about the current refinery capacity for producers on the North Slope. Commissioner Balash believed the two North Slope refineries had a per day capacity of 15,000 and 10,500 barrels.

Representative Guttenberg was concerned that the amendment may allow a company to move production away from the North Slope and to repurchase it from a separate entity in order to qualify for the credit.

Commissioner Balash replied that there was a two-part test including the volumetric limitation, which would require a company to make a significant change in its capacity in order to qualify. The second related to the manner in which a company did business; the question was whether or not a company sold primarily to third parties in arm's length transactions. He pointed to page 3, line 3 of the amendment specifying that a refinery's primary function was the manufacturing and sale of products to third parties in arm's length transactions. He detailed that an arrangement where a company sold to a third party and repurchased products at a later time did not qualify as an arm's length transaction.

Representative Guttenberg asked if a company would qualify for the credit if it leased a facility and bought the products produced at the facility. Commissioner Balash believed that there would be a practical consequence and limitation on the practice if it occurred; he noted that it would be noticed quickly.

Representative Guttenberg asked if the department would be alerted to the situation when the company applied for the tax credit. Commissioner Balash replied in the affirmative.

[6:32:27 PM](#)

Co-Chair Austerman asked if the amendment had been written by the administration. Commissioner Balash replied that an amendment had been drafted by the administration and passed through Legislative Legal Services.

Co-Chair Austerman asked how the \$15 million and other credits had been selected for the amendment. Commissioner Balash replied that the figures had been arrived at by a "backing in process." He detailed that the department had used the price differential that would be required to

achieve a pricing close to WTI and had looked at calculating the value from a royalty perspective. The number was then shifted to a defined tax credit.

Co-Chair Austerman pointed to page 3, lines 20 through 21 that allowed a company to carry the credit forward for five years if it had tax credits in excess of actual taxes. He asked for verification that subsection (d) would entitle a company to receive payment in cash from the state at the end of a five-year period if it had not used all of its tax credits.

Commissioner Balash replied in the affirmative; the credits were intended to be refundable. He detailed that similar to other credits, a company would be eligible for a tax credit refund through the Department of Revenue (DOR) if its corporate income tax liability was not as large as the tax credit.

Co-Chair Austerman asked whether other credits provided to the oil industry were refundable. Commissioner Balash replied that certain production tax credits were eligible for a refund.

Co-Chair Austerman asked if the credit was limited by the number of refineries. He believed three refineries currently fell under the amendment. He wondered whether other refineries could be eligible if companies used the infrastructure credit to bring them up to speed.

Commissioner Balash did not believe the scenario was likely or feasible. He elaborated that there were currently four refineries that would qualify including the Flint Hills Refinery; however, because the credits would not be available until January 1, 2015 he expected that there would only be three facilities that would qualify [due to the pending closure of the Flint Hills Refinery].

Representative Gara asked if there was a \$15 million total cap on the amendment.

[6:36:26 PM](#)

Commissioner Balash referred to page 3, line 18 of the amendment. The total cap for a one-year period was \$20 million. The investment incentive credit was capped at \$5 million and the refinery credit was \$15 million.

Representative Gara asked if the total credit for the three refineries could be \$60 million per year for five years. Commissioner Balash replied in the affirmative.

Representative Gara pointed to language on page 3, line 14 of the amendment that specified the tax credit could not reduce a tax payer's liability below zero. He thought Commissioner Balash had indicated that an entity could still receive the credit if its tax liability was below zero.

Commissioner Balash answered that a company could not have a liability below zero; however, any unused credit available to a company could be refunded. He used a company beginning with a tax liability of \$2 million as an example. He elaborated that if the company had earned the \$5 million investment incentive credit it would be required to apply the credit against its \$2 million liability. The remaining \$3 million could be refunded, but not used to take the company's tax liability below zero.

Representative Gara thought it sounded like the liability was below zero.

Co-Chair Austerman replied that the liability could not be below zero on the books, but the credit could be carried forward for a refund in the future.

[6:39:11 PM](#)

Representative Holmes asked for clarification that the cash refund could be received by a company in any given year.

Co-Chair Austerman replied in the affirmative, but a company could also choose to carry the credit forward.

Co-Chair Stoltze asked Commissioner Balash to clarify. Commissioner Balash answered that a tax payer could choose to carry the credit forward, but he believed it was unlikely. He detailed that a company could receive the refund each year [during the five-year period].

Co-Chair Austerman pointed to the language on page 3, line 14.

Representative Wilson spoke to the \$5 million and reminded members that \$50 million of investment in a refinery would

be required in order to receive the tax credit. She asked for verification that at the end of the five-year period the three refineries would have invested \$750 million to qualify for the credit. Commissioner Balash replied in the affirmative.

Representative Wilson asked about the current balance and purpose of the oil and gas tax credit fund. Commissioner Balash answered that the oil and gas tax credit refund fund had been established in 2007. The decision had been to move away from transferrable credits, which had put companies that had earned a tax credit in the position of selling the credit at a discount. He explained that the legislature had established the fund because the impact on the treasury was the same and the goal was to see the value of the credit realized by the party making the investment. The fund had enabled companies to avoid selling the credits at a discount to another company with a tax liability.

Representative Wilson wondered how the money was deposited into the fund. Commissioner Balash replied that the fund was capitalized by the legislature in its appropriations process. He relayed that the fund was currently in use and in operation by DOR. He was uncertain of the current balance.

Representative Wilson remarked that the commissioner of DOR had reported that the fund contained \$90 million at present. She believed a specified amount of money was deposited into the fund from each barrel of royalty oil.

[6:43:12 PM](#)

Commissioner Balash deferred to DOR on the fund details.

Representative Wilson wanted to ensure that the account funds were not limited to general fund appropriations and that money was deposited specifically for tax credits.

Co-Chair Stoltze invited presenters to address the committee. He relayed that a more robust discussion would continue at a later time.

[6:44:01 PM](#)

TARA SWEENEY, VICE PRESIDENT, EXTERNAL AFFAIRS, ARCTIC SLOPE REGIONAL CORPORATION (via teleconference), read from a prepared statement:

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

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

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

Ms. Sweeney referred to a PowerPoint presentation titled "Arctic Slope Regional Corporation Path to a Sustainable Refining Industry" dated April 2014 (copy on file). She turned to slide 2 and continued reading from a statement:

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

The recent announcement that Flint Hills Resources is shutting down its refinery in June has sent shock-

waves throughout the state, but Flint Hills' economic problems are not unique. Alaska refineries that are dependent upon drawing ANS crude from TAPS are fighting to remain in business in this state. Leadership from this committee and the legislature is needed to help this vital industry to ensure that petroleum products Alaskans need are refined here in Alaska, from Alaska crude oil.

Ms. Sweeney directed attention to slide 3 and read from prepared remarks:

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

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

[6:47:50 PM](#)

Ms. Sweeney moved to slide 4 titled "Introduction to Petro Star." She read from her remarks:

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

DOUG CHAPADOS, CEO AND PRESIDENT, PETRO STAR INC., turned to an overview of Petro Star on slide 5 and read from a prepared statement:

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

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

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

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

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

[6:51:06 PM](#)

Mr. Chapados spoke to the company's two refineries on slide 6:

### Valdez Refinery

- 60,000 barrel/day crude distillation unit
- 12,000 barrel/day distillate hydrotreater and associated process units
- 270 million gallon annual capacity
- Primary products are commercial and military specification jet fuels and ULSD
- Only Petro Star simultaneously produces - year round - both arctic grade and #2 marine/highway diesel

### North Pole Refinery

- 22,000 barrel/day crude distillation unit
- 95 million gallon annual capacity
- Primary products include commercial and military spec jet fuels, home heating oil and low-sulfur diesel
- North Pole also serves as the bulk distribution point for ULSD sales within the Fairbanks-area and volumes destined for the North Slope

Mr. Chapados relayed that the 12,000 barrels per day of ultra-low sulfur diesel produced at the Valdez Refinery represented half of the state's demand. He added that the North Pole Refinery was significantly smaller than the Valdez Refinery and was directly adjacent to the Foot Hills Refinery in North Pole. The North Pole Refinery served as the bulk distribution point for volumes headed for the North Slope and other communities.

Mr. Chapados moved to slide 7 titled "Petro Star's 2013 Contribution to the Alaska Economy." He read from prepared remarks:

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

Mr. Chapados read from slide 7:

- Provided 304 full time positions in Alaska, including:
  - o 151 in Fairbanks/North Pole
  - o 66 in Valdez
  - o 25 in Kodiak
  - o 25 in Unalaska
  
- Paid salaries and wages of \$28 million, including
  - o \$10.5 million in Fairbanks/North Pole
  - o \$7.8 million in Valdez
  - o \$1.5 million in Kodiak
  - o \$1.8 million in Unalaska
  
- Produced 270 million gallons of refined products
  - o 65 million gallons at the North Pole Refinery
  - o 205 million gallons at the Valdez Refinery
  - o Supplies 100% of Alaska's military jet fuel demand (JBER, Eielson AFB, Ft. Wainwright, Coast Guard Air Station Kodiak) and 100% of USCG MGO (marine diesel fuel) demand in Kodiak and Unalaska
  
- Re-invested approximately \$300 million in capital projects in Alaska, over the last seven years

Mr. Chapados expounded that most of the 66 Valdez employees were engaged in the refinery operation. The Kodiak employees operated a marine terminal and fuel distribution point. The 25 employees in Unalaska were divided between three marine terminals. He noted that the refineries had the total capacity to produce over 360 million gallons per year; the company was currently producing 270 million gallons per year. Petro Star had significant reserve capacity to meet demand that would not be met in the future given the Flint Hills Refinery closure.

[6:54:54 PM](#)

Mr. Chapados provided additional 2013 statistics on slide 8:

- Engaged 750 vendors statewide, including:
- Interior 250
  - Valdez 100
  - Kodiak 70

Generated fuel sales of 282 million gallons, including:

- Interior 82 million
- Valdez 40 million
- Kodiak 15 million
- Unalaska 30 million

Provided products and services to more than 14,100 customers, including:

- Interior 8,000+
- Valdez 1,100+
- Kodiak 4,000+
- Unalaska 200+

Other significant Kodiak facts:

- Petro Star supplies 50% of the Kodiak's diesel, heating oil, and gasoline demand
- Petro Star provides 100% of the fuel requirements for Kodiak Electric Association, the City of Kodiak and Kodiak Island Borough School District
- Petro Star is the only propane distributor on Kodiak Island

Mr. Chapados expounded that total fuel sales included products the company bought and resold from other refineries. Most customers in the Interior, Valdez, and Kodiak primarily purchased heating oil. The company sold a significant volume of marine diesel to the fishing fleets in Kodiak and Unalaska.

Mr. Chapados turned to slide 9 titled "Current Challenges" and read from a statement:

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

In short there are two major challenges facing in-state refining. The first is the high cost of ANS crude. ANS is one of the most expensive in the United States despite being of lower quality than lighter,

sweeter crude from fields like the Bakken in North Dakota - which currently sells at a large discount compared to ANS.

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

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

Mr. Chapados relayed that Petro Star's North Pole Refinery had been visited by the defense logistics agency to determine how the Flint Hills Refinery closure would impact Petro Star. The officials were interested in the company's status and its future ability to supply product for Eielson. He continued to address slide 9 in a prepared statement:

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

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

Petro Star has paid over \$525 million in penalties over the last nine years, and nearly half that amount in the past three years alone: The Quality Bank is getting worse at the same time market conditions are getting worse for Alaska refiners and its effects are devastating. Over these past three years, most of the margin between Petro Star's crude oil price and the price it received for its refined products like commercial jet fuel was paid out in Quality Bank penalties.

Faced with the combination of exorbitant Quality Bank fees and high crude costs, Petro Star and ASRC have had to put on hold capital projects that would grow Petro Star's business in Alaska and benefit consumers statewide just when these are needed most.

7:00:12 PM

Mr. Chapados provided a look at the governor's proposal from a refinery perspective on slide 10:

#### Royalty Oil

- Benefit to in-state refiners because it expands the potential pool of available ANS crude.

#### In-State Refinery Tax Credit

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

#### Qualified In-State Refinery Infrastructure Expenditures Tax Credit

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

Mr. Chapados elaborated on slide 10. He relayed that the royalty oil benefit was an expansion of the potential suppliers of ANS crude oil to the instate refineries. He stated that as the volumes of oil in TAPS had diminished it was becoming increasingly difficult to source crude oil for sale to instate refineries. The company expected to be interested in talking to the state about purchasing royalty oil in the future. The provision offered another method to get oil to instate refiners specifically through instate producers. Petro Star believed the instate refinery tax credit was equitable because it was done on a per refinery basis; it aimed to mitigate the high cost of ANS crude oil and addressed the fact that not all refiners were purchasing oil from the state at present.

Co-Chair Stoltze made a joking comment about the confidentiality note at the bottom of the presentation.

Mr. Chapados concluded his remarks. Petro Star viewed the qualified instate refinery infrastructure expenditure tax credit as a mechanism to spur reinvestment into the industry by instate refiners with a reasonable cap. He stated that if refiners made significant commitments to infrastructure investments they would be responsible for 90 percent of the costs. He relayed that Petro Star had spent over \$150 million on its ultra-low sulfur diesel facility. He wanted the company to qualify for the \$5 million in credits, but he did not believe it would happen.

[7:02:34 PM](#)

Ms. Sweeney provided concluding remarks:

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

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

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

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

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

[7:04:57 PM](#)

Co-Chair Austerman asked about Petro Star's tax liability in order to get an idea what the \$15 million credit would do. Mr. Chapados preferred to not share the figure. He noted that it would have been miniscule in 2013. He relayed that for the current year the company did not have a tax liability year to date.

Co-Chair Austerman asked for clarification. Mr. Chapados explained that the company would have needed to generate a profit in order to have a tax liability.

Co-Chair Austerman referred to earlier testimony by Commissioner Balash related to unused tax liabilities and carry forward. He asked whether the removal of the language related to making cash payment to companies if they had enough tax to not fulfill credits would impact Petro Star's business plans.

Ms. Sweeney asked for the amendment sections Co-Chair Austerman was referring to.

Co-Chair Austerman pointed to page 3, line 14 of the amendment. He wondered how Petro Star's business plans would be impacted by the removal of language on page 3, line 14 related to the carry forward of unused tax credits in a five-year period and on lines 19 through 21 pertaining to a refund of an unused portion of the credit.

Ms. Sweeney replied that the removal of the language would have a significant impact on Petro Star's viability (especially the removal of language on line 19).

Co-Chair Austerman surmised that without a tax liability it would be difficult to receive a tax credit unless it could be carried forward. Ms. Sweeney believed that under the section a company with zero tax liability was eligible for a refund.

Co-Chair Austerman explained that the company did not have a liability, but money would come out of someone's pocket to pay it to do business to help make it profitable. He had a problem creating a profit for a company out of a no tax situation and giving the company money.

[7:09:17 PM](#)

Ms. Sweeney pointed to ASRC's ownership in Petro Star. She elaborated that they would not be having the discussion with the committee if they did not feel that there were issues related to the viability of the refining industry in Alaska. She did not believe the provisions would create a windfall for the organizations, but it would help the industry stabilize and determine ways to grow. She referred to the five-year sunset date on the provision; during the time she was hopeful Petro Star would be positioned for growth.

Representative Thompson remarked on the railroad's declining business. He wondered about Petro Star's role and how the railroad's business could increase in the future.

Mr. Chapados answered that Petro Star had been in extensive conversations with the Alaska Railroad Corporation on plans to install rail loading and offloading facilities to move Petro Star's product to market more efficiently and in larger volumes. The facilities would address the finite amount of trucking capacity in the state. He could not provide further information given that the details were covered by a non-disclosure agreement. He relayed that both organizations were excited about the potential.

Co-Chair Stoltze commented on the railroad.

[7:12:20 PM](#)

Representative Guttenberg pointed to slide 9 that identified the Quality Bank as a profit center for royalty owners and shippers and a burden on Petro Star. He asked for further detail.

Mr. Chapados answered that Petro Star believed that the Quality Bank was currently the product of a flawed judge's decision at the Federal Energy Regulatory Commission (FERC) level. He relayed that the decision was increasingly

impacting the company. He detailed that in the past month the combined cost of ANS crude oil plus the Quality Bank had exceeded the sale value for jet fuel Petro Star delivered to the Anchorage market. He explained that the Quality Bank was used to compensate shippers for the degradation that their oil underwent when TAPS refiners re-injected oil back into the pipeline; it also adjusted for the varying qualities of crude oils on the North Slope. He relayed that 2013 had been Petro Star's worst year in terms of profit from ongoing operations; it had paid \$72 million to the Quality Bank. The four major recipients of the payment were the three major oil producers and the state.

Representative Gara asked for verification that the prior year was Petro Star's worst year for profits and that the company was on track for a loss in the current year. Mr. Chapados responded in the affirmative.

Representative Gara noted that a company would receive the proposed \$15 million credit even if it had no tax liability. He looked at the \$5 million credit (page 5, lines 2 through 4) and observed that a company could claim the credit if it made enough investments. He asked if the company would receive the \$5 million credit even if it made no profit.

Mr. Chapados replied in the affirmative.

Representative Gara remarked on the state's difficult fiscal environment. He provided a hypothetical scenario where the company's had a \$2 million loss and the state gave it \$20 million. Under the scenario, the state gave the company an \$18 million profit; \$15 million of which the company did nothing for and \$5 million of which was reimbursement for qualified expenditures on capital. He wondered why the bill should not be more closely tailored.

Mr. Chapados answered that the amendment had been developed by the administration in response to the challenges the company had presented to the governor. He spoke to the \$18 million in profit from Representative Gara's scenario. He detailed that in order to receive the money Petro Star and ASRC would need to invest \$50 million in one year. He believed the figure was representative of the company's commitment in prior years and what it would like to have in the coming years. Petro Star saw the credits as a mechanism

that would allow the refining industry to weather the current storm.

[7:18:01 PM](#)

Representative Gara was uncomfortable with Section 3 of the amendment. He wondered if there was something the state could do to help Petro Star avoid the Quality Bank penalties. He wondered if an infrastructure upgrade could be more narrowly tailored that would not require the state to spend as much money.

Mr. Chapados replied that FERC ultimately decided the methodology related to the Quality Bank. He elaborated that more than 20 years earlier the Regulatory Commission of Alaska (RCA) had disagreed with the FERC ruling. In recent years the RCA had concurred with FERC's decision. He did not believe the state could significantly adjust for the increased penalties Petro Star paid. Petro Star had made a request to the administration for the entities to work with other parties to the ongoing Quality Bank proceeding to determine if a settlement was possible; a settlement that would forestall additional litigation and to make the Quality Bank more reasonable. He underscored that Petro Star did not believe the Quality Bank should be zero; it appreciated that it was having an impact on the quality of crude oil in the pipeline; however, Petro Star did not believe its current payment of \$72 million was reasonable.

[7:20:27 PM](#)

Representative Edgmon understood the importance of the refinery. He wondered about the five-year transition plan and what Petro Star would do to improve its economics during that time. He spoke from the perspective of a village corporation chairman; the corporation had shut down a couple of its subsidiary companies, which had been painful. He noted that the implications related to refineries were larger statewide.

Ms. Sweeney replied that the bill represented a step in the right direction for the companies. She relayed that ASRC deployed its assets with a disciplined approach. She detailed that ASRC had a congressional mandate to provide benefits back to its shareholders through ANCSA. The company had to look at its business lines and investment opportunities dispassionately when it looked at what fit

its business portfolio. She stated that it was the company's fiduciary responsibility to manage the assets appropriately on behalf of its shareholders. She communicated that with provisions such as the ones included in the amendment, the company could work to stabilize Petro Star so that ASRC could look at reinvesting its money into the organization to enable it to grow.

[7:23:18 PM](#)

Representative Edgmon asked for verification that the five-year proposal had been offered by the governor. Ms. Sweeney replied in the affirmative.

Representative Edgmon asked if ASRC had originally wanted the time period to be longer. Ms. Sweeney replied in the affirmative.

Mr. Chapados added that the refining industry was very capital intensive. He elaborated that investments were not typically made on a five-year timeframe; typically Petro Star was looking out 10 to 20 years or longer. He spoke to making a return on investment and referred to the ultra-low sulfur diesel investment; the investment did not pay off in a short period of time, but the company had made the commitment to produce the product. He shared that Petro Star had projects in the queue including at least one rail transportation project. The bill would factor into ASRC's decision to invest in the project. He stressed that efficiency was important to Petro Star; over the years the company had made extensive efforts to increase fuel and electricity efficiency at the plant. The company believed increasing efficiency was the one way it could compete with larger competitors, while remaining viable. He detailed that it had been a recipe for success in terms of high energy costs experienced in Alaska; the company used crude oil as fuel; therefore, it had incentive to maximize efficiency and minimize the volume of energy consumed.

[7:26:08 PM](#)

JAMES TANGARO, VICE PRESIDENT, KENAI REFINERY, TESORO, relayed that Tesoro had testified in support of the legislation in the past. He observed that the bill had changed.

Co-Chair Stoltze noted that the bill would potentially change given a pending amendment.

Mr. Tangaro communicated that the Tesoro Kenai Refinery had started in 1969 during Alaska's original oil boom; it continued to process oil from the Swanson River, Cook Inlet, North Slope, and other sources. The refinery employed approximately 210 people and had the capability of processing 72,000 barrels per day. The company had about 30 full-time contractors and approximately 515 employees statewide. He stated that the most important component of the bill was the royalty oil contract; the contract extension would provide a stable supply of ANS crude while giving the company the volumetric flexibility to accommodate seasonal fluctuations in its run rates. The availability, flexibility, and stability offered by the contract extension would have a positive effect on Tesoro's ability to maintain operations at the Kenai Refinery.

Mr. Tangaro referred to the proposed amendment and relayed that the company appreciated the governor's acknowledgement that Alaska continued to be a challenging location for the refining industry and that the refining jobs were critical to Alaskan communities. He relayed that maintaining the refineries had many statewide benefits. He observed that refining was a complicated business. He spoke to the importance of maintaining a level playing field for all participants in Alaska's refining business. He noted that the company's prior testimony on the legislation was on record from a past hearing.

Co-Chair Stoltze apologized for the short timeframe. He thanked Mr. Tangaro for his testimony.

HB 287 was HEARD and HELD in committee for further consideration.

#  
ADJOURNMENT

[7:29:53 PM](#)

The meeting was adjourned at 7:29 p.m.