

ALASKA STATE LEGISLATURE
SENATE RESOURCES STANDING COMMITTEE

March 30, 2016

3:30 p.m.

MEMBERS PRESENT

Senator Cathy Giessel, Chair
Senator Mia Costello, Vice Chair
Senator John Coghill
Senator Peter Micciche
Senator Bert Stedman
Senator Bill Stoltze
Senator Bill Wielechowski

MEMBERS ABSENT

All members present

COMMITTEE CALENDAR

SENATE BILL NO. 205

"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 SB 205 OUT OF COMMITTEE

CONFIRMATION HEARING

Alaska Gasline Development Corporation
Dave Cruz

- CONFIRMATION ADVANCED

PREVIOUS COMMITTEE ACTION

BILL: SB 205

SHORT TITLE: APPROVAL OF SALE OF ROYALTY OIL TO TESORO

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

03/23/16	(S)	READ THE FIRST TIME - REFERRALS
03/23/16	(S)	RES, FIN
03/30/16	(S)	RES AT 3:30 PM BUTROVICH 205

WITNESS REGISTER

DAVE CRUZ, President and CEO
Cruz Companies
Palmer, Alaska

POSITION STATEMENT: Appointee to the Alaska Gasline Development Corporation (AGDC).

JIM SHINE, Special Projects Assistant
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: Presented SB 205.

CORRI FEIGE, Director
Division of Oil and Gas
Department of Natural Resources (DNR)
Anchorage, Alaska

POSITION STATEMENT: Answered questions related to SB 205.

MATT GILL, Senior Manager
External Affairs
Tesoro Alaska

POSITION STATEMENT: Supported SB 205.

CAMERON HUNT, Vice President and Manager
Kenai Refinery
Tesoro Alaska

POSITION STATEMENT: Commented on Tesoro contract details and SB 205.

ACTION NARRATIVE

[3:30:09 PM](#)

CHAIR CATHY GIESSEL called the Senate Resources Standing Committee meeting to order at 3:30 p.m. Present at the call to order were Senators Stedman, Stoltze, and Chair Giessel.

[3:31:02 PM](#)

Confirmation Hearing **Alaska Gasline Development Corporation**

CHAIR GIESSEL announced the confirmation hearing for Dave Cruz as a board member to the Alaska Gasline Development Corporation (AGDC) as the first order of business. She noted that members' packets had an AGDC fact sheet as well as his application for appointment. She invited Mr. Cruz to tell them why he wishes to continue serving on the board.

DAVE CRUZ, President and CEO, Cruz Companies, Palmer, Alaska, said he was born and raised in Alaskan. He has been an industry person since 1976 when he was fortunate enough to work on the pipeline right out of high school. His family has been here for almost 90 years. He has been a business owner for over thirty years. Currently he heads up Cruz Companies, construction, marine, and oil field operations in Alaska, North Dakota, Washington State, and Fort McMurray, Alberta, Canada.

MR. CRUZ said he had been on the AGDC Board since its conception. He has served as a board member, the vice chair, the interim president, and is currently the chairman, and feels the gas pipeline is essential to the state. Fortunately, he has never wanted for a job in this state and he wants to pass these opportunities on to the next generations.

CHAIR GIESSEL asked who the attorney for AGDC is.

MR. CRUZ replied Ken Vassar, who retired at the start of the year, was the first general counsel. Now John Burns is taking his place. He had been with AGDC as the board chair and brought a wealth of experience back to it.

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SENATOR WIELECHOWSKI joined the committee.

SENATOR STOLTZE noted that SB 125 had just passed the Senate and asked if he thought there is a constructive and positive role for ex-officios on the AGDC board.

MR. CRUZ answered that he had no objection to that. He applauded the legislature for creating AGDC and felt it provided an opportunity for the state to be an equal partner in AKLNG, and if it's the legislature's wish to have two legislative members sit on the board, he would not oppose it.

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SENATOR COGHILL joined the meeting.

SENATOR WIELECHOWSKI asked if he thought the board is more of a technical working board or more of a policy making board.

MR. CRUZ answered that this board is not a rubber stamp board. Members are required to be active where they bring expertise to the committee. For instance, he serves as chair of the Technology Committee (informally known as the PEC Committee)

that deals mainly with Permits, Engineering and Construction (PEC).

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SENATOR COSTELLO joined the meeting.

MR. CRUZ said being on this board is a big commitment, not just showing up once a month.

SENATOR WIELECHOWSKI asked if he has experience building pipelines or LNG plants, or marketing gas.

MR. CRUZ answered, "Yep, I've got a lot of experience." His companies have built pipelines and performed maintenance for Alyeska Pipeline. He worked on the original TransAlaska Pipeline (TAPS) and another company he controls, Alaska Interstate Construction, has been on every major North Slope pipeline for the last 30 years. He is past president of Associated General Contractors of Alaska and understands the relationships in the contracting community and what capabilities Alaskan contractors have. He has worked on large plants and at terminal camps under contract to Alyeska Pipeline, another maintenance project. He has had lots of opportunity to interface on this type of project.

SENATOR WIELECHOWSKI asked if the board is lacking in expertise in any area.

MR. CRUZ said at the initial start of AGDC, they had to bring in levels of expertise to make this corporation "stand up." Today, AGDC is a running operating machine. So, it's not requiring all tech guys, because they have gotten past that point. They successfully delivered the ASAP project to a class 3 estimate with a 20 percent contingency factor last year, and that project is now on hold. AKLNG is a project that is well-planned and well-funded moving forward. ASAP is just basically being monitored and adding onto the technical side of AKLNG with cost saving measures, permits, and data-sharing. He doesn't need a whole bunch of engineers sitting next to him to facilitate this project now. He needs people with a commercial and labor background. The board is well-rounded today and works cohesively as a group.

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SENATOR STOLTZE remarked that Mr. Cruz is the one "constant" on the AGDC Board, and asked now that it has people who are standing up for Alaskans instead of a bunch of oil executives

what his take is having served with all the members. Was it tilted before with views antithetical to the interests of Alaskans?

MR. CRUZ answered at that time a great wealth of knowledge was available to deal with some large-scale pipelines like the TAPS. That was a help at that time. They were sincere. He never felt any member supported a special interest group. They took an oath to do what was best for the State of Alaska and that's what they abided by. He could ask any member of the current board to do something, anything, even volunteer, and they will do it. He is happy with the composition of both board memberships. When they started out everything was new and fresh. They set out with an initial mission, the ASAP project, and completed it. He is very proud of that endeavor, because he saw a project get built from a standup to a class three estimate, which is good enough to go to bond and good enough to go to bid.

CHAIR GIESSEL recognized Hugh Short, another AGDC board member, in the audience.

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SENATOR STEDMAN asked for a couple minute overview of what is happening in Alberta, Canada, because it "is very critical to other things that we do here, and we rarely have the opportunity to have somebody who has exposure in Alberta to share with us."

MR. CRUZ said the one thing that is very interesting about Fort McMurray is that the terrain, the trees, everything is very similar to what one can find in Willow, Alaska. But the remarkable thing is that Alberta has 100 companies developing its oil sands, not just three or four. "It's the Saudi Arabia of North America." Another remarkable thing is that it appears that when they start talking about a pipeline in September, it's done by the end of March. The government is not getting in the way there and is actually facilitating these projects.

He explained that some National Geographic pictures were taken of the earlier oil sands by someone who is against it. However, the sheens are being cleaned up and the open pit mine is being reclaimed. It's hard to tell where the mine was. Another thing is the addition of a next generation of steam assisted lift (Steam Assisted Gravity Drainage (SAGD)). A pad has 10 vertical wells and then right behind it a 45-degree well goes down that is a steam line. The gas coming off is used to generate enough steam so the heavy oil can be lifted up. The complexes are small and have a small pad (a couple acres) with a station on it. A

lot of the technology is similar to Alaska's: use of ice roads and different geotextiles. It's a very positive environment, so one sees a lot of excitement going forward.

SENATOR STEDMAN asked what the current economic trends are in Alberta and, maybe in the Dakotas, if he has operations there.

MR. CRUZ answered that Alberta has slowed down quite a bit, but oil sands investments are long term, a 40 year life-span. The Dakotas are a different environment. His company went down there in 2010 because they had slowed down in Alaska, and the first thing that was apparent was that the Alaska model was the cleanest and best at working on ice - you can't tell a road was even there the next year.

However, in North Dakota, it took 80 days to get paid, which takes too long for his company. So, upon asking one of his clients what was up he found that it takes him only 60 days to get oil from drilling to production and they wanted a few extra days to not get themselves into a cash problem. Mr. Cruz said he could not believe that the industry had the technical expertise to do it that fast. Here it takes 10 years, the problems being permitting and all the other challenges that all Alaska construction projects face. Folks in Alaska don't see the industry, but if they were sitting in Dickinson, North Dakota, they would be looking at five pump jacks out the window. North Dakota is down right now, but that type of oil field takes a flick of a switch and it comes back up, unlike Alaska where you can't let it go cold.

SENATOR STEDMAN said if North Dakota can do it in 60 days, he wished Alaska could do it in 120 days.

MR. CRUZ added that the permitting agency is different in North Dakota where one is dealing with a rancher or a farm owner who is usually welcoming you to their property. They have terms and conditions just like here; you don't make a mess. But getting the drilling permit in 2010 took seven days, and you could probably get it faster.

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CHAIR GIESSEL asked how the Alberta government is responding to the low price environment.

MR. CRUZ answered that the national Canadian government changed and now has the approach that the industry was making too much money. So, they changed the tax structure, which didn't help

them out at all. And then the Alberta government changed almost for the same and created another huge problem, and now there are some very good deals on oil field equipment in Alberta.

CHAIR GIESSEL asked if companies are paring down.

MR. CRUZ said yes, substantially, because a very strong market went away. On a bad year in Alberta they drilled 16,000 wells and Alaska drilled 70.

SENATOR STOLTZE asked how he communicates with the administration.

MR. CRUZ answered that the State Gasline Team consists of the AGDC, the Administration, the Department of Natural Resources (DNR), Department of Revenue (DOR), the Department of Law (DOL), and that team has a weekly meeting and is constantly interfacing on different issues. This project has many moving parts and operates by using a critical path schedule with a responsibility, accountability, consulted and informed (RACI) chart. He feels that it is working well. They also have very good relations in the sponsor meetings in which the heads of ConocoPhillips, ExxonMobil, BP and the governor show up, along with the deputy commissioner and himself, as well as the AGDC interim president; those are day-long meetings.

SENATOR STOLTZE asked if he hears from anyone with a direct line to the governor who is not on the board. Does the governor have a defacto designee?

MR. CRUZ answered no, but he can call the governor up and in a minute and he will get back to him. Nobody has better access to the governor than the board chair, the vice chair or the president.

SENATOR WIELECHOWSKI asked about the level of independence the AGDC has.

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MR. CRUZ replied that all the board members and the executive team take this corporation very seriously. They have a responsibility to do what is best for Alaska as well as this legislature and the administration. "We are not a rubber stamp board, at all."

SENATOR WIELECHOWSKI asked what their budget is for FY17.

MR. CRUZ answered that he would have to look at the numbers again, but "I need you guys to make certain that we have this thing funded."

SENATOR WIELECHOWSKI asked what the impacts would if it is not fully funded.

MR. CRUZ said AGDC won't be able to complete its mission if that happens. They have a fiduciary responsibility to spend this money wisely, be accountable for it, and give results for it. They understand Alaska's financial condition and they have pared down. This is a world class project and they cannot pull back on it.

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SENATOR WIELECHOWSKI asked with the downturn in the price of oil, if our partners are concerned about spending money on this project. Should they wait until oil prices rise again or would that set the project back further?

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SENATOR MICCICHE joined the committee.

MR. CRUZ said if oil was \$100/barrel, every economist would be worried about the bottom, which hopefully was seen at \$26 this year. To him, now is not the time to cut back on this project, because a lot of planning is still in place. One of the milestones AGDC has achieved is having the Corps of Engineers 404 permit this year for a right-of-way from Prudhoe Bay to Point MacKenzie, and that's usually one of the things that slows a project down. AGDC has the ability to hand those permits - for a price - to AKLNG that can facilitate a project. This was able to happen because the funding continued. If this project is slowed down and oil goes to \$65 in two years and it starts back up, the window of having first gas in 2022 or 2025 will be missed.

MR. CRUZ said:

I firmly believe that we need to keep working diligently on this project and keep it funded. We will do our level best to be accountable for this money and we are accurate on our budgets and continue to be able to answer these tough questions. But unless you are ready to go the world will pass you by....

SENATOR WIELECHOWSKI said some legislators have expressed concern about what they perceive as being a lack of transparency within AGDC. Is that fair?

MR. CRUZ answered it maybe appears that way, but some personnel issues require executive sessions. No action is taken in executive session. The board is very open and very cognizant about what reasons exist for using executive session.

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SENATOR WIELECHOWSKI asked if he is familiar at all with the Alaska Gasline Port Authority (AGPA).

MR. CRUZ answered no.

SENATOR WIELECHOWSKI said there has been some concern that Governor Walker was putting the "AGPA gang" back together and asked if he was concerned that someone is pushing an agenda that may not be in the best interests of the AGDC or the state.

MR. CRUZ answered that at no time has anyone pushed going back to AGPA. If this project stalls, deadlines will be missed.

SENATOR WIELECHOWSKI asked if he had any thoughts on whether there should or shouldn't be confidentiality agreements within AGDC.

MR. CRUZ said he has them all and added that AGDC is a quasi-public private corporation and certain things - commercial or proprietary - will need to be held confidential.

SENATOR WIELECHOWSKI asked if it was appropriate to hire Rigdon Boykin and pay him that salary for his expertise.

MR. CRUZ answered that he met with Mr. Boykin many times and he was doing his best to get the AKLNG project to move forward. The agreements that were needed amongst the partners were stalled and that is where his efforts were focused. In the end if a project comes together, he contributed. Only the future can tell.

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CHAIR GIESSEL asked for clarity if AGDC is a subdivision of the executive branch or an independent entity.

MR. CRUZ answered that he believes they are 100 percent an independent entity.

CHAIR GIESSEL opened public testimony.

SENATOR MICCICHE said he has a lot of faith in Mr. Cruz and is excited that is he willing to be reappointed.

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CHAIR GIESSEL found no further comments and closed public testimony. She stated that in accordance with AS 39.05.080 the Resources Committee reviewed the following and recommends the appointment be forwarded to a joint session for consideration: Alaska Gasline Corporation Board of Directors, Dave Cruz, Palmer, appointed 9/13/2013, reappointed 9/14/15. Term expires 9/13/2020. This does not reflect an intent by any of the members to vote for or against the confirmation of the individual during further sessions.

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At ease

SB 205-APPROVAL OF SALE OF ROYALTY OIL TO TESORO

[4:07:52 PM](#)

CHAIR GIESSEL announced consideration of SB 205 [version 29-GS2225\A was before the committee].

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JIM SHINE, Special Projects Assistant, Department of Natural Resources (DNR), Anchorage, Alaska, presented SB 205. He said it ratifies a contract for sale of royalty oil from the state to Tesoro. He explained that essentially, the state can elect either royalty in kind (RIK) versus royalty in value (RIV). Taking it in value means the producer produces, transports and markets the oil on the state's behalf. In an RIK situation the state takes possession of the oil and sells it itself.

When electing either a best interest finding must be made according to AS 38.05.182 that also says RIK is the default. But that still requires a best interest finding. This process was commenced through a solicitation of interest that went out in January 2015 to all the in-state refineries to gauge market interest in purchasing royalty oil.

MR. SHINE said that the state receives all royalties as RIV now. That is kind of an anomaly as the state has historically, back to 1979, sold RIK to in-state producers, starting with Mapco, Williams, Petro Star, Flint Hills, and Tesoro. Today, because

the contract with Tesoro terminated on January 31, 2016, the state is taking all of its North Slope royalties in value.

He explained that a best interest finding needs to be made that taking RIK is in the state's best interest, and as part of that it is directed per statute to sell it by competitive bid unless there is no adequate competition. The department received responses from BP and ConocoPhillips, which have North Slope topping plants for in-field use. Their response was that they would take volumes, but they weren't interested in processing them in-state. Flint Hills responded that they weren't taking volumes, because they had closed their doors in June 2014. Tesoro and Petro Star both responded with a willingness to purchase RIK barrels. Tesoro agreed to the state's price terms in the solicitation and Petro Star responded that they would like to purchase barrels, but at a different pricing mechanism that was not as advantageous to the state and not in line with the solicitation.

At that time the commissioner made a determination that there was not adequate competition based on the pricing responses and proceeded with a non-competitive negotiated contract with Tesoro.

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MR. SHINE said the decision criteria in AS 38.05.183 direct the commissioner in selling royalty oil to provide the maximum benefit to the citizens of the state. Some of the criteria include the cash value offered (price terms), the effect on the economy, the benefits of refining and providing those products in-state, and eight other criteria listed in AS 38.06.070, which are reviewed by the Royalty Board.

He explained that they issued the preliminary best interest finding on February 3, 2016; attached to that as an exhibit was the proposed contract with Tesoro that was out for a 30-day public comment period. During that time they received public comments from Petro Star and its parent corporation, ASRC, and those were addressed in the proposed final contract that is before the legislature today. That contract was submitted to the Royalty Board and it was unanimously approved with a recommendation of ratification by the legislature.

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The Royalty Oil and Gas Development Advisory Board, known as the Royalty Board, under AS 38.06.070(a), also reviewed the contract under the following decision criteria:

- revenue needs of the state
- projected local regional needs for the products
- desirability of capital investment in local secondary development
- social impacts
- projected additional costs and responsibilities put on the state
- additional criteria include the existence of labor and consumption markets, potential environmental positive and negative impacts, and projected proposed transaction upon commercial enterprises.

The Royalty Board after considering the contract in line with these criteria did unanimously approve the contract, he said.

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MR. SHINE explained that the actual contract before the legislature is a five year contract for sale of 20-25,000 barrels of royalty oil per day. Tesoro takes possession of those at the Valdez Marine Terminal and then barges them over to the Tesoro Nikiski refinery.

He discussed the formula used to determine the RIK versus RIV valuation methodology: in the RIV world the producers' netback when they transport from the Valdez Marine Terminal to the West Coast a marine transportation deduction is netted back off of the final (ANS) sales prices. In an RIK situation the state doesn't have that marine transportation because it's not being sent from Valdez down to the West Coast. So, you essentially start with the U.S. West Coast average and then deduct the \$1.95 RIK differential, which is meant to represent the value of the price of oil sold in-state.

Another provision is if they don't nominate oil for three consecutive months, the contract will terminate.

SENATOR WIELECHOWSKI asked him to explain the \$1.95 figure.

MR. SHINE said basically the Commercial Section of the Division of Oil and GAS uses the \$1.95 RIK differential in the last Tesoro contract to reflect the in-state price of a barrel of oil.

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ALEX NOUVAKHOV, Commercial Manager* Division of Oil and Gas* Department of Natural Resources (DNR)* explained that the

pricing formula assumes West Coast price for ANS as a basis and then there are deductions from that to arrive at the price which the state receives. The deductions include things like tariffs for the TAPS and relevant upstream pipelines, quality adjustments based on the quality of the crude, and in cases of RIV pricing a marine transportation cost deduction.

In RIK pricing, an RIK differential is used instead of that marine transportation cost deduction. It is a location differential which mimics and reflects the private transactions which occur for ANS within Alaska (without transporting the crude to the U.S. West Coast).

MR. SHINE said the equation for RIK was on slide 9 as follows:

ANS Spot Price - \$1.95 - Tariff Allowance +/- Quality
Bank Adjustments - Line Loss 9

- ANS Spot Price = Average U.S. West Coast Price for Alaska North Slope oil (reported by industry trade publications Platts and Reuters)
- \$1.95 RIK Differential
- Destination value minus marine costs so RIK > RIV.
- Tariff Allowance = TAPS and Pipelines upstream of PS-1.
- Quality Bank Adjustments = as reported by TAPS Quality Bank Administrator.
- Line Loss (loss of volume between PS1 and the VMT).

SENATOR WIELECHOWSKI said he was still trying to figure out \$1.95 and asked if the \$3.70 is the current deduction for shipping from Valdez to the West Coast. Does the \$1.95 represent the in-state transportation cost?

MR. SHINE responded that the \$3.30-\$3.70 per barrel is the average of marine transportation deductions right now as reported by Department of Revenue (DOR). It is the cost to ship a barrel of oil from Valdez to the destination (mostly the U.S. West Coast). He didn't know how to further clarify the \$1.95 other than it is the deduction to represent the value of the price of a barrel of oil sold within the state in a private transaction.

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SENATOR WIELECHOWSKI said he still wanted further clarification. He asked, "Because they don't have to ship it down there, why are we allowing a \$1.95?"

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MR. NOUVAKHOV answered that the \$1.95 is a location differential that reflects the market dynamics. Even though the crude does not leave the state, transactions between private buyers and sellers still have a location differential that is determined by supply and demand. It is not a transportation deduction of any sort. The best interest finding had a table from the Department of Revenue that showed the location differential between private transactions at various locations within the state.

CHAIR GIESSEL asked what page the best interest finding table that he was referring to was on.

MR. NOUVAKHOV answered that table 1 on page 11 shows the past location differentials. That table shows historic location differentials between private sales of crude ranged from \$1.34-\$2.12.

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SENATOR WIELECHOWSKI asked how much the state loses for every penny of differential.

MR. NOUVAKHOV answered that he didn't have that number here, but he could calculate the impacts penny by penny on a barrel and get it to him.

SENATOR WIELECHOWSKI asked the rationale behind going from \$1.65 to \$1.95. "Has the market adjusted that much?"

MR. NOUVAKHOV answered the last two contracts they had were with Flint Hills and Tesoro. The Flint Hills contract had \$2.15 and Tesoro (which expired in January 2016) had \$1.95 for a differential. So, the \$1.95 in the current proposal is in line with the past contract with Tesoro and a little better than the contract which was in place with Flint Hills, and it is within the range of location differentials for private contracts in the state.

SENATOR STOLTZE remarked that this is a take it or leave it provision and it is not amendable.

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SENATOR MICCICHE asked if he understood that this \$1.95 is an assumption that if BP purchased the same quantity from ExxonMobil that the location differential would be very similar.

MR. NOUVAKHOV answered that it is not an assumption. This DOR figure is based on actual contracts which they have access to between private parties, but the information it forecasts for a future year is an assumption.

SENATOR MICCICHE said that illustrates his point that Tesoro is not getting a special deal. In fact, in their 2014 contract they had less of a deduction than Flint Hills. He assumed when the Flint Hills contract was written that the current going price for location differential between private parties was somewhere around \$2.15.

MR. NOUVAKHOV said that was correct; in 2013 it was \$2.12.

SENATOR COGHILL said it's important to understand how you arrive at this, but it looks like the state was about to switch between RIK and RIV much more rapidly than under this contract. "Is that the reason for this number being so critical at this point?"

MR. SHINE responded that the \$1.95 is not a transportation deduction. Market factors determine that location differential. The \$1.95 is a fixed price over the life of the five-year contract. The delta between the \$1.95 location differential and the marine transportation deduction that they would otherwise be incurring in an RIV situation is approximately \$1.50-\$1.75 per barrel. Over the life of this contract that difference equates to \$45-56 million more to the state over RIV. "If we elect RIK we have to at least be equal to or greater than RIV."

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SENATOR STOLTZE asked him to comment about the supply of asphalt that is such a critical part of Alaska's building industry- which plant can provide it and where they are located.

MR. SHINE said he wasn't an expert on asphalt or the construction industry, but representatives from Tesoro could better answer that.

SENATOR STOLTZE said he was interested in other suppliers besides Tesoro and in having a more economical distribution. "Was that discussed by the Governor's team, and did that enter into the best findings?"

MR. SHINE replied selling royalty oil to in-state refineries - Tesoro, Petro Star, and Flint Hills, - historically provides a certain security of supply as their feed stock for producing those products that are used within the state.

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CORRI FEIGE, Director, Division of Oil and Gas, Department of Natural Resources (DNR), Anchorage, Alaska, added that asphalt and the sale of asphalt was not necessarily a part of the best interest finding discussion or the negotiation of the RIK contract, because the contract itself deals with the sale of the ANS crude. What the refiner chooses to use that crude for and what derivative products comes off of that is not a function of the best interest finding. Tesoro can speak to the refined products that they put out. It was part of the discussion at one point with Petro Star that they, too, were also looking at developing an asphalt plant. But the division does not have access to that information.

SENATOR STOLTZE said a decision like this that affects availability should have more departments involved; maybe the commissioner of DOTPF should have been consulted. It is a gap in the process that can exponentially increase the cost of state projects and locally-funded projects.

CHAIR GIESSEL said that the committee has a contract before them versus micromanaging a project.

SENATOR MICCICHE said he was interested in RIK contract terms for employment of Alaska residents and no discrimination against Alaska companies and residents. Does Tesoro meet that requirement?

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MR. SHINE replied that the most recent RIK contracts use pretty standard terms. The "commercially reasonable efforts" means a reasonableness standard of diligence, because requiring the in-state use of products has constitutional issues. A Supreme Court case dealing with limiting the processing of forest products to those used in-state was found unconstitutional based on the Dorman Commerce Clause. As with any contract, they absolutely encourage employment of Alaskans and local hire. Tesoro currently employs 210 local Alaskans bringing \$127 million to the economy annually. They meet that mandate and there are no indications that will ever change.

SENATOR MICCICHE said that works for him.

MR. SHINE said should Tesoro fall below a certain credit rating (BBB-), then they would be required to supply a letter of credit equal to the value of 90 days of oil delivery (slide 8). It

protects the state in the event that credit ratings fall below a certain level, which has not been the case over the last two years.

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SENATOR MICCICHE asked the similarities between this contract and the previous two contracts.

MR. SHINE replied that the only major difference really is in the RIK differential. It was \$2.15 for Flint Hills in 2014, but the valuation has been identical in the last two years of contracts with Tesoro for purchase of royalty barrels. The other difference would be in volume of barrels that are under contract. The 2014 Flint Hills contract had a nomination window of 18,000-30,000 barrels per day. When they closed their doors in 2014, that contract terminated.

SENATOR MICCICHE said that says to him that the department is largely allowed to do their jobs on contractual arrangements, and the Parnell contract is essentially identical to the Walker contract, although there may be tougher questions depending on which administration you support the most. Realistically the contract is independent and very similar to others in nature.

MR. SHINE said that was correct. He said slide 10 highlights the point he made earlier that the value this contract brings to the state of an estimated \$45-56 million more over the next five years than it would otherwise receive for royalty in value.

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SENATOR MICCICHE asked if he is saying there is more potential profit for purchasing the state's oil in RIV rather than an RIK sale such as this.

MR. SHINE answered the RIV purchaser would be someone on the West Coast, although he didn't follow the question.

SENATOR MICCICHE restated if you add \$45 million more value to the state in RIK, then one would think this is more profitable to the state and RIV would be more profitable to the other purchasers (because the state would lose \$45-56 million).

MR. SHINE said that was correct. The delta between the \$1.95 location differential and the approximate \$3.50 marine transportation deduction in an RIV situation is where the state realizes the most economic benefit in this contract over RIV, and that number equates to \$45-\$56 million.

He said slide 11 talks about additional royalty oil sales. The state will nominate up to 95 percent of its available royalty barrels for sale and is in current negotiations with Petro Star to provide royalty oil to them over the next five years. Those contracts will terminate about the same time as this Tesoro contract. The state has contracts with Tesoro and Petro Star right now and 95 percent of its volumes are nominated. They actually have more additional barrels than was predicted and those will be offered for sale on an equal basis to both contracting parties.

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MR. SHINE said Petro Star had raised a couple of issues in their public comments to the proposed contract. Those fall into two buckets: the first being the length of the contract with Tesoro. The initial contract was for five years with the option to extend for five years. That would have to be among mutual consent of the parties and it would come back to the legislature for ratification. That provision has since been struck. The contract before them for ratification is a stand-alone, five-year contract.

Another concern that was addressed was with respect to a pro-ration preference to Tesoro in exchange for nominating a little less volume, so more could be provided to Petro Star. But after consideration and receiving that comment, the pro-ration preference was also struck. So, it's status quo if the state has its royalty barrels under contract. If there is a field maintenance or a downturn in production and that state doesn't have enough barrels to meet contractual obligations, then all the royalty purchasers are pro-rated proportionate to their share.

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SENATOR WIELECHOWSKI asked him to talk about the other bids they received.

MR. SHINE answered that the department sent a solicitation of interest to five refineries within the state - Flint Hills, Petro Star, Tesoro, BP, and ConocoPhillips - and got responses from BP and ConocoPhillips, which have North Slope topping plants for in-field use, indicating willingness to purchase barrels, but they were not planning on refining them within the state. They were going to be added to export shipments. The response from Flint Hills was that they were not interested in purchasing, because they were no longer operating. The response

from Petro Star indicated that they were willing to enter into a non-competitive, negotiated process for a pricing mechanism that was not the same as provided in the solicitation of interest, whereas Tesoro responded affirmatively, indicating a willingness to participate in a competitive bid or an informal negotiated process and met the price term solicitation.

SENATOR WIELECHOWSKI asked if the bids from BP and ConocoPhillips would have resulted in more profit to the state.

MR. SHINE answered that the price is just one of the considerations the commissioner has to review in making a best interest finding. They probably agreed with the price term of \$1.95, but they were not going to refine within the state and export it. When all of the criteria in AS 38.05.183 is considered, the state would receive more value in selling its RIK to an in-state refiner that would provide those products to local markets.

MR. NOUVAKHOV added their discussions with BP and ConocoPhillips did not go into the pricing as much. They made indications that they would be potentially interested in bidding for the crude, but they wouldn't be able to meet in-state refining conditions. Given the statute which requires the state to make a best interest finding for any export of crude - crude that is in excess to the in-state demand - they couldn't reach that threshold, because indications Petro Star and Tesoro combined came to a different that RIK that was available. So, the state couldn't very well make a best interest finding that it had excess crude to sell for export.

SENATOR WIELECHOWSKI asked if they did a financial analysis on providing the oil to BP and ConocoPhillips would the state get a production tax on that and was that added value factored in.

MR. NOUVAKHOV answered that this is royalty oil and it would make no difference for production tax to whom they are selling it (Tesoro, petro Star or back to a producer). The fiscal aspects of the sale would not be different. So, in terms of a marginal economic impact there is no difference who the buyer is.

CHAIR GIESSEL noted that Tesoro was in the room for questions.

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SENATOR STOLTZE asked Mr. Shine when he looked at royalty prices if he looked at any issues of motor fuel price collusion and affordability.

MR. SHINE replied that is not a criteria that is expressly provided in the statute that the commissioner consider. They look at what refined products will be delivered and used in state, but the actual price of fuel is very far removed from the actual sale of feedstock to the refineries.

A number of factors influence the sale of gasoline in the state. The Seattle oil price information service (OPIS) price plus a small percentage differential is typically what sets the market rate for gasoline prices within the state. So, between the state selling RIK to Petro Star or Tesoro and what somebody pays at the pump there are a number of transaction and transportation costs that get added to that, as well as capital costs, employment and overhead. The price of gasoline is not considered in selling the state's RIK. They look to maximize the benefit of the resources to the citizens of the state.

MR. SHINE said that asphalt is not an express consideration, but this went out to public comment for 30 days and before the Royalty Board in a very transparent process and they didn't receive any comments suggesting that they consider the asphalt industry in the determination.

SENATOR STOLTZE asked if the asphalt production issue was ever brought up other than the comment period.

MR. SHINE answered no, to his knowledge, but Director Feige mentioned that the issue has come up in the context of Petro Star maybe making improvements at their refinery to make asphalt more available within the state.

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SENATOR STOLTZE said that has come up in the process, but not formally in the comment period.

MR. SHINE responded yes.

CHAIR GIESSEL asked Ms. Feige who took that over producing asphalt when Flint Hills stopped.

MS. FEIGE responded that she did not know if it was assumed by another operator, but she thought not.

MR. NOUVAKHOV answered that he didn't know that anyone took that over, but they had discussion with Petro Star about future plants.

CHAIR GIESSEL invited Tesoro to the table.

[4:53:41 PM](#)

MATT GILL, Senior Manager, External Affairs, Tesoro Alaska, supported SB 205. He said Tesoro Corporation is currently a Fortune 100 company; it is an independent refiner and marketer of petroleum products. Tesoro's refining operation started in Alaska with purchase of its Kenai Refinery in 1969. The Kenai Refinery has an operational capacity of up to 72,000 barrels per day. It's primarily focused on jet and diesel production followed by gasoline and gasoline blend stocks, heating oil, heavy oils, propane and asphalt. They operate a 68-mile common carrier products pipeline that transports jet fuel, gasoline, diesel fuel to the Port of Anchorage and the Anchorage International Airport. The wholesale delivery of their products occurs through their terminals in Kenai, Anchorage, the Nikiski Dock, and the Port of Anchorage.

In addition to being the largest taxpayer in the Kenai Borough, Tesoro provides over 225 in-state, family-wage jobs at the refinery and terminals along with about 30 fulltime contractors that are working in and around the refinery year-round. They are a major supporter of the Cook Inlet Regional Citizens Advisory Council (CIRCAC) as well as the largest member of Cook Inlet Spill Prevention and Response Team (CISPRT).

They actively support a wide range of events and programs across the state. In 2015 they gave over \$300,000 in grants from the Tesoro Foundation and their intention is to beat that number in 2016. Each year they sponsor all the 5th and 6th grade classes on the Kenai Peninsula to conduct a mission at the Kenai Challenger Learning Center. They are the signature sponsor of the Caring for the Kenai Program as well as the founding sponsor of the Alaska Business Week, a statewide business program that gets put on each summer.

MR. GILL said this legislation is the result of over a year of dialogue and productive negotiations between Department of Natural Resources (DNR) and Tesoro Corporation and by all accounts, they are very impressed with the state's ability to understand their issues and with their ability to come to a mutually beneficial agreement that is win/win for the state and Tesoro as well as accommodating to the other in-state refiners.

Their estimates indicate that the state will continue to receive a price for its royalty in kind oil that exceeds the price it would receive if it elected to keep its royalty oil in value. The estimated additional revenues is \$45-56 million for the span of the contract. For Tesoro, this five-year contract will provide a stable supply of ANS crude while also giving them the volumetric flexibility to help accommodate seasonal fluctuations in demand for their refined products.

MR. GILL said the availability, flexibility, and stability that this contract offers has a positive impact on their ability to maintain their ongoing operations at the Kenai Refinery. In order to accommodate the needs of the other in-state refiners, Tesoro and the state modified this contract to reduce the volumes as well as eliminate a pro-ration clause and the five-year extension option. Tesoro believes in Alaska's future and is committed to being an active corporate citizen and looks forward to continuing to provide Alaskans with clean burning fuels and successfully running their refinery for perhaps another 47 years.

CHAIR GIESSEL asked who should be asked the asphalt question.

MR. GILL answered that would best be directed to Cameron Hunt.

[4:58:19 PM](#)

CAMERON HUNT, Vice President and Manager, Kenai Refinery, Tesoro Alaska, said that Tesoro has picked up all of the asphalt volume for Southcentral and the Fairbanks area demand with the closing of Flint Hills. This last summer they produced 430,000 barrels and are investing in improvements to their loading rack to speed up asphalt loading at the Nikiski Refinery. Through press releases they have found that Petro Star is also building capacity to supply asphalt from their North Pole refinery.

SENATOR MICCICHE asked the percentage of Alaska hire at the Kenai Refinery.

MR. HUNT answered that he didn't have a percent for Alaskan hire. They are unable to find in-market for certain specialty educational backgrounds such as chemical engineers. He can say that 100 percent of their refinery employees do live in the state, which the North Slope companies can't necessarily claim. Whenever it's possible to hire locally, they do so especially in their operations workforce, especially mechanics, carpenters, and electricians, and they were even able to hire several Flint

Hills employees after it closed and relocate them down to the Kenai.

CHAIR GIESSEL opened public testimony, and finding no comments, closed it.

SENATOR COSTELLO moved to report SB 205, version 29-GS2225\A, from committee with individual recommendations and attached fiscal note(s). There were no objections and it was so ordered.

5:02:21 PM

Finding no further business to come before the committee, Chair Giessel adjourned the Senate Resources Committee meeting at 5:02 p.m.