

**HB**

**287**

<TARGET><BILL>HB 287</BILL><SUBJECT>HB  
287</SUBJECT><COMM>SFIN28</COMM></TARGET>

# SENATE FINANCE COMMITTEE REPORT

DATE: 4/17/14

FURTHER: Rules/T. Carr

DATE TURNED IN TO OFFICE: 4/20/14

**Finance Committee** considered CS FOR HOUSE BILL NO. 287(RLS) am

## HB 287-APPROVE TESORO ROYALTY OIL SALE

"An Act relating to the determination of the royalty received by the state on oil production refined or processed in the state; providing tax credits for qualified infrastructure expenditures for in-state refineries and hydrocarbon processing facilities; 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."

and recommends:

- be replaced with SCS (SHB 287) (FIN)  Same Title  Technical Title Change  New Title/SCR No. 31
- adopt previous SCS SCS/CS- Forthcoming  Same Title  Technical Title Change  New Title/SCR No. \_\_\_\_\_
- attached amendment(s)
- adopt \_\_\_\_\_ Letter of Intent
- further referral to \_\_\_\_\_ Committee

Dept Abbr.	
ADM	LWF
CED	LAW
COR	LEG
CRT	MVA
EED	DNR
DEC	DPS
DFG	REV
GOV	DOT
DHS	UA

NEW FISCAL NOTE(S)				
Dept.	Fiscal	Indet.	Zero	FN #
Fiscal Info Forthcoming				

PREVIOUS FISCAL NOTE(S)				
Dept.	Fiscal	Indet.	Zero	FN #
DNR		✓		2

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	PRINTED LAST NAME	DO PASS	DO NOT PASS	NO REC	AMEND
<i>Anna L. Fairclough</i>	FAIRCLOUGH			✓	
<i>Clair Bishop</i>	BISHOP	✓			
<i>Joseph J. ...</i>	DUAL ...			✓	
<i>...</i>	Hoffman			✓	
<i>...</i>	ORSON	✓			
CO-CHAIR: <i>L. Meyer</i>	MEYER			✓	
CO-CHAIR: <i>Kelly</i>	KELLY	✓			

# Fiscal Note

State of Alaska  
2014 Legislative Session

Bill Version: HB 287  
Fiscal Note Number: \_\_\_\_\_  
( ) Publish Date: \_\_\_\_\_

Identifier: HB287SCSCS(FIN)-DOR-TAX-04-20-14  
Title: OIL ROYALTIES; TAX CREDIT  
Sponsor: RLS BY REQUEST OF THE GOVERNOR  
Requester: S FIN

Department: Department of Revenue  
Appropriation: Taxation and Treasury  
Allocation: Tax Division  
OMB Component Number: 2476

**Expenditures/Revenues**

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2015	Included in	Out-Year Cost Estimates				
	Appropriation Requested	Governor's FY2015 Request	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
<b>OPERATING EXPENDITURES</b>	<b>FY 2015</b>	<b>FY 2015</b>					
Personal Services							
Travel							
Services							
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
<b>Total Operating</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Fund Source (Operating Only)**

None							
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Positions**

Full-time							
Part-time							
Temporary							

<b>Change in Revenues</b>	***		***	***	***	***	***
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Estimated SUPPLEMENTAL (FY2014) cost: 0.0 *(separate supplemental appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

Estimated CAPITAL (FY2015) cost: 0.0 *(separate capital appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No  
If yes, by what date are the regulations to be adopted, amended or repealed?

**Why this fiscal note differs from previous version:**

Reflects changes adopted by the SFIN committee on 4-20-14.
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Prepared By: Matt Fonder, Director  
Division: Tax  
Approved By: Angela M. Rodell, Commissioner  
Agency: Department of Revenue

Phone: (907)269-1033  
Date: 04/20/2014 09:00 PM  
Date: 04/20/14

## FISCAL NOTE ANALYSIS

STATE OF ALASKA  
2014 LEGISLATIVE SESSION

BILL NO. SCSCSHB287(FIN)

### Analysis

**Bill Language:**

This bill involves the approval of the royalty sale oil contract with Tesoro Corporation, determinations of royalty oil received by the state, and also adds a section to DOR's corporate income tax statutes creating a new corporate income tax credit for certain in-state oil refineries. This analysis is limited to the tax credit created in this bill.

-The tax credit created by this bill is a new corporate income tax credit for a taxpayer that owns an in-state refinery and incurs "qualified infrastructure expenditures" (attributable to the in-state purchase, installation, or modification of tangible personal property for the in-state manufacture or in-state transport of refined petroleum products or petroleum-based feed-stocks) during a tax year. The credit may not exceed the lesser of 40% of total qualifying expenditures or \$10 million per tax year. The credit sunsets in 5 years. The taxpayer is required to apply the credit against any corporate income taxes owed to the state, and any unused portion can be carried forward to future tax years, or it can also be refunded by the state.

**Revenues:**

It is difficult to determine the amount of credits which may be claimed by taxpayers with these new credits. There are a limited number of in-state refineries, and the maximum credit would be \$10 million each tax year (for up to 5 tax years) per qualifying refinery. If a refinery was able to "max-out" these combined credits, it would be entitled to a credit of \$50 million over 5 years, but the taxpayer would have had to expend \$125 million in "qualified infrastructure expenditures" to obtain the maximum amount of credits. Because these credits are refundable, if a taxpayer is able to "max-out" these combined credits for 5 years, the state would realize reduced revenues of \$50 million over 5 years.

It is unlikely that in-state refineries would have a corporate income tax liability of \$10 million in any given tax year, so the bulk of these credits would likely be carried forward to future tax years, or be refunded.

**Expenditures:**

The department can implement the provisions of this bill with existing resources.

**Regulations:**

The department does not anticipate that it will need to adopt regulations to implement this bill.

# Fiscal Note

State of Alaska  
2014 Legislative Session

Bill Version: CSHB 287(FIN)  
Fiscal Note Number: 2  
(H) Publish Date: 4/15/14

Identifier: HB287CS(FIN)-DNR-DOG-4-14-14  
Title: APPROVE TESORO ROYALTY OIL SALE  
Sponsor: RLS BY REQUEST OF THE GOVERNOR  
Requester: HFIN

Department: Department of Natural Resources  
Appropriation: Oil & Gas  
Allocation: Oil & Gas  
OMB Component Number: 439

**Expenditures/Revenues**

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2015 Appropriation Requested	Included in Governor's FY2015 Request	Out-Year Cost Estimates					
			FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
<b>OPERATING EXPENDITURES</b>								
Personal Services								
Travel								
Services								
Commodities								
Capital Outlay								
Grants & Benefits								
Miscellaneous								
<b>Total Operating</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Fund Source (Operating Only)**

None								
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Positions**

Full-time								
Part-time								
Temporary								

<b>Change in Revenues</b>	***		***	***	***	***	***	***
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**Estimated SUPPLEMENTAL (FY2014) cost:** 0.0 *(separate supplemental appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**Estimated CAPITAL (FY2015) cost:** 0.0 *(separate capital appropriation required)*  
*(discuss reasons and fund source(s) in analysis section)*

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No  
If yes, by what date are the regulations to be adopted, amended or repealed? N/A

**Why this fiscal note differs from previous version:**

Revised to reflect the committee substitute adopted by the House Finance Committee, which added provisions to allow lessees to apply the price of the oil they sell to in-state refineries to set the value of the royalty in-value volumes associated with sales upon request to and approval by the commissioner of the Department of Natural Resources (DNR).

Prepared By: <u>Esther Tempel, Legislative Liaison</u>	Phone: (907)465-4730
Division: <u>Commissioner's Office</u>	Date: 04/14/2014 11:00 AM
Approved By: <u>Joe Balash, Commissioner</u>	Date: 04/14/14
Agency: <u>Department of Natural Resources</u>	

FISCAL NOTE ANALYSIS #2

STATE OF ALASKA  
2014 LEGISLATIVE SESSION

BILL NO. CSHB 287(FIN)

Analysis

**Royalty Oil Sale Contract to Tesoro**

This bill provides legislative approval of an amendment to a contract to sell North Slope royalty oil to Tesoro Refining & Marketing, LLC for use in the Tesoro refinery at Nikiski, Alaska. This amendment will extend deliveries of North Slope royalty oil to Tesoro for an additional year until January 31, 2016. The State of Alaska will deliver royalty oil under the contract, as amended, starting February 1, 2014 through January 31, 2016.

If approved, the sale of royalty in-kind oil through this amended contract will have no fiscal impact to operating expenditures and positive indeterminate change in revenues.

**Royalty Oil for In-State Refiners and Processors**

For contracts entered into on or after January 1, 2015, this bill will allow lessees, upon request to and approval of the Department of Natural Resources Commissioner, to apply the price of the oil they sell to in-state refineries to set the value of the royalty in-value volumes associated with these sales. This mechanism differs from the existing lease terms on royalty valuation that could otherwise raise the amount of the royalty payments owed to the state based on the "higher-of" rule.

There is some potential among some of the lessees, particularly those who have no access to the U.S. West Coast oil market, to pass on the savings from the new AS 38.05.180(hh) that would induce them to sell oil to in-state refineries at a lower price. With this provision, the lessees are assured that the state will not come back later in audit and claim a higher-of royalty value.

If enacted, this bill will have no fiscal impact to operating expenditures but an indeterminate negative impact on state royalty revenues.

For example, if one of these lessees were to supply all of the in-state refineries at a total of 100,000 barrels per day and priced these sales at \$0.25 per barrel less than the amount that the lease value terms would require, the savings to in-state refineries would be more than \$9 million per year. The royalty in-value share on these 100,000 barrels per day is approximately 12.5 percent. This means that the cost to the state in reduced royalty revenue in this hypothetical example is about \$1.1 million per year.

# Fiscal Note

State of Alaska  
2014 Legislative Session

Bill Version: CSHB 287(RLS)  
Fiscal Note Number: 4  
(H) Publish Date: 4/16/14

Identifier: HB287CS(RLS)-DOR-TAX-04-16-14  
Title: APPROVE TESORO ROYALTY OIL SALE  
Sponsor: RLS BY REQUEST OF THE GOVERNOR  
Requester: H Rules

Department: Department of Revenue  
Appropriation: Taxation and Treasury  
Allocation: Tax Division  
OMB Component Number: 2476

**Expenditures/Revenues**

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2015	Included in	Out-Year Cost Estimates				
	Appropriation Requested	Governor's FY2015 Request	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
<b>OPERATING EXPENDITURES</b>	<b>FY 2015</b>	<b>FY 2015</b>	<b>FY 2016</b>	<b>FY 2017</b>	<b>FY 2018</b>	<b>FY 2019</b>	<b>FY 2020</b>
Personal Services							
Travel							
Services							
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
<b>Total Operating</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Fund Source (Operating Only)**

None							
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

**Positions**

Full-time							
Part-time							
Temporary							

<b>Change in Revenues</b>	***	***	***	***	***	***	***
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**Estimated SUPPLEMENTAL (FY2014) cost:** 0.0 (separate supplemental appropriation required)  
(discuss reasons and fund source(s) in analysis section)

**Estimated CAPITAL (FY2015) cost:** 0.0 (separate capital appropriation required)  
(discuss reasons and fund source(s) in analysis section)

**ASSOCIATED REGULATIONS**

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No  
If yes, by what date are the regulations to be adopted, amended or repealed?

**Why this fiscal note differs from previous version:**

Note reflects ammendment adopted by H RLS committee on 4-16-14.

Prepared By: Matt Fonder, Director Phone: (907)269-1033  
Division: Tax Date: 04/16/2014 10:50 PM  
Approved By: Angela M. Rodell, Commissioner Date: 04/16/14  
Agency: Department of Revenue

FISCAL NOTE ANALYSIS #4

STATE OF ALASKA  
2014 LEGISLATIVE SESSION

BILL NO. CSHB 287(RLS)

**Analysis**

**Bill Language:**

This bill involves the approval of the royalty sale oil contract with Tesoro Corporation, determinations of royalty oil received by the state, and adds a section to DOR's corporate income tax statutes, creating a new corporate income tax credit for certain in-state oil refineries. This analysis is limited to the tax credit created in this bill.

-The tax credit created by this bill is a new corporate income tax credit for a taxpayer that owns an in-state refinery or hydrocarbon processing facility and incurs "qualified infrastructure expenditures" (attributable to the in-state purchase, installation, modification, adjustment, or other alteration of tangible personal property for the manufacture or transport of refined petroleum products or petroleum-based feed-stocks) during a tax year. The credit may not exceed the lesser of 40% of total qualifying expenditures or \$10 million per tax year. The credit sunsets in 5 years. The taxpayer is required to apply the credit against any corporate income taxes owed to the state, and any unused portion can be carried forward to future tax years, or it can also be refunded by the state.

**Revenues:**

It is difficult to determine the amount of credits which may be claimed by taxpayers with these new credits. There are a limited number of in-state refineries and hydrocarbon processing facilities, and the maximum credit would be \$10 million each tax year (for up to 5 tax years) per qualifying refinery or hydrocarbon processing facility. If a refinery or hydrocarbon processing facility was able to "max-out" these combined credits, it would be entitled to a credit of \$50 million over 5 years, but the taxpayer would have had to expend \$125 million in "qualified infrastructure expenditures" to obtain the maximum amount of credits. Because these credits are refundable, if a taxpayer is able to "max-out" these combined credits for 5 years, the state would realize reduced revenues of \$50 million over 5 years.

It is unlikely that in-state refineries or hydrocarbon processing facilities would have a corporate income tax liability of \$10 million in any given tax year, so the bulk of these credits would likely be carried forward to future tax years, or be refunded.

**Expenditures:**

The department can implement the provisions of this bill with existing resources.

**Regulations:**

The department does not anticipate that it will need to adopt additional regulations to implement this bill.

Adopted  
4/20/14  
AMENDMENT #1

28-GH2862\O.3  
Nauman  
4/20/14

OFFERED IN THE SENATE

BY SENATOR MEYER

TO: SCS CSHB 287(FIN), Draft Version "O"

- 1 Page 1, line 3:
- 2 Delete "**and hydrocarbon processing facilities**"
- 3
- 4 Page 3, lines 11 - 12:
- 5 Delete "**or hydrocarbon processing facility**"
- 6
- 7 Page 3, lines 12 - 13:
- 8 Delete "Except as provided in (b) of this section, a"
- 9 Insert "A"
- 10
- 11 Page 3, line 13:
- 12 Delete "or hydrocarbon processing facility"
- 13
- 14 Page 3, lines 14 - 15:
- 15 Delete "or processed hydrocarbon products"
- 16
- 17 Page 3, lines 20 - 21:
- 18 Delete "or hydrocarbon processing facility"
- 19
- 20 Page 3, lines 22 - 27:
- 21 Delete all material.
- 22
- 23 Reletter the following subsections accordingly.

- 1
- 2 Page 4, line 12:
- 3 Delete "(e)"
- 4 Insert "(d)"
- 5
- 6 Page 4, line 19:
- 7 Delete "or hydrocarbon processing facility"
- 8
- 9 Page 4, line 26:
- 10 Delete "or hydrocarbon processing facility"
- 11
- 12 Page 4, lines 29 - 30:
- 13 Delete "or hydrocarbon processing facility"
- 14
- 15 Page 5, line 2:
- 16 Delete "or hydrocarbon processing facility"
- 17
- 18 Page 5, lines 3 - 4:
- 19 Delete "or hydrocarbon processing facility"
- 20
- 21 Page 5, lines 12 - 14:
- 22 Delete all material.
- 23
- 24 Renumber the following paragraphs accordingly.
- 25
- 26 Page 5, lines 17 - 18:
- 27 Delete ", petroleum-based feedstock, or processed hydrocarbon products"
- 28 Insert "or petroleum-based feedstock"

# ALASKA STATE LEGISLATURE

## SENATE FINANCE COMMITTEE

Senator Pete Kelly, Co-Chair  
State Capitol, Room 516  
Juneau, AK 99801-1182  
(907) 465- 3709 - Phone  
(907) 465- 4714 - Fax  
Senator.Pete.Kelly@akleg.gov



Official Business

Senator Kevin Meyer, Co-Chair  
State Capitol, Room 518  
Juneau, AK 99801-1182  
Phone - (907) 465- 4945  
Fax - (907) 465- 3476  
Senator.Kevin.Meyer@akleg.gov

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## AGENDA

Saturday, April 20, 2014

Senate Finance Room 532 – 1:00 PM

HB 306-EVAL. INDIRECT EXPENDITURES; TAX CREDITS

HB 287-OIL ROYALTIES; TAX CREDIT

HB 384-ALASKA MINIMUM WAGE

HJR 10-CONST. AM: TRANSPORTATION FUND

Bills previously heard or scheduled



**TESORO**

Tesoro Alaska Company  
54741 Tesoro Road  
P.O. Box 3369  
Kenai, Alaska 99661

April 18, 2014

Senator Kevin Meyer, Co-Chair Senate Finance Committee  
Senator Pete Kelly, Co-Chair Senate Finance Committee  
Members of the Senate Finance Committee  
State Capitol Building Room 532  
Juneau, Alaska 99801

Re: Support for House Bill 287

Dear Senators,

I am writing to you in support for House Bill 287 "An Act relating to the determination of the royalty received by the state on oil production refined or processed in the state; providing tax credits for qualified infrastructure expenditures for in-state refineries and hydrocarbon processing facilities; 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."

Tesoro Corporation is a Fortune 100 company and is an independent refiner and marketer of petroleum products. Tesoro's refining operations started Alaska with the purchase of the Kenai refinery back in 1969.

Our Kenai refinery has the operational capacity to produce up to 72,000 barrels per day and is primarily focused on Jet and Diesel production followed by gasoline and gasoline blendstocks, heating oil and heavy fuel oils, propane and asphalt. We operate a 68-mile, common-carrier products pipeline that transports jet fuel, gasoline and diesel fuel to the Port of Anchorage and the Anchorage International Airport. The wholesale delivery of our products occurs through our terminals in Kenai, Anchorage, our Nikiski dock and the Port of Anchorage.

In addition to being the largest taxpayer in the Kenai Peninsula Borough, Tesoro is also able to provide around 210 family wage jobs at the refinery, along with about 30 full-time contractors that are working in and around the refinery year round. Additionally, we are able to employ another 200 plus employees around the state at our 31 company-owned Tesoro 2-Go retail outlets as well as our operators who work at our terminals in the Port of Anchorage and in Nikiski.

We are a major supporter of the Cook Inlet Regional Citizens Advisory Council (CIRCAC) and the largest member of the Cook Inlet Spill Prevention & Response team (CISPRI).

We actively support a wide range of local events and programs – from employee fundraising for the United Way to youth sports programs. Each year we sponsor all of the 5th and 6th grade classes on the Kenai Peninsula to conduct a mission at the Kenai Challenger Learning Center and we are the Signature Sponsor of “Caring for the Kenai” program.

Tesoro strongly urges you to support House Bill 287, "An Act relating to the determination of the royalty received by the state on oil production refined or processed in the state; providing tax credits for qualified infrastructure expenditures for in-state refineries and hydrocarbon processing facilities; 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."

Section 6 of this legislation is the result of constructive dialog and productive negotiations between the Department of Natural Resources and the Tesoro Corporation. Tesoro originally entered into negotiations with the State of Alaska that resulted in a one year contract beginning in February 2014 and ending in January of 2015.

This original contract received a Best Interests Finding, was approved unanimously by the State’s Royalty Board and was signed by both parties in October of 2013 without the need for Legislative approval.

Upon further analysis of our future needs, Tesoro sought to amend the contract to add one additional year using identical terms that would deliver royalty oil until January of 2016. A new Final Best Interest Finding was produced by the DNR and the State’s Royalty Board again voted unanimously for approval. Since the combined duration of the contracts were beyond a one year time frame, the need for legislative approval is necessary.

By all accounts, our company was very impressed with the State’s ability to understand our issues and arrive at a mutually beneficial agreement that is truly a win-win for both parties.

For the State, the DNR estimates that it will continue to receive a price for its Royalty-in-Kind oil that exceeds the price it would have receive if it elected to keep its Royalty Oil in Value.

For Tesoro, this contract will provide us with a stable supply of ANS crude while also giving us the volumetric flexibility to help accommodate seasonal fluctuations in demand for refined products. The availability, flexibility and stability that this contract offers will have a positive impact on our ability to maintain our ongoing operations at our Kenai refinery.

Tesoro is appreciative of the incentives that the Governor has proposed and the legislature has chosen to include in this legislation. The change to the HOV calculation should encourage producers to prioritize sales of ANS crude to in-state refiners over other potential buyers and the qualified infrastructure tax credits will help us attract more capital dollars to our Kenai refinery.

Tesoro believes in Alaska's future and is committed to being an active corporate citizen. We look forward to continuing to provide Alaskans with clean burning fuels to keep your homes warm, your planes flying and your cars and boats traveling across this great state.

I urge you to support House Bill 287.

Sincerely,

A handwritten signature in black ink, appearing to read 'Matt Gill', written in a cursive style.

Matt Gill  
External Affairs Senior Manager  
Tesoro Alaska Company



Royalty In-Kind Sale  
to  
Tesoro Refining & Marketing LLC

March 2014

Division of Oil and Gas  
Alaska Department of Natural Resources



## Royalty in-Value versus Royalty in-Kind



The state has a choice to take its royalty in-value (RIV) or in-kind (RIK).

- When the State takes its royalty as RIV, the lessees who produce the oil also market the State's share along with their own production and pay the State the value of its royalty share.
- When the State takes its royalty share as RIK, the State assumes ownership of the oil, and the commissioner disposes of it through the sale procedures prescribed by AS 38.05.183.



# Non-Competitive RIK Sale Process



- Statute presumes State's Best Interest is met by
  - Taking royalty in-kind—AS 38.05.182(a)
  - With sale to in-state buyer—AS 38.05.183(d)
  - Accomplished through a competitive process—AS 30.05.183(a)
- August 13, 2012 Informal Solicitation of Interest sent to:
  - North Slope Producers
  - In-state Refiners
  - Industry specific & general media



## RIK Contract Terms



- The proposed 2014 contract amendment merely extends Tesoro's current one-year contract negotiated in October 2013 for another year
- RIK Deliveries under the current one-year contract will begin February 1, 2014.
- The current one-year contract, **does not** directly reference RIV valuation in RIK price calculations.



## RIK Contract Price



**ANS Spot Price – \$1.95 – Tariff Allowance ± Quality Bank Adjustment – Line Loss**

- **ANS Spot Price = Average US 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 that  $RIK \geq RIV$ .
  - FHR's RIK Differential = \$2.15 subject to adjustment; FHR's contract also includes a "Special Commitments" clause
- **Tariff Allowance = TAPS and Pipelines Upstream of PS-1.**
- **Quality Bank Adjustment = as reported by the TAPS Quality Bank Administrator**
- **Line Loss = 0.0009 times the netback price**



## RIK Contract Quantity

- Initial Quantity Range
  - 5,000 – 15,000 barrels per day
  - May be adjusted after 12 months, with Commissioner approval
- Termination of Contract
  - Zero nomination for 3 months terminates contract
  - Contract terms comparable to the private market
- Refinery Turnaround
  - Contract allows Tesoro the flexibility to cease royalty oil purchases during maintenance
- Guarantees, reserves and proration clauses included



## Commissioner's Decision Criteria



AS 38.05.183(e) states that the commissioner must sell the State's royalty oil to the buyer who offers "maximum benefits to the citizens of the state." In making this determination the commissioner must consider:

- 1) The cash value offered
- 2) The projected effects of the sale on the economy of the state
- 3) The projected benefits of refining or processing the oil in state
- 4) The ability of the prospective buyer to provide refined products for distribution and sale in the state with price or supply benefits to the citizens of the state
- 5) The eight criteria listed in AS38.06.070(a), as reviewed by the Royalty Board



# Royalty Board's Decision Criteria



AS 38.06.070(a) states that the Alaska Royalty Oil and Gas Development Advisory Board must consider:

- 1) The revenue needs and projected fiscal condition of the state
- 2) The existence and extent of present and projected local and regional needs for oil and gas products
- 3) The desirability of localized capital investment, increased payroll, secondary development and other possible effect of the sale
- 4) The projected social impacts of the transaction
- 5) The projected additional costs and responsibilities which could be imposed upon the state and affected political subdivisions by development related to the transactions



## Royalty Board's Decision Criteria



AS 38.06.070(a) states that the Alaska Royalty Oil and Gas Development Advisory Board must consider:

- 6) The existence of specific local or regional labor or consumption markets or both which should be met by the transaction
- 7) The projected positive or negative environmental effects related to the transactions
- 8) The projected effects of the proposed transaction upon existing private commercial enterprise and patterns of investment

Purchaser  
Contract

Period

Total RIK Volumes  
(Barrels through Jun 2012)

**Negotiated In-Kind Sales**

Purchaser Contract	Period	Total RIK Volumes (Barrels)
<b>Alpetcc</b>		
Alpetco	7/80 - 6/81	7,390,392
Alpetco	7/80 - 6/82	31,576,511
<b>Chevron</b>		
Chevron 1	7/80 - 6/81	1,742,342
Chevron 2	5/83 - 5/84	6,721,336
Chevron 3	5/84 - 7/81	48,418,344
Kapank	12/86 - 12/91	8,611,247
Petrostar Purchases	12/86 - 12/91	2,348,070
Subtotal		67,841,239
Plus: Tesoro Exchange Barrels		16,015,527
<b>Total Chevron</b>		133,856,765

Flint Hills Resources	4/04-12/2004	153,697,898
<b>Total</b>		153,697,898

<b>Golden Valley Electric Association</b>		
GVEA 1	6/81 - 5/84	3,182,382
GVEA 2	6/84 - 9/85	2,611,064
GVEA 3	10/85 - 12/91	12,281,462
Total GVEA		17,974,808

<b>MAPCO (Williams)</b>		
Mapco 1 (Williams)	11/79 - 12/2003	279,766,663
Mapco 2	12/97 - 11/98	4,917,667
Mapco 3 (Williams)	12/98-12/2003	29,147,483
Williams 4 (refining)	1/2004-3/2004	5,582,298
Williams 5 (refining)		0
Total Mapco		318,413,111

<b>Petrostar</b>		
Petro Star	12/86 - 12/91	5,378,079
Less: Chevron Purchases	12/86 - 12/91	-2,348,070
Petro Star JV	3/92 - 12/93	0
Total Petrostar		3,030,009

<b>Tesoro</b>		
Tesoro 1	7/80 - 6/81	1,737,316
Tesoro 2	7/80	2,550,000
Tesoro 3	12/81 - 1/82	838,299
Tesoro 4	1/83 - 12/94	179,783,385
Tesoro 5 11 months	10/85 - 8/90	47,364,935
Tesoro 5 Reservation Fee	10/85 - 8/90	-38,707,561
Tesoro 6	1/95 - 12/95	13,703,946
Tesoro 7	1/96-12/98	38,865,223
Subtotal		246,135,543
Less: Chevron Exchange Barrels		-16,015,501
<b>Total Tesoro</b>		230,120,042

**Competitive In-Kind Sales**

<b>First Competitive RIK Sale</b>		
Asoka Petroleum Co.	Jul-81	622,698
ARCO Products Co	7/81 - 12/81	1,847,668
Oasis Petroleum Co	7/81 - 1/82	838,604
Shell	7/81 - 1/82	4,191,436
Schio	8/81 - 1/82	3,649,689
Union	7/81 - 1/82	4,328,966
<b>Total</b>		15,479,061

<b>Second Competitive RIK Sale</b>		
Chevron 4	4/85 - 3/86	5,703,996
Chevron 5, 6, 7	4/85 - 9/85	3,226,724
Schio	4/85 - 12/85	855,688
Taxaco 1	4/85 - 12/85	2,867,772
Taxaco 2	4/85 - 3/86	9,506,988
Union 2	4/85 - 9/85	1,135,522
US Oil & Refining - B	4/85 - 3/86	3,802,521
<b>Total</b>		27,198,211

<b>Quasi-Competitive RIK Sale</b>		
Chevron 8	10/85 - 3/86	954,349
Union 3	10/85 - 3/86	715,760
US Oil & Refining - 12	10/85 - 3/86	1,908,696
<b>Total</b>		3,578,805

Total Market Sales RIK Oil & Gas Production reflected from July 1980 to June 2012



# Best Interest of the State Served by the RIK Contract with Tesoro

- Cash Value Offered with Contract
  - Total cash value of \$193 to \$580 million during the year of the extension.
  - Any anticipated increases in marine transportation allowance will favor RIK contract
- Positive effect on the State
  - Maintain stability in in-state refining and distribution of refined products.
  - Support jobs and economy of Kenai Peninsula Borough



## Tesoro's Nikiski Refinery



- Began operations in 1969
- Largest most complicated refinery in Alaska (manufacturer of ultra-low sulfur road diesel)
- Currently producing approximately 710 million gallons of refined product (Jet fuel = 35 percent)
- Tesoro supplies more than 60 percent of the gasoline and 28 percent of the jet fuel consumed in Alaska.
- Employs 200 Alaskans in high paying positions
- Operates 31 company owned Tesoro 2Go retail stores, 44 Tesoro-branded stations, and 4 USA Gasoline stations



Questions?



Alaska Department of  
**NATURAL  
RESOURCES**

**Briefing Paper**  
CSHB 287(RLS)am  
Commissioner's Office  
April 2014

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**Purpose:**

This bill grants legislative approval of an amendment of a royalty oil supply contract negotiated between the State of Alaska and Tesoro Refining & Marketing Company, LLC (Tesoro), the owner and operator of the Kenai Refinery.

This bill also facilitates continued operation of in-state refineries and incentivizes certain in-state oil refineries and hydrocarbon processing facilities. By creating a more favorable tax climate, we have the opportunity to expand an industry that provides jobs for Alaskans, adds value to Alaska's oil, and will help keep our resources in Alaska and available to Alaskans.

**Tesoro Royalty Oil Contract:**

The Department of Natural Resources (DNR) and Tesoro recently entered a one-year royalty oil supply contract in October 2013 to deliver up to 15,000 barrels per day of Alaska North Slope royalty oil beginning February 1, 2014. Legislative approval was not required for "the sale, exchange or other disposition of oil or gas *for one year or less* if the sale, exchange, or other disposition of oil or gas is entered into to relieve storage or market conditions."

Subsequent to the approval of the one-year contract, DNR and Tesoro agreed to an amendment to continue deliveries for one year beyond the State's current contractual obligation. Extending the October 2013 Agreement through January 31, 2016 and committing to royalty oil deliveries for more than one year triggered additional provisions of AS 38.05.183 and AS 38.06.055 that require a recommendation of the Alaska Oil and Gas Royalty Development Advisory Board (Royalty Board) and approval by the Alaska Legislature.

The Royalty Board reviewed the proposed amendment through a public hearing process and, in accordance with AS 38.06.050, issued a written recommendation on December 11, 2013, for legislative approval of the sale. Their resolution, along with the DNR commissioner's determination, is included in the Final Best Interest Finding and Determination for an Amendment of the "Agreement for the Sale of Royalty Oil between and among the State of Alaska and the Tesoro Refining & Marketing Company, LLC, a Delaware Limited Liability Company, October 25, 2013."

**Refineries Incentives:**

The price of feedstock is the largest single cost factor in the manufacture of distilled products for end-use. Changes in the marketplace have taken us from a time when Alaska North Slope (ANS) crude was traded at a discount to other crudes to where in the last 5 or 6 years, ANS now trades at a premium—making it more difficult for Alaska refineries to compete.

The provisions in the bill allow the DNR commissioner, upon approval of a request from the lessee, to value the royalty owed by the lessee to the state at the price the lessee receives for the oil it sells to an

in-state refinery. Without this ability, the commissioner and the lessee must abide by the value terms of the lease based on the 'higher of rule'. This will free the lessee from having to adjust royalty due to the state.

The bill also adds another new section to DOR's corporate income tax statutes, creating a corporate income tax credit for in-state refineries or hydrocarbon processing facilities who incur "qualified infrastructure expenditures" during a tax year, and the credit is the lesser of 40% of qualified expenditures or \$10 million. The credit created by the bill is refundable, and can only be applied against corporate income taxes for a period of 5 years to January 1, 2020.



**Amendments to bill sections related to royalty share of oil production (AS 38.05.180)**

**New section 1** amends AS 38.05.180(cc) to include the DNR commissioner's ability to accept payment on a federal lease for the state's royalty share of oil production. Current law is limited to gas production.

**New section 2** adds new subsections (hh) under AS 38.05.180 to allow the DNR commissioner to enter into an agreement with the lessee to use or accept as a price for the royalty oil an amount not less than the contract price between the lessee and an in-state refiner. The price would not exceed the amount that would otherwise be due under the lease. Before entering into an agreement, the commissioner must make a written finding that the agreement is in the state's best interest; the in-state refiner meets certain criteria; and the contract price or prospective royalty receipts are balanced by employment opportunities or other tangible benefits to the state. The subsection defines how contract or purchase parties are affiliated through influence, interest, or action.

Subsection (ii) defines "in-state refiner", "price established in the contract between lessee and an in-state refiner", and "state's royalty share of oil production".

**Amendments to bill sections related to the Alaska Net Income Tax Act (AS 43.20)**

**New section 3** adds a new section AS 43.20.053, which adds a new corporate income tax credit for a taxpayer that owns an in-state refinery or hydrocarbon processing facility and incurs "qualified infrastructure expenditures". The credit may not exceed the lesser of 40% of total qualifying expenditures or \$10 million per tax year and sunsets in 5 years. The taxpayer is required to apply the credit against any corporate income taxes owed to the state, and any unused portion can be refunded by the state.

New subsection (b) clarifies the credit may not be applied to an expenditure for the installation, modification, adjustment, or other alteration of tangible personal property primarily used for the manufacture or transport of liquefied natural gas, compressed natural gas, or to convert natural gas to liquids.

New subsection (h) defines "processed hydrocarbon products", "qualified infrastructure expenditure", "refined petroleum products" and "unpaid delinquent tax".

**New section 4** amends AS 43.55.028(a) to include the qualified infrastructure expenditures as a credit that can be paid from the oil and gas tax credit fund.

**New section 5** amends AS 43.55.028(g) to allow the Department of Revenue to adopt regulations to carry out purposes of this section for refunds and payments under the qualified infrastructure expenditure.

**Bill sections related to Uncodified law**

**Section 6** (previously Section 1) provides legislative approval of an amendment of a royalty oil contract between the State of Alaska and Tesoro Corporation and Tesoro Refining & Marketing Company LLC, attached as Exhibit 1 to the final best interest finding and determination executed January 9, 2014.

**Section 7** provides an effective date of January 1, 2015 for Sections 1-5.

**Section 8** provides an immediate effective date for Section 6 related to the Tesoro royalty oil contract.



# Interior Alaska – The “Place” To Do Business

100 Cushman St., Suite 102 | Fairbanks, Alaska 99701-4665  
Phone (907) 452-1105 | fax (907) 456-6968 | www.FairbanksChamber.org

April 11, 2014

**RE: Letter of Support for House Bill 287 – As Amended**

Dear Representatives Austerman & Stoltze and members of the House Finance Committee,

The Greater Fairbanks Chamber of Commerce is a business advocacy organization that currently represents over 700 businesses. Our advocacy efforts aim to ensure that the Interior of Alaska has a strong and healthy economic environment and that the greater Fairbanks area is an attractive place for business. We believe that House Bill 287, as amended will help stabilize the refining industry, which is of great significance to not only our local economy, but to the statewide economy as well. As such, the Greater Fairbanks Chamber of Commerce asks that House Bill 287, as amended, be passed into law before the conclusion of this legislative session.

The Chamber is very concerned about the economic viability of the in-state refining industry. Immediately after the Flint Hills Resources announcement, our Board of Directors formed a special in-state refining committee and passed a resolution encouraging actions to address the pending closure (attached).

Since the announcement, our Chamber appreciates the efforts of Governor Parnell, Attorney General Geraghty, ADEC Commissioner Hartig and members of the Interior Delegation to address the numerous challenges that face the in-state refining industry, including Flint Hills Resources.

These challenges certainly include the high cost of royalty oil and the high cost of doing business in Alaska. The Chamber defers to the Governor, the Legislature, and the industry as to how best to address each of these issues. However, it is clear that HB 287 is an effort by those directly involved to make positive changes to some of the significant competitive factors that challenge the industry, and to do so in a manner that is equitable to all in-state refiners.

On that basis, the Greater Fairbanks Chamber of Commerce urges the passage of HB 287, as amended.

Sincerely,

**THE GREATER FAIRBANKS CHAMBER OF COMMERCE**

Steve Lundgren  
Board of Directors, Chair

Lisa Herbert  
Executive Director

Cc: Governor Sean Parnell  
Commissioner Joe Balash, Department of Natural Resources  
Sarah Sweeney, Arctic Slope Regional Corporation  
Doug Chapados, Petro Star Inc.  
Jeff Cook, Flint Hills Resources

## INVESTORS

### DIAMOND

BP Exploration  
ConocoPhillips  
ExxonMobil  
Fairbanks Daily News-Miner  
Fairbanks Memorial Hospital & Denali Center  
Flint Hills Resources Alaska  
Mt. McKinley Bank

### PLATINUM

Alyeska Pipeline Service Co.  
Doyon, Limited  
Fred Meyer Stores  
Golden Heart Utilities  
Wells Fargo Bank Alaska

### GOLD

Birchwood Homes  
Carlson Center  
Denali State Bank  
Design Alaska  
Doyon Utilities LLC  
First National Bank Alaska  
GCI  
Kinross Fort Knox Mine  
Lynden  
Northrim Bank  
Sumitomo Metal Mining Pogo LLC  
Usibelli Coal Mine  
WAL-MART Stores, Inc.

### SILVER

Alaska Airlines  
Alaska Communications  
Alaska Railroad  
Alaska USA  
Dr. Christopher Henry  
Henry Orthodontics  
Everts Air Cargo, Everts Air AK  
Exclusive Paving/Univ. Redi-Mix  
Fairbanks Natural Gas  
Flowline Alaska  
General Teamsters Local 959  
Golden Valley Electric Association  
Hale & Associates, Inc.  
JL Properties, Inc.  
Key Bank  
MAC Federal Credit Union  
Personnel Plus  
Sam's Club  
Shell Exploration & Production Co.  
Spirit of Alaska FCU  
State Farm Insurance  
Tammy Randolph, Agent  
Ed Randolph, Agent  
Tanana Valley Clinic  
TDL Staffing  
Tower Hill Mines-Livengood Gold Project  
University of Alaska Fairbanks  
Verizon Wireless  
Vivamore Companies  
Yukon Title Company



## Interior Alaska – The “Place” To Do Business

100 Cushman St., Suite 102 | Fairbanks, Alaska 99701-4665

Phone (907) 452-1105 | Fax (907) 456-6968 | www.FairbanksChamber.org

Introduced By: Flint Hills Resources Ad Hoc Committee  
Date Introduced: Monday, February 24, 2014  
Date Passed: Monday, February 24, 2014  
Date Transmitted: Tuesday, February 25, 2014

### RESOLUTION 14-0224B

#### A RESOLUTION BY THE GREATER FAIRBANKS CHAMBER OF COMMERCE TO SUPPORT THE IN-STATE OIL REFINING INDUSTRY

**WHEREAS**, the Greater Fairbanks Chamber of Commerce represents its members by advocating for a healthy economic environment that promotes the greater Fairbanks area as an attractive place for both business and community; and

**WHEREAS**, the closure of the Flint Hills Resources refinery is of grave concern to the Chamber because of the significant negative impacts to the local and state economies.

**NOW, THEREFORE BE IT RESOLVED**, that the Fairbanks Chamber:

1. Supports the efforts underway by government and industry leaders to engage directly and immediately to take all prudent actions necessary to preserve and expand whatever in-state value added oil refining is feasible.
2. Recommends that all responsible parties work to segregate the refinery surface estate from the legacy environmental issues if possible in order to improve the opportunity for successful restructuring that might allow future refinery operations by a new owner to proceed, while ensuring that the environmental issues are properly addressed.
3. Acknowledges the Alaska Department of Environmental Conservation's responsibility to manage the environmental issues, which must be based on transparent, defensible, peer reviewed science and site specific risk assessment.
4. Recommends continued efforts to lower the cost of energy into the Interior to improve the opportunity for refinery operations to be competitive.
5. Recommends a thorough reevaluation of the state royalty contracts in the context of overall statewide benefit to citizens to include: railroad, tax base, jobs, re-investment of local energy dollars instead of exporting those dollars, and state revenue.
6. Recommends that local governments take appropriate actions necessary to support the local refinery industry.

#### INVESTORS

##### DIAMOND

BP Exploration  
ConocoPhillips  
ExxonMobil  
Fairbanks Daily News-Miner  
Fairbanks Memorial Hospital &  
Denali Center  
Flint Hills Resources Alaska  
Mt. McKinley Bank

##### PLATINUM

Alyeska Pipeline Service Co.  
Doyon, Limited  
Fred Meyer Stores  
Golden Heart Utilities  
Wells Fargo Bank Alaska

##### GOLD

Birchwood Homes  
Carlson Center  
Denali State Bank  
Design Alaska  
Doyon Utilities LLC  
First National Bank Alaska  
GCI  
Kinross Fort Knox Mine  
Lynden  
Northrim Bank  
Sumitomo Metal Mining Pogo LLC  
Usibelli Coal Mine  
WAL-MART Stores, Inc.

##### SILVER

Alaska Communications  
Alaska Airlines  
Alaska Railroad  
Alaska USA  
Dr. Christopher Henry – Henry  
Orthodontics  
Everts Air Cargo, Everts Air AK  
Exclusive Paving/Univ. Redi-Mix  
Fairbanks Natural Gas  
Flowline Alaska  
General Teamsters Local 959  
Golden Valley Electric Association  
Hale & Associates, Inc.  
JL Properties, Inc.  
Key Bank  
MAC Federal Credit Union  
Personnel Plus  
Sam's Club  
Shell Exploration & Production Co.  
Spirit of Alaska FCU  
Tanana Valley Clinic  
TDL Staffing  
Tower Hill Mines-Livengood Gold  
Project  
University of Alaska Fairbanks  
Verizon Wireless  
Viviamore Companies  
Yukon Title Company

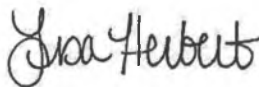
**BE IT FURTHER RESOLVED** that this resolution be distributed to:

Governor Sean Parnell, State of Alaska  
Lieutenant Governor Mead Treadwell, State of Alaska  
Mike Nizich, Chief of Staff, Governor Parnell  
Randy Ruaro, Deputy Chief of Staff, Governor Parnell  
Alaska State Legislature  
Commissioner Joe Balash, Alaska Department of Natural Resources  
Commissioner Larry Hartig, Alaska Department of Environmental Conservation  
Fairbanks North Star Borough  
City of Fairbanks  
City of North Pole  
Alaska Chamber  
Resource Development Council of Alaska  
Alaska Oil & Gas Association  
The Alliance  
Consumer Energy Alliance - Alaska  
Fairbanks Daily News-Miner  
Membership of the Greater Fairbanks Chamber of Commerce

**THE GREATER FAIRBANKS CHAMBER OF COMMERCE**



Steve Lundgren  
Board of Directors, Chair



Lisa Herbert  
Executive Director



**TESORO**

Tesoro Alaska Company  
54741 Tesoro Road  
P.O. Box 3369  
Kenai, AK 99611  
907 776 8191  
907 776 3801 Fax

March 18, 2014

Representative Bill Stoltze, Co-Chair House Finance Committee  
Representative Alan Austerman, Co-Chair House Finance Committee  
Members of the House Finance Committee  
State Capitol Building Room 519  
Juneau, Alaska 99801

Re: Support for House Bill 287

Dear Legislators,

I am writing to you in support of House bill 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."

Tesoro Corporation is a Fortune 100 company and is an independent refiner and marketer of petroleum products. Tesoro's refining operations started Alaska with the purchase of the Kenai refinery back in 1969.

Our Kenai refinery has the operational capacity to process up to 72,000 barrels per day and is primarily focused on jet and diesel production followed by gasoline and gasoline blend stocks, propane and asphalt. We operate a 68-mile, common-carrier products pipeline that transports jet fuel, gasoline and diesel fuel to the Port of Anchorage and the Anchorage International Airport. The wholesale delivery of our products occurs through our terminals in Kenai, Anchorage, our Nikiski dock and the Port of Anchorage.

In addition to being the largest taxpayer in the Kenai Peninsula Borough, Tesoro is also able to provide around 210 family wage jobs at the refinery, along with about 30 full-time contractors that are working in and around the refinery year round. Additionally, we are able to employ another 200 plus employees around the state at our 31 company-owned Tesoro 2-Go retail outlets as well as our operators who work at our terminals in the Port of Anchorage and in Nikiski.

We are a major supporter of the Cook Inlet Regional Citizens Advisory Council (CIRCAC) and the largest member of the Cook Inlet Spill Prevention & Response team (CISPRI).

We actively support a wide range of local events and programs – from employee fundraising for the United Way to youth sports programs. Each year we sponsor all of the 5th and 6th grade classes on the Kenai Peninsula to conduct a mission at the Kenai Challenger Learning Center and we are the Signature Sponsor of the “Caring for the Kenai” program.

Tesoro strongly urges you to support House Bill 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."

This legislation is the result of constructive dialog and productive negotiations between the Department of Natural Resources and the Tesoro Corporation. Tesoro originally entered into negotiations with the State of Alaska that resulted in a one year contract beginning in February 2014 and ending in January of 2015.

This original contract received a Best Interests Finding, was approved unanimously by the State's Royalty Board and was signed by both parties in October of 2013 without the need for Legislative approval.

Upon further analysis of our future needs, Tesoro sought to amend the contract to add one additional year using identical terms that would deliver royalty oil until January of 2016. A new Best Interest Finding was produced by the DNR and the State's Royalty Board again voted unanimously for approval. Since the combined duration of the contracts was beyond a one year time frame, the need for legislative approval is necessary.

By all accounts, our company was very impressed with the State's ability to understand our issues and arrive at a mutually beneficial agreement that is truly a win-win for both parties.

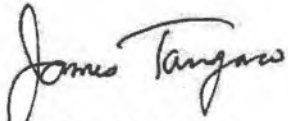
For the State, the DNR estimates that it will continue to receive a price for its Royalty-in-Kind oil that exceeds the price it would have received if it elected to keep its Royalty Oil in Value.

For Tesoro, this contract will provide us with a stable supply of ANS crude while also giving us the volumetric flexibility to help accommodate seasonal fluctuations in demand for refined products. The availability, flexibility and stability that this contract offers will have a positive impact on our ability to maintain our ongoing operations at our Kenai refinery.

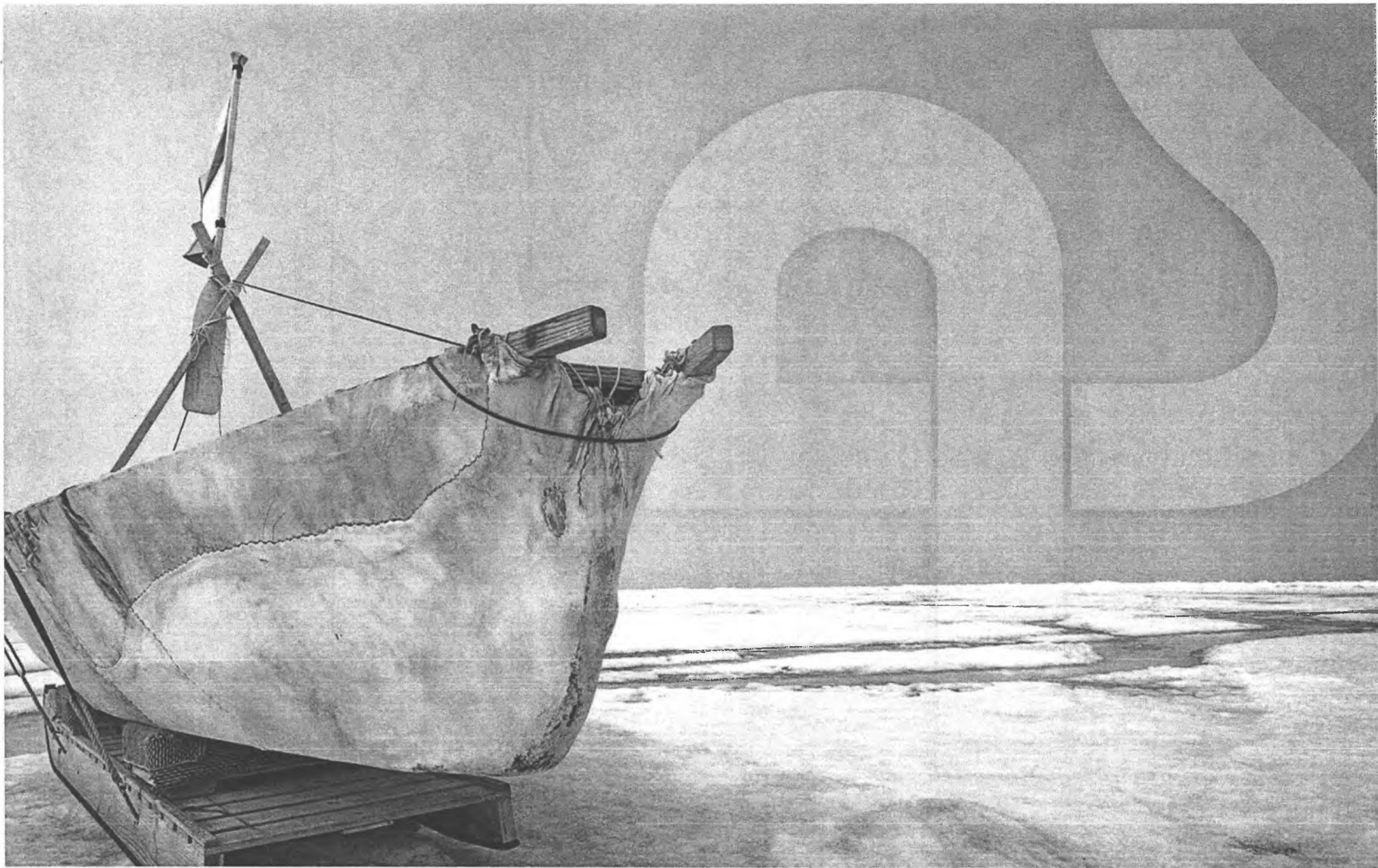
Tesoro believes in Alaska's future and is committed to being an active corporate citizen. We are proud to continue providing clean burning fuels to keep your homes warm, your planes flying and your cars and snow machines traveling across the Great State of Alaska.

I urge you to support House Bill 287.

Sincerely,

A handwritten signature in cursive script that reads "James Tangaro".

James Tangaro  
Vice President Kenai Refinery  
Tesoro Alaska Company



*Path to a sustainable refining industry*

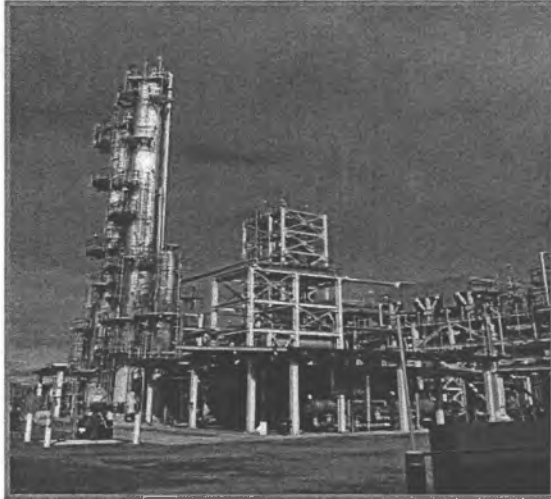
**April 2014**

**PETRO ST R INC.**



# PETRO STAR OVERVIEW

## REFINING OPERATIONS



### 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
- Last “green field” refinery constructed in the U.S. (1992)
- ASRC invested over \$150 million in the Valdez refinery

### 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



# PETRO STAR OVERVIEW

## BACKGROUND INFORMATION

*Only locally owned and operated refining and marketing company in Alaska*

- **Two refineries**
  - North Pole
  - Valdez
- **Marine terminals in**
  - Valdez
  - Kodiak
  - Dutch Harbor
- **Products**
  - Ultra low sulfur diesel (ULSD)
  - jet fuel
  - marine diesel
  - heating oil
- **Heating oil distribution operations serving**
  - Valdez
  - Kodiak
  - Fairbanks/North Pole

# PETRO STAR OVERVIEW

## BACKGROUND INFORMATION

- **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+
  
- **Military support**
  - Supplies 100% of the military grade jet and marine diesel fuel
  - Eielson, JBER, Coast Guard Air Station Kodiak, Ft. Wainwright
  - Approximately 50-60 million gallons annually

## CURRENT CHALLENGES

### HIGH COST CRUDE OIL

#### **ALASKA NORTH SLOPE (ANS) crude is**

- One of the most expensive domestic crude oils available to U.S. West Coast refineries
- Far exceeds the market value of higher quality mid-continent crude now being railed to the West Coast
- Only option for Trans Alaska Pipeline System refiners

#### **DISADVANTAGE because:**

- In-state refiners must now compete with U.S. West coast and foreign imports from Asia and the Middle East produced from far lower cost crude oils
- Drive Alaska energy prices higher

## CURRENT CHALLENGES

### TRANS-ALASKA PIPELINE SYSTEM (TAPS) QUALITY BANK METHODOLOGY

- The modern Quality Bank proceedings have been in dispute nearly 25 years, since 1989
- Compensates shippers for a different quality crude oil tendered at Pump Station 1
- Refineries located along TAPS always pay the Quality Bank- all shippers and royalty oil owners share in the distribution of Quality Bank payments made by the refiners
- Petro Star has paid \$72M into the Quality Bank in 2013
- Quality Bank is broken because it consumes most of the available margin between refined products and ANS crude
- The current TAPS Quality Bank methodology has evolved from its original purpose to become a profound burden on TAPS refiners like Petro Star

# H.B. 287/HCR 22

## Petro Star and ASRC support H.B. 287 & HCR 22

### H.B. 287

- **Royalty Oil**

- Benefit to in-state refiners because it expands the potential pool of available 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 60% of the total project cost.

### HCR 22

- Directs the Administration to resolve the Quality Bank dispute.

## CONTACT INFORMATION

Tara Sweeney

*Senior Vice President of External Affairs*

907-339-6031

[tsweeney@asrc.com](mailto:tsweeney@asrc.com)

Doug Chapados

*Petro Star President and Chief Executive Officer*

907-339-6600

[dlchapdos@petro-star.com](mailto:dlchapdos@petro-star.com)



arctic slope regional corporation

PETRO STAR INC.  8



# Quyanaqpak



arctic slope regional corporation

PETRO STAR INC. <sup>9</sup>

**BACKGROUND**

*The high cost of energy in the Interior is a chronic public policy issue facing the State of Alaska that has local, regional and statewide implications. Arctic Slope Regional Corporation is Alaska's largest homegrown company with over 630 employees and 700 shareholders residing in the Interior, so this issue strikes at the core of our organization. ASRC seeks a seat at the table to be part of a comprehensive solution to address the high cost of energy statewide; and, specifically for the purposes of this discussion, in the Interior region of Alaska.*

*This concept paper highlights the issue, desired outcome, potential unintended/unanticipated impacts of introducing natural gas into the Interior market to consumers and businesses, and potential options/solutions to be considered by the State of Alaska. ASRC hopes that this information will be considered throughout the decision making process engaged in by the State of Alaska. ASRC values its relationship with the State of Alaska on many issues and continues to work to preserve a positive working relationship with the Parnell Administration; therefore, representatives of our organization will remain ready to discuss the high cost of Interior energy, as well as any other energy issues statewide.*

**THE ISSUE**

The high cost of energy in the Interior region of Alaska. This has a material economic impact on Alaskans and Alaska businesses.

**DESIRED OUTCOME**

Orderly delivery of affordable energy options to the Interior region of Alaska and statewide.

**POTENTIAL IMPACTS**

It is imperative that the State of Alaska understand that one option being considered - the delivery of natural gas to the Interior - may have negative impacts on some consumers and businesses. This section will address the unintended impacts and the risks to these consumers, heating fuel distributors, and TAPS dependent refineries.

- ***Unintended Impacts Of State-Subsidized Natural Gas Proposals***

Introduction of natural gas into the Interior market will severely shrink the heating oil market in the Interior. This, in turn, will impact the following sectors:

**(1) HEATING OIL CONSUMERS**

Remaining heating oil customers will be faced with a cost structure in which delivery costs are high and distributor operating costs generally will have to be absorbed by a diminished customer base. Indeed, as distributors are forced out of business, these cost increases will be compounded for remote or unconnected consumers.

Distributors with statewide operations may be able to absorb increases in their costs of doing business and survive, but the increased cost of doing business in the Interior will drive up their overall cost of doing business statewide. Suddenly, what appeared to be an isolated, regional energy issue will have transformed into a larger, statewide challenge.

**(2) HEATING OIL DISTRIBUTORS**

Build-out of a centrally located natural gas distribution system will displace a customer base for heating oil distributors, which are generally small businesses. The loss of a centrally located customer base will increase the costs of doing business as their deliveries are limited to customers beyond the gas distribution system.

Even within natural gas build-out areas, heating oil distributors will face working capital constraints.

**(3) INTERIOR REFINERS**

Replacement of heating oil with natural gas will shrink the market for one of the principal products of Interior refiners.

**The Alaska refiners along TAPS already are weakened because of the dual pressures of high ANS crude oil prices and crippling penalties imposed upon them by the TAPS Quality Bank. Seventy five percent of the cost of a gallon of heating oil comes from the cost of crude oil and Quality Bank.**

*ABOUT ANS CRUDE*

The refiners along TAPS have no choice but to buy ANS crude, and it currently is one of the highest-priced crude oils in the country. The TAPS Quality Bank was designed to compensate for the impact of refinery return streams on the price of ANS crude, but it has grown to be the second highest cost to TAPS refiners—higher than process fuel—and a major profit center for the ANS producers. Moreover, as the extraordinary price of ANS demonstrates, any effect that the refinery return streams have on ANS prices are negligible at best. Indeed, the high price of ANS crude has prompted several refineries in the Pacific Northwest – including one owned by a North Slope producer - to invest in the infrastructure to transport Bakken crude from North Dakota by rail to their refineries rather than purchase ANS crude delivered by tankers.

*ABOUT QUALITY BANK*

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). Alaska refiners have learned from experience that they will not prevail at FERC against the major producers. Indeed, when the Quality Bank was litigated in a months-long proceeding in 2002, the FERC ultimately settled on a Quality Bank methodology that made the refiners pay the oil producers

more than any party requested, and the RCA concurred. This led directly to the excessive Quality Bank penalties that are imposed on the TAPS refiners today.

Heating oil and jet fuel are two of the most important products made by the TAPS refiners. The combination of high ANS crude prices and excessive Quality Bank penalties have already made it impossible for the TAPS refiners to profitably compete with fuel imported into the Anchorage jet fuel market from the Pacific Northwest or Far East, as evidenced by the closure of two out of three Flint Hills crude processing units in recent years. The introduction of cheap natural gas into the Interior will only exacerbate the refiners' poor economics that have resulted from the jet fuel problem. This is particularly ironic, since, were crude oil and quality bank costs lower, the TAPS refiners could replace lost heating oil demand by selling more commercial jet fuel.

- *Risks To TAPS Dependent Refineries: Wider Risks To Alaska Consumers And Institutions*

Natural gas introduction to the Interior market may have impacts on the Interior refiners that could threaten their viability, and any further weakening of instate refining will have significant ripple effects statewide. The failure of any of the TAPS dependent 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. The former could make closing Eielson more attractive to the Defense Department, and the latter could raise costs—and lower attractiveness—of Fairbanks to commercial air carriers.

Failure, or further contraction, of Interior refineries would severely impact the Alaska Railway, which in turn will have a negative impact on the Interior economy as a whole.

### POTENTIAL SOLUTIONS

ASRC has raised important unintended consequences, and we offer the following potential solutions to consider. We believe in a comprehensive approach to lowering Interior energy costs, rather than piece-meal solutions that ignore the potential for unintended consequences. At this time, we do not know what approach the State of Alaska is planning to take. While there is no easy fix, we are confident that the State will take measured steps to address both the current cost burden borne by Interior Alaskans and the potential consequences that cheap natural gas will have on some Alaska consumers and businesses in the Interior. This section will address an *Energy Cost Equalization* program that will mitigate the consequences of State action on "beyond build-out" consumers as well as on Alaska businesses.

- **Energy Cost Equalization**

We propose consideration of a *new* comprehensive program designed to assist the State of Alaska in having a viable lower-cost energy program for the Interior. This program could be called *Energy Cost Equalization (ECE)*. ECE is a program with two linked components. The first component is designed to directly reduce the space heat costs of Alaskans who will be beyond the reach of the Interior natural gas build-out. We envisage this as operating in a manner analogous to that employed by the Power Cost Equalization program. Essentially, the State would subsidize individual consumers' space heat expenditures by paying heating oil distributors a portion of the consumers' bills. This assistance would prevent the creation of a separate "beyond build-out" group of Alaskans who would be forced to endure high energy costs while their neighbors enjoyed low-cost natural gas. Without this assistance, suburban and rural Alaskans would endure space heat cost that would be increased by the effects of natural gas deliveries. The ECE would directly address this issue.

The second component of the ECE would consist of production incentives for jet fuel production by the TAPS refiners and would work in concert with the first. The incentives would partially offset the effects of high crude oil prices and the Quality Bank, and allow the TAPS refiners to compete effectively in the Anchorage commercial jet fuel marketplace. By thus providing an alternative market for volumes that now are being sold as heating oil, this would directly mitigate some of the impact of making cheap natural gas available in the Interior, and this second part of ECE would complement the first by keeping those program costs down. In addition, by reducing the producers' overall costs, it would help the TAPS refiners compete more effectively throughout Alaska, which could create state-wide benefits. This aspect of the ECE would both directly address the refiners' concerns and act to hold down the cost of necessary direct consumer assistance.

The complete ECE thus would provide the following benefits:

1. Protect "beyond build-out" consumers and lower cost to consumers
2. Support the Alaska Railroad as the carrier for healthy quantities of jet fuel
3. Benefit to the airline industry by encouraging competition for jet fuel sales
4. Help protect Eielson from BRAC closure or force reduction
5. Ensure the future viability of in-state refiners, and especially Interior refiners

The two components, as mentioned earlier, are inextricably linked. The first component is necessary to address "beyond build-out" space heating costs and minimize the problems that inevitably will occur during build-out. The second component is necessary to keep the in-state refining industry viable and avoid the catastrophic consequences that would follow further loss of Alaskan refining capacity. In addition, the second component will play an integral part in

keeping heating oil costs down for Interior consumers and thereby will mitigate the costs of direct subsidies to those customers.

- **Mitigation Measures for Consumers, Employees and Distributors**

Market conditions will not support a heating oil distribution industry sector in the Interior at current levels if cheap natural gas is introduced into the market. The State of Alaska must consider how affected businesses can continue to participate in the Alaska economy and transition into new lines of businesses if they cannot continue. An attractive option would be for the State of Alaska to assist heating oil suppliers by providing low-or no-interest loans to pay off capital investments whose earning power will be eroded, and/or support to finance transitions to new lines of business.

In addition to financing options for capital investments or sector transitions, the State of Alaska should also consider how it will ensure an orderly transition from heating oil to natural gas, without adversely impacting current distributors. Business closures or contractions will have a direct impact on hard-working Alaskans. Employees of heating oil suppliers may fall victim to closures or contractions. The State should consider funding retraining and job search assistance, and if necessary extended unemployment benefits.

## **CONCLUSIONS**

Through the *Energy Cost Equalization* program outlined above, the transition to natural gas in the Interior may be accomplished with a minimum of disruption and a continued healthy refining sector in the State. ASRC is interested in participating in developing this type of solutions that benefits all affected parties. Only when this is done will it be possible to avoid the worst of the unintended consequences of addressing the needs of one group without considering all the broader, state-wide impacts.

Finally, based on the information available to date- ASRC understands that the State of Alaska may be interested in purchasing/constructing/owning/operating/ a natural gas liquefaction facility on the North Slope. This is in ASRC's backyard and, consequently, we believe that ASRC might be uniquely positioned to become an important participant in the process. For this reason, we commit to reviewing this project, as information is made publically available, and to engage in our standard due diligence process to assess the project's commercial viability and the potential for a meaningful public-private partnership.

## HB 287-APPROVE TESORO ROYALTY OIL SALE

The following is the link to the amendment of a royalty oil contract between the State of Alaska and Tesoro noted as "Exhibit 1" in the legislation.

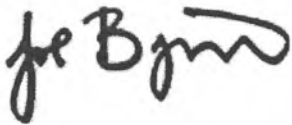
[http://dog.dnr.alaska.gov/Royalty/Documents/RIKDocuments/FBIF TSO Contract 1 8 14.pdf](http://dog.dnr.alaska.gov/Royalty/Documents/RIKDocuments/FBIF_TSO_Contract_1_8_14.pdf)

## Doniece Gott

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**From:** Sen. Pete Kelly  
**Sent:** Thursday, April 17, 2014 4:23 PM  
**To:** Senate Finance Committee  
**Subject:** FW: Please pass CSHB 89 - response and control of Aquatic Invasive Species

Public testimony



*Joe Byrnes*

Staff for Senator Pete Kelly  
907-456-3709



**From:** Tim Stallard [<mailto:weeds.free.ak@gmail.com>]  
**Sent:** Thursday, April 17, 2014 15:30  
**To:** Sen. Pete Kelly; Sen. Kevin Meyer; Sen. Anna Fairclough; Sen. Mike Dunleavy; Sen. Click Bishop; Sen. Donny Olson; Sen. Lyman Hoffman  
**Subject:** Please pass CSHB 89 - response and control of Aquatic Invasive Species

Hello Members of the Senate Finance Committee

With only a few days left in the session, I urge you to hear and pass CSHB 89, "An Act relating to the rapid response to, and control of, aquatic invasive species and establishing the aquatic invasive species response fund."

This bill and its predecessor HB365 in the previous session both passed the House with around 37 yea votes (I don't think there were any 'no' votes). This demonstrates the near universal and non-partisan concern among your House colleagues about the tremendous threats that invasive species pose to our rich marine and freshwater aquatic resources. Many of you may have heard from your Legislative colleagues in the western US about the daunting problems they are facing due to aquatic invasive species. We don't want that to happen here!

This bill will help ADF&G and DNR respond quickly to aquatic invasive species problems (hopefully before they can blow up) and is needed to protect our resources that Alaskans rely on for food, fun, jobs, and life.

Thank you for your consideration and service to Alaska.

Regards,

Tim Stallard

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*Keeping Weeds OUT of the Picture*