

**ALASKA STATE LEGISLATURE
HOUSE RESOURCES STANDING COMMITTEE**

March 6, 2014

12:05 p.m.

MEMBERS PRESENT

Representative Peggy Wilson, Vice Chair
Representative Mike Hawker
Representative Craig Johnson
Representative Kurt Olson
Representative Paul Seaton
Representative Geran Tarr

MEMBERS ABSENT

Representative Eric Feige, Co-Chair
Representative Dan Saddler, Co-Chair
Representative Scott Kawasaki

OTHER LEGISLATORS PRESENT

Representative Andrew Josephson

COMMITTEE CALENDAR

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."

- MOVED HB 287 OUT OF COMMITTEE

PREVIOUS COMMITTEE ACTION

BILL: HB 287

SHORT TITLE: APPROVE TESORO ROYALTY OIL SALE

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

01/29/14	(H)	READ THE FIRST TIME - REFERRALS
01/29/14	(H)	RES, FIN
03/03/14	(H)	RES AT 1:00 PM BARNES 124
03/03/14	(H)	Scheduled But Not Heard
03/05/14	(H)	RES AT 1:00 PM BARNES 124
03/05/14	(H)	Scheduled But Not Heard
03/06/14	(H)	RES AT 12:00 AM BARNES 124

WITNESS REGISTER

JOE BALASH, Commissioner
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: On behalf of the administration, introduced HB 287.

KEVIN BANKS, Petroleum Market Analyst
Division of Oil & Gas
Department of Natural Resources
Anchorage, Alaska

POSITION STATEMENT: Answered questions regarding HB 287.

JAMES TANGARO, Vice President Kenai Refinery
Tesoro Alaska Company
Kenai, Alaska

POSITION STATEMENT: Testified in support of HB 287.

ACTION NARRATIVE

[12:05:18 PM](#)

REPRESENTATIVE MIKE HAWKER called the House Resources Standing Committee meeting back to order at 12:05 p.m. Representatives Tarr, Seaton, Olson, P. Wilson, Johnson, and Hawker were present at the call back to order. Representative Josephson was also present.

HB 287-APPROVE TESORO ROYALTY OIL SALE

[12:05:50 PM](#)

REPRESENTATIVE HAWKER announced the only order of business is 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."

REPRESENTATIVE HAWKER noted HB 287 was introduced by the House Rules Standing Committee at the request of the governor. He said the intention is to move the bill today following testimony and any amendments.

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JOE BALASH, Commissioner, Department of Natural Resources (DNR), introduced HB 287 on behalf of the administration. He said he has a slide pack ready for presentation but proposed to instead provide a summary and answer the committee's questions.

REPRESENTATIVE HAWKER agreed to Commissioner Balash's proposal, saying committee members are well aware of what are royalty-in-kind sales and members are only looking for an explanation of why HB 287 is before the committee.

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COMMISSIONER BALASH explained that in fourth quarter 2013 the Division of Oil & Gas, Department of Natural Resources, entered into a sales contract with Tesoro to provide between [5,000] and 15,000 barrels per day of Alaska North Slope supply to Tesoro's Nikiski refinery. Because the contract was for less than one year, it could be executed without going through a legislative review. However, in further discussion, the operator expressed a desire to extend the contract, and legislative approval is needed to extend it beyond one year. The price terms for this particular sale are different than the ones that were before the committee last year when it considered the much larger volume for sale to "Flint Hills" in North Pole. A reason for that difference is driven in part by the lack of specific special commitments. Some special commitments were made in the Flint Hills case and therefore Flint Hills received a higher deduction off of the total price than is seen here with Tesoro; it is a difference of about 20 cents. The other terms are largely the same, with the exception of the volumes. Commissioner Balash said the Tesoro refinery in Nikiski has been operating since 1969 and is the largest and most sophisticated refinery in Alaska. The refinery manufactures ultra-low-sulphur diesel (ULSD), and while it is not the only refinery making this product, it makes the most. The Tesoro refinery has a diverse product line that includes jet fuel to the Ted Stevens Anchorage International Airport, a lot of gasoline, as well as the ULSD. The Nikiski plant provides more than 200 high-paying jobs, so it is a good opportunity to add value to one of Alaska's resources. He said refining is a business that he hopes will remain a part of Alaska's economy for some time.

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REPRESENTATIVE HAWKER, regarding [DNR's] October 24, 2013, best interest finding for the sale of Alaska North Slope (ANS) royalty oil to Tesoro Refining and Marketing Company, LLC, noted

that a public comment period of at least 30 days was held and was closed on September 23 for which no public comment was received. It is therefore presumed that no one is challenging this best interest finding by the department.

COMMISSIONER BALASH confirmed that is correct, saying that under the statutes of "183," a hearing was conducted with the [Alaska Royalty Oil and Gas Development Advisory Board] that also recommended the approval of this particular sales contract.

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REPRESENTATIVE TARR inquired whether closure of the Flint Hills refinery will have any impact on this contract in terms of volume. For example, whether more than 15,000 barrels per day would be available for the Tesoro contract.

COMMISSIONER BALASH responded the specific negotiation on the volume for this contract was somewhat limited because of the sale of royalty to Flint Hills. Both contracts have a proration clause in the event that the state, for whatever reason, winds up short on royalty production -- the state is able to reduce the volume it is selling to either or both refineries. As information related to the Flint Hills closure continues to be understood, it is important to note that the contract approved for Flint Hills is a larger volume and is still in place. The first notification of a zero barrel requirement under the contract has been received. After the receipt of three zero barrel monthly nominations in a row, the contract terminates. So, it would be mid to late second quarter 2014 that the Flint Hills contract would run its natural course and terminate, freeing up those royalty barrels for selling to a different party, perhaps even Tesoro.

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REPRESENTATIVE P. WILSON understood the current initial quantity range included a clause that the quantity may be adjusted after 12 months with commissioner approval. She asked whether the contract was just for 12 months.

COMMISSIONER BALASH confirmed the initial contract was for 12 months. Responding further, he explained this is an extension and further authorization, and the department is presently investigating with Tesoro whether and how the volumes can be increased if additional royalty volumes become available, but nothing in that regard has been closed yet.

REPRESENTATIVE P. WILSON inquired whether she is correct in understanding that this is another contract for another year.

COMMISSIONER BALASH believed this contract runs through 2016, so it would be approximately one additional year.

REPRESENTATIVE P. WILSON surmised the provision saying the commissioner can change those amounts after 12 months is moot.

COMMISSIONER BALASH replied that, in this case, what would be looked at is an opportunity after the first year to make a change in the second year because this is, in effect, now a two-year contract. He explained that the initial contract was just one year. A new contract is being entered into which extends that initial contract by one year and includes the latitude to increase the volume after the first 12 months. He deferred to the Division of Oil & Gas to provide further information.

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KEVIN BANKS, Petroleum Market Analyst, Division of Oil & Gas, Department of Natural Resources (DNR), confirmed the initial contract period was for one year, as stated by Commissioner Balash. A term in that one-year agreement talks about re-adjusting the volumes; this term is something of a vestige of the contract the state has with Flint Hills. In the Flint Hills case, it was intended to give Flint Hills an opportunity to reduce volumes because that seemed to be a bigger issue for that company. In this case with Tesoro, it is a clause that actually does not have effect in a one-year term. Now that the division would like to be able to add a second term, it will give the opportunity to adjust the volumes up or down depending on the needs expressed by Tesoro.

REPRESENTATIVE P. WILSON said she wants to ensure that it is not being automatically said that the contract is going to be renewed again for one year and have all the wording the same in the contract. She asked whether she is correct in understanding that the contract is being renewed for one year, but some of the language in the contract has been changed.

MR. BANKS responded the only difference in the new one-year-addition contract is the language that changes the date. The original contract and all of the terms are identical except for the dates that the contract will run.

REPRESENTATIVE HAWKER understood that HB 287 authorizes an extension of the existing contract. So, instead of it being the one year that could be entered into without legislative approval, the contract is being extended beyond that first one-year, which requires legislative approval and is what is before the committee.

MR. BANKS replied correct.

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REPRESENTATIVE P. WILSON noted she has not seen the contract itself but understands it may be adjusted after 12 months with commissioner approval. She expressed her concern that "they would be able to do that." While she knows it is understood that way, it is sometimes understood one way but it does not say that -- it says it may be adjusted after 12 months with commissioner approval. It does not say when that 12 months starts. If the same contract is being done here, and it is up for starting to continue, it does not say "we're going back to the first contract at the beginning and saying ... 12 months ... have gone by and so we can do it now." Some attorney may say this contract has been extended and so from the date the legislature has extended it perhaps it says it may be adjusted after 12 months. She said she wants to ensure that it says "what we intend it say," adding she does not have a question with what it says, but wants to ensure there are not unintended consequences because of that.

REPRESENTATIVE HAWKER requested Mr. Banks to clarify the change provision that is in the contract and whether it does say what the division intends it to say.

MR. BANKS, reading from the language in the contract, spoke as follows:

The buyer may elect to reduce the initial sale oil quantity by giving notice. The initial sale oil quantity shall remain as stated for 12 months after the ... day of first delivery.

MR. BANKS continued, explaining the 12-month period that Representative P. Wilson is concerned about is triggered by the delivery of oil under the existing original contract. Any change to reduce the amount of oil would occur after January 1, 2015, and the commissioner has the right to approve or deny that. It is specifically built into the contract to reduce the

amount, not necessarily to increase it. He said he thinks it is saying exactly what should resolve the concerns raised by Representation P. Wilson.

REPRESENTATIVE P. WILSON agreed it sounds like her concerns are addressed.

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REPRESENTATIVE TARR surmised that when the contract with Flint Hills is eliminated in three months there will be royalty oil to get to somebody else. She asked whether the contract is written in such a way that it would delay until 1/1/15 the opportunity to make adjustments, although she allowed that the state could look for somebody else during that time period.

COMMISSIONER BALASH responded the opportunity of that gap will likely require the department to enter into a second contract with Tesoro for the state to be able to sell additional volume to Tesoro above 15,000 barrels per day because the adjustment provision only allows for going down.

12:24:23 PM

REPRESENTATIVE HAWKER opened public testimony on HB 287.

12:24:45 PM

JAMES TANGARO, Vice President Kenai Refinery, Tesoro Alaska Company, said Commissioner Balash hit most of the key points contained in his March 3, 2014, letter to the committee [included in the committee packet]. He stated that Tesoro supports HB 287 and urges the committee to support it as well. The refinery has existed for 45 years, has no plans to be elsewhere, and is a big part of the community. He said HB 287 extends the contract and gives Tesoro a firm supply of Alaska North Slope crude and the flexibility to operate the refinery efficiently. The bill is important to Tesoro, he said.

REPRESENTATIVE HAWKER related his staff has reviewed DNR's best interest findings, which state that the Tesoro refinery supplies 35 percent of the jet fuel used at Ted Stevens Anchorage International Airport.

MR. TANGERO replied it is 35 percent or a little higher.

REPRESENTATIVE HAWKER further shared that DNR's best interest findings state that the Tesoro refinery provides 60 percent of the gasoline consumed by Alaskans, indicating the importance of the commercial service provided by the refinery to Alaskans.

MR. TANGERO answered thank you.

12:27:00 PM

REPRESENTATIVE HAWKER closed public testimony after ascertaining that no one else wished to testify.

12:27:26 PM

REPRESENTATIVE P. WILSON moved to report HB 287 out of committee with individual recommendations and the accompanying fiscal note.

REPRESENTATIVE HAWKER observed it is an indeterminate revenue fiscal note because the value of the resource is unknown over time because the price fluctuates with the open market.

There being no objection, HB 287 was reported from the House Resources Standing Committee.

12:28:04 PM

ADJOURNMENT

There being no further business before the committee, the House Resources Standing Committee meeting was adjourned at 12:28 p.m.